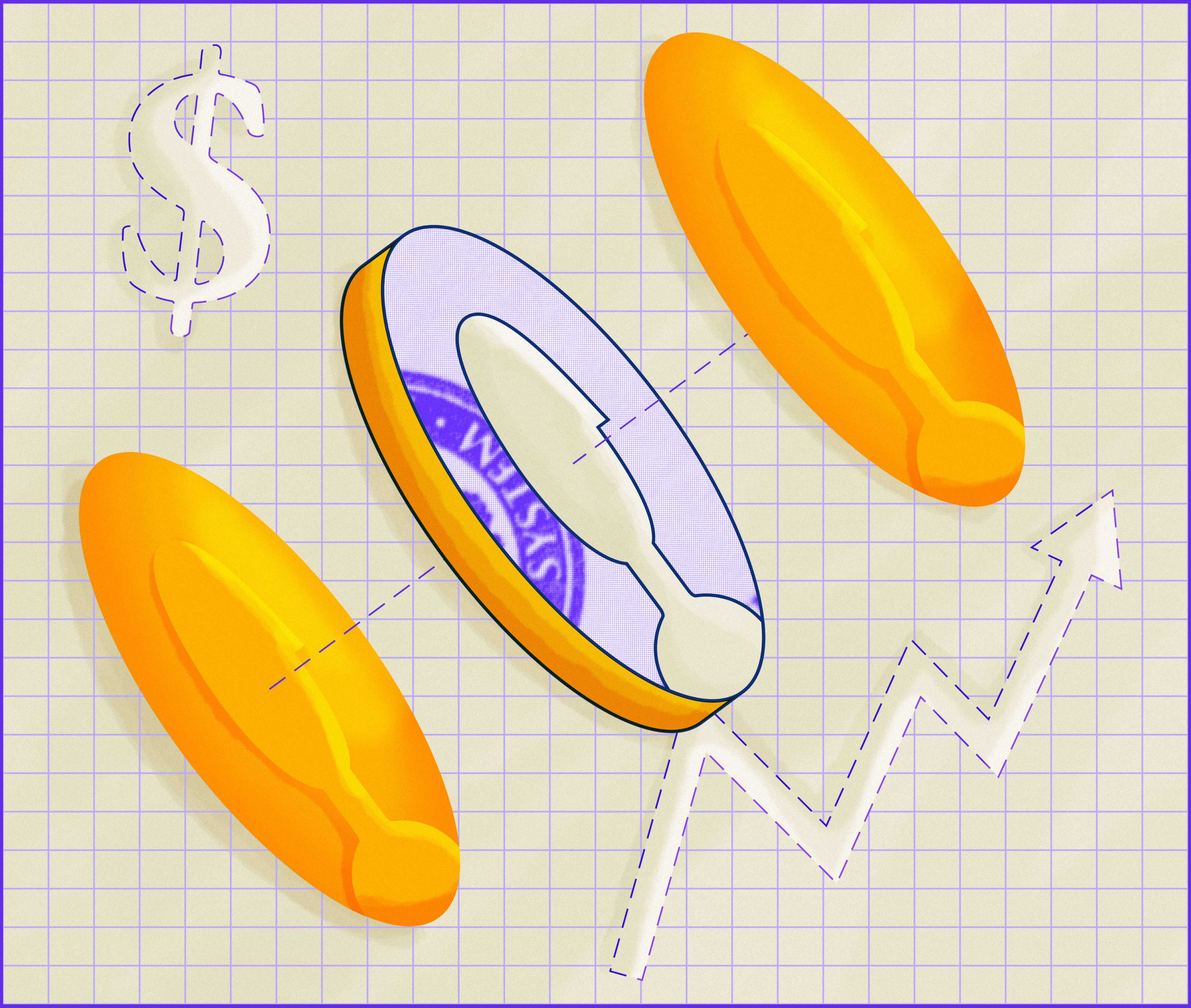
Finance 101: Your Startup Essentials



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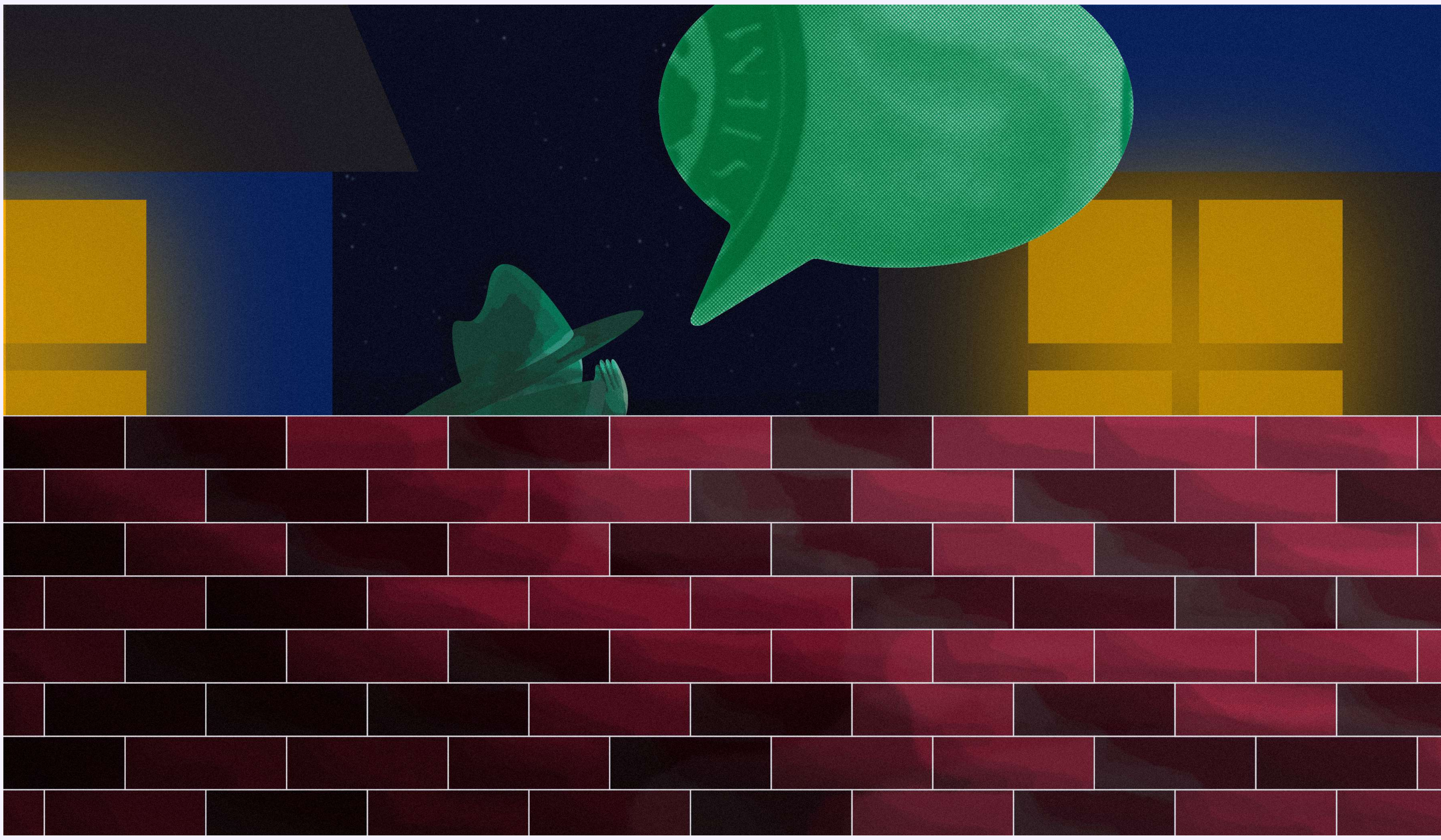
Introduction

It's easy for fast-growing companies to downplay the importance of bookkeeping and accounting. After all, they can be scary, painful, and time-consuming. You'd much rather focus on your business.

But as your business grows, so does the complexity of your books. By the time it's essential to have clean books, like when you're raising money, selling your company, or even just preparing your taxes, the process can be so expensive and time-consuming that it derails the rest of your business.

The best time to implement bookkeeping and accounting best practices is *right now.* As all business owners know, you're never going to be less busy than you are today.

In this guide, we'll cover everything you need to know in order to get your financials running smoothly so that you can focus on what you really care about: building and scaling your business. You'll learn the fundamentals of bookkeeping, the important metrics to monitor, pitfalls to avoid, and the indicators that it's time to bring on a CFO.



The Fundamentals

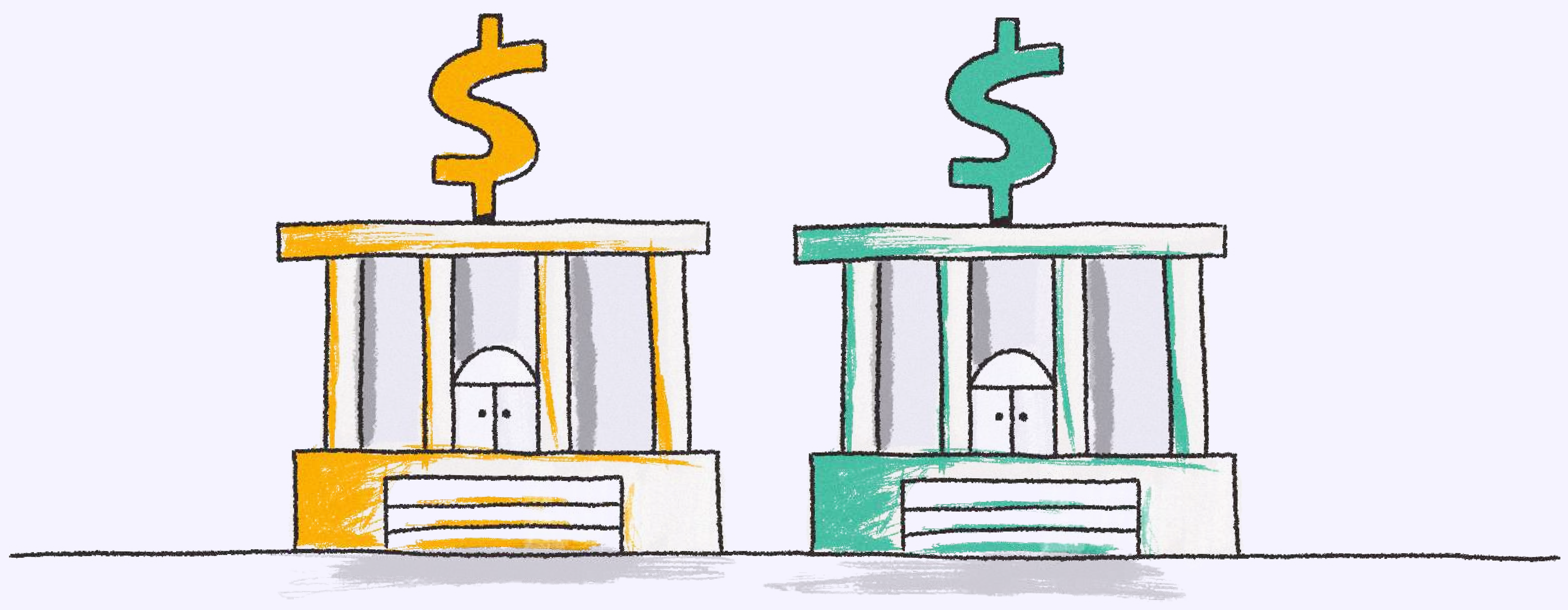
Chapter 01

The fundamentals of accounting form the bedrock of an efficient finance team. If you keep separate accounts, practice double-entry bookkeeping, and use accrual accounting, you'll be able to stay organized no matter how complicated your business becomes.

Separate your business and personal accounts

If there's one takeaway from this ebook, it should be this:

Don't mix your business and personal accounts.



If you don't separate your accounts...

- **Your taxes will be a nightmare** because you will have to go through every single transaction you made in the past year and designate it as business or personal.
- **An audit could devastate you** because the IRS might take a look at all the 'business' expenses run through your personal account and determine that you don't have a business; you just have a hobby.
- **You will miss out on savings.** Businesses have specific expenses they can deduct. You might not be able to recoup the money you're owed if your personal and business expenses are jumbled together.
- **Your personal accounts could be liable for business claims in the event of a business crisis.** If your business runs into problems later on, commingling your personal and business accounts exposes your personal assets to lawsuits. Anyone with a legal claim against your company's debt could hold you personally liable.
- **You won't be able to cleanly track t**he business's actual revenue and expenses, which makes it hard to understand the health of the company.

It's simple to create separate checking and credit card account for your business. Businesses should then pay for everything directly out of these accounts. We'll cover what banks and credit cards you should be using later on.

Use double-entry bookkeeping

Double-entry bookkeeping is an accounting system in which all financial transactions are recorded using two types of transactions: debits and credits. When you post a transaction, the *number* of debits and credits used can be different, but the *total dollar amount* of debits must equal credits.

You will note these transactions in a section of the business's General Ledger. In a double-entry statement, you'll see debits on the left-hand side and credits on the right. Double-entry bookkeeping makes it easier to detect errors because of the accounting equation it relies upon.

This equation states that:

Assets – Liabilities = Equity

Assets represent everything a company owns. Liabilities are everything a company owes. Equity is the owner's stake, including owner contributions into the company. Imagine, for example, that you sold all of your assets for cash and used the cash to pay off all your liabilities. Any cash left over would be your equity balance. Double-entry bookkeeping keeps this equation balanced.

If the two sides of this equation are out of balance, this is a sure sign there's an error in the books. If bookkeeping errors go undetected, you may be making decisions based on faulty information. That could lead to bounced checks or bank charges further down the road.

Double-entry bookkeeping has been around since the Renaissance, and it's the only accounting method that complies with Generally Accepted Accounting Principles (GAAP).

The benefits of double-entry bookkeeping

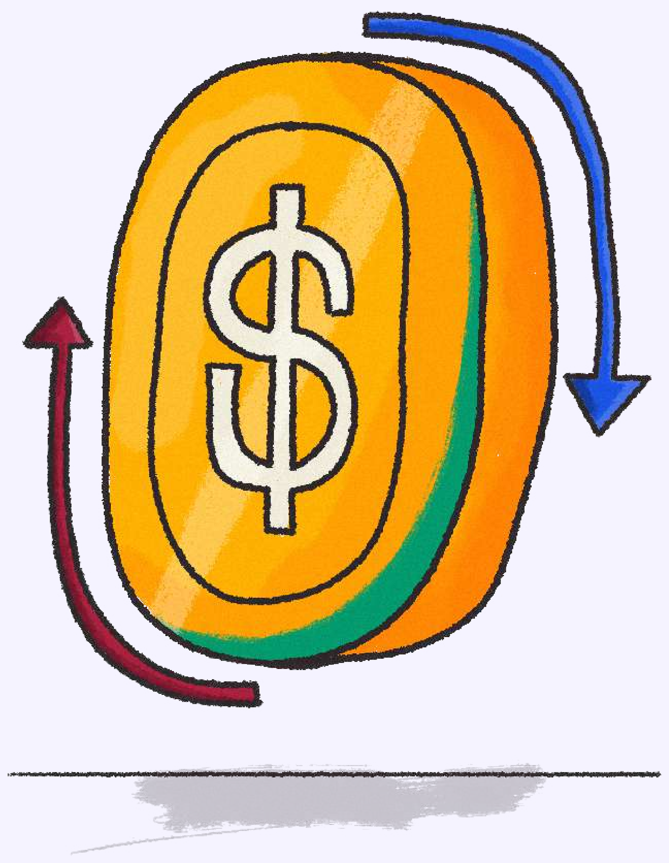
While it's tempting to make your business setup easier by opting for single-entry bookkeeping in which you only record the date, amount, and name of each transaction, double-entry bookkeeping has many advantages:

- **Improved error and fraud identification** - Double-entry accounts allow bookkeepers to identify and fix errors quickly. Each transaction must balance the total dollar amount of debits and credits. In fact, most accounting software packages give you an error message if debits and credits are out of balance. When you identify transactions that aren't adding up, you can take action right away to fix them and prevent issues in the future.

- **Knowledge of profit and loss** - It's easier for you to identify profit and loss because revenue and expense transactions are clearly stated.

- **Simpler preparation of financial statements** - When you use double-entry bookkeeping, you can prepare financial statements straight from the books, because all the necessary information is already recorded.

Double-entry provides a 360-degree view of a business's financial transactions, making financial reporting smoother and operations more transparent.



Use accrual accounting

You have two options for basic accounting: cash basis or accrual basis.

Cash basis accounting recognizes revenue and expenses based on cash inflows and outflows. If you were using the cash basis method, you would note an expense when you paid the bill—which might not necessarily be the same time that you *incurred* the expense. If you bought something on 30-day credit, you would note the expense in the ledger on the day you pay it, not the day you bought the item. Cash basis accounting is the simpler of the two methods and posts revenue and expenses using your cash account's activity.

Accrual accounting, on the other hand, ignores cash inflows and outflows. Instead, the accrual method recognizes revenues when earned and expenses when they're incurred. You post revenue when you send out an invoice, regardless of when that invoice gets paid.

The benefits of accrual accounting

Accrual basis accounting provides a better picture of business health and allows for budgeting and profit projections.

Most importantly, in some cases the **IRS requires that you use accrual accounting** (generally, related to tracking inventory or having significant revenues.) So if you plan on scaling, it's better to start with accrual accounting early rather than trying to switch to it later, which can be both costly and time-consuming.

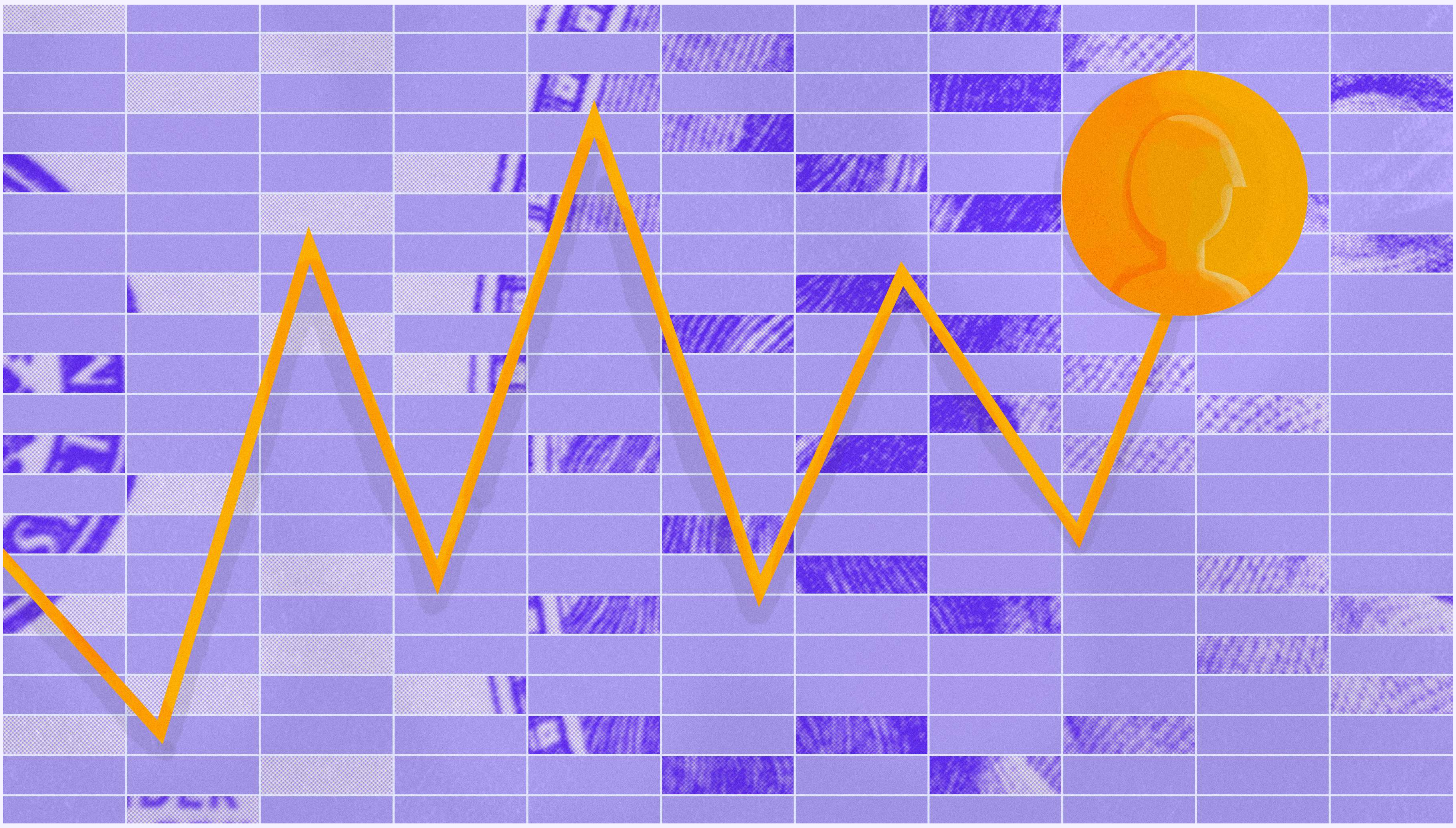
Another reason to use accrual accounting is that it **simplifies the process of taking on investment**. If you take an investor meeting and show them your cash-basis books, they won't have a clear picture of your business's actual health.

Cash basis accounting can show wide fluctuations in monthly profit and loss because of the uneven nature of cash receipts and payments. That means that the results for the quarter probably won't be representative of annual results and won't truly reflect profits. Without more information, investors can't get a feel for longer-term trends and therefore can't extrapolate on future profit or burn rate.

Master the basics to make your life easier

Companies that fail to practice good financial hygiene are setting themselves up for pain down the road. It's like trying to climb Mount Everest without a guide or proper gear—it's possible, but some basic preparation will make things so much easier.

Solid financial infrastructure allows you to raise money more efficiently, effortlessly scale, and handle taxes with minimal anxiety.



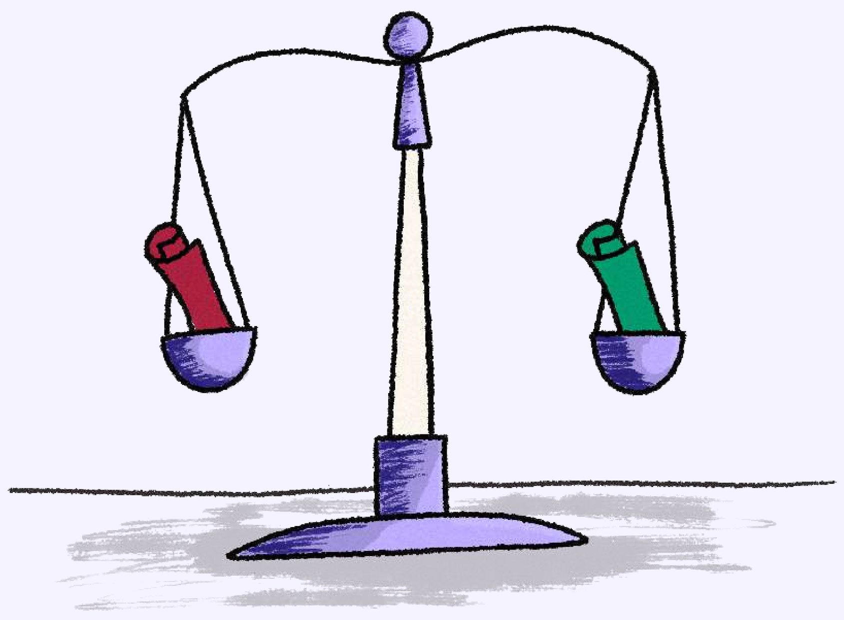
Financial Health

Chapter 02

Now that we've covered the fundamentals of accounting, it's time to dive into how you can track your transactions and use them to generate financial statements. The big reason you need to create these statements is because they are required by the IRS come tax time. But beyond that, financial statements are a way of assessing your financial health.

Think of these statements like the dashboard of a car. The dashboard gives the driver a snapshot of what they need to know to safely and efficiently operate the car, such as speed, RPMs, and fuel level. If something is out of whack, the dashboard alerts the driver, who can then decide to pull over or not.

Similarly, your financial statements tell you at a glance whether you are on sound financial footing. If there are errors in the statements, it's important to correct them to make sure your business decisions are made with accurate numbers.



Balance sheet

The balance sheet shows a company's assets (what you own), liabilities (what you owe), and equity (the difference between your assets and liabilities).

The balance sheet provides a snapshot of your financial position at one moment in time and allows you to figure out your solvency vs. liquidity ratios, which are important for managing debt. The balance sheet also helps you understand whether you can acquire capital, distribute dividends, or even just pay your bills.

A thorough understanding of your balance sheet also allows for better budgeting. With an accurate budget, a business can plan operations, coordinate activities, and better communicate high-level plans.

Income statement

Also commonly known as a profit and loss (P&L) statement, your income statement shows revenues, expenses, and net income (profit) or net loss over a given period of time. At its core, it tracks money entering the business and money leaving the business.

Most businesses use a multi-step income statement. The main sections are:

Revenue — the sales you generate

Cost of goods sold — the direct costs incurred to create your product or service

Operating expenses — costs that are not directly related to making your product or service

Net income (or loss) — your profit or loss for the period

This can help you determine which aspects of your business should receive more money and which are in need of support. Income statement analysis of this kind can also help with forecasting and assessing risk, as it gives you a clear idea of how certain initiatives translate into earnings.

The income statement also helps give investors and lenders a picture of whether you'll be profitable or when you expect to be.

Statement of cash flows

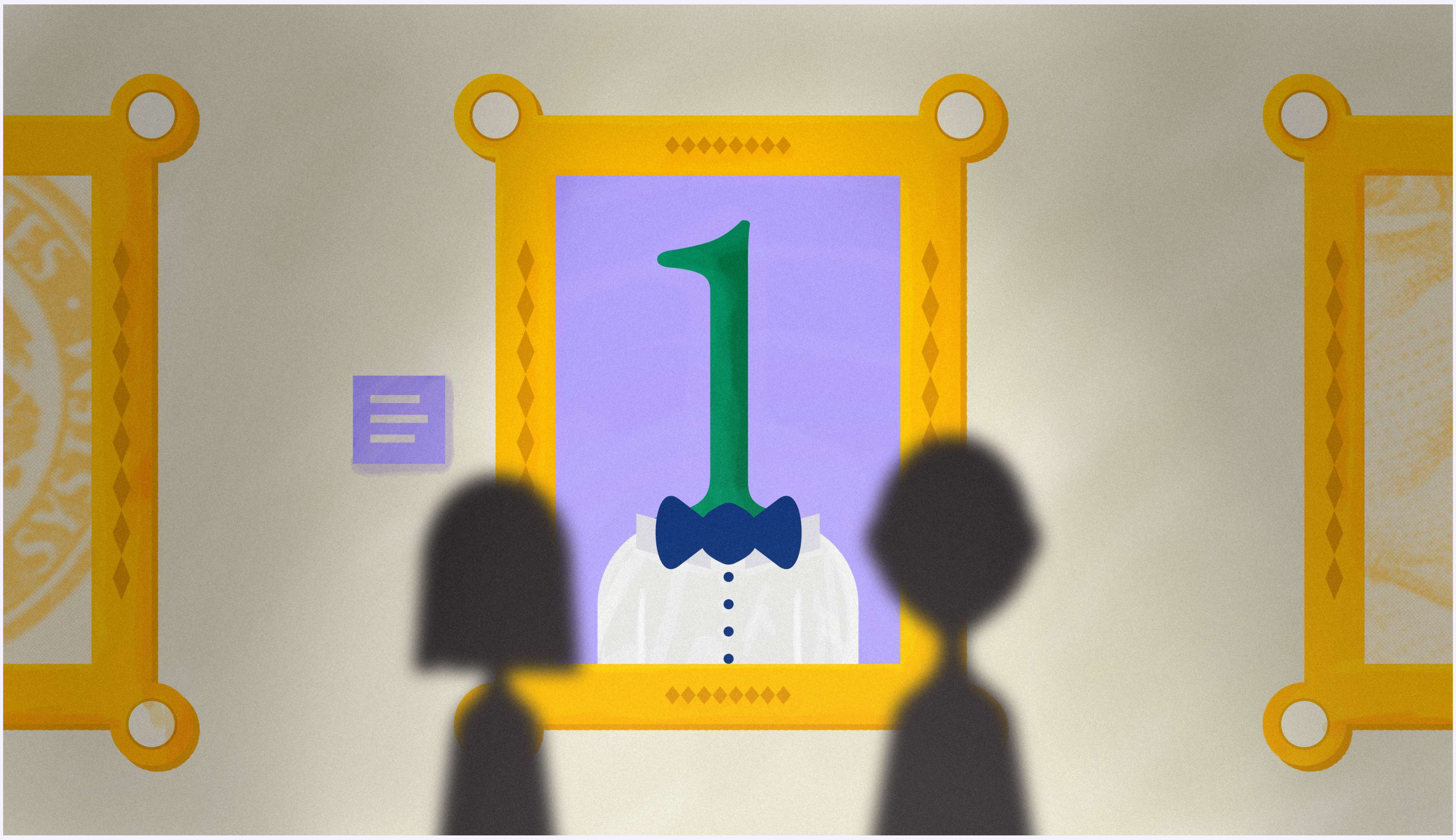
The statement of cash flows is a summary of the cash moving in and out of your business. While similar to the income statement, there is a key difference — the income statement uses accrual accounting, while the statement of cash flows tracks when cash is actually received or spent. Recall that accrual accounting records income when earned, rather than received. Similarly, expenses are recorded when incurred, rather than when paid. In the statement of cash flows, these are all visible when the money actually moves.

An understanding of this statement helps you determine how much cash is actually entering and leaving the business each month. After all, you'll always want to know where you stand from a cash perspective. If you see a large discrepancy between your revenues and your cash flow, you can take action. That could mean changing up how you invest, switching vendors, improving your efforts to collect receivable balances, or re-assessing how you extend credit.

The statement of cash flows also helps potential investors determine the financial viability of your business. Do you have a history of successfully predicting and covering expenses? How long does it take to pay your suppliers? Questions of this type help investors figure out the stability of your operation.

Use the financial statements to look forward

Your books provide a summary of what has happened in your business over the last month, quarter, or year. The statements summarize how much revenue you generated, your monthly personnel costs, or how your asset balances are fluctuating. But when looked at with an eye for growth opportunities, these statements can help you peer into the future. If you want to raise money, develop a new product, open a new office, or take any other action to grow your business, you'll rely on the financial statements as guides to what is possible given your financial situation.



Metrics to Memorize

Chapter 03

Every company needs to monitor its performance metrics and not just because investors will want to see them when you try to raise money. These numbers can expose fundamental truths about your financial situation, such as how long you can stay solvent and when you will become profitable.

Here are the four things that you absolutely need to be tracking:

> "Good metrics aren't about raising money from VCs – they're about running the business in a way where founders know how and why certain things are working..."[1]
>
> -**Jeff Jordan,** Andreessen Horowitz

1. Cash in the bank

This one is pretty intuitive. How much cash do you have in the bank right now? Don't overlook this simple metric as an indicator of whether you have the means to sustain your operation.

The cliché is true — cash is king. Without accurate tracking of cash, you can't measure two massively important metrics, which are your burn rate and runway.

2. Burn rate

Burn rate is the actual amount of cash your account has decreased by in one month. Most of the time, it describes a company's negative cash flow. It doesn't include outstanding obligations, money that was transferred into another account, or money that's on its way. It's just everything you're paying for right now, such as payroll and rent.

To find the burn rate for a given month, subtract the cash balance for the current month from the cash balance from the previous month.

$$\textbf{Burn Rate} = \textbf{Cash balance in prior month} - \textbf{Cash balance in current month}$$

1. '16 Startup Metrics', https://a16z.com/2015/08/21/16-metrics/

What Does It Mean If Your Burn Rate Is Negative or Zero?

Normally, the calculation above results in a number equal to or above zero. But there are a few situations in which your burn rate may come back as negative, meaning you are profitable. You're earning more money than you're spending. Say you just scored a round of funding — your burn rate might show as negative for that month because you appear to be gaining money overall.

If you haven't added any investor funding, a negative burn rate could indicate that your revenue is finally greater than your expenses. If your burn rate is zero, it indicates that you're earning and spending an equal amount of money. If your burn rate is negative, congratulations, your company is profitable—but then people generally stop using the term "burn rate" to refer to it.

3. Runway

Your burn rate calculation can be used to calculate runway, i.e., the number of months you have left before your business runs out of cash. Since burn rate reflects the net cash that has left your account in a month, you can use that trend to extrapolate and see how many months it would take before you "burn" through your cash balance.

How to Calculate Runway

This calculation is often best done with your average burn rate, and it's fortunately a very simple one.

$$\frac{\text{Total cash held}}{\text{Average burn rate}} = \text{\# months before you run out of money}$$

The resulting number is how many months you have left before you run out of money (assuming that your expenses and revenue are constant and that you don't add additional funding).

An Example Startup Runway Calculation

1. Calculate Burn Rate

Let's say your current cash balance is $150,000, and last month's cash balance was $200,000.

$$\$200{,}000 - \$150{,}000 = \$50{,}000$$

2. Calculate Runway

Since you currently have $150,000, we will divide your burn rate from your cash balance to get your runway:

$$\$150{,}000 \div \$50{,}000 = 3 \text{ months}$$

In this example, your startup has only three months of cash before running out of money.

Does Your Startup Have Enough Runway?

Interpreting burn rate and runway is an important part of the job of any startup CEO or business owner. Knowing how much cash you'll need will be an ongoing evaluation as you build the business.

The answer to the question, "do you have enough runway?" depends on how long you think it will take before you secure more funding or start earning sufficient revenue to offset expenses.

If you only have three months of runway, but your product won't launch for another six months, then you clearly don't have enough runway. A good rule of thumb for tech startups is to always have at least six months of runway.

If you don't have six months of cash in the bank, it makes it harder to raise money—investors will realize that you need the money, which means that you will have less freedom to shape the terms of the investment (because you realistically don't have any other option).

Burn rate is a coarse calculation because it doesn't reflect all the subtleties going on in your business, but it's also a very real number — it says, very clearly, how much time you have until you are totally out of money.

4. Annual Recurring Revenue (ARR)

If you have recurring revenue (because you're a subscription business, whether SaaS or otherwise), you'll want to be tracking your Annual Recurring Revenue (ARR).

Your ARR is the amount of revenue you generate each month on an ongoing basis. Said another way: if no one new subscribed and no one canceled and you operated the business for one year, your ARR is the amount of revenue you'd generate from your subscription service. Compute your ARR by adding up the amount each of your customers would pay you every month, and multiply that number by 12.

ARR is important because it helps with:

- **Forecasting** — Once you have a few months of consistent data on your subscription-based revenue, you can extrapolate forward and make detailed business plans based on that information.

- **Measuring growth** — The leading companies in tech have fast ARR growth, and understanding how you compare to other players in the industry. 2-3x yearly ARR growth is the sign of a company doing really well.

Not a SaaS business? **Check out this video** for other metrics you may want to track.

The bottom line

Cash position, burn rate, runway, and ARR are numbers you'll want to know to assess the health of your business. (Potential investors will also definitely ask as well, so it's good to know these numbers off the top of your head.)

Financial Pitfalls to Avoid

Chapter 04

Now that you have a handle on the basics, we want to highlight nine things you can do to avoid common startup financial mistakes.

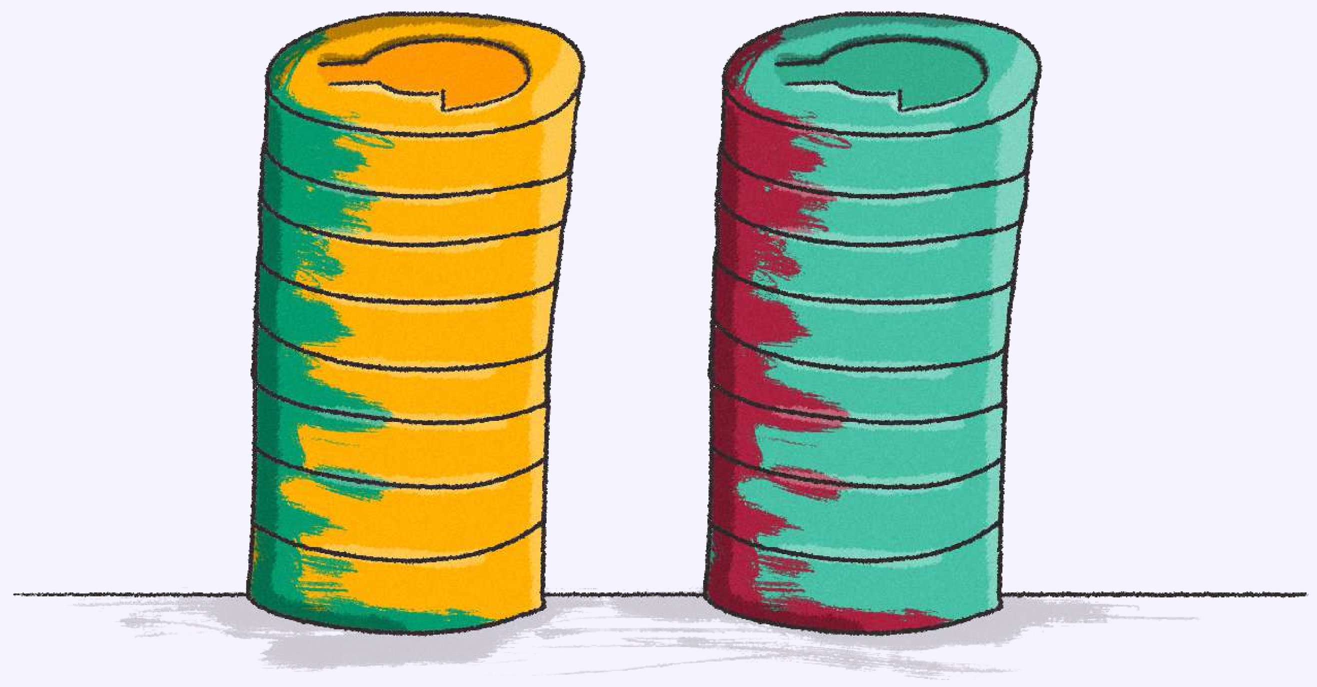
Don’t mix your company’s money with your money

We covered this one in Chapter 1, but it bears repeating. Mixing your assets and your company’s assets can create important legal and tax headaches for yourself and your company. This is called “commingling,” and it can cause you a bunch of problems down the road. In particular:

- Generally, the stockholders of a corporation or LLC are protected by what’s called a “liability shield” that legally separates you and your company. Importantly, debts that your company owes are separate from debts that you personally owe, thanks to this liability shield. If you’ve commingled your company’s assets with your personal assets, you could entirely lose this liability shield protection.

- If you don’t properly track and document your company’s financial activities separately from your own, you could potentially owe a lot more in taxes (because the IRS could decide that the personal things your company is buying for you are actually compensation you haven’t been paying taxes on).

If you have just one takeaway from this section, it’s this: please don’t casually spend company money on your personal expenses.



Always use a payroll system to pay employees

Maybe you think that you don't have the time to set up a payroll system or you think that the payment that you want to make is "only a small amount," but you'll create a mess for yourself if you pay employees without using a payroll system. Carefully calculated tax withholding payments and form filings are due shortly after any wages are paid, and there's no way that you're going to want to do this all by hand. When you pay an employee through a payroll system, it will help you with these payments and filings.

If you have an employee move to another state, be sure to update their address promptly in your payroll system and take care of any resulting registrations that you need to do in that state. If you have the wrong address in your payroll system, you'll make the wrong state tax filings and can cause headaches for yourself and the employee.

File corporate tax returns, even if you make no money

Even if your startup had no revenue, you still need to file taxes for it. Assuming you're a C corp and have a calendar fiscal year, the federal tax return deadline is on or around April 15.

The best way to get your business taxes completed on time is to hire a tax preparer well in advance who can help you with your specific situation (including your state taxes, whose deadlines and requirements vary by state.)

We suggest hiring a tax preparer by December or January and getting them your books early, to beat the seasonal rush. Before your taxes can be started, you'll need up-to-date books for your company for the year. Pilot also offers a complete tax preparation service along with quick and dedicated support. No more gathering up your info for your tax preparer and answering endless questions about your books.

Don’t forget about non-corporate tax-related fees and filings

State and federal tax returns and payroll filings aren’t the only government filings required of your company —there is actually a whole slew of other requirements. For example, if you are a tech startup based in San Francisco (but incorporated in Delaware as a C corp), here are some other fees and filings to have on your radar[1]:

Delaware-specific:

- Delaware annual report and business entity tax

California-specific:

- California statement of information[2]

San Francisco-specific:

- San Francisco business registration
- San Francisco gross receipts and payroll expense tax
- San Francisco business property tax

Federal:

- 1099-MISC forms

1. Keep in mind that this is not a comprehensive list, but a good tax preparer will be able to help you figure out what your obligations are.
2. This is separate from the franchise tax that’s paid alongside the state tax return filing

Collect needed W-9 information before you make a qualifying payment

Businesses need to file a form called 1099-MISC every year for certain payments that they made in the course of their business that year. Filing 1099s at the end of the year isn't difficult as long as you have the necessary information on hand.

The best way to obtain this information is to collect it as you go, rather than retroactively trying to put it together after the end of the year. Specifically, many businesses will request a Form W-9 from any vendor who might later require a 1099 before paying the vendor for the first time. Collecting this information upfront when the relationship is being established helps ensure that you have the information when you need it; otherwise, you could be stuck trying to track down this information from unresponsive vendors whom you paid many months ago.

Your tax preparer can help you with determining which vendors require a 1099, but the requirements are also laid out in the 1099 instructions. The most common reason to need to file a 1099 is if you pay $600 or more in non-employee compensation to a non-corporation (e.g., an individual, estate, partnership, or LLC that is taxed as a partnership).

Make sure someone is paying attention to your books

There are three critical reasons to have proper financial records for your company:

- You'll need books for filing taxes
- At some point, you'll probably need to provide financial statements to a third party, such as a potential investor, landlord, or business partner
- Your financial records contain important information about your business that can save you money

The first two items above are fairly self-explanatory, but many people underestimate the value that they can derive from the third: you'd be surprised at how often we see mistaken double charges, sometimes for large transactions like rent. Getting these corrected can immediately save the company thousands of dollars.

Get professional bookkeeping help

In the abstract, it doesn't feel like maintaining financial records for the company should be a huge burden, and you might convince yourself that doing the work yourself helps keep you closer to the details of the business.

Unfortunately, the reality is that maintaining high-quality books reliably is surprisingly time-consuming, and it's not the best use of your time. It's a burden even if you're an expert at it, which is why even full-time financial professionals tend to hire a third-party bookkeeping firm to take care of the day-to-day bookkeeping. A good bookkeeping provider will make sure that the process is conducted the way that you want while saving you time and frustration.

If you know that a trusted partner (like Pilot) is taking care of the books, you can instead focus on running your business.

If you've raised significant money, get a competitive banking interest rate

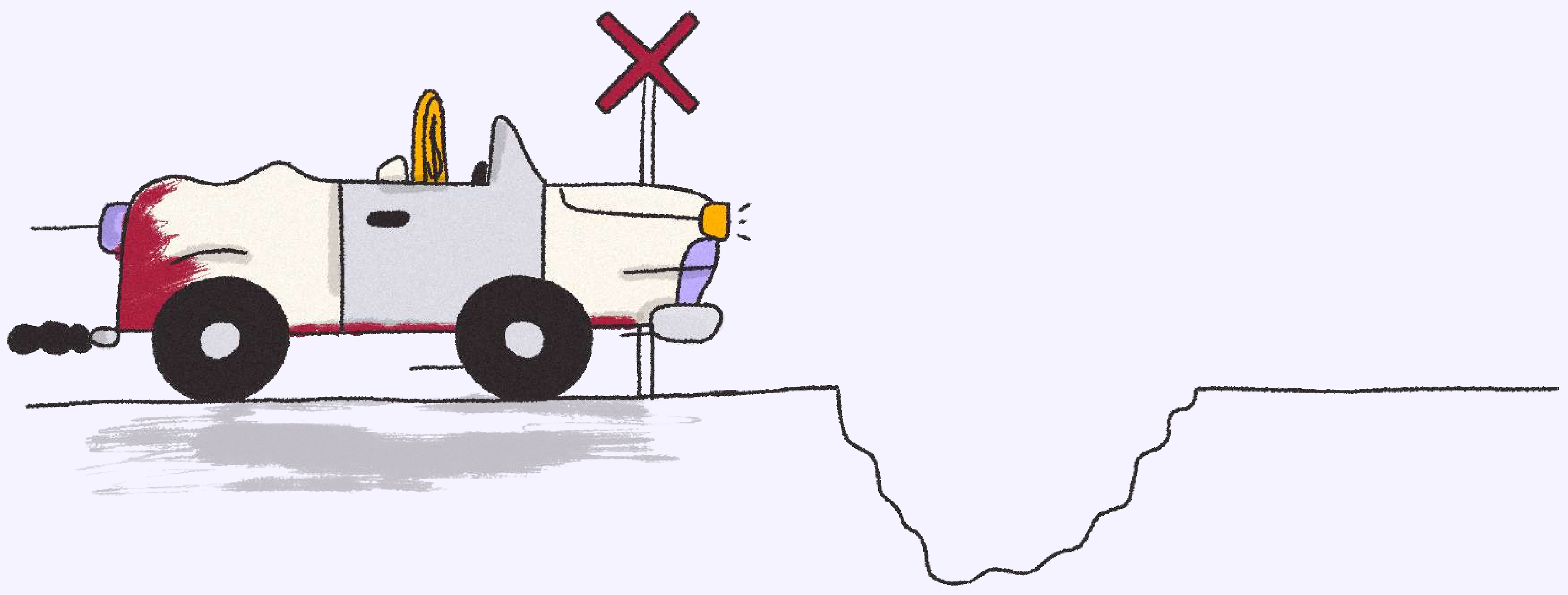
Depending on how much money your company has raised, getting a competitive interest rate can easily be worth your time. An interest rate of 1.5% means that a company that has $2M in the bank can generate $2,500/month in interest and that a company that has $10M in the bank can generate $12,500/month in interest.

Unfortunately, your business bank account won't give you anything near that rate with your default checking and savings accounts. But some banks do provide a way to obtain a competitive rate if you know how to ask. For example, Silicon Valley Bank can provide your business with a "cash sweep account" that automatically invests excess cash in your company's checking account into a government money market fund with much better rates.

If you qualify, claim the R&D tax credit

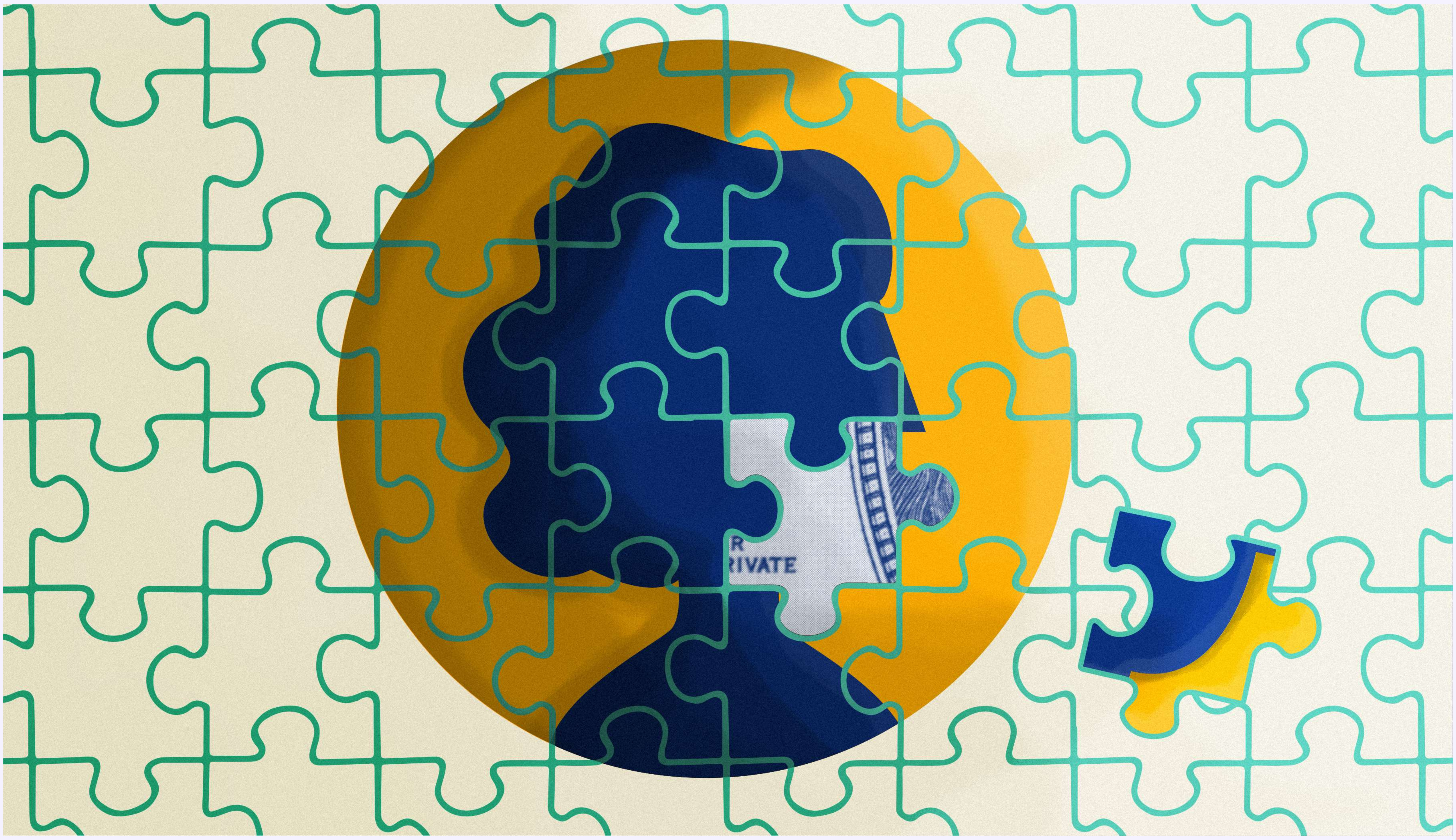
Your startup may be able to claim a substantial R&D tax credit that you can apply against your payroll taxes. The fact that the credit can be applied to your payroll tax is what makes this really interesting since you save money even if your company didn't generate a profit that year.

The best way to determine whether your company is eligible and how much credit your company can claim is to work with your tax preparer on that question, but you can get a sense of what counts as "qualifying research and development" on the tax credit's Wikipedia page. In addition to this requirement, your company basically has to be less than five years old and has to have made less than $5 million in "gross receipts" in the year you're applying for the credit.



Avoid costly pitfalls

Following these recommendations will help you avoid mistakes that can be disastrous. In a competitive market where one slip-up can derail your business, it's critical to have rules of thumb to follow so that basic financial worries are taken off your plate.



Do you need to hire a CFO?

Chapter 05

A question that comes up again and again when we talk to startups is, "Do I need to hire a CFO?"

Instead of hemming and hawing or saying "it depends," we'll just cut to the chase: if you're not already sure, you probably don't need a CFO.

If you are gearing up to take your company public, then yes, you need a good CFO. But the vast majority of startups are not at that level yet, and your external bookkeeper or accountant can likely play double-duty to cover any fractional CFO needs you might have. To make this determination, it's helpful to look at which financial tasks are mission-critical for early-stage startups:

File your corporate income tax returns

This is non-negotiable. You'll have to file federal and state taxes even if you haven't made any money. As we discussed in Chapter 4, you'll most likely want a tax preparer to help you out with this. (For example, Pilot Tax or any number of other great tax preparers.)

File your miscellaneous registration filings

There is a large bucket of tax-related issues separate from income tax returns. This includes things like compliance filings, a Delaware franchise tax, or a 1099-MISC form. Again, we suggest using a tax preparer to handle these tasks for you. Their entire job is to understand the nuances of how to efficiently handle these regulatory issues.

Do month-end bookkeeping

Maintaining up-to-date books is a big part of good accounting hygiene. If for nothing else, you need clean books so that your tax preparer has accurate information to work off of.

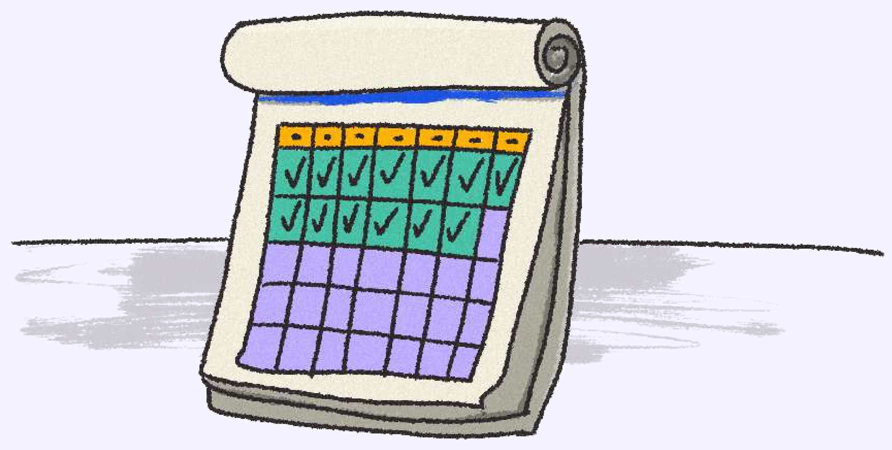
If you fall behind on your books, it's bad for two reasons:

1. As the business owner, you're flying blind. You don't have the ability to see how much money you have and where it's going.

2. It's way more time-consuming and expensive to do your books once a year than once a month. Plus, it's just plain miserable to crank through a big backlog all at once. You'll eventually have to get your books up-to-date, so why not just stay on top of it?

Take care of day-to-day financial tasks

By day-to-day, we mean things like paying your rent, depositing checks, and running payroll. We find it's best to have someone at the company taking care of these tasks, whether that's the CEO or an office manager.



The reason we like having these done in-house is that someone close to the company might have valuable information that a bookkeeper or outsider just wouldn't know. You might have just talked to a vendor on the phone and realized that a bill doesn't actually need to be paid until a month after its listed due date, whereas someone who doesn't work full-time at your company wouldn't have that context.

Stay lean as long as possible

As your company grows, and you start doing more complex forecasting, budgeting, and financial planning, it makes sense to engage a CFO who has startup experience. But the average CFO makes over $300,000 per year. Don't take on such a significant expense unless it's absolutely necessary and they can prove they are going to bring a lot of value to the table.

Your tax preparer can knock out your taxes and other regulatory filings, your bookkeeper takes care of your books, and someone internal runs the day-to-day accounting functions—in our experience, that setup can get you very far.

Terms to Know

Chapter 06

Understanding these accounting terms will help you with day-to-day tasks, give you a better understanding of the overall health of the business, and allow you to speak confidently to any third party who is helping you with your finances.

Accounts Receivable (AR)	Money you have not yet received for services previously rendered. In other words, money owed to you by clients you've sent an invoice to (or otherwise billed). If an invoice lingers in accounts receivable for too long, it might be time to consider it bad debt.
Accounts Payable (AP)	Money you owe to your suppliers or vendors, based on a bill you've received from them.
Assets	Things you own. These are often physical, tangible things, but they can also be promises from other people to either give you money or perform a service for you. **Some examples of assets:** **Cash** - in your bank account or an investment account. **Fixed Assets** - tangible, physical assets like equipment. **Prepayments you've made to a vendor** **Security deposits you've paid to your landlord** **Loans you've made to another party**
Balance Sheet	Snapshot that lists your assets, liabilities, and equity as of a specific date.
Cash Flow	How money has moved into, and out of, your business.
Cost of Goods Sold	The direct and indirect costs incurred to sell a product. For example, if you're a retailer making baseball gloves, the cost of buying leather and the cost of paying workers to make the gloves are both examples of cost of goods sold.

Expenses

Fixed Expenses

Expenses that don't scale with the level of sales or production of your product. (For example, your office space is generally a fixed expense—generally, if you sold twice as much of your product, you wouldn't need an office that was twice as large.)

Variable Expenses

Expenses that change with levels of production. Sales, marketing, or customer support expenses are often variable expenses (since they scale up as your customer base increases.)

Equity

If you sold all of your assets for cash, then used cash to pay all your liabilities, and you have a cash balance remaining, that's equity. Effectively, this is "how much your company is worth," and is sometimes called the "book value" of the company. (Note that this is distinct from your "valuation"—how your venture capital investors might value your equity.)

Income Statement

Also known as the Profit and Loss statement. True to its name, it tells you your income. Your revenues minus your expenses equal your net income.

Generally Accepted Accounting Principles (GAAP)

A set of rules created by the accounting industry so that financial statements are comparable. Being compliant with GAAP is generally not a requirement for early-stage companies.

General Ledger

A record that shows the details of all your accounting transactions. What amounts, what was debited and credited, what was the date of the transaction, what was the reason for the transaction?

Gross Profit

Sales minus cost of sales. If you sell something for $70 and your direct material and labor costs are $40, gross profit is then $30. Gross profit is distinct from net income—it's how much you made selling the product, but doesn't take into account any of your operating expenses (office rent, advertising budget, R&D costs, salaries for your engineering team, etc.)

Trial Balance

A listing of all accounts and balances as of a specific date.

Liabilities

This is the amount you owe to other people. Sometimes this is "a loan that someone gave you," sometimes it's your credit card bill before you've paid it off, and sometimes it's the result of a promise you made to someone to do work for them, before the work has been done.

Limited Liability Company (LLC)

An LLC is a type of company. It is made up of a single member or multiple members, each of whom shares the responsibility of running the company. The primary benefit of an LLC is that it legally separates the business from its owners, and rather than getting "double taxed" as both a corporation and an individual, all taxes are passed through to the individual.

Profit Margin

For every dollar sold, what's the profit you earned on that dollar? That's your profit margin. It's a way to compare the profit of products that have different prices, and it helps you determine the best sales mix to maximize profits.

Net Income

This is your revenue minus expenses.

Accrual accounting requires that you recognize revenue when it is earned and that you post expenses when they are incurred. This is so that revenue and expenses are matched in the proper period.

Revenue

Operating revenue

Revenue from sales of the core product.

Non-operating revenue

This is revenue that comes from activities that are unrelated to the main business, like subletting your office space or selling your old laptops.

S Corporation (S Corp.)

An S corp is a type of corporation that has unique tax properties. The owner of an S corp has elected to pass corporate losses, income, credits, and deductions through to shareholders for tax purposes. It's similar to an LLC but different in that S corps can issue stock, they are capped at 100 members, and you have to be a U.S. citizen to start an S corp.

Write-off

This is the process of expensing an asset that can no longer be considered an asset on the balance sheet. For example, if you have obsolete inventory, you can't sell it. So you need to write it off as an expense.

Similarly, if you have a bad debt, where someone can't pay you, you'd write it off as a bad debt expense.

Summing Up

While accounting is much more than the sum of the above terms, understanding the basics is important and can help you out in a pinch. You can reference the above list when you need a quick refresher on a basic topic or when you are about to hop on an impromptu call with an investor who wants to talk financials.

Let Pilot take the work off your plate

We hope you enjoyed this book and found it useful and informative, and we'd love to hear your feedback—please get in touch at hello@pilot.com.

While we hope it was a useful primer on the basic concepts for company bookkeeping and tax prep, we know that sometimes you just want an expert to take care of it for you. That's where Pilot comes in—we specialize in bookkeeping and tax prep for high-growth technology startups, ranging from pre-seed to Series C. We're built by startup founders for startup founders and we've felt this pain before, so we know exactly what it's like.

If you're interested in having us potentially take the bookkeeping and tax prep off your plate, so you can focus on building a successful company, we'd love for you to get in touch with us here.

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