

Simplified Accounting

For most successful small business people, selling and delivering products and services must be their principal focus. Keeping track of the money, accounting, frequently takes a back seat. We accountant's used to see receipts and deposit slips in shoeboxes at year-end. Many small businesspeople had only two goals for their accounting "system": keep a positive checkbook balance and file a tax return with as little tax as possible. The cost of turning shoebox accounting into tax returns and financial statements was staggering. With the growth of inexpensive, easy to use computerized accounting systems such as QuickBooks, these two goals are easier to achieve, but additional benefits are also within reach. Real-time reports from these systems enable small business owners to spot trends in sales and costs that can be optimized before year-end, leading to greater profits, better cash flow or lower taxes. Sending these files to us electronically can hold down the cost of public accounting services.

However, many of these systems are operated in such a disorganized manner that it is difficult for the accountant to extract year-end tax information, much less for the owner to obtain useful management information. These systems make it so easy for a bookkeeper to add accounts, vendors, customers or part number (items), that reports can become so long and complex they cease being meaningful. For example, I recently worked on a company with about \$200,000 per year sales that had 96 active general ledger accounts. This means the average account had about \$2,000 in total transactions and some had none! The financial statements were several pages long and very disorganized. I doubt the owners ever looked at anything beyond checkbook balance, total sales and net income. Just as you would not build a house upon a foundation that was not precisely laid and structurally sound, you should not run an accounting system without planning what you expect out of it and how you are going to get it.

Chart of Accounts

The Chart of Accounts is the foundation of a useful accounting system. Modern systems permit accounts with or without numbers. Although it may seem old fashioned, we recommend the use of numbers for several reasons. An experienced bookkeeper can enter numbers accurately at much faster than text. Account numbers enable bookkeepers to rapidly enter common entries without risk of spelling an account name wrong and getting either the wrong account or adding a new, but unnecessary account. Account numbers enable the public accounting firm to efficiently and economically handle year-end. Account numbers also enable the owner or financial person to sort the financial statements in a logical order instead of alphabetical order.

Required Accounts - Accounts should be organized to get the best quality information in several areas. It is necessary for the income tax return to break-out 3-26 types of revenue and 15-22 types of cost, depending on the type of business return filed. Assets, liabilities and equity require about 25 accounts. Most businesses have no activity in several of the account categories, leaving a typical small business with 20-30 accounts required by the tax return. Beyond these basics, accounts should be chosen and organized so each will have a significant number of transactions and dollar volume and that each will be meaningful to the owner in managing the business.

Account Structure – Most computerized accounting systems allow the accounts to be arranged in system generated major groups, major accounts and minor accounts. Printing a “compressed” financial statement will show totals from the system groups and the major accounts. Printing an “expanded” statement will print all the accounts, including minor accounts at every level. This allows short, easy to read statements at the compressed level and detailed statements when it is necessary to find out why a major account balance is higher or lower than expected. Since the accountant can access any account at any level, it is possible to bury tax-required accounts in major accounts if the detail is not needed for management analysis. For example, meals and entertainment must be separated from travel on the tax return, but for management purposes they can all fall under the major account “Travel & Entertainment”.

Meaningful Major Accounts – Some examples of meaningful major accounts:

- Sales – Merchandise, service, interest earned
- Cost of Sales – Labor, material and subcontracts
- Expenses – Variable expenses (driven by sales), advertising, communications, insurance, maintenance & repair, (building) occupancy, payroll, payroll taxes & employee benefits, supplies, taxes, travel & entertainment, professional services.
- Assets – most systems have major asset categories already installed, so accounts can be more specific within each category and there is less need for minor accounts:
 - Bank – each numbered account including checking and savings. Sweep accounts often don’t need to be separated from the account being swept.
 - Accounts Receivable – usually only one account needed, since there is supporting detail by individual customer.
 - Other Current Asset – prepaid expenses, inventories
 - Fixed Assets – land, building, equipment, accumulated depreciation. More detail is generally not required since the public accounting firm must maintain detail listings of fixed assets that can also be used by the business owner.
- Liabilities – less need for minor accounts
 - Accounts payable – usually only one needed due to supporting detail
 - Other Current Liability – customer deposits (if separated from negative receivables), accrued liabilities, sales tax liability, payroll liabilities
 - Long Term Liability – one account for each loan payable
- Equity – depends on the type entity. Partnerships should have a separate account for each partner.

Minor Accounts – Minor accounts, also know as subaccounts, can be used when it is necessary to track account activity over a long period of time, but not to look at the account in most management reports. An example might be separating the prepaid expense asset into subaccounts for utility deposits, prepaid insurance and prepaid property taxes.

Other Ways to Look at Accounting Data - Most accounting systems have several different dimensions to look at data beyond the chart of accounts. These dimensions permit reports with more specific, detailed information than the complete financial statements. They also reduce the need for a complex chart of general ledger accounts:

- Customer (Accounts Receivable), vendor (Accounts Payable), and item (inventory) – the balance of each of these major accounts can be sorted into the companies, people and

things that make up the total. For Accounts Receivable and Accounts Payable, this means management can spot problem areas due to older balances. For inventories, reports identify quantities of items that are greater or less than needed to efficiently run the business.

- Job (Job Costing) – A subset of customer, a job enables revenues, costs and profit to be tracked for a defined project of limited duration. This verifies the quality of bidding and can be fed back into the system to prepare new bids.
- Class – When a company has several major product lines, several stores or several rental properties, it is possible to use the same account numbers for all of them, but use the Class feature during data entry to permit separate financial statements or statement columns for each Class. This eliminates the clutter of having a general ledger account for each product line or location.
- Custom Sort – With very little effort reports can be custom tailored to sort and/or subtotal transactions in a single account by: date, payee, type of transaction, amount or dozens of other criteria.
- Non Financial Reports – Customer lists, customer mailings and emailed invoices can be produced from most systems.

Setting up a System

Accounting systems are often set up by a bookkeeper who has limited knowledge of the nature of the business, management information requirements or data needed for taxes or financial statements. Often, any savings from having the bookkeeper set up the system are offset by additional public accounting expense. We urge business owners to seek the advice of their public accountant or financial consultant to set up the system. This permits the Company to get the most out of the system for what is being spent on data entry and analysis. It is not necessary to use all the features discussed above and it is never too late to restructure a badly installed system for better performance. In many cases restructuring will give you a better picture of historical data as well as future entries.

Controlling a System

Although most of your attention as a business owner needs to be focused elsewhere, you should exercise at least minimum control over the accounting operation, both for the quality of accounting results and for the security of your money and other Company assets:

- Limit the number of added accounts, either by requiring management or accountant approval of additions or by establishing a written outline of the chart that shows where each future account would be added. Since transactions often need to be entered before it is clear where they will fall in the accounting system, establish a “Suspense” account where the bookkeeper will record transactions with no apparent account. Have your accountant periodically review the suspense account and recommend accounts and transactions to clean it out.
- Most owners sign all the checks, but by then it may not be clear what you are paying for or whether you should pay it. A better method is to review all Accounts Payable invoices. Some you will want to review yourself and others might be delegated to certain employees, such as a foreman reviewing budgeted job materials. During the review, assign the account if the cost is unusual and the bookkeeper might not know how to classify the expense. Get a rubber stamp with boxes for dates, initials and account

numbers. You still should sign the checks, but that should go more quickly when the accounting is already good.

- Have the bookkeeper balance each checking account every month. Periodically check the reconciliation to be sure it the reconciled amount agrees with financial statements. Sometimes having a family member balance the accounts adds a level of security to your checkbook.
- If your company has installment debt, be sure each payment is broken into principal (reduction of the loan) and interest (expense). If the lender does not provide this detail, your accountant can prepare a schedule.

Conclusion:

A little extra work, some done only once, can pay big dividends by making your accounting system run smoothly, cost less to operate and provide you better information to run your business. Austin Associates provides three types of service to support this effort: contract bookkeeping, general accounting and management advisory service. Please speak to your lead accountant to determine which service best meets your needs.

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