Bare Bones Biz Presents

Where Did the Money Go?

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Where Did the Money Go?

Accounting Basics for the Business Owner Who Wants to Get Profitable!

ELLEN ROHR

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Bare Bones Business Publishing
3120 S. Know It All Lane
Rogersville, MO 65472
877.629.7647

www.barebonesbiz.com

ISBN 13: 978-0-9845876-0-5

Printed in the U.S.A.

Dedication

To Frank J. Blau Jr, my mentor and friend: Frank, you have done more than anyone to end business illiteracy and improve the lives of your fellow business owners. On behalf of all your 'eagles,' "Thank You." You are loved and appreciated…and your legacy is expanding.

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Acknowledgments

“My best friend is the one who brings out the best in me.”

~HENRY FORD

To my best friends…

Thank you Dan Holohan. You helped me understand that these words were worth sharing. You are always there with love, advice and support. Thank you so much.

Thank you Al Levi. You always listen thoughtfully to my plans…then insist that I write them down and get after it! Thanks for imposing action and discipine to my grand dreams. This book is a result of your love and help. Thanks, Al.

Thank you Gail Gudell, for de-mystifying accounting with the words, “Ellen, you’ve got to put it somewhere.”

Thanks to the Bare Bones Biz Team…for sharing the mission of peace, prosperity and freedom through extraordinary business.

Thank you to my family for love, humor and perspective. Special thanks to Max and Hot Rod, for dreaming big dreams with me.

XOXO$

Introduction

You own your own business—terrific! Are you having fun and raking in the profits? Or, are you on a treadmill of too much work with too little reward? Business is booming, but at the end of the month…you haven't made any money! There is nothing left in the checking account, and there is a stack of unpaid bills on your desk. WHAT HAPPENED??

This book will teach you the basics you need to keep track of your business. Find out where the money goes…and learn how to make more of it. The information I share in this book, we should've learned in sixth grade. I didn't. I didn't even learn business basics in college, and I graduated at the top of my class with a degree in Business Administration. I went to work in the family plumbing business, and nearly flushed it down the drain.

Through the help of great mentors, I got smarter and more prosperous. Business is easy when you keep score and apply business basics. I feel honored bound to share this simple business and accounting information. This book will help you become a better financial steward. No bad thing comes from knowing "your assets from your elbow."

My wish is that you become wildly successful! Money is a medium for exchanging energy. The more money you make, the more options you have. At Bare Bones Biz, we believe that honorable, profitable free trade expands peace prosperity and freedom across the planet.

So, here's to expanding options for you, your family, your team members and your community.

Some tips for using this book . . .

1. **This book is intended to help you learn basic business accounting and financial reports. If you were to learn a foreign language, it would help to have a beginner's book of common words and phrases. In the language of**

accounting and business, this book demonstrates the basic reports and defines the common words and terms.

2. Do you have financial statements? If so, have them handy. As I present the financial reports, see if you can find the information on your own Balance Sheet and Profit and Loss statements. If you discover that your reports are a "slinky knot mess" of bad data, commit to getting them "fixed"...up-to-date and with the right account balances.

3. Don't have financial statements? You can figure out how to create them, using a simple accounting system. Enlist your accountant to help you get the accounting program set up and beginning balances properly entered. But first…

4. Read this book from beginning to end to follow the flow of information as Bob Bird's company grows.

5. Then use the book as a reference to help you when you dig into your own financial statements. Find and fix the ones you have. Or, get started with your in-house accounting system.

6. I use QuickBooks™ in my business. And I used QuickBooks™ to generate the financial reports samples in this book. QuickBooks™ is a solid, easy-to-use accounting program. It's also the most popular program worldwide. If you have never used an accounting program, I recommend you get going with the online version of QuickBooks™.

7. Use this book as a training tool to help others at your company understand basic business and accounting. Are you considering making the move to Open Book management? Good for you. This will help your team get up to speed on financial reports.

8. Don't expect to become an expert overnight. Like any skill, it takes practice to get good at understanding and using financial information! The financial reports are the scorecards. They help you see if you are winning or losing so that you can respond… and make better, faster, more profitable decisions. Commit…and don't quit.

9. You can't delegate financial responsibility. You can get help…from your bookkeeper and accountant. But it is your money and your financial stewardship. You gotta know where the money goes. The good news is…this is easy. It's something you can do.

10. In this book, I use a plumbing contracting company to demonstrate the accounting. However, accounting is a universal language! The principles in this book apply to any business, anywhere in the world.

16 REASONS TO LEARN HOW TO READ AND USE FINANCIAL REPORTS

1. **So you can make more money.**
2. **So you can sleep better at night, knowing where you stand financially.**
3. **So you can teach your kids, friends, students, employees how to keep score in business so that they can win the game too.**
4. **Because you are determined to be successful and know that the really rich guys know how to read financial statements.**
5. **Because you want to make a living doing what you love...but you are afraid to lose your shirt in your own business.**
6. **Because you want to quit your day job and do what you dream of doing...profitably!**
7. **Because you want to understand what all those financial words like liability, equity, assets and gross margin really mean.**
8. **So you don't have to pretend you know how to read financials...you'll know!**
9. **So you don't look stupid in front of your banker.**
10. **Because you want to sell your company someday.**
11. **Because you want to find out if you can afford another truck? Employee? Benefits?**
12. **Because you want to keep from getting—or find out if you have been—"ripped off."**
13. **Because you want to confront the truth in your business—are you winning? Or losing money?**
14. **Because you want to "turn things around."**
15. **Because you want to entice a venture capitalist to invest in your company.**
16. **Because you want to give generously to yourself, your employees and your community.**

My Story...

Why I Wrote this Book.

Once upon a time, my husband “Hot Rod” Rohr and his buddy Richard Yox started a plumbing and heating company called Hot Rod and Yox, Inc. Silly name, but then, they were silly guys. Mostly interested in (winter) skiing and (summer) offering motorcycle rides to unsuspecting young women. I was one such woman, and subsequently became Mrs. “Hot Rod “Rohr. (How could I pass on a name like that?)

Hot Rod and Yox were good technicians and the business grew. Some days, work would get overwhelming. On a Friday afternoon, Yox complained about a remodeling project. He was fed up with the general contractor and our flaky employees. He said, “If I don’t do it myself, it will never get done.” Yox had worked 60 hours that week, and he wasn’t feeling well.

By Saturday, Yox was in the hospital. By Sunday afternoon, he died. He had had health problems for many years, but didn’t take great care of himself . . . too much work to do.

We missed Yox . . . his sense of humor and his goofy laugh. He and Hot Rod had been friends since they were eight years old. But, the work, well, it did get done without him. Not just like he would have done it, but pretty darn close. I try to remember Yox whenever I am feeling irreplaceable. Business should enhance your life, not suck it out of you.

Yox had been the bookkeeper at Hot Rod and Yox, Inc. After he died, I raised my hand to take over those duties. Hot Rod had no interest in the paperwork, and was more productive out in the field. I had a degree in business, so I figured—piece of cake—I can handle the accounting for a dinky plumbing and heating company. Up until this time, I just ran for parts occasionally, and arranged the weekly golf outing.

I was excited to use my store-bought financial knowledge.

Most accounting in small plumbing-heating-cooling companies is done by the plumber's wife. Why? Because she has been formally trained for a financial position? Heck no. Because she watches her husband struggling with the bank statement and finally says, "You go on over to Mrs. Fernwicky's and put in the new water heater. I'll finish this up."

I figured I was a step ahead because of my business education. And I had lots of experience in all kinds of businesses with all kinds of jobs. But, I was SO WRONG. The next few years were... humbling. Every month I would ask, "Where did the money go?"

I didn't know why we weren't making any money. I would try and talk to Hot Rod about it, and all he heard was, "You are not doing enough." It was so stressful on both of us.

Then, at Hot Rod's urging, I wrote a letter to Frank Blau. Hot Rod had read an article Frank had written for a plumbing magazine about what a contractor should charge. My letter was a request for help—and a pathetic justification of why we were charging $30 per hour.

Frank called me on the phone a few days later. After he introduced himself, he told me I had my head so far…Ahem. You get the idea. He told me I didn't know the first thing about business or accounting and that we would never make a profit charging $30 per hour. I was deeply offended! I hung up the phone. And, I spent the night burning up the adding machine and discovered what our company was costing per hour to keep it going. I got sick to my stomach.

Then, I got angry.

I did NOT want to crunch numbers, look at spreadsheets or confront our financial situation. I wanted so badly for a magical bean counter fairy to wave a wand and make millions of dollars appear in our checking account.

"Shouldn't our accountant handle this?" I fumed. "I don't have time to figure this out," I whined. I just didn't want to deal with the money. That approach might have worked if we had lots of money. However, we were running out and digging a deep hole of debt. (Of course, I had not yet made the connection between not having any money and not knowing anything about how to account for money!)

Sigh. When the pain of the current condition becomes greater than the fear of change…you'll change. When I finally got fed up with financial worries, I took a deep breath and said, "OK. I'll do this." I became the company bean counter.

No one else was going to figure this out for me. It was my responsibility. Hot Rod was doing his part…he worked from dawn 'til dusk turning wrenches. It would have to be me. I was finally ready to go over, under, around or through any obstacle between me and financial understanding. I was ready…finally.

Once I committed, it took me about a year to develop a firm understanding of the accounting. Thank goodness for my helpful accountant, Brenda. I struggled along and she checked my homework. I tackled my accounting software and labored over debits and credits. I did whole months of data entry all wrong and had to undo and redo them. I once lost 11 months of data when a neighborhood kid stopped by to visit, stepped on the electrical extension strip and turned off the computer. (Computers were more sensitive back then.)

However, there were serendipitous moments of …fun. Yes, fun! Accounting is like a crossword puzzle. Numbers add up and across. If you are "off" somewhere, it is probably you, not the computer or the software. And, it is FUN to find and fix the glitch in your data entry. I raised my nerd flag and to this day I wave it proudly.

The BEST part: Finally understanding where we stood financially. I was afraid of knowing. That's why I fought it for so long. Once we had the data, so many of the emotional issues fell away. We had the score and could make decisions based on the score. No more arguing about working hard enough or being good enough. We could see the problem. We weren't charging enough. We had to raise our prices. If that meant we would go out of business, so be it. What a relief.

Turns out people pay much higher prices than you think they would. How about that? We made decisions based on the data. I knew where the money went and how to make more of it. Very cool.

How about you? Why not you? Commit…or quit. Should you choose to commit and learn basic accounting, you will have a skill set that makes you more powerful. You will also have the tools you need to manage your family fortune…as well as get profitable in your own business. No bad thing comes from learning business and accounting basics.

Here's the key for moving from rookie bean counter to rockin' money maker: Your commitment. This stuff is NOT that hard. You can do it. Figuring out what the accounting words mean is more than half the challenge. You can do it. Basic accounting is a simple, beautiful logical system. You may even learn to love it.

You will need some help. Are you struggling with a bossy, unavailable or uncommunicative accountant right now? Do not put up with a weak financial team. Do not be held hostage. Know there are people out there who love bookkeeping and accounting and determine to find one to help you. Find an accountant who will teach you how to handle the bookkeeping and will check your homework. Or, contact me at contact@barebonesbiz.com and I will steer you in the right direction.

Once I committed, there was no turning back. I had confronted the truth and knowledge imposes responsibility. I called Frank back and asked him if he would help me learn to be a real businessperson. Frank has been my mentor since that day. (Thanks, Frank!)

If I only knew then what I know now!! That financial statements—the Balance Sheet and Profit and Loss Statement—are the KEY to getting and staying profitable! They are the ticket to sanity in an insane world and the salvation of every struggling business!

OK, I'm getting carried away. I'm not the type who naturally loves numbers. I'm not neat and tidy, or particularly organized. The only reason I learned about financial statements is because our company was sucking the life out of my life. I had to figure out what was going on. I was sick and tired of too much work, growing debt and no options. Once I learned how to keep score, we started making better decisions. We got out of debt, we grew our company…and we got a life!

Now I enjoy the process…reviewing the reports, watching them improve. It's fun to keep score! That's what financial reports are…the scorecards in the game of business.

I know what it is like to dig a hole of debt and despair. Frank was my first mentor. Since then, I have been blessed to have so many great mentors. They taught me how to get out of debt, build a profitable business and create a fortune. We sold our plumbing business in 1995, and since then I have helped hundreds of business owners start, fix and grow extraordinary businesses. I helped launch a plumbing franchise company. We grew from zero to $40 million in franchisee sales in 47 locations in under 2 years. Bare Bones Biz, Inc. is my latest venture and I love working with my amazing team to help expand prosperity and freedom!

I've also learned that there is more to making money than just the accounting and financial skills. There are emotional and spiritual issues. You may have "blocks" around the area of money and wealth and prosperity. As you learn the technology of money, you will run into these areas of energy. Pay attention to your resistance and find mentors who will help you with that, too. (Later in the book, I will recommend my favorite mentors…living and dead!...who may be of service to you!)

I am so grateful that I know how to make money. I love helping people discover the freedom of a winning business. So many have helped me along the way. I am honor bound to help others.

So, that's why I wrote this.

"The really rich guys know this stuff."

~CHARLES AVOLES

To get good at financial management, work through this book…and practice with your own financials!

My hope is that you walk away from this book with…

- a better understanding of financial statements and WHY you need the information they provide.
- a clear understanding of basic accounting terms.

- an understanding that, as the owner, it is your job to know where you stand financially and to firmly assume responsibility for the accounting and financial management of your company.
- a commitment to generate current, accurate financial statements every week.
- confidence that you can understand financial reports and use the information to make better, faster, more profitable decisions.
- A belief that you deserve to make a great living doing what you love to do, in the service of others…and that you will confront and handle any challenge or block in your path to success!

If you look at your Financial Statements, analyze them, ask questions, make predictions, make mistakes, fix mistakes…week after week…you will become an expert on your business! And it will expand your prosperity and freedom!

"Money doesn't always bring happiness. People with ten million dollars are no happier than people with nine million dollars."

~HOBART BROWN

Don't Panic

This Is Only A Test!

Let's find out what you know already. Please take this pre-test. No panicking. If you miss every single answer I won't make you sit in the corner wearing a pointy cap. (Note: There may be more than one correct answer to a question.)

Name:____

See?! You got the first questions right! Take a deep breath and get set…Get Ready…Go!!

1. Another term for Overhead is…

- ☐ Indirect Costs
- ☐ Liabilities
- ☐ Expenses
- ☐ A type of garage door

2. Which of the following items is not found on a Balance Sheet?

- ☐ Inventory
- ☐ Assets
- ☐ Direct Costs
- ☐ Accumulated Depreciation
- ☐ Equity

3. How is the basic accounting formula usually represented?

- ☐ Sales - Direct Costs = Net Profits
- ☐ Assets = Liabilities + Owner's Equity

- ☐ Assets - Expenses = Net Equity
- ☐ All of the above

4. Billable hours refers to …

- ☐ The direct labor hours for which you bill the customer.
- ☐ The time your bookkeeper spends sending invoices to your customers.
- ☐ The total time your technician is available to do service work.
- ☐ The amount of hours for which you paid your techs, minus the hours actually worked.
- ☐ All of the above.
- ☐ None of the above.

5. It is possible to have a net loss for the month and still have enough cash to run the business for the next two months…true or false?

6. It is possible to have 20% net profit for the year to date and not have enough cash to run the business for one more month…true or false?

7. Below is a list of expense items. Check the ones that are Direct Costs.

- ☐ Materials
- ☐ Tools
- ☐ Training
- ☐ Seminars
- ☐ Trucks
- ☐ Office Supplies
- ☐ Billable Labor Costs
- ☐ Permits
- ☐ Sales commission
- ☐ Owner's Salary

8. Sales - Direct Costs = ____________________.

9. Another name for Direct Costs is…

- ☐ Expenses
- ☐ Overhead
- ☐ Cost of Goods Sold
- ☐ Job Site Expenses
- ☐ Those that your boss directed you to expense.

10. How often should you review your financial reports? ____________and by when should you have the previous month "closed?" ____________

11. Currently, when you read your company's financial statements, you …

- ☐ look at trends.
- ☐ look at the past month's activity compared to the year to date numbers.
- ☐ look at budgeted vs. actual amounts.
- ☐ compare this year's activity to the same month in past years.
- ☐ all of the above.
- ☐ none of the above.

12. After you have looked at your company's financial statements, you…

- ☐ file them properly.
- ☐ thank your accountant and pay the bill for his or her services.
- ☐ call in your managers to explain any discrepancies or questions you have about the information.
- ☐ share the financial information with your employees.
- ☐ think of creative ways to improve performance.
- ☐ all of the above.
- ☐ none of the above.

13. A Chart of Accounts is…

- ☐ the way you code accounting information.
- ☐ the labels under which you file your accounting information.
- ☐ the General Ledger and classifications used in accounting.
- ☐ all of the above.

14. Do you know how much money is necessary, on average, to cover Overhead expenses every month?

- ☐ Yes , $______________
- ☐ No, help me!

15. The Profit and Loss Statement…

- ☐ is another name for the Balance Sheet.
- ☐ summarizes sales revenues and expenses over a period of time.
- ☐ lists the assets, liabilities and owner's equity of your company.

- ☐ all of the above.
- ☐ none of the above.

Good Job! You did it! Now, let's get learning! At the end of the book you can try this test again. You'll be amazed at what you've learned.

Have Your Financial Statements Handy!

Do you have financial statements—Balance Sheet and Profit and Loss Statement from your accounting program? Pull them out and keep them handy. You will want to refer to them as we learn this information. We'll define terms as we go along. (If you don't have them, you can get them. More to come on that, later in the book.)

WHAT THE HECK ARE FINANCIAL STATEMENTS ANYWAY?

A HUGE reason why you may not understand financial information as well as you would likes that the terms are confusing and the words are weird. (Like *vehicular depreciation*!) Also, there are usually several words that mean the same thing. Only you don't know which ones. So you get lost and confused and feel stupid. Then you give up on the whole darn thing.

So, I am going define the terms as we go. (And there is a handy Glossary of Weird Accounting Terms as the end of the book.)

FINANCIAL STATEMENTS ARE THE SCORECARD FOR YOUR BUSINESS.

Usually, Financial Statements refer to the Balance Sheet and the Profit and Loss Statement. The Balance Sheet is a report that shows the financial condition of the company. The Profit and Loss Statement (also called the 'P&L' or the Income Statement) is the profit performance summary. We'll examine the Balance Sheet and Profit and Loss Statement in detail…and share examples of how they reflect the action and financial position of a business. Financial Statements can include the supporting documents like cash flow reports, accounts receivable reports, transaction register, etc.—any report that measures the movement of money in your company. Financial Statements are what the bank wants to see before it loans you money. The IRS insists that you share the score with them, and asks for your Financial Statements every year. The financials are the Scorecards in the game of business.

Playing for Keeps

Do you play golf? Tennis? Bridge? Do you ever bet on the outcome of the game? Does it add to the excitement when you "Play for Keeps"? Sure!

I love Pro Basketball. The Pros play for keeps and I think it makes for very exciting games. I am a Utah Jazz fan. When they play, I pitch a tent in front of the TV. I like to watch basketball on TV better than in person. I love hearing the play-by-play and color commentary by the sportscasters.

During the games, the statistical reports are constant. It is fun to see the stats of each player… who is contributing and who is having an 'off' game. No hiding from the score.

Now, even when Utah has a great team—lots of skills, solid plays, good things to say about each other—they may lose the game. Could we take the win from the other team and say, "The Jazz deserve the win. They are such nice guys! Besides, you have won lots of other games" No ma'am. The highest score wins.

Because the other team won, does it mean the Jazz are good-for-nothing-losers? Nah. It's just a game. They get to try again tomorrow.

And face it…would the game be as exciting if we didn't keep score? Would you even watch it? Would the athletes even want to play? The statistics take the baloney out of the game. It works or it doesn't. The ball went through the hoop…or it missed. Don't you think the simplicity of sports, the easily identified truth of sports, is what makes the games so compelling?

There is an entire industry devoted to keeping track of the Pros. Collectable Basketball cards tell you all kinds of information about what these guys have done…points, assists, free throw percentages. The statistics tell you a lot about a player.

But, not everything.

Frankie Sharpshooter Guard: 6'1" 180 lbs.

	Field Goal	% Free Throws	% Rebounds	Assists	Steals	Blocks	Points
NBA Career	.494	.856	3.4	9.7	1.4	0.3	17.2
Current Season	.499	.838	3.6	11.4	1.3	0.2	22.5
All Guards	.465	.800	3.0	4.2	1.1	0.2	11.4
Per 48 Minutes	.499	.838	4.6	14.5	1.6	0.2	28.7

What do you know about a player from his stats?

What won't the stats tell you?

FINANCIAL STATEMENTS ARE LIKE THE BACK OF THE BASKETBALL CARD.

A single set of Financial Statements is like one basketball card. You can't tell if you're improving or getting worse. You don't know how you stack up against last month or last year…or the rest of the business world. Your Financials won't indicate whether or not you are a nice person!

However, Financial Statements, especially when analyzed over time, give you incredible information about your company. Primarily, are you winning or losing?? The Financials are the scorecard.

Keep score. Play for keeps. Enjoy the game. Win!

WHAT FINANCIAL STATEMENTS WILL AND WON'T TELL YOU.

"Money, which represents the prose of life, and which is hardly spoken of in parlors without an apology, is, in its effects and laws, as beautiful as roses."

~RALPH WALDO EMERSON

Financial Statements will help you…

- Pinpoint the strengths and weaknesses of your company.
- Create a realistic selling price.
- Decide if you should borrow money or borrow more money.
- Figure out where the cash goes.
- Identify and reward the over-achievers.
- Know with certainty your break-even point.
- Figure out which jobs are winners and which are losers.
- Discover you've got an embezzling problem.
- Approach your banker knowing how much he will lend you.
- Know what is going on—with Assets, Liabilities, Equity, Sales, Expenses—at your company.

The Financial Statements represent everything in terms of money. Money isn't everything but you need a common denominator. Money really does the job nicely. The basic arithmetic used in accounting is addition and subtraction and simple division. It really is a nice, neat system of keeping score.

"BUT, MY EMPLOYEES ARE MY GREATEST ASSET."

You might say that your employees are your greatest asset. I would think highly of you if you did. In accounting, people are left off the Balance Sheet. Hard to assign dollar value to—or, worse, claim ownership of—a human being. Still, how you spend money says a lot about how you really feel about your employees. If you love them you will provide training, heap on generous benefits, throw parties for them now and then, and buy Girl Scout cookies from their kids. All those gestures of love are recorded in the Financial Statements. You know the saying… "Money Talks!"

Financial Statements WON'T tell you…

- How to get out of a bad financial position. The clues are there but you must make the call.
- What lies in the future. Even the most sophisticated forecasting has a solid helping of guesswork.

They won't tell you whether a man is good or bad, honest or dishonest…but a man's checkbook will tell you what is important to him.

All in all, the Financial Statements tell you more about your company's performance and financial well-being than any other source of information. By analyzing the Financial Statements every month you will learn to spot trends and discrepancies. A single set of statements is not enough.

HOW TO "HAVE" ANYTHING YOU WANT IN LIFE.

The Financial Statements are wonderful tools, if you are ready and willing to use them to increase your prosperity. BUT…

If you can't accept success and wealth in your life, no amount of financial education will overcome your self-imposed limitations.

You have heard the story…about the fellow who wins $1 million and then loses it a week later. Your wealth is ultimately determined by your ability to have wealth.

A TALE OF CHAMPION LEVEL "HAVINGNESS"

I have a wonderful friend—Buffy Roper. I met her when we were both coffee shop waitresses in Ocean City, New Jersey.

I hated working there! The manager had the awful habit of referring to himself as 'we' and 'we' never had enough silverware to go around. I used to keep a stash of knives in my apron to make sure my customers didn't have to pick up their chicken fried steak with their fingers! I was just about convinced getting the job was a huge mistake. But, then, Buffy befriended me. She is one of those extraordinary and rare people who is always, every single day, on top of the world. Buffy always had enough steak knives.

Buffy was 19 when I met her. Even then she was absolutely sure that she would…have a fabulous career, find true love, bear six children, be ridiculously wealthy and travel the world.

Buffy is now the owner of a rockin' laundry and linen supply company. She and her love-of-her-life boyfriend work together. Buffy has 6 kids…all adorable. And she travels with all of them!

So…you can have it all. You must be clear on what you want and address the personal issues that keep you from being successful. Spend time soul-searching…what do you want to be when you grow up? What is your mission, your purpose in this lifetime? Buffy's path has not been a smooth journey. There have been ups and downs and unexpected moments. But she has created the things that she was 100% clear on.

Look at your own life. Haven't you done that too?

"Thoughts become things. Choose good ones."

~MIKE DOOLEY

To be sure, our lack of success can be tied to ignorance of sound business practices. But the bigger issue is our lack of self-worth. This book will provide tools and information that can help you create a successful business. IF you will address the personal issues that will sabotage your efforts.

Think you can BE a successful, prosperous businessperson? Good. Then, you must DO what is necessary to HAVE that which you desire. The formula for "Havingness" is

BE > DO > HAVE

Suppose you want to have lots of money...so you can write $1,000,000.00 check to your church's youth group program. You must BE-come a person capable of wealth. And, you must DO things that ensure wealth…like using financial statements to operate a successful business. Then you can HAVE the rewards.

You can work on your beingness…on who you are and how you can serve. You can focus on exploding the energy and emotional blocks that keep you stuck. You can also DO things that are aligned with the person you intend to become even if you are not there yet. *Act as if* you are the person that you would like to be. Consider, "What would I do if I had the capacity to write a $1million check? How would I care for my money? How would I spend my day? Who would I reach out to help me be a good financial steward? What would I do to make more money? How would I spend it?"

Knowing what you want to HAVE is exciting and motivating. It is the beginning of the creative process. Doing what's needed is where you find the fun and the joy of life. Becoming someone capable of having and doing those things...is success. You can BE, DO and HAVE it all!

Here is a list of some of my favorite mentors, their books and websites…

- *Excuses Begone* by Wayne Dyer

- *Your Money or Your Life* by Joe Domingues and Vicki Robin
- *Think and Grow Rich* by Napoleon Hill
- *Rich Dad, Poor Dad* by Robert Kiyosaki
- *How to Stop Worrying and Start Living* by Dale Carnegie
- *The Seven Spiritual Laws of Success* by Deepak Chopra also www.deepakchopra.com
- *The Power of Positive Thinking* by Norman Vincent Peale
- *The Great Game of Business* by Jack Stack
- *The Leadership Engine* by Noel Tichey
- *Dare to Win* by Mark Victor Hansen and Jack Canfield
- *Reclaiming Higher Ground* by Lance Secretan
- *Body and Soul* by Anita Roddick
- *Start With Why* by Simon Sinek also, www.startwithwhy.com
- *Good to Great* by Jim Collins
- *Grinding it Out* by Ray Kroc
- *Time to Make the Donuts* by Bill Rosenberg
- *The Business of Contracting* by Frank Blau
- *The Richest Man in Babylon* by George S. Clason
- *First Things First* by Stephen R. Covey
- *The Greatest Salesman in the World* by Og Mandino
- *The E-Myth* by Michael Gerber
- *The Everything is Energy Radio Show* with hosts David and Kristin Morelli at www.everythingisenergy.com
- and sooooooo many more! But these will get you going!

Flood your mind with powerful, positive thoughts and concepts. Turn off the news. Lay claim to your power to be, do and have whatever you want.

And, keep track of the money, honey.

"Trust in God but tie your camel."

~ANONYMOUS

Ready? Set.

Here We Go!

Ready to start learning ? Let's go! Let's create a make-believe company. As we record the activities of this business we will gain an understanding of Double-Entry accounting and the Financial Statements.

INTRODUCING…EAGLE PLUMBING COMPANY !

"Well, I am not going to snake Mrs. Peabody's drain and that's final!"

Allow me to introduce Bob Bird. Bob Bird has worked for ten years for a plumbing company—Turkey Drain Cleaning. He is fed up with the low pay, dirty work and dead end position he has as the service manager. And he is NOT going to handle the drain cleaning calls just because that good-for-nothing Billy Joe didn't show up today!

Bob wants to strike out on his own. Be the boss. Come in late. Leave whenever. Make the big bucks. He is sick of making other people rich. It's his turn! Bob's Uncle Harry died a few months ago and left Bob $5,000. Bob tucked the $5,000 under his mattress. Let's follow Bob as he starts Eagle Plumbing Company and track every move he makes.

Bob will buy a truck and some inventory. He'll make a couple of sales and pay his bills. For the sake of simplicity, all these activities will occur on a single day: December 31, Year 1.

Extra Credit Question: Can you play out the make-believe financial scenario before you ever started a new company or product line? Before you added the next truck or hired the next employee? Hmmmm? YES! What a great idea. Use the power of imagination—and accounting—to plan your business.

"Plan or be planned for."

~JIM ABRAMS

THE BALANCE SHEET

Let's pull out a blank scorecard: the Balance Sheet. The Balance Sheet shows the financial position of the company at a given point in time. Every transaction in the company ultimately affects the Balance Sheet.

The Balance Sheet is like a snapshot of the business. Imagine a newborn baby. That baby's very first picture will record what he looked like on day one of his life. His kindergarten class photo will show you what he looks like at age five. Every photo will capture a specific moment in time. The child's past is still visible in a current photo…the scar on his nose from a bicycle accident. The same features are there, but changed as a result of growth and activity.

So the Balance Sheet reflects the financial condition of the company on a specific date. The Balance Sheet doesn't start over. It is the cumulative score from day one of the business to the time the report is created.

The basic accounting formula is the basis for the Balance Sheet:

Assets = Equities

LET'S DEFINE A FEW WORDS THAT WILL HELP YOU UNDERSTAND THE BASIC ACCOUNTING 'TOOLS.'

Assets: The 'stuff' the company owns. Anything of value—cash, accounts receivable, trucks, inventory, land. Current assets are those that could be converted into cash easily. (Officially, within a year's time.) The most current of current assets is cash, of course. Fixed assets are those things that you wouldn't want to convert into cash for operating purposes…like your building.

Equities: Funds that have been supplied to the company to get the 'stuff.' Equities show ownership of the assets or claims against the assets.

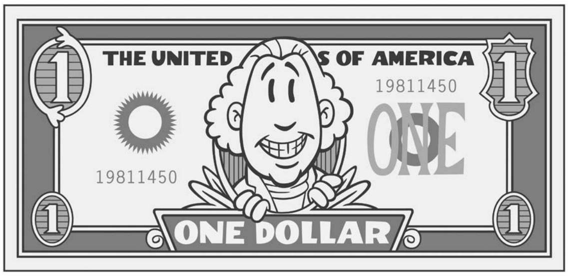
If someone other than the owner has claims on the assets, it is called a **Liability**.

If you secure a loan to buy assets you would create a liability. Because this is so common, the basic accounting formula is usually presented as:

Assets = Liabilities + Equities

This is what the whole darn thing comes down to: what you have and how you got it. It is not any more complicated than that.

We will use this basic equation to systematically gather all kinds of information about the company as we record its activities. The activities of a business cause increases and decreases in its assets, liabilities and equities. Accounting uses accounts to, well, account for and keep track of those changes. See how simple this is?? Let's keep track of Bob's first business transaction using the Balance Sheet…



Transaction #1

BOB TAKES THE $5,000.00 FROM UNDER HIS MATTRESS AND OPENS A CHECKING ACCOUNT.

Bob's Uncle Harry was a real character. Chock full of life! Well, until he died, of course. Actually keeled over on the construction site. He was a cabinet maker, still working at 87 years old.

Uncle Harry was very fond of Bob. He used to take Bob with him when he ran for parts. He would philosophize to young Bob. On religion: "If God had wanted man to go to church on Sunday, He wouldn't have invented fishing, football and horse racing." On marriage: "It's a shame that dowry business fell out of fashion." And Uncle Harry's career advice was clear: "Plumbing. Plumbers make all the money. I guess they sock it away in Swiss bank accounts because they don't look like they have money. But as sure as my name is Harold T. Bird, plumbing is where the money is!"

So, Bob became a plumber. But his ten years of experience with Turkey Drain Cleaning hadn't left much money in his pocket. When Uncle Harry died, he left a $5,000 inheritance to his favorite nephew. Bob had just shoved the cash under his mattress. Now, he pulled the money out and held it in his hands, the bills spread out like a poker hand.

"Uncle Harry, you're going to be proud of me. Today's the day I start my OWN plumbing business. Thanks for the money and the words of wisdom." Bob raised his eyes to the heavens…and wondered if they had horse racing up there.

So Bob's first act of business as the owner of Eagle Plumbing Company is to set up a checking account with Uncle Harry's $5,000 gift. Let's record this action on the Balance Sheet…

Balance Sheet		
Assets =	Liabilities +	Equities
Cash $5,000		Paid in Capital $5,000

Cash increased. Equity increased. When Bob puts money into his company it's called Paid in Capital, an Equity account. It is a reflection of his ownership in the company.

See the how we record the $5,000 twice? This is Double Entry accounting.

MORE DEFINITIONS…

Double-Entry Accounting is a system used to keep track of business activities. Double-Entry maintains the basic Balance Sheet equation: Assets = Liabilities + Equities. And...

Debits = Credits

Debits are entries with a positive number. Credits are entries with a negative number. However, the impact of a negative entry or a positive entry depends on what type of account you are entering the data into.

DOUBLE-ENTRY ACCOUNTING IS BASED ON KHARMIC LAW!

Double-Entry Accounting is based on the basic laws of the universe: what goes around comes around. For every action there is an equal reaction. In one door and out the other. This system of accounting is BRILLIANT and logical and simple. When dollars are recorded in one account they must be accounted for in another account in such a way that the activity is well documented and the accounting equation stays in balance.

Throughout this book we will keep score with Double-Entry accounting. There will be lots of examples to help you understand this accounting principle.

The Chart of Accounts is the complete listing of all the accounts in the company. It is the framework that supports the entire accounting system.

Within the assets, liabilities and equities you can list as many accounts as you need to gather good information about the company and its activities. Your Chart of Accounts can be expanded and adapted to help you gather good data. When you really know what is going on, you have the basis for good management decisions.

The next page has the Chart of Accounts that we will use for keeping track of Bob Bird and Eagle Plumbing. To make the basics easy to follow, I am using a very simple Chart of Accounts. As we go through this book, you will see how we keep score by entering dollar amounts in these accounts. These accounts will maintain the basic accounting equation:

Assets = Liabilities + Equity

MORE DEFINITIONS…

Each type of asset, liability, and equity is called an **account.** You use debits and credits to increase or decrease the accounts depending on the type of transaction.

#1 Chart of Accounts

Account	Type
1-1110 · Cash	Other Current Asset
1-1200 · Accounts Receivable	Other Current Asset
1-1800 · Inventory	Other Current Asset
1-2100 · Truck - Original Cost	Fixed Asset
1-2120 · Truck - Accum. Depreciation	Fixed Asset
2-1100 · Accounts Payable	Other Current Liability
2-2100 · Note Payable - Truck Loan	Long Term Liability
3-1000 · Paid-In Capital	Equity
3-8000 · Retained Earnings	Equity
4-1000 · Sales	Income
5-1000 · Materials	Cost of Goods Sold
5-2000 · Billable Labor	Cost of Goods Sold
5-3000 · Permits	Cost of Goods Sold
6-1000 · Owner's Salary	Expense
6-1050 · Non-Billable Labor	Expense
6-2000 · Advertising	Expense
6-2050 · Depreciation	Expense
6-3000 · Education	Expense
6-3050 · Insurance	Expense
6-3060 · Interest on Truck Loan	Expense
6-3075 · Miscellaneous	Expense
6-4000 · Office Supplies	Expense
6-4050 · Professional Services	Expense
6-4075 · Shop Supplies	Expense
6-5000 · Tools	Expense
6-5050 · Truck Maintenance & Repair	Expense
6-6000 · Uniforms	Expense
9-1000 · Taxes	Other Expense

Each account is cumulative and shows all the transactions that affect that account. To keep all the transactions straight in our examples, I will put the transaction number next to each item.

The **General Ledger** contains the information collectively for each account. Picture the General Ledger as a big book where all the accounts are listed. (In a computerized accounting program you can run a **Detail Trial Balance** report to print the information in the General Ledger.)

> **Note:** *Check with your accountant and your own software manuals to find out what the reports are called for your accounting system. I've tried to use the most common terms but the words can vary from program to program.*

The **Journal** is a record of all the transactions in the order in which they occur. The Journal Entries are then posted to the General Ledger. The Journal can also be called the **Transaction Register.** Think of the Journal as the diary, the day-by-day record of what happened in the company.

RULES FOR DEBITS AND CREDITS…

There is evidence that double-entry accounting was used throughout the Roman Empire. Luca Pacioli, a monk and compatriot of Leonardo daVinci, is often called the "father of accounting" because he was the first to publish a detailed description of the double-entry system. (I got this information from www.wikipedia.com.) Unchanged since Pacioli's writings, accounting is a universal language. The basics presented here work in any language, with any type of money, and in every business. Here are the basic rules:

For asset, liability and equity accounts, the rules of Debits and Credits are…

To increase an asset account, debit it.
To decrease an asset account, credit it.
To increase a liability or equity account, credit it.
To decrease a liability or equity account, debit it.

"With money in your pocket, you are wise and you are handsome and you sing well too."

~YIDDISH PROVERB

THE ACCOUNTS, THE JOURNAL AND THE GENERAL LEDGER CONTAIN THE INFORMATION FOR THE FINANCIAL STATEMENTS.

This is where you look to find the details, or to uncover a mistake.

You probably will use some kind of accounting software to help you keep score. Here's what the Journal (Transaction Register) and the General Ledger (Detail Trial Balance) would look like for transaction #1:

#1 Journal

Date	Num	Memo	Account	Debit	Credit
12/31	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
TOTAL				**5,000.00**	**5,000.00**

#1 General Ledger

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
Total 1-1110 · Cash				5,000.00	0.00	5,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
TOTAL				**5,000.00**	**5,000.00**	**0.00**

#1 Balance Sheet

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	5,000.00
Total Other Current Assets	5,000.00
Total Current Assets	5,000.00
TOTAL ASSETS	**5,000.00**
LIABILITIES & EQUITY	
Equity	
3-1000 · Paid-In Capital	5,000.00
Total Equity	5,000.00
TOTAL LIABILITIES & EQUITY	**5,000.00**

BEHIND THE DATA ENTRY SCREENS IN YOUR ACCOUNTING PROGRAM…

Now, here's the inside skinny. In an accounting program, the debits and credits go on behind the entry screens. When you enter a deposit to record Transaction #1, the deposit will debit account 1-1110 Cash and credit account 3-1000 Paid In Capital. You can see the impact of your entries when you run the background reports…in the General Ledger and the Journal.

For basic data entry details and instructions, your accounting system "help" screens and tutorials. What you will learn in this book is the effect of those entries on your Balance Sheet. The Balance Sheet tells you what you HAVE (Assets), what you OWE (Liabilities) and what you OWN (Equity). Good to know! Accounting programs tend to down-play the whole debits and credits thing because they think it is confusing. It can be! However, for me, once I understood the flow of the data entry and debits and credits, it made accounting and financial reports clear and easier to grasp. Hopefully the information in this book will help you stitch together what happens to your financial position when you engage in business activities and day-to-day transactions. You don't need to become an expert bookkeeper to be a great business owner. However, it can help you understand and demystify the reports. That's how it worked for me. Once I got it, I was no longer intimidated by the financials. Once I got it, I started to keep better score and make more money.

Whew! Lots of definitions and concepts! Time for some more examples to help your understanding… Let's look at Bob's next move and see the effect on the Balance Sheet and the supporting evidence in the Journal and the General Ledger.

NOTE: Throughout the book, we will show you these financial reports…

- Balance Sheet
- Profit and Loss
- Journal
- General Ledger

…after every transaction. You'll see the effect of the transactions. I'm not going to demonstrate entering Invoices, Applying Customer Payments, Making the Deposits or Writing Checks. Consult your accounting software Help screens and tutorials for how to do basic bookkeeping tasks. This book will demonstrate what the end effect of basic data entry activities on the financial reports. So, assume the bookkeeping duties have been done as you review the reports.

Transaction #2

BOB BUYS A TRUCK.

Bob is feeling pretty flush with that $5,000 in the bank. Time to spend some money! To get his plumbing business off the ground, Bob needs a truck. Bob is in absolute heaven. He just loves trucks and today he's going to buy one! The only new truck he has ever had was the one he bought when he was sixteen years old. He recalls every detail of that rig. It was a Jeep Wrangler. Painted all red, white and blue…kind of a stars and stripes theme. The stinky-new smell of the vinyl seats 'outgassing.' The tires that were still so new they hadn't worn off the little rubber, mold-injected-excess bits. The first day he owned it he took the motor out of that brand new vehicle, oiled everything and put it back in. Just because he could. He loved it so much. Actually named it 'Stevie,' after Stevie Nicks of Fleetwood Mac.

Alas, now, he only has $5,000 in the checking account. Trucks nowadays cost ten times what they did when he was in high school. Even if he forgoes the sweet Ford 4x4 'dually' with the pin stripes and the air brushed "Dogs Playing Poker" artwork, Bob will need to borrow some money. Settling down a little, Bob selects a very functional one-ton van with utility shelving. The salesman, eager to cut a deal, agrees to loan Bob the full $15,000 to purchase the truck. Let's record the transaction…

#2 General Ledger

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
Total 1-1110 · Cash				5,000.00	0.00	5,000.00
1-2100 · Truck - Original Cost						
	12/31	#2	Bob buys a truck.	15,000.00		15,000.00
Total 1-2100 · Truck - Original Cost				15,000.00	0.00	15,000.00
2-2100 · Note Payable - Truck Loan						
	12/31	#2	Bob buys a truck.		15,000.00	-15,000.00
Total 2-2100 · Note Payable - Truck Loan				0.00	15,000.00	-15,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
TOTAL				**20,000.00**	**20,000.00**	**0.00**

Balance Sheet

So, the basic equation stays in balance. I bet you understand why it's called the Balance Sheet by now, huh? Look back at page 37. Note the changes for each account. The Balance Sheet shows the cumulative effect of Bob's business activities. Check out the accounts and the Journal Entries. This is the detail behind the information on the Balance Sheet. Notice that each account shows the total of the account. The accounts

Asset = Liabilities + Equity.

- Assets have a Balance in the Debit Column.
- Liabilities and Equity have a balance in the Credit Column.

If you want to get into detail, check page 127 for a reference guide for Debit and Credit rules.

You might be more familiar with a Balance Sheet that is formatted like this one. Still in balance, still holds to the basic equation…Assets = Liabilities + Equity. Note that the dollar amount is increasing. The company is growing.

#2 Balance Sheet

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	5,000.00
Total Other Current Assets	5,000.00
Total Current Assets	5,000.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**20,000.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Total Equity	5,000.00
TOTAL LIABILITIES & EQUITY	**20,000.00**

#2 Journal

Date	Num	Memo	Account	Debit	Credit
12/31.	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31.	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
TOTAL				**20,000.00**	**20,000.00**

At this point the company is growing as a result of 'Other People's Money' flowing into the company via the Ford loan. One way to get cash is to put money directly into the checking account. If the owner supplies the cash, it is recorded as Paid-In Capital. The owner thereby increases his equity, ownership, in the company. If someone else supplies the cash, by way of loan, a liability is created.

When a new company starts up, it will need some cash to get going. Ultimately the cash needed to run the company should come from selling goods and services! But hang on…we'll address that in a few pages!

MORE ABOUT ASSETS & LIABILITIES …

Not all assets are the same! Cash is king! Cash is so useful! On the other hand, your truck, though also an asset, is not as flexible. You don't want to sell your truck and use the cash today the phone bill. Make sense? So, we categorize the assets—cash, and other assets that could be converted to cash within a year's time, are called Current Assets.

CURRENT ASSETS INCLUDE:

- **Cash**...the green stuff and coins! Money in the bank.
- **Accounts Receivable**...when you do the work today and someone promises that they will pay you for the work next month, that promise is called an account receivable. It's a current asset because by next month—you hope—it will be paid, and turn into cash in the bank.
- **Inventory**...when you buy inventory the idea is to sell it (and the labor to install it) and create cash, or accounts receivable.
- Assets that are not as easily converted to cash—or shouldn't be sold just to create cash—are called **Fixed Assets**. These include vehicles, tools, buildings and land. These assets are best used for operating the business and doing the work—not for selling in order to create cash to pay bills.

Liabilities are also broken down into two basic categories...Current Liabilities are short term liabilities, obligations that are due within the next twelve months. Long term liabilities are obligations that give you more than a year to pay them back. Make sense?

CURRENT LIABILITIES INCLUDE...

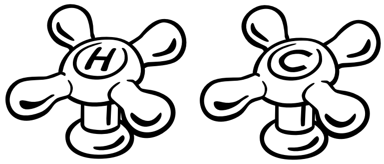
- **Accounts Payable**...when you buy something from somebody—like materials for a job— you may promise to pay them in 30 days. That promise is called an account payable.
- **Sales tax and payroll taxes** may also be accounted for as payables.

So, it's important to watch the amounts in the current assets and current liabilities. You need more in current assets than current liabilities or you will be unable to pay your bills! This measurement of current assets to current liabilities is called your current ratio.

CURRENT ASSETS : CURRENT LIABILITIES

You will sleep better at night if you can maintain a 2:1 current ratio! In other words, aim for twice as much in current assets as you owe in current liabilities. If you want your bank to loan you money, they will look at your current ratio to determine your ability to pay your bills on time.

How are you doing? Try to follow the flow of the money and the impact of the transactions on the reports. It's not so hard is it?



Transaction #3

BOB GOES SHOPPING.

Bob spends the day driving around in his new truck. He is so pleased with himself. He is following his dream…he's an independent business owner, an entrepreneur!

He swings the truck into the supply house yard. Bob saunters to the counter. These guys know him. He has picked up parts from this wholesaler for the last ten years. Oh, the hours he has spent here, whining about his former boss, "If I ran the show, things would be different. How can I get any work done when I am always here, waiting on my parts order ?? My boss never stocks what we need! When I go out on my own I will load up on the inventory."

Of course, Bob doesn't have an account set up yet, so today he pays cash for his purchases. He buys $3,000 worth of ballcocks, nipples and male and female adapters to keep on his truck.(No doubt, plumbing repair parts have the oddest names!) Feeling like a man who has set the world straight, Bob saddles up in his new truck and heads off into the sunset…and off to make his first sale! Let's track Bob's purchases on the Balance Sheet. Cash decreases. Inventory appears on the Balance Sheet. He swapped one asset for another one.

HELPFUL HINTS

- Compare the Balance Sheet on the next pages with the one on page 40. While the total numbers stay the same, you can see that Bob is in a different cash position now. With each transaction, flip back to the previous transaction and compare the reports. What changed? This will help you understand this stuff!
- Look at the accounts after transaction #3.
- Look at the Journal and General Ledger for transaction #3.

#3 Journal

Date	Num	Memo	Account	Debit	Credit
12/31.	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31.	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31.	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
TOTAL				**23,000.00**	**23,000.00**

#3 General Ledger

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
	12/31	#3	Bob goes shopping.		3,000.00	2,000.00
Total 1-1110 · Cash				5,000.00	3,000.00	2,000.00
1-1800 · Inventory						
	12/31	#3	Bob goes shopping.	3,000.00		3,000.00
Total 1-1800 · Inventory				3,000.00	0.00	3,000.00
1-2100 · Truck - Original Cost						
	12/31	#2	Bob buys a truck.	15,000.00		15,000.00
Total 1-2100 · Truck - Original Cost				15,000.00	0.00	15,000.00
2-2100 · Note Payable - Truck Loan						
	12/31	#2	Bob buys a truck.		15,000.00	-15,000.00
Total 2-2100 · Note Payable - Truck Loan				0.00	15,000.00	-15,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
TOTAL				**23,000.00**	**23,000.00**	**0.00**

#3 Balance Sheet

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	2,000.00
1-1800 · Inventory	3,000.00
Total Other Current Assets	5,000.00
Total Current Assets	5,000.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**20,000.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Total Equity	5,000.00
TOTAL LIABILITIES & EQUITY	**20,000.00**

Right about now you may be asking yourself…

IF MY ACCOUNTING SYSTEM IS COMPUTERIZED, DO I NEED TO KNOW THIS STUFF?

The Answer: No and Yes.

You DON'T need to know the fine points of bookkeeping and accounting. Your accountant needs to know them and your bookkeeper needs to know them. Your computerized accounting system will probably handle all the double-entry stuff just fine.

When you make an entry in your accounting program, the debits and credits go on behind the scenes. For instance, when you write a check, the credit is to cash. When you assign the check to an expense account, the debit goes to that expense. When you enter a sale, behind the scenes there is a credit to an income account, and a debit to accounts receivable. Remember, you can follow the flow of debits and credits by running the Journal or reviewing the General Ledger. (There is a complete list of the rules for debits and credits at the end of the book.)

I NEVER wanted to learn the numbers. I am much too flighty and my attention span is much too short for all this hard facts stuff. But I had to learn this because our business was ruining my life. Once I got into it, I found out how fun it is to keep score.

I also found out all the mistakes that my accountant had been making! It wasn't her fault. I had given her vague information and had never checked the reports!

You need to know how to read, interpret and act on the Financial Statements. Your assessment of the Financials will be enhanced if you know what they are and how they account for different activities. A basic understanding of how a tool works will help you use that tool better.

It may be that you are the bookkeeper and accountant for your company. If so, this overview of Double-Entry accounting will help you see the framework on which all your data entry hangs. This will make it easier to correct erroneous information. Could it be that you have some reports that you don't trust? Do you want to change your accounting to generate better managerial data? An understanding of Double-Entry accounting will help you fine tune your information.

You need to know that the information you get from your Financials is correct. I would lay$1,000 down that you will find major information that is just plain WRONG in your Financials once you start checking them out on a regular basis. Common problem? Garbage in, garbage out. Unless the data entry person knows where the data is supposed to be entered, your information will be worthless.

You don't need to know everything about accounting. **You do need to know everything in this book…as a bare minimum!**

Let's use what we know from the Financials and do some analysis…

Bob's inventory purchase affected his cash flow. Although the total value of the assets didn't change on the Balance Sheet, Bob has to pay special attention to cash. It works better for buying things than swapping with chickens. Of all assets, cash is the most precious.

Play with a couple of "What If?" transactions and see how they would affect Bob's business.

What if…

- Bob can get a great deal on low-flush toilets! If he buys 100 of them, he only pays $50 each. Is that a good deal?
- If Bob fills his propane tanks in July, he only pays $.65 per gallon, as opposed to $1.39 per gallon he expects to pay in December. Should he stock up?

What are the Cash Flow implications of these activities?

Cash Flow: The movement and timing of money, in and out of the company. The heartbeat of a business is Cash Flow.

A cash flow statement is a report that shows, month by month, how much money you predict will come into and flow out of your company. Bankers love this. You can use it for a budget.

Could you have lots of cash on hand and still be losing money in your business?? YES! Could you be profitable…but your checking account is empty? YES!

Do you use Cash Basis or Accrual Basis accounting at your company?

Cash Basis Accounting: When you account for your business activities, no adjustments are made for pre-paid expenses or unearned income. You record the transaction in full on the day the money shows up, or leaves the company.

Accrual Basis Accounting: When you account for your business activities, you adjust for pre-paid and unearned items. Under this basis, revenues (Sales) are credited to the time period in which they are earned, and expenses are credited to the time period in which they are incurred.

Whew…lots of mumbo jumbo. Let's use an example to clarify.

Let's say Bob Bird needs propane to heat his shop. To take advantage of the summer selling price of the fuel, he buys a year's supply of propane in July. He writes a check for $2,000.

With Cash Basis Accounting, Bob would expense the entire amount in the month the check was written—July. With Accrual Basis Accounting, Bob would determine how much fuel would be used each month, and expense that amount each month. By either exact fuel monitoring or a well thought out guess, Bob can account for a portion of the fuel expense each month.

However, for managerial reasons, your internal information should always be calculated on an Accrual Basis.

Accrual basis accounting is more accurate. It shows a truer picture of what is happening at your company. You can also create a cash flow statement (report) to keep an eye on cash available and cash needed from day to day, week to week.

HERE'SA BONUS ROUND QUESTION: WHAT IS BOB'S NET EQUITY IN HIS COMPANY?

Net Equity = Total Assets - Total Liabilities

So at this point Bob's Net Equity is $5,000 ($20,000 - $15,000). Net Equity is also called Net Worth and it reflects Bob's ownership of the Assets. Notice that we are just restating the basic accounting formula: Assets = Liabilities + Equity.

Be aware that Net Worth is not what the company is worth. Would you like to sell your company some day? Great. Be aware that the selling price of your company will be based on its ability to generate money, not on Net Worth or Assets. Profit! Ah, that is the breath of life for your company. Let's check in with Bob Bird and see if he can generate some profit dollars with his company.

> HELPFUL HINT: *You can set up a Balance Sheet for yourself and your family—and I suggest you do! It's great to see what you HAVE (assets) and take note of what you OWE (liabilities) and realize the difference (net worth) ... what you OWN. Unlike a business, personal net worth is a good measure of your family fortune. Do you aspire to a debt-free life? Do you want to build your investments and real estate holdings? You can keep score with a personal Balance Sheet and Profit and Loss Statement.*

"I am indeed rich, since my income is superior to my expense, and my expense is equal to my wishes."

~EDWARD GIBBONS

THE INCOME STATEMENT

Bob Bird is ready to plumb! Let the phone ring; let the sales begin! How do we account for Sales?

Let's pull out another scorecard: The Profit and Loss Statement. The Profit and Loss Statement (also called an Income Statement or a 'P&L') is a report that shows changes in the Equity of the company. Expenses are decreases in Equity. Revenues are increases in Equity. The basic equation for the Profit and Loss Statement is

Revenues - Expenses = Profit

If the Expenses are greater than the Revenues we get a negative profit. Also known as a—gulp—Loss.

The Income generated during the month gets transferred to the Balance Sheet at the end of the month. In fact, the Profit and Loss Statement is like a magnifying lens on the activities that effect the changes in the Equity of the company. The profits from the month increase the Equity of the company. A Loss results in a decrease in Equity.

MORE DEFINITIONS….

The Profit and Loss Statement and the Balance Sheet are connected. The Net Profit dollar amount of the Profit and Loss Statement is the **Current Earnings** dollar amount on the Balance Sheet. You see, the net change in the Equity section of the Balance Sheet is Income (also called Net Profit.

The cumulative account for all the earnings for the company is called **Retained Earnings**. At the end of the year, the Net Income number moves to the Retained Earnings spotting the Equity Section. Why? Well, they aren't current anymore!

While the Balance Sheet gives you a snapshot of the company's financial well being, the Profit and Loss Statement shows you revenues and expenses over a period of time. Usually over month or a year, although you could generate Profit and Loss Statements every day.

Understanding and analyzing your Profit and Loss Statements can help you with these decisions…

- How much do I need in Sales to achieve my goals?
- Is my selling price adequate?
- Am I spending too much or too little on ________?

The Profit and Loss Statement answers the question WHERE DID THE MONEY GO???

The Profit and Loss Statement tells you **how much money you made OR LOST during the accounting period.**

So, let's follow Bob Bird on his first sale…

Transaction #4

BOB SELLS A HOSEBIB.

The phone rings! "Thank you for calling Eagle Plumbing, how may I help you?" Bob answers in his most professional voice.

"Yo Bob, this is Fred, from next door. Do you have one of those things that you turn off theater to the hose with?" asks Fred Freeload, Bob's next door neighbor.

"You mean a silcock?" Bob responds.

"A what? No, man, I mean a thingy that shuts the water off to the hose. Mine's busted."

Bob is used to Fred calling and 'borrowing' things like replacement toilet parts and water heater elements. Things that usually get installed, not returned. Fred fancies himself a do-it-yourselfer. But Fred's mechanical skills are limited…and his DIY jobs usually turn into day-long projects for Bob once he comes to the rescue. Bob sighs and decides to charge Fred for the part…with something extra for the time Bob is sure to spend helping out. Bob paid $95 for the silcock (a.k.a. a hosebib) at the supply house and, pulling a selling price out of thin air, he sells it to Fred for $150.

Here's how we record the transaction on a simple Profit and Loss Statement. The Expense in this transaction is the hosebib.

Notice how transaction #4 affects the Balance Sheet. Compare this to the Balance Sheet on Page 45. Note the changes. This transaction affects a few accounts.

- There is an increase in Cash of $150.
- The hosebib leaves Inventory…decrease of $95.
- The profits from the Profit and Loss Statement transfer to the Balance Sheet as an increase in Equity, recorded as Current Earnings.

The Balance Sheet shows that Eagle Plumbing is growing again. This time Income from operating the business increases Bob's Equity. Cool, huh?!

#4 Profit & Loss

Ordinary Income/Expense	
Income	
4-1000 · Sales	150.00
Total Income	150.00
Cost of Goods Sold	
5-1000 · Materials	95.00
Total COGS	95.00
Gross Profit	55.00
Net Ordinary Income	55.00
Net Income	**55.00**

#4 Balance Sheet

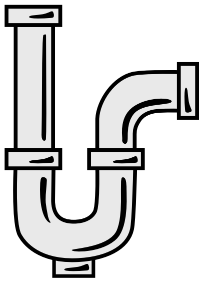
ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	2,150.00
1-1800 · Inventory	2,905.00
Total Other Current Assets	5,055.00
Total Current Assets	5,055.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**20,055.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Net Income	55.00
Total Equity	5,055.00
TOTAL LIABILITIES & EQUITY	**20,055.00**

#4 Journal

Date	Num	Memo	Account	Debit	Credit
12/31.	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31.	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31.	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
12/31.	#4	Bob sells a hose bib.	4-1000 · Sales		150.00
		Bob sells a hose bib.	1-1110 · Cash	150.00	
		Bob sells a hose bib.	5-1000 · Materials	95.00	
		Bob sells a hose bib.	1-1800 · Inventory		95.00
				245.00	245.00
TOTAL				**23,245.00**	**23,245.00**

#4 General Ledger

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
	12/31	#3	Bob goes shopping.		3,000.00	2,000.00
	12/31	#4	Bob sells a hose bib.	150.00		2,150.00
Total 1-1110 · Cash				5,150.00	3,000.00	2,150.00
1-1800 · Inventory						
	12/31	#3	Bob goes shopping.	3,000.00		3,000.00
	12/31	#4	Bob sells a hose bib.		95.00	2,905.00
Total 1-1800 · Inventory				3,000.00	95.00	2,905.00
1-2100 · Truck - Original Cost						
	12/31	#2	Bob buys a truck.	15,000.00		15,000.00
Total 1-2100 · Truck - Original Cost				15,000.00	0.00	15,000.00
2-2100 · Note Payable - Truck Loan						
	12/31	#2	Bob buys a truck.		15,000.00	-15,000.00
Total 2-2100 · Note Payable - Truck Loan				0.00	15,000.00	-15,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
4-1000 · Sales						
	12/31	#4	Bob sells a hose bib.		150.00	-150.00
Total 4-1000 · Sales				0.00	150.00	-150.00
5-1000 · Materials						
	12/31	#4	Bob sells a hose bib.	95.00		95.00
Total 5-1000 · Materials				95.00	0.00	95.00
TOTAL				**23,245.00**	**23,245.00**	**0.00**



Transaction #5

BOB SELLS A WATER HEATER, INCLUDING INSTALLATION.

Let's work out another Sales transaction on the Balance Sheet and Profit and Loss Statement. Just as he is wrapping up with Fred, the phone rings. A real customer this time! Mrs. Lawson is a sweet old lady. She saw Bob's truck buzzing past her house anddecided she would call. Her old water heater had started to leak and she figured it might need to be replaced. Gosh, it had to be at least 15 years old.

She moved into this home that many years ago, and she had never had any work done on the water heater.

Bob rushes to Mrs. Lawson's House and tries to dazzle her with his expertise and devotion to customer service. In fact Bob chatters on and on about his skills and licenses and his promises to be there in a flash should anything ever go wrong. Mrs. Lawson is smiling and nodding. Bob thinks she is agreeing to everything he is recommending. Really, she is very hard of hearing. He offers to install an new water heater. Bob paid $160 for the water heater when he stocked his truck. As he did before, he makes up a selling price.

Now, just to make it easy on us, let's say Bob accurately calculates the cost of his wages including all benefits to be $45 per hour. He predicts, based on past experience that it will take him a total of 3 hours to replace the heater, including all travel time and clean up. He pays himself a total of $135 for his work as a technician. Bob also needs to get a $15 permit for the job.

Aiming high Bob pulls a selling price of $450—he remembers Turkey Drain Cleaning would charge $475 for the same heater—and scribbles it on an invoice. Mrs. Lawson nods and smiles and writes a check for $450. Although she couldn't understand much of what he was saying, she knows he brought a water heater with him. If she writes a check he can get to work…and then she won't have to pretend to listen to him anymore! Let's record this transaction on the Profit and Loss Statement and Balance Sheet. Let's assume...

#5 Profit & Loss

Ordinary Income/Expense	
Income	
4-1000 · Sales	600.00
Total Income	600.00
Cost of Goods Sold	
5-1000 · Materials	255.00
5-2000 · Billable Labor	135.00
5-3000 · Permits	15.00
Total COGS	405.00
Gross Profit	195.00
Net Ordinary Income	195.00
Net Income	**195.00**

#5 Balance Sheet

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	2,450.00
1-1800 · Inventory	2,745.00
Total Other Current Assets	5,195.00
Total Current Assets	5,195.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**20,195.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Net Income	195.00
Total Equity	5,195.00
TOTAL LIABILITIES & EQUITY	**20,195.00**

- Labor cost is: 3 hours @ $45.00 per hour = $135.00
- Material Cost is: $160.00
- Permit Fee is: $15.00
- Total cost is $310 and. . .
- Bob charges $450.00 for the job.

Here is the Profit and Loss Statement …after both transactions. Compare it to the Profit and Loss Statement on page 52. Note the changes.

#5 Journal

Date	Num	Memo	Account	Debit	Credit
12/31	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
12/31	#4	Bob sells a hose bib.	4-1000 · Sales		150.00
		Bob sells a hose bib.	1-1110 · Cash	150.00	
		Bob sells a hose bib.	5-1000 · Materials	95.00	
		Bob sells a hose bib.	1-1800 · Inventory		95.00
				245.00	245.00
12/31	#5	Bob sells a water heater, including installation.	5-1000 · Materials	160.00	
		Bob sells a water heater, including installation.	1-1800 · Inventory		160.00
		Bob sells a water heater, including installation.	5-2000 · Billable Labor	135.00	
		Bob sells a water heater, including installation.	1-1110 · Cash		150.00
		Bob sells a water heater, including installation.	4-1000 · Sales		450.00
		Bob sells a water heater, including installation.	1-1110 · Cash	450.00	
		Bob sells a water heater, including installation.	5-3000 · Permits	15.00	
				760.00	760.00
TOTAL				**24,005.00**	**24,005.00**

#5 General Ledger

Date	Num	Memo	Account	Debit	Credit
12/31/2009	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31/2009	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31/2009	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
12/31/2009	#4	Bob sells a hose bib.	4-1000 · Sales		150.00
		Bob sells a hose bib.	1-1110 · Cash	150.00	
		Bob sells a hose bib.	5-1000 · Materials	95.00	
		Bob sells a hose bib.	1-1800 · Inventory		95.00
				245.00	245.00
12/31/2009	#5	Bob sells a water heater, including installation.	5-1000 · Materials	160.00	
		Bob sells a water heater, including installation.	1-1800 · Inventory		160.00
		Bob sells a water heater, including installation.	5-2000 · Billable Labor	135.00	
		Bob sells a water heater, including installation.	1-1110 · Cash		150.00
		Bob sells a water heater, including installation.	4-1000 · Sales		450.00
		Bob sells a water heater, including installation.	1-1110 · Cash	450.00	
		Bob sells a water heater, including installation.	5-3000 · Permits	15.00	
				760.00	760.00
TOTAL				**24,005.00**	**24,005.00**

WOW! EAGLE PLUMBING IS KICKING BUTT! THIS BUSINESS *BUSINESS* IS EASY!

However....If this was all there was to it, then the world would be full of prosperous businesses. How could you lose??

In reality most business fail…breaking their owners in the process. What happens???

Most business owners don't understand and account for the **Indirect Costs** of doing business when they set selling prices!!

There are **Direct Costs** (Job Site Expenses, Cost of Goods Sold) and **Indirect Costs** (Overhead)

While Bob is out selling and plumbing, bills are being delivered to his home office…telephone, printing, yellow page ads, insurance. Bob's Profit and Loss Statement needs to be expanded to include ALL the Expenses associated with doing business. In reality, there are a lot of expenses involved in running Eagle Plumbing. Bob is aware of the Materials, Labor and Permit. These expenses are *directly* related to a specific job. They are Job Site Expenses, Cost of Goods Sold or Direct Costs.

The other expenses involved in operating the company are Overhead, or Indirect Costs. These expenses are *indirectly* related to jobs. Indirect Costs include advertising, insurance, office expenses, donations, truck repairs…the list goes on. These costs are often overlooked or discounted by folks who don't look at their Financials.

In fact, it is likely that Eagle Plumbing's Indirect Costs exceed the Direct Costs. Unless Bob takes a look at his *total* costs of doing business, his out-of-the-blue selling prices will sink his company. After a few months of operating, the indirect costs will take all of Bob's cash…and take him farther in debt. Bob will shake his head and wonder…

"Where did the money go?"

If you are a banker or an accountant, I might ruffle your feathers here …brace yourself!

Bob priced the hosebib $55 over his direct cost of the item. Was this a good move? Did he make any money? Bob just pulled that selling price out of thin air.

When business owners make up selling prices, they trot out this silly phrase as their reasoning: *I charge what the market will bear.* Sadly, virtually all business literature, and most accountants and bankers, will back up the going rate theory. You will be instructed to establish a selling price that is within a percentage point or two of what everyone else in the market is charging.

May I suggest that if most businesses fail—about 80% in the first three years—it is foolish to base your financial well being on what others are charging. What makes you think the fellow down the road has any idea what he is doing? Sure he is busy…busy isn't so hard. Creating and sustaining profits and developing careers for you and your staff…ah, there's the rub.

THIS IS WHY I WROTE THIS BOOK!

When creating selling prices, base them on your real costs of doing business, including fair compensation for you and your hardworking employees…NOT ON WHAT THE MARKET WILL BEAR.

Consider what the market will bear… $20,000 for a Rolex watch, $125 for a cigarette lighter, $4 for a six pack of soda. The market is not strictly price driven…or even primarily price driven.

This is what it takes to make money in your business:

- Develop a fair price based on your costs.
- Present your products in such a way that value outweighs price.

Why is this what the market will bear nonsense so ingrained? Ignorant men will defer to the opinion of experts. **Some experts in accounting will tell you silly rules like:**

- Take your cost of product and double it to create a selling price.
- Find out what others in your industry are charging, and then charge less.
- If you are not making any money, cut down on your expenses.

These suggestions are not based on facts. You need to know what your costs are, then create a selling price that will cover all costs plus profit.

THE DIFFERENCE BETWEEN MANAGERIAL ACCOUNTING AND "UNCLE SAM" ACCOUNTING

My savvy friend Manola Robison has a nice way to help you understand the difference between the kind of accounting that the government needs to see on your tax returns and the kind of accounting that will give you the information you need to run your business.

Manola says, "Your accountant wants to make sure you comply with IRS regulations. There are rules you must follow with "Uncle Sam" Accounting. By the time your accountant has ensured that your Financials are ready for "Uncle Sam" they are old news. "Uncle Sam "accounting has an 'outside' orientation, meaning that the Financials are generated for the government and bankers. Managerial Accounting has an 'inside' orientation. This financial information is generated to help you manage your company. You want news hot off the press so you can make informed decisions as quickly as possible."

I'm not suggesting the ol' 'two sets of books' here!! Your Managerial information is not at odds with the "Uncle Sam" information. Rather, it is quickly gathered and analyzed for in-house management. The "Uncle Sam" version waits for the dust to settle from the previous month, and focuses on tax law compliance.

Here's a nice illustration of the difference between Managerial information and "Uncle Sam "accounting… Your accountant will structure your Profit and Loss Statement to determine profits before taxes. Why? Because that is the information he uses to determine what your tax liability is! You, however, also need to look at post tax profit. Is it enough? How much do you need to charge to make it all work? What changes can you make today? Make sure your 'inside' accounting gives you the information you need.

Taxes are a cost of doing business and need to be figured into the selling price of your services. If I had a dollar for every time I've heard a contractor say, "I was doing really well this year, but, then the IRS took it all!" You can only guess at many costs when you look into the future. But TAXES? Count on them, for crying out loud. And price accordingly.

SEPARATING INDIRECT COSTS FROM DIRECT COSTS IS A MANAGERIAL ACCOUNTING DECISION.

Left to his own devices, your accountant will probably list all the expenses of the company inane section below Sales in the Profit and Loss Statement. Maybe he separates the Material and calls it Cost of Goods Sold. But this information is too vague and general to use for decision making in your company. Let's add more accounts to the Profit and Loss Statement to gather more information.

Profit and Loss Statement

"What about these costs?" No activity yet, be patient.

There could be many more categories for expenses. We'll keep it simple in this illustration to make the concepts easy to understand.

Notice that the Expenses have been divided into two categories…Direct Costs and Indirect Costs. Let's define the terms:

Direct Costs (a.k.a. Cost of Goods Sold, Cost of Sales or Job Site Expenses): These expenses are directly related to a sale. If the sale didn't happen, the expense would not be incurred. Direct Costs refers to material, labor costs and permits used at a specific jobsite. Or, the cost of the item you purchased intending to resell it.

If a tool was purchased to be used on a specific job and it was used to the point of complete depreciation on that job, then you would include that tool as a Direct Cost. If you bought atoll to be used on lots of different jobs it would not be a Direct Cost. It would be an Indirect Cost.

Most business owners understand Direct Costs and charge their customers enough to cover these costs. It's the Indirect Costs that get overlooked.

Indirect Costs (a.k.a. Operating Expenses or Overhead): Every expense other than the Direct Costs. These are the costs you need to operate the business every day, to keep a roof overhead. They are indirectly related to sales. These costs remain fairly constant whether you have lots of sales, or sales are down.

An example of an Indirect Cost is the telephone bill. If Bob Bird had no sales this day, well, the telephone expense would still be incurred. Indirect Costs can't be assigned to a specific job. To what job do you assign the copy machine repairs? Get the idea?

Each selling price should be calculated to include a portion of your entire Indirect Costs burden. It would not make sense to hit up Mr. Jones for your entire rent payment. Why is it helpful to separate the Indirect Costs from the Direct Costs? As a manager, you need to know how much money it takes to cover Indirect Costs every month. Busy or slow, Indirect Costs are racking up, hour by hour. How much does it take to 'crack the nut' each month? Without sales, Direct Costs go away—no problem. Ah, but not so with the Indirect Costs…you better know how much you need to run your company.

Indirect Costs include owner's salary. Why? Well, the owner is entitled to compensation for the administrative functions he performs in the company. Bob can put on his technician uniform and earn wages in the field. Those wages are Direct Costs. As the owner-manager Bob needs a salary that compensates his work as a manager. His owner's salary is an Indirect Cost.

Look again at the Profit and Loss Statement. Notice that after you subtract Direct Costs from Sales you arrive at Gross Profit.

Gross Profit: Subtract the Indirect Costs from Sales to find Net Profit. If your Gross Profit is really solid, you may have enough to cover all Indirect Costs and generate respectable profit. How much Gross Profrit is enough? As you become proactive with your company's Financials, you will understand what you need to achieve your goals.

Net Income (a.k.a. Current Earnings or Net Profit): This is the 'bottom line.' This is the real profit figure after ALL expenses have been deducted. This is my favorite statistic.

You'll remember that this figure connects the Profit and Loss Statement to the Balance Sheet. The Net Income dollar amount is the Current Earnings dollar amount. As the Profit and Loss Statement is really a look at the change that takes place in the Equity section of the Balance Sheet, the Net Income is the 'net change' in Equity.

"But wait a minute. I am not a plumber! I sell T-shirts!"

As an example company, I created Eagle Plumbing. Eagle Plumbing is a typical service company. This company is much like any business that 'sells' their expertise, or time. Doctors, consultants, lawyers, trades people, and contractors to name a few.

But what if you sell strictly products…like T-shirts? I suggest this model will still work for you. The reality is your shop has only so much time every day to make sales.

A BRIEF LECTURE ON WHY YOU NEED PROFIT AND OWNER'S SALARY

Most business owners mistakenly believe that they will gather up all the profit left over at the end of the year, stuff it in their pockets and consider themselves compensated. Wrong!

The company is a separate, living, growing entity. Profit fuels your company's growth. If you choose to buy a new building, or buy a company to do Air Conditioning work, you finance the company's growth with profit. You can share profit with your employees via a profit-sharing plan. As the owner, Bob is entitled to a return on investment for his risk and exposure as an investor. Cool, huh?

Your salary compensates you for the headache, heartache, time, risk and energy you put into the company. Your salary provides for you and your family. You need BOTH profit and salary. Enough said.

Back to the Profit and Loss Statement…

Let's take a look at the duties that Bob Bird performs at Eagle Plumbing. Sometimes he is doing service work, other times he is performing administrative tasks. His time should be split up into Direct and Indirect Costs.

WHAT YOUR ACCOUNTANT WON'T TELL YOU. DETERMINING THE BILLABLE HOUR.

Unless you purposefully train your accountant to do otherwise, he will lump all Payroll expenses together. But, sometimes you are 'turning wrenches' or selling. Sometimes you are running for parts, cleaning up, training or standing by. You're limited to what you can sell based on the number of labor hours you have. To understand what's happening in your business, you need to know how much time you are generating sales compared to all your other duties.

You need to track your employees' time as well. Using our service company example, suppose the service technicians are available for calls 8 hours a day, 5 days a week, a total of 40 hours each. Of those 40 hours, each tech will generate some time for which you are able to bill the customer via an invoice. The hours that are billable to the customer are called Billable Hours.

"HEY…I PAY STRICTLY ON COMMISSION. WHY DO I NEED TO WORRY ABOUT BILLABLE HOURS? I DON'T PAY THE TECHS IF THEY DON'T SELL."

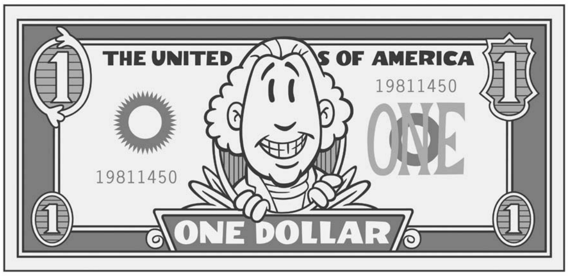
Whether your pay structure is commission based or hourly, you still need to know the number of hours Billable, and compare to the hours not Billable. There are only 24 hours in a day. Of those, your service providers are only available for a fixed number of hours. That's all the time you have to recover all the Indirect (Overhead) costs that your company generates every day.

If you pay on a commission basis, you don't pay the service providers for non-Billable hours. That's fine. BUT, you're not home free. Your rent, advertising, administrative costs, etc., are still racking up. Your company's survival depends on a minimum number of Billable hours.

Most state labor laws will still require you to keep track of the total hours put in by your people. Also, you can't help them get better and more efficient if you don't measure their performance!

If you sell services by the hour…**The number of Billable Hours at your company is the variable with the biggest impact on your Financial Statements.**

Let's use Bob Bird and Eagle Plumbing Co. to help us understand the impact of Billable hours:



Transaction #6

BOB FILLS OUT HIS TIMESHEET.

At Eagle Plumbing, the only employee is Bob. He wears a lot of hats…customer service representative, dispatcher, bookkeeper, technician, warehouse manager. Although Bob HATES paperwork, he has filled in his time card. I'm so glad because this data is so critical. Take a look at his time card.

Timesheet for Bob Bird		12/31/year1
Hours	**Activity**	**Billable?**
2	hosebib	no
3	water heater	yes
1	sweep walk, wash truck	no
2	phone, bids	no

Assume Bob will only work at Eagle 8 hours a day (Ha!). He has calculated his hourly cost including benefits to be $45 per hour for any task he is performing for the company. Of 8 available hours, Bob had 3 Billable hours—the water heater installation.

> **Bonus Question:** *Should the 2 hours that Bob spent with Fred and the hosebib be considered Billable hours? Is travel time Billable time? An argument could be made for calling these hours Billable…that's fine. The key is being consistent with your data.*

So, for this example let's agree that the other 5 hours are not Billable. However, the customer pays for this time as well. How? Hang on…we're getting there.

Let's record Bob's pay on the Profit and Loss Statement and Balance Sheet using the timesheet information. We had already paid Bob for his Direct Labor Cost. We just need to account for the Indirect Cost of his Owner's Salary. This is what the Financials look like now….to keep it simple, we are including all taxes in the $45 per hour figure.

Let's consider the five hours that Bob spent doing other tasks at Eagle Plumbing. For simplicity we'll put all five hours in Indirect Cost/owner's salary. Bob decides to compensate himself as the owner for those five hours. (5 X $45 = $225)

#6 Profit & Loss

Ordinary Income/Expense	
Income	
4-1000 · Sales	600.00
Total Income	600.00
Cost of Goods Sold	
5-1000 · Materials	255.00
5-2000 · Billable Labor	135.00
5-3000 · Permits	15.00
Total COGS	405.00
Gross Profit	195.00
Expense	
6-1000 · Owner's Salary	225.00
Total Expense	225.00
Net Ordinary Income	-30.00
Net Income	**-30.00**

#6 Balance Sheet

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	2,225.00
1-1800 · Inventory	2,745.00
Total Other Current Assets	4,970.00
Total Current Assets	4,970.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**19,970.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Net Income	-30.00
Total Equity	4,970.00
TOTAL LIABILITIES & EQUITY	**19,970.00**

#6 General Ledger

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
	12/31	#3	Bob goes shopping.		3,000.00	2,000.00
	12/31	#4	Bob sells a hose bib.	150.00		2,150.00
	12/31	#5	Bob sells a water heater, including installation.		150.00	2,000.00
	12/31	#5	Bob sells a water heater, including installation.	450.00		2,450.00
	12/31	#6	Bob fills out his time sheet.		225.00	2,225.00
Total 1-1110 · Cash				5,600.00	3,375.00	2,225.00
1-1800 · Inventory						
	12/31	#3	Bob goes shopping.	3,000.00		3,000.00
	12/31	#4	Bob sells a hose bib.		95.00	2,905.00
	12/31	#5	Bob sells a water heater, including installation.		160.00	2,745.00
Total 1-1800 · Inventory				3,000.00	255.00	2,745.00
1-2100 · Truck - Original Cost						
	12/31	#2	Bob buys a truck.	15,000.00		15,000.00
Total 1-2100 · Truck - Original Cost				15,000.00	0.00	15,000.00
2-2100 · Note Payable - Truck Loan						
	12/31	#2	Bob buys a truck.		15,000.00	-15,000.00
Total 2-2100 · Note Payable - Truck Loan				0.00	15,000.00	-15,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
4-1000 · Sales						
	12/31	#4	Bob sells a hose bib.		150.00	-150.00
	12/31	#5	Bob sells a water heater, including installation.		450.00	-600.00
Total 4-1000 · Sales				0.00	600.00	-600.00
5-1000 · Materials						
	12/31	#4	Bob sells a hose bib.	95.00		95.00
	12/31	#5	Bob sells a water heater, including installation.	160.00		255.00
Total 5-1000 · Materials				255.00	0.00	255.00
5-2000 · Billable Labor						
	12/31	#5	Bob sells a water heater, including installation.	135.00		135.00
Total 5-2000 · Billable Labor				135.00	0.00	135.00
5-3000 · Permits						
	12/31	#5	Bob sells a water heater, including installation.	15.00		15.00
Total 5-3000 · Permits				15.00	0.00	15.00
6-1000 · Owner's Salary						
	12/31	#6	Bob fills out his time sheet.	225.00		225.00
Total 6-1000 · Owner's Salary				225.00	0.00	225.00
TOTAL				**24,230.00**	**24,230.00**	**0.00**

MORE ON THE TIMESHEET

Question for Discussion: How do you determine your Billable Hours? Take a minute to think about how you can apply this concept to your business.

#6 Journal

Date	Num	Memo	Account	Debit	Credit
12/31	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
12/31	#4	Bob sells a hose bib.	4-1000 · Sales		150.00
		Bob sells a hose bib.	1-1110 · Cash	150.00	
		Bob sells a hose bib.	5-1000 · Materials	95.00	
		Bob sells a hose bib.	1-1800 · Inventory		95.00
				245.00	245.00
12/31	#5	Bob sells a water heater, including installation.	5-1000 · Materials	160.00	
		Bob sells a water heater, including installation.	1-1800 · Inventory		160.00
		Bob sells a water heater, including installation.	5-2000 · Billable Labor	135.00	
		Bob sells a water heater, including installation.	1-1110 · Cash		150.00
		Bob sells a water heater, including installation.	4-1000 · Sales		450.00
		Bob sells a water heater, including installation.	1-1110 · Cash	450.00	
		Bob sells a water heater, including installation.	5-3000 · Permits	15.00	
				760.00	760.00
12/31	#6	Bob fills out his time sheet.	6-1000 · Owner's Salary	225.00	
		Bob fills out his time sheet.	1-1110 · Cash		225.00
				225.00	225.00
TOTAL				**24,230.00**	**24,230.00**

If you are a service company, you need to look at the daily timesheets and the number of hours billed via the invoice. Remember to compare the number of hours spent on a job to the number of hours billed on that job. (If you have a computer system that can help with this task, fine. If not, use a columnar pad or a simple spreadsheet program.)

"I CAN NAME THAT TUNE IN THREE NOTES!"

Remember that TV game show? The contestants, full of competitive enthusiasm, would try to identify a song in the fewest possible notes. Of course you want to perform any task that you do in the minimum amount of time. But beware of creating selling prices that are based on the 'ideal scene.' It is realistic to have some inefficiencies in the service business.

Suppose that when Bob Bird went to Mrs. Lawson's house he accidentally let her pet daschund out of the backyard. It could have taken an hour to round the dog up. While I don't suggest you assume that all heck will break loose on every job, you do want to include some extra minutes in your calculations.

If you sell only products, keep track of the number of hours that your salespeople are actively selling. As you track all your costs of doing business, direct and indirect, you will be able to determine the amount of sales per hour you will need to break even—and make a profit.

"I CAN MAKE IT UP IN MATERIALS!"

Can you charge $50 per Billable Labor Hour and make up the difference in Material? Assuming you are a service provider, if your customers were looking for material only, would they call you? Can you compete with a warehouse supplier or home center on a straight material sale?

In the previous example Bob sold a hosebib, parts only. However, isn't it more realistic that Bob would be asked to install the hosebib…even if the homeowner got the part from someone else? His value in the marketplace is his ability to INSTALL, not supply, the material.

You can generate profits from material sales. But, I recommend that service providers price to cover your Overhead via the Billable Labor Hour. That way, if you don't get the material sale, you still win.

Are you willing to lose money on every low material job? If not, price your Billable Hour to cover all costs and generate profit. Then all material sales are gravy.

Your customers value your ability to put the "darned thing in" or figure out the problem! The primary "widget" in the service industry is the Billable Hour.

After all, Bob can't sell and install 15 water heaters in a single day. He only has 24 hours! If you could sell unlimited materials, this would be a different discussion. But installed materials impose labor hours…and you only have so many labor hours per tech, per day.

If you run a retail outlet, your material sales could generate enough money to cover all expenses, including salaries and compensation and a nice profit. BUT, you are still limited by TIME…**how many hours a day is the store open to sell?** Perhaps you could break even by selling 5,000 T-shirts. But could you sell that many? Could you have that many on hand? Could that many people want them? How much TIME would it take to generate sales of 5,000 shirts? Your selling price must always take the TIME factor into account. This book is written specifically for folks who sell services by the hour BUT the concepts can be expanded to any business.

Transaction #7

BOB ACCOUNTS FOR HIS OVERHEAD EXPENSES.

Good ol' Bob has seen the light. He knows that there is more to running the business than he first imagined. The first thing he must do is get realistic about how much his company is costing to run each day. Bob realizes that he is incurring all kinds of expenses other than the Direct Costs of Labor and Materials. (Atta boy, Bob!) So he makes a list of all the bills he pays over the course of the year. The Chart of Accounts can be a handy tool for this. Let's assume for the sake of our educational experience today that Bob accurately accounts for one day's worth of Overhead expenses. What does this do to the Financials?

ANALYZING THE INCOME STATEMENT

Remember, just to make it easy, Bob Bird's first and only day of business in Year 1is December31st. This is make-believe! So, let's evaluate his Financials. Note that we've added a percentage column to the Profit and Loss Statement. This is handy! It will make it easier to compare financial reports from different time periods. The numbers will jump around a lot. Trends are easier to spot when you look at the percentages. What information about Eagle Plumbing can be gathered from looking at the Profit and Loss Statement? What does the Profit and Loss Statement tell us? (By the way, what would Bob's accountant say at this point? "Good news, Bob! You won't have to pay Income Tax!" Of course, that's because he didn't make any money!)

What can Bob do with the information at this point? HINT: Bob has 3 Billable Hours. Analyze the Profit and Loss Statement in light of that data:

- What is Bob's Billable Hour Efficiency? Answer: 3 hours/8 hours = 38%
- How does Billable Hour Efficiency impact your Financial Statements?

There is a widely accepted misunderstanding about small shop operators that I will do my best to clear up: "I run a small shop so my overhead is low. That's why I can charge a low price." THIS IS SHEER NONSENSE!

In terms of total dollars spent on overhead items, a small shop will spend less than a large shop. BUT, a small shop has fewer Billable hours. Non-Billable hours and other Overhead expenses must be loaded on the Billable hours and passed on to the customer. Bob has only three billable hours and he must "sell" them for enough money to pay all his bills and make a profit. A larger shop spends more dollars on Indirect Expenses, but they can spread those dollars over many more Billable Hours.

It is common for a small shop to have higher costs per Billable Hour than a large shop. With all the things Bob Bird must do as an owner—answer the phone, run for parts, clean up—three billable hours a day may be realistic.

You need to create a Selling Price that covers all your costs of doing business and is based on a realistic number of Billable Hours.

This is it. This is the key to making all the money you want in your business. This is how to make it fun to go to work. **Your Selling Price needs to be based on your costs of doing business applied to a reasonable number of Billable Hours**. Then you will have a fighting chance at making your entrepreneurial dreams come true.

SIMPLE BREAK EVEN FORMULA:

The Break Even point is when you don't make any profit but you just cover all costs. Nice number to know! To determine your Break Even cost (excluding materials) per hour…

add up . . .

Direct Costs + Indirect Costs = Total Costs to Recover

then . . .

Total Costs to recover / Total Hours Billed* = Break-Even Cost per Billed Hour

*Or if you sell only products use Total Hours Available to Sell in place of Total Hours Billed.

Back to analyzing Bob Bird's Financials. In summary, Bob could…

- Create a selling price that is not just pulled out of thin air.
- Develop a budget with an eye to actual costs.
- Set sales goals.
- Realize he still has a lot to learn about the scorecard…but he is GETTING SMARTER!

See how the scorecard leads you to management decisions based on fact, not fiction? See how sane this is? Can you imagine that Bob can hardly wait to look at next month's score and see how he did?

#7 Profit & Loss - Year 1

Ordinary Income/Expense	
Income	
4-1000 · Sales	600.00
Total Income	600.00
Cost of Goods Sold	
5-1000 · Materials	255.00
5-2000 · Billable Labor	135.00
5-3000 · Permits	15.00
Total COGS	405.00
Gross Profit	195.00
Expense	
6-1000 · Owner's Salary	225.00
6-2000 · Advertising	35.00
6-3000 · Education	5.00
6-3050 · Insurance	10.00
6-4000 · Office Supplies	10.00
6-4050 · Professional Services	25.00
6-5000 · Tools	15.00
6-5050 · Truck Maintenance & Repair	30.00
6-6000 · Uniforms	20.00
Total Expense	375.00
Net Ordinary Income	-180.00
Net Income	**-180.00**

#7 Balance Sheet -Year 1

ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	2,075.00
1-1800 · Inventory	2,745.00
Total Other Current Assets	4,820.00
Total Current Assets	4,820.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
Total Fixed Assets	15,000.00
TOTAL ASSETS	**19,820.00**
LIABILITIES & EQUITY	
Liabilities	
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	15,000.00
Total Long Term Liabilities	15,000.00
Total Liabilities	15,000.00
Equity	
3-1000 · Paid-In Capital	5,000.00
Net Income	-180.00
Total Equity	4,820.00
TOTAL LIABILITIES & EQUITY	**19,820.00**

Do you see that, because Bob still has Cash, he might not realize that he's in trouble?

#7 General Ledger -Year 1

Type	Date	Num	Memo	Debit	Credit	Balance
1-1110 · Cash						
	12/31	#1	Bob takes money from under his mattress.	5,000.00		5,000.00
	12/31	#3	Bob goes shopping.		3,000.00	2,000.00
	12/31	#4	Bob sells a hose bib.	150.00		2,150.00
	12/31	#5	Bob sells a water heater, including installation.		150.00	2,000.00
	12/31	#5	Bob sells a water heater, including installation.	450.00		2,450.00
	12/31	#6	Bob fills out his time sheet.		225.00	2,225.00
	12/31	#7	Bob accounts for his overhead expenses.		150.00	2,075.00
Total 1-1110 · Cash				5,600.00	3,525.00	2,075.00
1-1800 · Inventory						
	12/31	#3	Bob goes shopping.	3,000.00		3,000.00
	12/31	#4	Bob sells a hose bib.		95.00	2,905.00
	12/31	#5	Bob sells a water heater, including installation.		160.00	2,745.00
Total 1-1800 · Inventory				3,000.00	255.00	2,745.00
1-2100 · Truck - Original Cost						
	12/31	#2	Bob buys a truck.	15,000.00		15,000.00
Total 1-2100 · Truck - Original Cost				15,000.00	0.00	15,000.00
2-2100 · Note Payable - Truck Loan						
	12/31	#2	Bob buys a truck.		15,000.00	-15,000.00
Total 2-2100 · Note Payable - Truck Loan				0.00	15,000.00	-15,000.00
3-1000 · Paid-In Capital						
	12/31	#1	Bob takes money from under his mattress.		5,000.00	-5,000.00
Total 3-1000 · Paid-In Capital				0.00	5,000.00	-5,000.00
4-1000 · Sales						
	12/31	#4	Bob sells a hose bib.		150.00	-150.00
	12/31	#5	Bob sells a water heater, including installation.		450.00	-600.00
Total 4-1000 · Sales				0.00	600.00	-600.00
5-1000 · Materials						
	12/31	#4	Bob sells a hose bib.	95.00		95.00
	12/31	#5	Bob sells a water heater, including installation.	160.00		255.00
Total 5-1000 · Materials				255.00	0.00	255.00
5-2000 · Billable Labor						
	12/31	#5	Bob sells a water heater, including installation.	135.00		135.00
Total 5-2000 · Billable Labor				135.00	0.00	135.00
5-3000 · Permits						
	12/31	#5	Bob sells a water heater, including installation.	15.00		15.00
Total 5-3000 · Permits				15.00	0.00	15.00
6-1000 · Owner's Salary						
	12/31	#6	Bob fills out his time sheet.	225.00		225.00
Total 6-1000 · Owner's Salary				225.00	0.00	225.00
6-2000 · Advertising						
	12/31	#7	Bob accounts for his overhead expenses.	35.00		35.00
Total 6-2000 · Advertising				35.00	0.00	35.00
6-3000 · Education						
	12/31	#7	Bob accounts for his overhead expenses.	5.00		5.00
Total 6-3000 · Education				5.00	0.00	5.00
6-3050 · Insurance						
	12/31	#7	Bob accounts for his overhead expenses.	10.00		10.00
Total 6-3050 · Insurance				10.00	0.00	10.00
6-4000 · Office Supplies						
	12/31	#7	Bob accounts for his overhead expenses.	10.00		10.00
Total 6-4000 · Office Supplies				10.00	0.00	10.00
6-4050 · Professional Services						
	12/31	#7	Bob accounts for his overhead expenses.	25.00		25.00
Total 6-4050 · Professional Services				25.00	0.00	25.00
6-5000 · Tools						
	12/31	#7	Bob accounts for his overhead expenses.	15.00		15.00
Total 6-5000 · Tools				15.00	0.00	15.00
6-5050 · Truck Maintenance & Repair						
	12/31	#7	Bob accounts for his overhead expenses.	30.00		30.00

#7 General Ledger -Year 1 (cont.)

	Type	Date	Num	Memo	Debit	Credit	Balance
	Total 6-5050 · Truck Maintenance & Repair				30.00	0.00	30.00
	6-6000 · Uniforms						
		12/31	#7	Bob accounts for his overhead expenses.	20.00		20.00
	Total 6-6000 · Uniforms				20.00	0.00	20.00
TOTAL					**24,380.00**	**24,380.00**	**0.00**

#7 Journal-Year 1 ▼

Date	Num	Memo	Account	Debit	Credit
12/31	#1	Bob takes money from under his mattress.	1-1110 · Cash	5,000.00	
		Bob takes money from under his mattress.	3-1000 · Paid-In Capital		5,000.00
				5,000.00	5,000.00
12/31	#2	Bob buys a truck.	1-2100 · Truck - Original Cost	15,000.00	
		Bob buys a truck.	2-2100 · Note Payable - Truck Loan		15,000.00
				15,000.00	15,000.00
12/31	#3	Bob goes shopping.	1-1800 · Inventory	3,000.00	
		Bob goes shopping.	1-1110 · Cash		3,000.00
				3,000.00	3,000.00
12/31	#4	Bob sells a hose bib.	4-1000 · Sales		150.00
		Bob sells a hose bib.	1-1110 · Cash	150.00	
		Bob sells a hose bib.	5-1000 · Materials	95.00	
		Bob sells a hose bib.	1-1800 · Inventory		95.00
				245.00	245.00
12/31	#5	Bob sells a water heater, including installation.	5-1000 · Materials	160.00	
		Bob sells a water heater, including installation.	1-1800 · Inventory		160.00
		Bob sells a water heater, including installation.	5-2000 · Billable Labor	135.00	
		Bob sells a water heater, including installation.	1-1110 · Cash		150.00
		Bob sells a water heater, including installation.	4-1000 · Sales		450.00
		Bob sells a water heater, including installation.	1-1110 · Cash	450.00	
		Bob sells a water heater, including installation.	5-3000 · Permits	15.00	
				760.00	760.00
12/31	#6	Bob fills out his time sheet.	6-1000 · Owner's Salary	225.00	
		Bob fills out his time sheet.	1-1110 · Cash		225.00
				225.00	225.00
12/31	#7	Bob accounts for his overhead expenses.	6-2000 · Advertising	35.00	
		Bob accounts for his overhead expenses.	6-3000 · Education	5.00	
		Bob accounts for his overhead expenses.	6-3050 · Insurance	10.00	
		Bob accounts for his overhead expenses.	6-4000 · Office Supplies	10.00	
		Bob accounts for his overhead expenses.	6-4050 · Professional Services	25.00	
		Bob accounts for his overhead expenses.	6-5000 · Tools	15.00	
		Bob accounts for his overhead expenses.	6-5050 · Truck Maintenance & Repair	30.00	
		Bob accounts for his overhead expenses.	6-6000 · Uniforms	20.00	
		Bob accounts for his overhead expenses.	1-1110 · Cash		150.00
				150.00	150.00
TOTAL				**24,380.00**	**24,380.00**

BOB BOUNCES BACK!!

"I've had it with this stinking business," Bob whines. "No way to make a decent living." Bob invited Joey to join him for a going-out-of-business drink.

"Bob," his friend Joey says sharply, "The problem is YOU."

"What do you mean? I did my best! Lost $180 in one day of business. It's the economy!" Bob is grasping at any excuse.

Joey is an accomplished businessman. He made a fortune with a computer repair service called "The Revenge of the Geeks." He shakes his head and says, "Bob, you just need to look at the scorecard of your business. You kept track of everything! That was great! Go back to the Profit and Loss Statement, figure out your costs and sell your services for more than it costs you to provide them. Quit your whining and get to work!"

The pilot light in Bob's soul starts to burn a bit brighter. "Joey, you really think I can pull off running my own company?"

"Of course you can. It's not that hard. Just pay attention to the score, and the game will be fun!"

Bob pays for the drinks and heads back to Eagle Plumbing. This time he will SOAR!!!!

Let's peek into the future and look at a year's worth of data. Assume Bob established a new selling price for labor and has a whole year under his belt. He also hired a plumber to help him. Now, what do we know about Eagle Plumbing Company??

- Analyze Eagle Plumbing's Financial Statements for Year 2 on pages 75 and 76.
- Compare to the Financial Statements from Year 1 on page 71.
- Make some observations and jot them down:

P& L-Year 2

	Jan - Dec YR2	% of Income
Ordinary Income/Expense		
Income		
4-1000 · Sales	300,000.00	100.0%
Total Income	300,000.00	100.0%
Cost of Goods Sold		
5-1000 · Materials	60,000.00	20.0%
5-2000 · Billable Labor	57,000.00	19.0%
5-3000 · Permits	3,000.00	1.0%
Total COGS	120,000.00	40.0%
Gross Profit	180,000.00	60.0%
Expense		
6-1000 · Owner's Salary	45,000.00	15.0%
6-1050 · Non-Billable Labor	25,000.00	8.3%
6-2000 · Advertising	1,875.00	0.6%
6-2050 · Depreciation	2,650.00	0.9%
6-3000 · Education	1,015.00	0.3%
6-3050 · Insurance	1,400.00	0.5%
6-3060 · Interest on Truck Loan	2,035.00	0.7%
6-3075 · Miscellaneous	2,500.00	0.8%
6-4000 · Office Supplies	1,320.00	0.4%
6-4050 · Professional Services	1,425.00	0.5%
6-4075 · Shop Supplies	13,400.00	4.5%
6-5000 · Tools	5,390.00	1.8%
6-5050 · Truck Maintenance & Repair	6,455.00	2.2%
6-6000 · Uniforms	1,535.00	0.5%
Total Expense	111,000.00	37.0%
Net Ordinary Income	69,000.00	23.0%
Other Income/Expense		
Other Expense		
9-1000 · Taxes	9,000.00	3.0%
Total Other Expense	9,000.00	3.0%
Net Other Income	-9,000.00	-3.0%
Net Income	**60,000.00**	**20.0%**

Balance Sheet-Year 2

	Dec 31, YR2
ASSETS	
Current Assets	
Other Current Assets	
1-1110 · Cash	14,725.00
1-1200 · Accounts Receivable	42,705.00
1-1800 · Inventory	17,540.00
Total Other Current Assets	74,970.00
Total Current Assets	74,970.00
Fixed Assets	
1-2100 · Truck - Original Cost	15,000.00
1-2120 · Truck - Accum. Depreciation	-2,650.00
Total Fixed Assets	12,350.00
TOTAL ASSETS	**87,320.00**
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Other Current Liabilities	
2-1100 · Accounts Payable	10,000.00
Total Other Current Liabilities	10,000.00
Total Current Liabilities	10,000.00
Long Term Liabilities	
2-2100 · Note Payable - Truck Loan	12,500.00
Total Long Term Liabilities	12,500.00
Total Liabilities	22,500.00
Equity	
3-1000 · Paid-In Capital	5,000.00
3-8000 · Retained Earnings	-180.00
Net Income	60,000.00
Total Equity	64,820.00
TOTAL LIABILITIES & EQUITY	**87,320.00**

Bob has come a long way and knows much more about business than he did a year ago! And the best part… HIS COMPANY GENERATED $60,000 IN PROFITS AND $45,000 IN OWNER'S COMPENSATION! GETTING BETTER!

Note: Here are some "extra credit" items…

- Check out the Truck under Assets…what happened to it? Depreciation!
- Notice the corresponding Depreciation Expense.
- Look at the Truck Loan…note the impact loan payments make. Do you see the Interest Expense on the Profit and Loss Statement?
- What is Bob's Current Ratio? Think he is paying his bills on time? It should be AT LEAST 1:1.
- Note that there are Accounts Payable and Accounts Receivable—remember these are promises...A/R is the amount promised to Bob by his customers for work done. A/P is the amount Bob has promised to pay his vendors.
- What's still missing? Community contributions! Retirement and benefits for Bob and his employee!
- Did Bob make less than his employee? Is that OK?

Now, look at your own Financials and evaluate them. Write your observations below:

How Much Should You Make?

It is common for the owner of a small business to make absolutely NO money! They never pay themselves. The owner even justifies it... "I don't need much. I just like the freedom of running my own company." Blah, blah, blah. I think it's a crime when folks don't make any money. In fact, it comes out of my pocket when they don't pay taxes for roads and schools!

You have an obligation to support yourself, your family and your community.

How much is enough? Well, it should be more than you can make working for someone else doing the same work. You have greater risk and responsibility as a business owner. How much is too much? Frankly, I don't see the high end. Making money doesn't make you a good guy or a bad person. How you spend your money is a better indicator of your integrity and character. YOU must decide what you want to make and create a selling price that ensures that you get it. Some food for thought...

UPS drivers make over $50,000 a year when you add up their benefits. Union auto workers average $80,000 to $90,000 including benefits. Pro-basketball players average $2 million per year. Nice benefits. The average small business owner makes about $35,000. No benefits. No vacation pay. No time off.

Remember you can't do wonderful things—contribute to charities, education, fuel someone else's dreams, care for your family—with money that you don't have. Decide what you wanton make. Write it down. Put it in your selling price. Make your dreams come true.

The next book in this business basics series is called *How Much Should I Charge?*

Go to www.BareBonesBiz.com to order. It tells you how to create a selling price that will make sure that you make the money you want!

HERE'S A HANDY CHECKLIST

TO HELP YOU ANALYZE YOUR FINANCIAL STATEMENTS:

- ☐ How does the data enter the accounting system? Is everyone involved in data entry and accounting fully trained? Don't assume accuracy!!
- ☐ Run the Balance Sheet and the Profit and Loss weekly. How are you doing for cash? Are you going to be profitable this month? If you are profitable every month, you are profitable for the year. Easy!
- ☐ What changes could you make—operationally or in sales or marketing—that would ensure your profitability this month?
- ☐ Are your company's Financials wrapped up, ready for your accountant and handy for your analysis by the 10th of the following month?
- ☐ Compare the Financials to last month, last year—same month, year to date.
- ☐ Look at the percentage column. Ratios are as important as the dollar amounts.
- ☐ Look for trends, changes that are more visible over the span of a few months.
- ☐ Notice if an account that generally has a positive balance suddenly has a negative balance…and vice versa.
- ☐ Look at the actual Financials in comparison to your budget. Are you close?
- ☐ Track and analyze Billable hours. This information in not found on the Financials directly. You'll have to track them from the invoices and the timesheets. Determine your Break Even per hour for the month.
- ☐ Talk to your managers about any discrepancies or questions you have about the information. Ask them what is going on with the numbers before you start dictating solutions. Work together.
- ☐ Share the data with your employees. Don't feel like you have to know everything about accounting. You can learn together and help each other.
- ☐ Think of creative ways to improve performance.
- ☐ Set goals or review and revise goals.
- ☐ Think of better ways to collect data and gather information.
- ☐ File one copy for safe keeping, plenty of others for handy access.
- ☐ Stay curious.
- ☐ Have fun.

Concise, consistent data is the key! There is no perfect way to keep score. Just do it… over and over and over.

"Perhaps the most valuable result of all education is the ability to make yourself do the thing you have to do when it ought to be done whether you like it or not; it is the first lesson that ought to be learned; and however early a man's training begins, it is probably the last lesson he learns thoroughly."

~T.H. HUXLEY

Lessons from Warren Buffet

Using Ratios to Assess Your Financial Situation

Once upon a time, business mogul Warren Buffer bought the Washington Post newspaper. The previous owner and publisher at the time was Katharine Graham. Ms. Graham is one of my heroes. Her father built the paper and transitioned it to Phil Graham, Katharine's husband. Katherine took on the publishing duties when her husband committed suicide. She guided the newspaper to editorial greatness, and navigated the Watergate scandal as Bernstein and Woodward reported it on the front pages. But the company was in financial trouble.

Warren Buffet's business building strategy is this: Seek out companies with undervalued, underutilized assets. Buy them. Fix them. Make lots of money.

He bought the Washington Post with that intention. He and Katharine hit it off immediately and he saw the potential in the newspaper and in her management. So he sat her down and taught her business basics. From what I have read about this powerhouse relationship in their biographies, they had a conversation something like this…

Warren: This is the Balance Sheet. Assets on the left, liabilities and equity on the right.

(Remember the Balance Sheet reflects the financial condition of the company on a specific date. The basic accounting formula is the basis for the Balance Sheet.)

Assets = Liabilities + Owner's Equity

As a business owner, Job One is to protect the assets. Job Two is to grow the assets. There are only three ways to grow assets.

#1—Borrow Money.

You could borrow money…assets go up and a Note Payable (a liability) goes up.

#2—Invest Money in the Company.

When you (or another owner/investor) puts money in the company…assets go up and Paid In Capital, an equity account) goes up.

#3—Create a Profit

When you sell stuff for more than it costs, you'll create a profit. Net Profit is reflected in the equity section of the Balance Sheet. If Net Profit (an equity account) goes up, assets go up, too. This is really the best way to increase assets, to create wealth. Sure you have to pay taxes on your profits, but that's the price you pay to live and work in this fine country. Sometimes investing money in a company can buy time, or equipment, that will help build the profitability of the company.

The Balance Sheet is an elegant demonstration of a universal law: for every action there is a reaction. Energy isn't lost…it changes form. Isn't this beautiful? Isn't this fun?

Katharine: It is! I get it. Let's make some money and make a positive impact on the world!

I like to imagine the conversation between Warren and Katharine this way. Warren Buffet loves business and capitalism and his enthusiasm is contagious. You can manufacture money out of nothing by creating something other people value. You can take a struggling company and fix it. It's a beautiful thing.

If you are scratching your head right now, it could be that you don't get the Balance Sheet. Or maybe your Balance Sheet isn't quite so elegant at the moment. Too much liability? Too little in assets? Let's do a little sleuthing and discover what the Balance Sheet has to share. It's helpful to know the Score in the game of business. You can always make it better.

Here's a sample Balance Sheet. Suppose this is your company and this is your first year in business. Let's take a look at what this Scorecard tells us about the financial health of the company…particularly when it comes to protecting and growing the assets.

BALANCE SHEET

ASSETS			**$$$**
	Current Assets		
		1-1110—Cash	2,459
		1-1200—Accounts Receivable	19,870
		1-1800—Inventory	12,745
		Total Current Assets	**35,074**
	Fixed Assets		
		1-2100—Truck - Original Cost	18,000
		1-2120—Accumulated Depreciation	-3,000
		Total Fixed Assets	**15,000**
	TOTAL ASSETS		**50,074**
LIABILITIES & EQUITY			
	Current Liabilities		
		2-1100—Accounts Payable	8,654
		2-1500—Credit Card	26,988
		Total Current Liabilities	**35,642**
	Long Term Liabilities		
		2-2100—Note Payable - Truck Loan	12,500
		Total Liabilities	**48,142**
	Equity		
		3-1000—Paid-In Capital	5,000
		Net Income	-3,068
		Total Equity	**1,932**
	TOTAL LIABILITIES & EQUITY		**50,074**

FINANCIAL RELATIONSHIPS...THERE ARE CLUES IN THE RATIOS

Quick Ratio and Debt to Equity Ratio

The Quick Ratio is a look at what you have in Cash and Accounts Receivable compared to what you have in Current Liabilities.

1-1110—Cash	**2,459**
1-2100—Accounts Receivable	**19,870**
Total	**22,329**
Total Current Liabilities	**35,642**

Ratio: 22,329 / 35,642 = .63 to 1

In other words, you have 63 cents for every dollar you need to cover your bills. .63 to 1. Not good. Also, most of that money is tied up in Accounts Receivable. Time to collect! Set a goal of getting this ratio to at least 1.5, or $1.50 in Cash and Accounts Receivable for every $1 in Current Liabilities.

The Debt to Equity Ratio is a look at your Total Liabilities to your Total Equity.

Total Liabilities = 48,142 and Total Equity = 1,932
Ratio: 48,142 / 1,932 = 25 to 1

For every dollar you have in equity you have $25 in liabilities. 25 to 1. The amount of debt you carry is up to you, and what you are comfortable with. Consider aiming for a Debt to Equity ratio of 3 to 1. Maybe you would like to be debt free? Know this...the banks and the supply houses are not going to manage this for you unless you stop making your payments.

Gulp. You are operating as a loss, losing wealth and increasing debt. Time to change course. As Hot Rod has told me when I am losing an argument, "When you are digging a hole for yourself, it's a good idea to stop digging."

You could fix this! Like Warren Buffet.

This Balance Sheet is a simple example. (Dear accounting folks, please no nitpicking. My numbers are made up to illustrate common problems.) According to this Balance Sheet, your company is in trouble. You are running out of cash and your assets are dwindling. Profits fix lots of problems...these problems specifically. If you could increase profits by, say $10,000 before this month is over, you would see assets go up. If those profits were delivered to the asset of Cash, not Accounts Receivable, even better. You could pay down your Current Liabilities. Your ratios would improve. Life would get better for you. So, craft and execute a plan for improving Marketing, Sales, Operations…whatever you choose that will impact profitability and cash.

Business is easy. As Jim Rohn said, "Easy means something you can do." You can do this.

Into and out of the company…

One more thing…discuss with your CPA how you should reflect the money you put into and take out of your company. Not only will it affect these ratios, your actions have tax implications.

You might put cash into your company and call it a liability, a Note Payable to you. However, Uncle Sam wants to see that loan treated as a real loan…with loan documents, interest paid and payments made. You might take money out of the company and call it an asset, an Account Receivable from you. Uncle Sam might see that and call it income that you haven't paid taxes on. I vote that money into and out of the company by the owner is reflected in the equity section of the Balance Sheet. Then, review quarterly with your CPA to consider your tax exposure and strategy.

The problems are where the game is, where the fun is! Really. Don't panic. Review your financial situation and vow to make it better.

Try Again.

Do you know more this time around?

1. **Another term for Overhead is…**
   - ☐ Indirect Costs
   - ☐ Liabilities
   - ☐ Expenses
   - ☐ A type of garage door

2. **Which of the following items is not found on a Balance Sheet?**
   - ☐ Inventory
   - ☐ Assets
   - ☐ Direct Costs
   - ☐ Accumulated Depreciation
   - ☐ Equity

3. **How is the basic accounting formula usually represented?**
   - ☐ Sales - Direct Costs = Net Profits
   - ☐ Assets = Liabilities + Owner's Equity
   - ☐ Assets - Expenses = Net Equity
   - ☐ All of the above

4. **Billable hours refers to …**
   - ☐ The direct labor hours for which you bill the customer.
   - ☐ The time your bookkeeper spends sending invoices to your customers.
   - ☐ The total time your technician is available to do service work.

- ☐ The amount of hours for which you paid your techs, minus the hours actually worked.
- ☐ All of the above.
- ☐ None of the above.

5. **It is possible to have a net loss for the month and still have enough cash to run the business for the next two months…true or false?**

6. **It is possible to have 20% net profit for the year to date and not have enough cash to run the business for one more month…true or false?**

7. **Below is a list of expense items. Check the ones that are Direct Costs.**
   - ☐ Materials
   - ☐ Tools
   - ☐ Training
   - ☐ Seminars
   - ☐ Trucks
   - ☐ Office Supplies
   - ☐ Billable Labor Costs
   - ☐ Permits
   - ☐ Sales commission
   - ☐ Owner's Salary

8. **Sales - Direct Costs = ____________________.**

9. **Another name for Direct Costs is…**
   - ☐ Expenses
   - ☐ Overhead
   - ☐ Cost of Goods Sold
   - ☐ Job Site Expenses
   - ☐ Those that your boss directed you to expense.

10. **How often should you review your financial reports? _____________ and by when should you have the previous month "closed?"____________**

11. **Currently, when you read your company's financial statements, you …**
    - ☐ look at trends.
    - ☐ look at the past month's activity compared to the year to date numbers.
    - ☐ look at budgeted vs. actual amounts.

- ☐ compare this year's activity to the same month in past years.
- ☐ all of the above.
- ☐ none of the above.

12. After you have looked at your company's financial statements, you…

- ☐ file them properly.
- ☐ thank your accountant and pay the bill for his services.
- ☐ call in your managers to explain any discrepancies or questions you have about the information.
- ☐ share the financial information with your employees.
- ☐ think of creative ways to improve performance.
- ☐ all of the above.
- ☐ none of the above.

13. A Chart of Accounts is…

- ☐ the way you code accounting information.
- ☐ the labels under which you file your accounting information.
- ☐ the General Ledger and classifications used in accounting.
- ☐ all of the above.

14. Do you know how much money is necessary, on average, to cover Overhead expenses every month?

- ☐ Yes , $__________________
- ☐ No, help me!

15. The Profit and Loss Statement…

- ☐ is another name for the Balance Sheet.
- ☐ summarizes sales revenues and expenses over a period of time.
- ☐ lists the assets, liabilities and owner's equity of your company.
- ☐ all of the above.
- ☐ none of the above.

16. Remember the goal you wrote down for yourself today?

- ☐ Did you accomplish it?

If you need a bit more help on a couple of the questions, refer to the Answer Sheet on the next page!

Answer Sheet

Use this information to...

- Clear up any words that may still be a little "foggy."
- Help someone else learn what the heck Financial Statements are!

1. Another term for Overhead is…

- ☑ Indirect Costs
- ☐ Liabilities
- ☐ Expenses
- ☐ A type of garage door

Go to your own Financial Statements. Find the Profit and Loss Statement. The expenses below the Gross Margin (a.k.a. Gross Profit) line are the Overhead, a.k.a. Indirect Costs. Also see pages 69-73.

2. Which of the following items is not found on a Balance Sheet?

- ☐ Inventory
- ☐ Assets
- ☑ Direct Costs
- ☐ Accumulated Depreciation
- ☐ Equity

Find your Balance Sheet. Do you see Direct Costs (a.k.a. Cost of Goods Sold, Job Site Expenses?) I hope not. Look on the Profit and Loss Statement. Do you see Direct Costs—Materials, Labor, Permits—listed there as either Direct Costs or Cost of Goods Sold? I hope so! Also see pages 69-73.

3. How is the basic accounting formula usually represented?

- ☐ Sales - Direct Costs = Net Profits
- ☑ Assets = Liabilities + Owner's Equity
- ☐ Assets - Expenses = Net Equity
- ☐ All of the above

Here's a clue...your Balance Sheet is based on this formula. Look at your Balance Sheet and refer to page 32.

4. Billable hours refers to …

- ☑ The direct labor hours for which you bill the customer.
- ☐ The time your bookkeeper spends sending invoices to your customers.
- ☐ The total time your technician is available to do service work.
- ☐ The amount of hours for which you paid your techs, minus the hours actually worked.
- ☐ All of the above.
- ☐ None of the above.

You won't find this information directly on the Financial Statements! You need to keep track from Timesheets and Invoices. Ideally the hours that you bill the customer (Billable Hours) match the hours that the tech spends on the job for the customer. See page 62.

5. It is possible to have a net loss for the month and still have enough cash to run the business for the next two months?

- ☑ True.

6. It is possible to have 20% net profit for the year to date and not have enough cash to run the business for one more month?

- ☑ True.

Look at your Profit and Loss Statement. See the Accounts Receivable line? You can have lots of Sales and Profits but little Cash to show for it.

7. Below is a list of expense items. Check the ones that are Direct Costs.

- ☑ Materials
- ☐ Tools
- ☐ Training
- ☐ Seminars

- ☐ Trucks
- ☐ Office Supplies
- ☑ Billable Labor Costs
- ☑ Permits
- ☑ Sales commission
- ☐ Owner's Salary

You can make a case for Tools if you totally use up the life of a tool on a particular job. The idea is that Direct Costs are those expenses directly created on the job (Job Site Expenses).

8. Sales - Direct Costs = Gross Margin.

Technically, Sales - Direct Costs (or Cost of Goods Sold) = Gross Margin, when expressed as a percentage and Gross Profit when expressed as a dollar amount.

9. Another name for Direct Costs is…

- ☐ Expenses
- ☐ Overhead
- ☑ Cost of Goods Sold
- ☑ Job Site Expenses
- ☐ Those that your boss directed you to expense.

One reason why Accounting can be confusing is that there are often several names for the same thing! That's why I included a glossary.

10. How often should you review your financial reports? ______________ and by when should you have the previous month "closed?"_____________

Could you run the Balance Sheet and P&L weekly? Could you close the books by the 10th of the next month? Sure, you could!

11. Currently, when you read your company's financial statements, you …

- ☐ look at trends.
- ☐ look at the past month's activity compared to the year to date numbers.
- ☐ look at budgeted vs. actual amounts.
- ☐ compare this year's activity to the same month in past years.
- ☑ all of the above.
- ☐ none of the above.

See page 81 for a checklist to get you started.

12. After you have looked at your company's financial statements, you…

- ☐ file them properly.
- ☐ thank your accountant and pay the bill for his or her services.
- ☐ call in your managers to explain any discrepancies or questions you have about the information.
- ☐ share the financial information with your employees.
- ☐ think of creative ways to improve performance.
- ☑ all of the above.
- ☐ none of the above.

One reason that I am a proponent of Open Book Management is that your employees can HELP you analyze the Financial Statements. You can learn this stuff together. See the handy checklist on page 81.

13. A Chart of Accounts is…

- ☐ the way you code accounting information.
- ☐ the labels under which you file your accounting information.
- ☐ the General Ledger and classifications used in accounting.
- ☑ all of the above.

The Chart of Accounts is the "Peg Board" on which the whole Accounting-Information system hangs. See page 35. Do you have a copy of your Chart of Accounts? Print one up. Look for the patterns in the numbering system. See the big picture! BE WARNED, however. Don't change the Chart of Accounts without the help and support of your accountant and computer system expert! Doesn't mean you shouldn't change it, just be careful not to mess up the information system in the process—a real possibility if you're not an expert in accounting or computerized accounting systems.

14. Do you know how much money is necessary, on average, to cover Overhead expenses every month?

- ☐ Yes , $__________________
- ☐ No, help me!

Do you see the Overhead (a.k.a. Indirect Costs, Operating Expenses) section of the Profit and Loss Statement? Now seek out past months' and past years' Profit and Loss Statements. Do some averaging. Can you see the dollar amount that you need to cover Overhead expenses each month come into focus? Can you see how you can budget in future expenses or increases in expenses? Cool, huh? And I'm happy to help you; find me at www.BareBonesBiz.com.

15. The Profit and Loss Statement…

- ☐ is another name for the Balance Sheet.
- ☑ summarizes sales revenues and expenses over a period of time.
- ☐ lists the assets, liabilities and owner's equity of your company.
- ☐ all of the above.
- ☐ none of the above.

Hurray for you! Congratulate yourself for what you have learned. Now, apply this information and be more successful...and make more money!

Ready to Make More Money?

So now you know that the money goes to pay all the costs of doing business. And even in the smallest home-based companies most of the money goes to the indirect costs of doing business: the little bills that filter in while you are busy doing the selling and servicing.

Not enough money goes to YOU, the owner. You have all the risk and headache and yet you are usually the last person paid. Sometimes you don't get paid at all.

Traditional business advice is "If you aren't making enough money, cut your overhead."Really? Could you offer the power company less than the total amount due on your utility bill? The only person who would take less if you choose to cut overhead is YOU. That doesn't seem fair to me.

My friend**, I suggest that your overhead is not large enough!** Owner's salary is an overhead item. So are benefits for you and your employees. Your salary and benefits are probably way too low…that's why you picked this book up in the first place.

Use this book to discover and use financial statements. They are the scorecard of your business. By merely paying attention to the score, your score will improve.

"That which you recognize, you energize."

~MARK VICTOR HANSEN

Please understand that I don't suggest that you run an undisciplined, wasteful company, with overhead needlessly inflated. But, my experience tells me that most small business owners are woefully underestimating the realistic costs involved with running a business. Certainly seek to run at maximum efficiency. Just don't fry up yourself and your team in the process by taking too little from your customers to make it worth your while.

I wish you courage and strength and tenacity. You will need these things when you realize you need to raise your prices. I suspect that that is what you will find once you get familiar with your company's scorecard—the financial statements.

If you are going to charge more, then you are going to have to give more. More service, love, attention, good manners, and value. Customers will gladly pay you for those things.

You will do your customers a great disservice if you go out of business. Most businesses DON'T make it—85% crash within the first 5 years. I just don't believe it is because the owners are lazy. Every business owner I know is going full speed and working well over 40 hours week. They fail to keep track of the business, they don't keep score. That's why they fail. **If you keep score you can identify your problems…and fix them.**

This book will help you make sense of your scorecard. Business can be a fun game, where ballplayers can win: owner, employees, customers, suppliers, the community…the universe!

BONUS #1

Building a Winning Bean Team.

I hope you have learned a lot from reading this book and exploring your own financials. If you have discovered that your financials are a mess, I am not surprised. If you have never learned the basics, chances are good your financials are a reflection of, "garbage in, garbage out." Not to worry! You can fix always fix it. Or, maybe you have never created financial reports before and now know it's the right thing to do. Great!

In any case, a successful business owner is well served to have a great "Bean Team" assembled. "Bean Team" is the term I use to describe the financial professionals—including you!—who work together to make sure your accounting data is spot on right and that you are in compliance with the government. A highly functioning Bean Team also makes sure that you are making better, faster, more profitable business decisions.

Unfortunately, I see too many business owners tolerating poor service (negligence?) from their accountants and bookkeepers. Here's an article I wrote to help you understand the roles of the Bean Team and encourage you to upgrade yours if need be!

The Martyr and The Intimidator

Leslie is the owner of a roofing company, a business she inherited from her father. Back in the day, her father managed a small crew and operated with handshake-contracts and stacks of cash. Now that her dad has retired, ambitious Leslie sees a different future. She wants to grow her company so that she can make a fortune…and provide career opportunities for her beloved team. And she wants to build on her (and her father's) reputation for taking great care of her customers.

Leslie called me one day, after reading one of my articles. She described the vision she has for her company and her intent to build an empire. In response to my questions, she shared that…

- She knew how much she had in Accounts Receivables, but only saw financial statements once a year…at tax time.
- She didn't understand how the financial statements related to what she did every day…sales, payroll, materials…so she pretty much ignored the reports anyway.
- She knew that she was in debt…but wasn't sure how much. She just secured another line of credit to keep the cash flowing.

Sigh. I confronted Leslie about her lack of financial literacy. "It's your company and your assets on the line. You need to KNOW. Tell me who is in charge of the accounting at your company."

For the last fifteen years, her mom has been the Bookkeeper. Mom does the books as "a favor" to Leslie. She works 40 plus hours a week but nothing is ever really finished or ready for Leslie to look at, so Les has quit asking for day-to-day financial information. Everyone else in the office avoids Mom, who seems to have a different set of rules from the rest of the team. While Mom is responsible for paying bills, who she pays and when is a mystery. Once, when Stan the warehouse man had a question about his paycheck, Mom flew out of the office sobbing, "And THAT'S the thanks I get?" It took Leslie three apologetic phone calls to woo her back.

At the end of the year, Mom hands whatever it is that she assembles for financial information to a fellow named Art. Art is an Accountant who files the tax return. Leslie has asked Art for help understanding the balance sheet and income statement he prepares for the return. She called and set up an appointment to meet with him. His secretary scheduled a date to meet…in six weeks. At that meeting, Art leaned over his massive mahogany desk and patted Leslie's hand. "You worry about running the business. I'm a professional. I will take care of the accounting," he said dismissively…then escorted her to the door.

Martyr Mom is holding Leslie back. Art the Intimidator is holding her hostage.

I advised Leslie to fire both of them.

"But, then what?" Leslie sputtered in response to my suggestion. "Where do I find another Accountant? Who else would I trust with my money? Where do I start? And, by the way, my mother will disown me."

Leslie asked me to help her get a handle on her financial situation.

"I can do that. I can help you get to a known financial position. I can create a clean, accurate set of financials for you. However, to build an empire, you must learn to do that yourself. You must build a team of financial pros who will help you get timely, accurate data…in a format you understand…so that you can make good business decisions.

"And, Leslie, your mom will get over it."

Here's what I shared with Leslie about developing her financial team…

Start by defining *who* is responsible for *what*. Create Financial Position Descriptions. Here is a list of the basic responsibilities for each of these positions.

The Bookkeeper

The Bookkeeper is responsible for day-to-day data entry into the accounting system.

- Invoices/Accounts Receivables
- Deposits
- Bill Paying/Accounts Payable

Bookkeeping should be done in-house. It is just not that hard to do! 90% of accounting is entering invoices, making deposits and paying bills. Do these functions in real time in your accounting system. No sense in doing them and having an outside Bookkeeper re-do them.

Bookkeeping is a PART TIME position unless your company is very large. Come on! How many calls does your company run a day? How long does it take to enter 10 invoices? Apply 10 payments and assemble one deposit? Pay five or six bills?

Bookkeeping needs to be up to date. At the very least, all information for the previous week should be entered and accurate by the following Wednesday.

The Customer Service Rep (CSR) or Dispatcher can help with bookkeeping duties. For instance, the Dispatcher could be responsible for entering Payables. The CSR can enter Invoices. This also adds system protection, because not just one person is responsible for all the accounting or all the money transactions.

The Controller

The Controller is responsible for assembling the financial reports on a weekly basis.

1. **Assembles the financial reports.**
   - Balance Sheet
   - Income Statement
   - Any other financial reports you require or request to help you make good management decisions.
2. **Assembles Payroll information.**
   - Calculates commission and bonuses.
   - Verifies the balance sheet accounts—monthly.
   - Balances the bank statements—monthly.

- Checks for and fixes bookkeeping errors.

This is a very part time position. Perhaps just a few hours a week. This person could be in-house, or a subcontractor who comes to your shop once a week.

Use a Payroll Service, like ADP or Paychex. They do a great job. Then, the Controller can make the journal entries from the Payroll Services reports.

The Controller duties are often neglected in a small shop. These responsibilities fall into no-where-land. Take responsibility for these functions yourself if they are not being done well. Then, you can hand the duties off. Get the Controller responsibilities handled and take note of how your decision-making improves!

The Accountant

The Accountant is primarily responsible for state and federal tax compliance. A good Accountant gives appropriate tax advice, and helps you manage your company to your best tax advantage.

- Prepares the tax return.
- Prepares monthly, quarterly, and yearly-required tax reporting and payments.
- Creates the depreciation schedule.
- Helps manage assets, accounts for the sale or purchase of assets.
- Checks the Controller's reports for accuracy and tax implications.

Look for an Accountant who is excited about helping you develop in-house accounting systems. He or she should be willing to train your Bookkeeper and Controller, or offer the help of some-one on his or her team to help in that capacity.

There is NO room in your life for a bossy, arrogant, know-it-all, too busy for you Accountant.

The Financial Planner

The Financial Planner works with you to help you achieve your long-term financial goals.

- Reviews your personal and company goals, financial reports and makes recommendations for asset management.
- Helps you create end game opportunities—for selling or transferring ownership in your business.

These Position Descriptions briefly outline the responsibilities, what needs to be done, by you and your financial professionals. Now, this does NOT mean you need four separate people. Here are a couple of possible financial team rosters…

Option 1

- A Bookkeeper who performs Controller duties.
- An Accountant who helps with financial planning.

Option 2

- A Bookkeeper.
- An Accountant who performs Controller duties.
- A Financial Planner.

Option 3

- A Bookkeeper
- YOU perform the Controller duties.
- An Accountant.
- A Financial Planner.

NONE of these professionals relieve you of the primary stewardship of your company. Your assets are on the line. You have to pay attention. A good financial team can help you make good decisions. You direct them…they don't direct you.

Be sure to have at least two people on the financial team. Be sure to document each procedure in writing. This way you are imposing structure, accountability…and a system of checks and balances. You will protect your assets, and keep your company safe from embezzlers. And, you will keep your financial team safe from suspicion.

And you will never be held back or held hostage again.

Now, where to find them…

Below are some ideas for finding your Best Bookkeeper! Or your BEST Bookkeeper/Controller. Of course, you will follow good human resources procedures for recruiting and hiring. This is an informal checklist of the things I look for.

Winning characteristics of a Bookkeeper/Controller…

- She loves crossword puzzles.
- He unconsciously straightens the items on your desk.
- She is impeccably neat. A messy Bookkeeper is an oxymoron.
- He is young at heart. I try not to be prejudiced, but I favor kids. Kids are people who are younger than me.
- She is a Virgo or a Libra. If you buy into astrology indicators.
- He has good relationships…with family, friends, significant other. Several ex-wives and the attendant emotional baggage are not good indicators.
- She is a non-smoker. ALWAYS have a non-smoking office.

- He takes it personally when the bank reconciliation is out of balance. It will work at him like a flea on a dog until he gets it figured out.
- She loves Microsoft Excel®.
- He is a good cook. There are lots of similarities between cooking and accounting: The importance of measuring. Attention to order and process. Quick response to mistakes.
- She is kind, enthusiastic and had a nice voice. After all, this person is going to have to put on the CSR hat at least once in a while.
- When you ask, "Could you…," he replies, "Yes, I can."
- She focuses on a task. She can enter a stack of payables without getting up even once.
- He drives people crazy with his attention to detail. He will drive you crazy at times, too. You may need to say, "I get it that it would be more accurate to take the sales accounts to the fourth decimal place. I am fine with whole numbers. It will be ok." Better to have to "round off" the edges than work with someone who is sloppy.

Where to look…

- **Recruit new moms.** The untapped resource of valuable professional skills lies with women who choose to work part-time or from home because they have young children. These moms value flexibility even more than money. Remember, all these financial positions are part-time. Also, new moms are great multi-task-ers. What they can get done in an hour is astonishing.
- **Develop the skills of someone who works for you.** For the Bookkeeper and Controller duties, you do NOT need a degree-ed accountant. Is there someone on your team who has some of the characteristics listed above? Talk to him or her about expanding his or her role at your company by taking on accounting duties. You can learn accounting and financial management skills together.
- **Be non-discriminatory in your recruiting and hiring.** Look for folks that others may overlook. Physical disabilities are not a problem in these positions. I recently met a passionate bookkeeper for a big outdoor goods retailer. This woman was born with only two fingers. She loves her job and I bet she is great at it!
- **Ask your Accountant and/or Financial Planner to recruit for you.** They know people who know people. Put the word out.

I went through this process myself when I realized that we weren't making any money and no one was going to figure out how to fix that for me. It was MY responsibility. I found a great financial team AND I learned enough about finance and accounting to understand how good my team is! (A "shout out" here to Gail, my sister and the world's BEST Bookkeeper and Controller. Also, "shout outs" to the wonderful financial pros I have been blessed to work with…Marilyn, Joan, Elinor, Craig, Rose, Chuck, Cathy, Kim, Lisa, Jan, Jessica, Tamara, Edwina, Marianne, Simon, Gary…and I meet more all the time. LOVE to you!)

Finding the right financial team to help you build your empire may appear to be a daunting task. Take heart and take my advice: Do NOT put up with a weak financial team. Fire them! Learn to do the duties yourself if you must. Do NOT be held hostage. Know there are people out there who LOVE bookkeeping and accounting and determine to find them. After all, you are building an empire. What a great game to play! They will be honored to join your team.

BONUS #2

Fixing your Accounting Mess.

If you have financial reports, you may find that your financials just look funny. By funny, I mean you can't find the basic accounts I illustrated throughout this book, or there are bizarre numbers throughout the reports. Maybe you don't know what the accounts are or where the numbers are coming from. Your Bean Team can help you (in my opinion, is honor bound to help you!) find and fix your in-house accounting so that you operate from a ***Known Financial Position (KFP)***. Press on until you are at KFP! I wrote this article to share some tips and methods for getting the books… right. Need more help? Visit us at www.BareBonesBiz.com or send an email to contact@barebonesbiz.com

Financial Management 201—Trouble-shooting Tips

When I was a college student, I got an 'A' in my Accounting 101 and 201 classes. Then I entered the "real" world and almost SUNK the family business because I had no idea what I was doing with the "real" accounting. You see, the examples in the college text book used financials that were correct. That means, the dollar amounts in the accounts could be trusted, and were assumed current and accurate.

The "Real" World…

Well, when I took a swing at entering my accounting data I made a big "Slinky knot" mess out of my accounting file. Ooops. I didn't learn how to FIX my accounting in college. That would have been useful! I learned what I know from falling in holes and climbing out of them.

As a business consultant, I see lots of financial reports. Most of them have a few "Slinky knots" in them…accounts that are just wrong. The data in those accounts are the result of mistakes in data entry. In my consulting work, I start by helping my clients get to KFP—a KNOWN Financial Position. Let's get the accounting correct. That's the first step. From there, we can see the impact of operational, marketing and sales behaviors. The good news is that you can always improve your financial situation once you know what it is. I am kind of like Super Nanny. I show up, we work together to clean up the accounting and we put simple systems, routines in place to help you stay at a KFP.

Sometimes, we clean stuff up and then it gets messy again. Just like Super Nanny, I go away after my consulting visit. It is up to my clients to maintain the systems we put in place. I can always come back and I often help over the phone. However, the key to staying at KFP is your willingness to learn enough about the accounting systems to enter data properly and to fix things when they get balled up.

If you are the owner of a very small shop, you might be the Financial Manager of your company (as well as the Service Manager and Marketing Manager and Salesperson, etc.) That's the way it goes. If you dream of being a bigger shop, take heart that every big company was once just your size. The way out…is through. Take responsibility and do a good job as the Financial Manager. Quit looking for a magical solution (accounting fairy?) who will handle the accounting for you. Learn how to do it yourself and document your basic procedures. This will help you hand off the accounting duties successfully.

The following are a few tips and tricks for finding and fixing the "Slinky knot" messes in your accounting program.

Financial Fix Tips and Tricks…

It's probably YOU. I often hear something along these lines, "That number wasn't there yesterday. It must be a QuickBooks™ problem." That weird dollar amount in your financial reports probably has a very simple explanation. Somebody, maybe you, entered that information. In every accounting software program, there are debits and credits. Sometimes the debits and credits are not visible from the data entry screen. You will have to do some digging. Follow the flow of information from the entry point to the Income Statement (aka Profit & Loss or P&L) and/or Balance Sheet. (In my lengthy career, there have been only 2 cases where the accounting program was corrupt. Chances are…YOU are the problem. ☺ Start trouble-shooting from that assumption.)

Stay current with your financial reporting. I recommend a WEEKLY review of the Balance Sheet and Income Statement. Some contractors I know get daily reports. That's great! Once a year at tax time is just not going to cut it. Get to KFP and run the financial reports at least once a week. It is so much easier to find and fix a mistake that happened in the last few days than trying to track down something goofy from six months ago. Also, you can fix the mistake in the current month. That is better than having to re-open a previous month and adjust it. Once I "close" a month, I don't like to open it again.

Go line by line down the Balance Sheet and Income Statement and look for "weird" things. If you are just getting started with this process, I can help. Or, your accountant may help you learn what's "weird" and what's right. What a great opportunity for him or her to add value to your relationship. KFP means that every account is RIGHT. It reflects what you have in Assets, what you owe in Liabilities and what you own in Equity. The Sales account should equal what you have sold for that period of time. The Expenses should reflect what you have expensed for that period of time. The financial reports should be current and true. Here's a list of "weird" things that may need some fixing…

- A dollar amount that is positive when it was negative last time (or vice versa.)
- A negative Asset. (Unless it is Accumulated Depreciation or Amortization. Those numbers are "contra" accounts and serve to reduce the value of the associated assets.)
- A negative Liability.
- Pay particular attention to your Payroll liabilities. I recommend using a Payroll service like ADP or Paychex. The number one reason: The service handles the liability so you don't have to. The service will tell you what the cash requirements are to pay your team and Uncle Sam. They will do the tax payments for you. The Journal Entry to enter Payroll is much easier if you don't have to keep track of the appropriate liabilities and payments. I attached a sample JE for entering Payroll. Follow the flow of debits and credits. You could create a sample transaction for your Payroll procedure and reference it every time you enter Payroll.
- A negative Sales account (unless it is the Customer Refunds or Discounts…contra accounts.)
- A negative Expense account. Now, an account may *look* weird but be *right*. For instance, if you enter a rebate for your Insurance it will show up as a negative expense for that month. Drill down and make sure.
- An account that is very different from last week or last month. If all of a sudden your Advertising expense went from about $2,500 per month to $300,000 this month, drill down. Something may have been miscoded.
- Have your accountant help you make the weird things right with an appropriate Journal Entry or reversing entry.
- Find out how it got weird, if you can, and update the data entry procedure. Written procedures are KEY to staying at KFP.
- If you don't know how it got weird, at least get it to right. If it is a small dollar amount, create an adjusting entry and watch to make sure it doesn't get weird again. If it does…look through the previous week's transactions for that account to find the

entry. This is forensic accounting! ☺

- If you do this once a week, YOU will get intimately familiar with the accounts and the dollar amounts. You will become an expert in what looks right and what looks "weird" and how to fix the weird stuff.

Run a transaction register report and look for the debits and credits. Different accounting programs call this report by different names. Look for the detail trial balance or the General Ledger journal to find the "guts" of every transaction. Double entry accounting is based on the universal law of "what goes around comes around." If something goes up, something else goes up or goes down by that amount. Debits and credits are the mechanics in the accounting system that cause the dollar amounts to go up and down…and the Balance Sheet to stay in balance. There are debits and credits behind every data entry screen. You can also affect accounts directly by creating a Journal Entry. I attached a "cheat sheet" of Debit and Credit rules. I reference this several times a week.

Look for before-and-after differences. If you are not sure of what is happening at a particular data entry point, try this:

- Run the Balance Sheet and Income Statement.
- Enter ONE transaction. Run the Balance Sheet and Income Statement again and see if you can see where the dollar amounts ended up. (Make sure no one else is in the accounting system while you do this.)
- This is a street smart way to discover the "set up" behind the data entry screen.

To recode, delete or reverse a transaction? It depends on your accounting program. With a basic off-the-shelf program like QuickBooks™, MYOB™ or Peachtree™, you can drill down to the transaction that needs to be fixed and recode it. Or, you can delete the transaction entirely and try again. With a more sophisticated industry-specific program like Successware™, Ergos™, etc. you may have to enter a transaction that reverses your original transaction and then re-enter the transaction properly.

Be careful with your initial company set up. That's where a lot of the behind the scenes accounting is created. If you are entering Service Sales and the dollar amount is showing up as Service Agreement Sales there may be an "item" or other set up instruction that is sending the information to the wrong sales account. Go to Company Set Up or the Items list and do some investigating. Figure out the default debits and credits and which accounts are affected. Update the "set up" and see if that fixes the problem.

Get bossy with your software support team. Call for help as you need it. If you don't understand what they are telling you to do, ask again for a clearer explanation. If they want to fix something for you, sit in as they do the correction so you can "follow the flow" of the debits and credits and learn from the experience. The more you know about your particular accounting software the less intimidated you will be by the accounting processes.

Be assertive with your "Bean Team"—your CPA or tax preparer. At the end of each quarter, take the time to make sure that your financials agree with the financial information your CPA is sending to Uncle Sam. Work together to enter the year-end Journal Entries needed to bring your accounting system up to accurate.

Learn to trust your intuition. As your understanding of double entry accounting increases, trust your gut feeling that a dollar amount is wrong or "weird." So often, I help someone fix a "Slinky knot" and they respond, "I thought that might be the problem!" If you have that thought, follow it and see what you uncover.

If it is your responsibility to get the financial "Slinky knot" untangled, take a deep breath and know this: You can do it. You may need some help. Contact me if you feel overwhelmed and we'll set up a time to visit on the phone. This accounting stuff is just not that hard once you learn the lingo and accounting basics. One of the smartest Financial Managers I know is working with an 8th grade education.

Once you get a handle on them, you can delegate the accounting tasks. It is a blessing to have done the accounting yourself because you will never be held hostage by your bookkeeper (or "girl in the office.") You can coach someone to be even better than you were at the basic accounting tasks. And you will understand the Balance Sheet and Income Statement so much better for the experience.

Momma knows best…

My son, Max, is taking a beginning accounting class this semester. Already, he is bogged down with fancy, once-in-a-blue moon, accounting test questions. It would be so much better if his professor took this time to teach his students how to set up a simple accounting program for a business they may actually run someday. It would be so cool if he showed them how to assemble and FIX the financial reports…addressing just the basic transactions:

- Entering Sales
- Applying Customer Payments
- Making the Deposit
- Entering Bills
- Paying Bills
- Entering Payroll
- Reconciling the bank accounts

That covers about 90% of all the data entry. If those things were done properly, your financials would be pretty solid. I suggest you, dear Office Manager, work with your team to create written procedures for those transactions. You probably need an accountant to help you with the fancier transactions…

- Entering a new vehicle or other asset
- Recording the sale of a vehicle or other asset
- Regular Depreciation expense
- Beginning Balances for a new company
- Year End adjustments to reflect your Tax Return information

So, why bother teaching how to do those kinds of transactions in beginning accounting classes? I suppose the accounting teacher is just showing off? What about teaching readily USEFUL accounting information? Sigh.

And, it would be *really* cool if the teacher showed the kids how to READ the Balance Sheet and Income Statement. Taught them how to USE the information to create a winning Selling Price strategy. Taught them how to set Goals with a simple Budget. Showed them how to KNOW when you have become a millionaire. Accounting is the scorekeeping in the great game of business. Kids of all ages like games and like to keep score. Why not make it…FUN?

BONUS #3

Getting your Team in on the Game.

OPEN BOOK MANAGEMENT: Consider operating as an open book company. Here's an article I wrote about Jack Stack…a guru in "open book" management.

Want to Play the Game?

> *"How do you get your technicians to buy in? When we made the switch to Flat Rate pricing, they all assumed the increase in our selling price went straight to my pocket!"*

Sound familiar? I hear this question at least once a day! I suggest, if you want your employees to really buy in to your prices, show them where the money goes. Open your books. Teach them how the business works. My wise suggestion is often rejected.

> *"If they knew how bad the numbers were, they would all leave!"*
> *"Frankly, I don't know how to read the financial statements myself!"*
> *"It's none of their business how much money I make!"*

Do it anyway. If your financial situation is bad, your employees know something is wrong. Their speculation will be much worse than knowing the truth. If you are not comfortable with financial data, you all can learn together. If you don't want to lay open your paycheck, you can ease into open book management by sharing some financial data now, and granting more access later.

Make a game of it!

Recently, I had the pleasure of meeting some folks who play the game very well! I attended a terrific seminar at the Springfield Remanufacturing Company (SRC) in Springfield, Missouri.

The Great Game of Business!

Jack Stack is CEO of SRC. SRC rebuilds engines. (They don't do plumbing, but, no matter. Read on.) Jack previously worked at International Harvester as a mid-level manager. At the time, International Harvester was $6 billion in debt with interest rates at 20% and they we relaying off 1,000 workers a day. (You think you've got problems.)

Jack decided that there must be a saner way to run a business than the my-way-or-highway management philosophy that was sinking International Harvester. Faced with laying off the remaining 119 employees, Jack and a dozen other managers came up with a plan to buy their division of the company.

Jack didn't really know much about business at the time. As they went from bank to bank seeking a loan (21 total!), he learned how to interpret the financial statements. Their numbers were horrible. By some error, I imagine, the 21st bank loaned the company $89 million with collateral of $100,000.00, borrowed from friends and relatives. Springfield Remanufacturing Company was in business!

Because of their fragile financial position, the company couldn't afford to be late on one payment or they would lose the company. Jack had no idea how he was going to pull it off. So, he turned to the employees and said, "We need to generate enough cash and profits to stay afloat. I don't know how to do it. Here are the financial statements. This is how we keep track of what's going on. I need your help!"

Every employee learned the financial side of the business. They made the connection that what they did at each work station impacted some number on the income statement or balance sheet. The employees saved the day! They took responsibility for the turnaround of the plant and pulled it off.

As the employees learned the game of business, they became eager to play bigger, more interesting games. Today SRC is comprised of 23 diversified companies, one of which produces the terrific seminar I attended explaining their take on open book management. The focus is notion manufacturing…it is about doing business in an open, cooperative, creative, responsible way.

The success of SRC makes a great story. So Jack Stack wrote a book, The Great Game of Business. It outlines the system that evolved at SRC. It is not an instant or exact formula. At the Great Game Seminar, several SRC managers explained the basic components:

1. Know and Teach the Rules.

The rules are dictated by the capital market. In other words, keep track of the moneybox, I know some of you think there are more important things than money. There are. But we are just talking about the game of business. To play the game, you need to find out how to get money into the company and decide what to do with it when it gets there.

The Balance Sheet and the Profit and Loss Statement are the principle scorecards. Don't feel bad if you don't really understand these reports. Jack claims a huge majority of the business population is financially illiterate. (Frank Blau says that more than 90% of the people who attend his seminars can't correctly compute a selling price!) But you can learn and share your knowledge with your employees as you go. At SRC, 30% of every new employee's time is spent learning the financial aspect of the business. Everybody plays the game.

By creating, analyzing and communicating the financial statements, you can find the numbers that really indicate the condition of the company. By setting targets for these "critical numbers" you lay out the rules of the game. (In your company consider starting with the Gross Margin.)

Do you see that if your employees have a stake in the process of determining the "critical numbers" and setting the goals, they commit themselves to winning the game? Are you getting a glimpse of how cool this can be??

2. Follow the Action and Keep Score.

Hold regular meetings to go over all the numbers. How are you doing with actual sales versus predicted sales? Are you over-budget on advertising because you couldn't resist the salesman with the talking refrigerator magnets? The numbers make everyone accountable! I love this! Especially refreshing in our point-the-finger society.

At SRC, there is a person responsible for every line on the financial statements. The numbers aren't cold, nasty, unrelated facts. One number may indicate that Suzy in Accounts Receivable is struggling with collections. The group can offer suggestions: improve C.O.D. procedures, quit selling to deadbeats, etc.

I used to think it was cool to get financial data within ten days of the next month. SRC employees report weekly figures. They can nip a problem before the month ends!

The financial statements provide the agenda for the meeting. As you go through each item on the Profit and Loss Statement and Balance Sheet, you check in with each department, see what's happening and decide on a course of action.

3. Provide a Stake in the Outcome.

You must be able to win the game and reap the rewards. If the only one who wins is you, the team won't carry you for long. Poll your employees to find out what they value…money, time off, education, insurance benefits. Create a bonus system and tie the bonus to hitting the critical numbers.

It's important to have a company-wide critical number goal. But be careful to reward individual performance as well. Often one outstanding employee is pulling the whole company along while the boss boasts about teamwork! People who contribute more should get more. Every position in the company can be tied to an incentive-based compensation plan.

SRC has a Employee Stock Ownership Plan (ESOP). This is a very hip way to tie compensation to the company's performance. Dish out stock to the owner-employees as a bonus for hitting the marks. Stock bonuses don't require immediate cash disbursement. But they are only worth something if the company improves in value by creating solid earnings! This is the ultimate buy-in.

4. You Gotta Wanna!

"You Gotta Wanna"…Jack calls this one of the Higher Laws of Business. Motivation comes from within. Your techs will be comfortable selling their services at a reasonable price when they believe in the price. If they understand every cost associated with developing the price, they can sell it. If they see how the customer benefits from the unique way that you do business and understand the costs associated with customer service, they can sell it. If they see what's in it for them, they will want to sell it. They gotta wanna.

As you play the game, your techs and the rest of the team will help you develop the selling price, using their keen knowledge of your company's financial data. They may even suggest a raise for you!

Your employees can win the game and make your company successful. You don't have to do it all by yourself. How wonderful to share in the success. Jack says, the Ultimate Higher Law in Business is… "When you appeal to the highest level of thinking, you get the highest level of performance." Good stuff!

Some parting words…

- It takes time and relentless training to really play the game.
- The process builds trust…in the process! And in each other.
- Visit the Great Game website (www.greatgame.com) for more information.
- Buy and read the book *The Great Game of Business* by Jack Stack.

Remember Monopoly? You love playing it. But, it's no fun all by yourself. Invite everyone to play and create a wonderful game with your business.

Profit & Loss

Balance Sheet

Journal

General Ledger

Other Weird Words

GLOSSARY

ACCOUNTING EQUATION: The Balance Sheet is based on the basic accounting equation. That is:

Assets = Equities Equity of the company can be held by someone other than the owner. That is called a liability. Because we always have some liabilities, the accounting equation is usually written… ***Assets = Liabilities + Owner's Equity***

ACCOUNTS: Business activities cause increases and decreases in your assets, liabilities and equity. Your accounting system records these activities in accounts. A number of accounts are needed to summarize the increases and decreases in each asset, liability and owner's equity account on the Balance Sheet and of each revenue and expense that appears on the Profit and Loss Statement. You can have a few accounts or hundreds, depending on the kind of detailed information you need to run your business.

ACCOUNTS PAYABLE: Also called A/P. These are bills that your business owes to the government or your suppliers. If you have bought it, but haven't paid for it yet (like when you buy on account), you create an account payable. These are found in the liability section of the Balance Sheet.

ACCOUNTS RECEIVABLE: Also called A/R. When you sell something to someone, and they don't pay you that minute, you create an account receivable. This is the amount of money your customers owe you for products and services that they bought from you but haven't paid for yet. Accounts receivable are found in the current assets section of the Balance Sheet.

ACCRUAL BASIS ACCOUNTING: With accrual basis accounting, you "account for "expenses and sales at the time the transaction occurs. This is the most accurate way of accounting for your business activities. If you sell something to Mrs. Fernwicky today, you would record the sale as of today, even if she plans on paying you in two months. If you buy some paint today, you account for it today, even if you will pay for it next month when the supply house statement comes.

ASSETS: The 'stuff' the company owns. Anything of value - cash, accounts receivable, trucks, inventory, land. **Current assets** are those that could be converted into cash easily (officially, within a year's time). The most current of current assets is cash, of course. Accounts receivable will be converted to cash as soon as the customer pays, hopefully within a month. So, accounts receivable are current assets. So is inventory.

Fixed assets are those things that you wouldn't want to convert into cash for operating money. For instance, you don't want to sell your building to cover the supply house bill. Assets are listed in order of liquidity (how close it is to cash) on the Balance Sheet.

BALANCE SHEET: The Balance Sheet reflects the financial condition of the company on a specific date. The basic accounting formula is the basis for the Balance Sheet:

Assets = Liabilities + Owner's Equity

The Balance Sheet doesn't start over. It is the cumulative score from day one of the business to the time the report is created.

BILLABLE HOUR: The labor hour that is sold as a service to the customer. For instance, a doctor's exam requires the doctor's time. If your service involves your time, the billable hours a very important number. There are only 24 hours in a day and you and your employees can be of service for only so many of those hours every day. How many? You must keep track with timecards…tallied daily, weekly, monthly, and yearly.

Doctors, plumbers, painters, house cleaners, lawyers, baby-sitters…are all limited by the number of hours that they have to provide their services. Knowing your billable hours can help make sure that you are charging enough for your services. All the costs of doing business must be recaptured by the sale of your billable hours.

Some activities in your business can not be directly billed to a customer—like sweeping the shop. These are called non-billable hours. The costs for these hours must be included in the selling price of the billable hours. (Learn how to price your services—call 1.877.629.7647 toll free and order *How Much Should I Charge?*—a beginner's guide to setting a selling price.)

The ratio of billable hours to the total hours available is called billable hour efficiency.

CASH BASIS ACCOUNTING: records the sale when the cash is received and the expense when the check goes out. Not as accurate a picture of what is happening at your company.

CASH FLOW: The movement and timing of money in and out of the business. In addition to the Balance Sheet and the Profit and Loss Statement, you may want to report the flow of cash through your business. Your company could be profitable but 'cash poor' and unable to pay your bills. Not good!

A cash flow statement helps keep you aware of how much cash came and went for any period of time. A **cash flow projection** would be an educated guess at what the cash flow situation will be for the future—you could use this for your budget.

Suppose you want to buy a new truck with cash. But that purchase will empty the bank account and leave you without any cash for payroll! For cash flow reasons, you might choose to buy a truck on payments instead.

CHART OF ACCOUNTS: A complete listing of every account in your accounting system. Every transaction in your business needs to be recorded so that you can keep track of things. Think of the chart of accounts as the peg board on which you hang the business activities.

CREDIT: A credit is used in Double-Entry accounting to increase a liability or an equity account. A credit will decrease an asset account. For every credit there is a debit. These are the two balancing components of every journal entry. Credits and debits keep the basic accounting equation (Assets = Liabilities + Owner's Equity) in balance as you record business activities.

DEBIT: A debit is used in Double-Entry accounting to increase an asset account. A debit will decrease a liability or an equity account. For every debit there is a credit. Note the handy debit and credit rules chart at the end of the book.

DEPRECIATION and ACCUMULATED DEPRECIATION: Depreciation means expensing an asset over a period of time. Depreciation is recorded as an expense and shows up on the Profit and Loss Statement. The balancing Double-Entry is recorded in accumulated depreciation, an account that shows the total amount of depreciation you have recorded for an asset. Accumulated depreciation appears on the Balance Sheet, right below the asset.

For example, let's say you have a truck that you use for deliveries. Tax laws allow you to expense the cost of that truck over the course of a few years. Each month you will make a journal entry that records the depreciation.

Journal Entry	Debit	Credit
Depreciation Expense	$700	
Accumulated Depreciation		$700

And the truck would be listed on the Balance Sheet like this…

Assets	
Truck	$20,0000
Accumulated Depreciation	($700)

So the asset is listed at its original cost and the accumulated depreciation account right below it tells you how much of the total cost of the asset has been expensed. You see, that asset will reduce in value over time, right? The asset less the accumulated depreciation amount gives you a rough estimate of the value of the vehicle.

This is an accounting technique. It isn't intended to show you the actual re-sale value of the truck! Some assets increase in value over time. Some lose their value or get 'used up' (like truck). Depreciation allows you to expense an asset that gets used up over time.

Note that depreciation is a non-cash expense. You don't get a bill in the mail every month saying, "Pay your depreciation!" The idea is that you could take the dollar amount that you are depreciating every month and put it in the bank. When five years are up (typically, you depreciate a truck over five years) you take that money and buy the company a new truck!

Now, consider this…could you replace the truck you have today with one of equal value in five years for the same selling price? In other words, if you bought a brand new truck in 1998for $25,000, would you expect the new 2003 model trucks to sell for $25,000? By then, a similar truck might cost $40,000. Depreciation can help you plan for replacing your truck but it is not the whole story. (The next book in this business basics series is called How Much Should I Charge? It helps you create a selling price that will make sure you can afford a new truck when you need one. Go to www.BareBonesBiz.com—and order a copy.)

Depreciation is a handy method for expensing an asset that loses value when you use it in your business. Office Furniture is another asset that gets used up, so you are allowed by tax law to depreciate it.

DIRECT COSTS: Also called cost of goods sold, cost of sales or job site expenses. These are expenses that include labor costs and materials. These expenses can be directly tracked to a specific job. If the job didn't happen, the direct costs wouldn't have been incurred. (Compare direct cost with indirect costs to get a better understanding of the term.) Direct costs are found on the Profit and Loss Statement, right below the income accounts.

Income - Direct Costs = Gross Margin

DOUBLE-ENTRY ACCOUNTING: An accounting system used to keep track of business activities. Double-Entry accounting maintains the Balance Sheet:

Assets = Liabilities + Owner's Equity When dollars are recorded in one account, they must be accounted for in another account in such a way that the activity is well documented and the Balance Sheet stays in balance.

You may not need to be an expert in Double-Entry accounting, but the person who is responsible for creating the financial statements better get pretty good at it. If that is you, go back through the book and focus on the 'gray' sheets. Study the examples and see how the Double-Entry method acts as a check and balance of your books.

Remember the law of the universe…what goes around, comes around. This is the essence of Double-Entry accounting.

EQUITY: Funds that have been supplied to the company to get the "stuff." Equities show ownership of the assets or claims against the assets. If someone other than the owner has claims on the assets, it is called a **liability.**

Total Assets - Total Liabilities = Net Equity This is another way of stating the basic accounting equation that emphasizes how much of the assets you own. Net equity is also called **net worth**.

EXPENSE: Also called costs. Expenses are decreases in equity. These are dollars paid out to suppliers, vendors, Uncle Sam, employees, charities, etc. Remember to pay bills thankfully, because it takes money to make money. Expenses are listed on the Profit and Loss Statement. They should be split into two categories, direct costs and indirect costs. The basic equation for the Profit and Loss Statement is: Revenues - Expenses = Profit (You'll see a profit if there are more revenues than expenses!…or a loss, if expenses are more than revenues.)

Remember, all costs need to be included in your selling price. The customer pays for everything. In exchange, you give the customer your services. What a deal!

FINANCIAL STATEMENTS: refer to the Balance Sheet and the Profit and Loss Statement. The Balance Sheet is a report that shows the financial condition of the company. The Profit and Loss Statement (also called the Profit and Loss statement or the P&L) is the profit performance summary.

Financial Statements can include the supporting documents like cash flow reports, accounts receivable reports, transaction register, etc. Any report that measures the movement of money in your company.

Financial Statements are what the bank wants to see before it loans you money. The IRS insists that you share the score with them, and asks for your Financial Statements every year.

GENERAL LEDGER: Once upon a time, accounting systems were kept in a book that listed the increases and decreases in all the accounts of the company. That book was called the general ledger. Today, you probably have a computerized accounting system. Still, the general ledger is a collection of all Balance Sheet and Profit and Loss Statement accounts…all the assets, liabilities and equity. It is the report that shows ALL the activity in the company. Often this listing is called a detail trial balance on the report menu of your accounting program.

GROSS MARGIN: Also called **gross profit.** This is how much money you have left after you have subtracted the direct costs from the selling price.

Income - Direct Costs = Gross Margin This is a good number to scrutinize each month, and to track in terms of percentage to total sales over the course of time. The higher the better with gross margin! You need to have enough money left at this point to pay all your indirect costs and still end up with a profit.

If your gross margin isn't high enough to do that, you need to raise your prices. (More on this impart Two of the Business Basics Series - How Much Should I Charge? Visit www.barebonesbiz.com to order!)

INCOME STATEMENT: also called the Profit and Loss Statement, or P&L, or Statement of Operations. This is a report that shows the changes in the equity of the company as a result of business operations. It lists the income (revenues or sales), subtracts the expenses and shows you the profit or loss. This report covers a period of time and summarizes the money in and the money out.

The Profit and Loss Statement is like a magnifying glass that shows the detail of activities that cause changes in the equity section of the Balance Sheet.

INDIRECT COST: Also called **overhead or operating expenses.** These expenses are indirectly related to the services you provide to customers. Indirect costs include office salaries, rent, advertising, telephone, utilities…costs to keep a 'roof overhead'. Every cost that is not direct cost is an indirect cost. Indirect costs do not go away when sales drop off.

INVENTORY: Also called **stock.** These are materials that you purchase with the intent to sell, but you haven't sold them yet. Inventory is found on the balance sheet under assets. It is considered a current asset because you will convert it into cash as soon as you sell it.

JOURNAL: This is the diary of your business. It keeps track of business activities chronologically. Each business activity is recorded as a journal entry. The Double-Entry will list the debit account and the credit account for each transaction on the day that it occurred. In your reports menu in your accounting system, the journal entries are listed in the **transaction register**.

LIABILITIES: Like equities, these are sources of assets—how you got the "stuff." These are claims against assets by someone other than the owner. This is what the company owes! Notes payable, taxes payable and loans are liabilities. Liabilities are categorized as **current liabilities** (need to pay off within a year's time, like payroll taxes) or **long term liabilities** (payback time is more than a year, like your building mortgage).

LIQUIDITY: How close it is to cash on the Balance Sheet.

MONEY: Also called moola, scratch, gold, coins, cash, change, chicken feed, jing, green stuff, etc. Money is the form we use to exchange energy, goods and services for other energy, godsend services. Used to buy things that you need or want. Beats trading for chickens in the global marketplace.

Money in and of itself is neither good or bad. I want you to make lots of it, and do great things with it!

NET INCOME: Also called **net profit, net earnings, current earnings or bottom line**. (No wonder accounting is confusing—look at all those words that mean the same thing!)

After you have subtracted ALL expenses (including taxes) from revenues, you are left with net income. The word net means basic, fundamental. This is a very important item on the income statement because it tells you how much money is left after business operations. Think of net income like the score of a single basketball game in a series. Net income tells you if you won or lost, and by how much, for a given period of time.

By the way, if net income is a negative number, it's called a loss. You want to avoid those. The net income is reflected on the Balance Sheet in the equity section, under current earnings (cornet profit). Net income results in an increase in owner's equity. A loss results in a decrease in owner's equity.

PAID-IN CAPITAL: Money that has been invested in the company by the owner. This is an equity investment.

RETAINED EARNINGS: The amount of net income earned and retained by the business. If net income is like the score after a single basketball game, retained earnings is the lifetime statistic. Retained earnings is found in the equity section of the Balance Sheet. It keeps track of how much of the total owner's equity was earned and retained by the business versus how much capital has been invested from the owners (paid-in capital).

Each month, the net profits are reflected in the Balance Sheet as current earnings. At the end of the year, current earnings are added to the retained earnings account.

Summary of Debit and Credit Rules

Keeping the Balance Sheet in Balance .

The six rules for debt and credit are:

- To *increase* an asset account, *debit* it.
- To *decrease* an asset account, *credit* it.
- To *increase* a liability or equity account, *credit* it.
- To *decrease* a liability or equity account, *debit* it.
- To *record revenues, credit* a revenue account.
- To *record expenses, debit* an expense account.

This diagram may help you remember the six rules for debit and credit.

BALANCE SHEET ACCOUNTS					
Assets = (Example: Cash)		Liabilities + (Example: Accounts Payable)		Equity (Example: Paid-in Capital)	
Debit increase +	**Credit** decrease -	**Debit** decrease -	**Credit** increase +	**Debit** decrease -	**Credit** increase +

The Profit and Loss Statement summarizes the changes in Equity that occur as a result of business operations.

INCOME STATEMENT ACCOUNTS			
Revenues (Example: Sales)		Expenses (Example: Owner's Salary)	
Debit	**Credit** increase +	**Debit** increase +	Credit

Congratulations!

You're on your way to making more money!

My mission is expand peace, prosperity and freedom by helping people create honorable, profitable businesses. My wish is that you take the information from this book and use it…to be more FREE!

You may think that *other* folks know the secrets to making money in business. YOU can do it! If you have the desire, you have the capacity. Business is not that hard!! You just need to keep score to be able to play the game well, to know whether or not you're winning, to understand where you need to make adjustments. Knowing how to read and use financial statements is a success factor. So is your commitment to believe in yourself and take right action. And, you must be willing to press on in the direction of your dreams.

This book is NOT the ultimate small business resource. It is the beginner's guide to basic business scorekeeping. It will teach you how to find out where the money goes. Because it always goes somewhere! And it will help you break through denial and get PROFITABLE. Charge more than it costs for your products and services and you will be profitable. If you are willing to know…you can grow!

There are a lot of great business books out there. This is the primer, the kindergarten course…the stuff that is not taught in school or in other books. It assumes you know nothing about business.

Eighty percent of all businesses are either out of business or losing money after a few years of the owner's blood, sweat and tears. Our family business was a disaster… until I learned the basics. I was fortunate enough to find lots of fantastic mentors—including my first, greatest one…one who was super generous with his time and wisdom. (Thanks, Frank Blau!) I would be honored to act as your mentor.

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I believe that honorable, profitable business expands peace, prosperity and freedom across the planet. Your business is no small thing. May you go and GROW! Keep me posted of your challenges and successes!

xoxo$