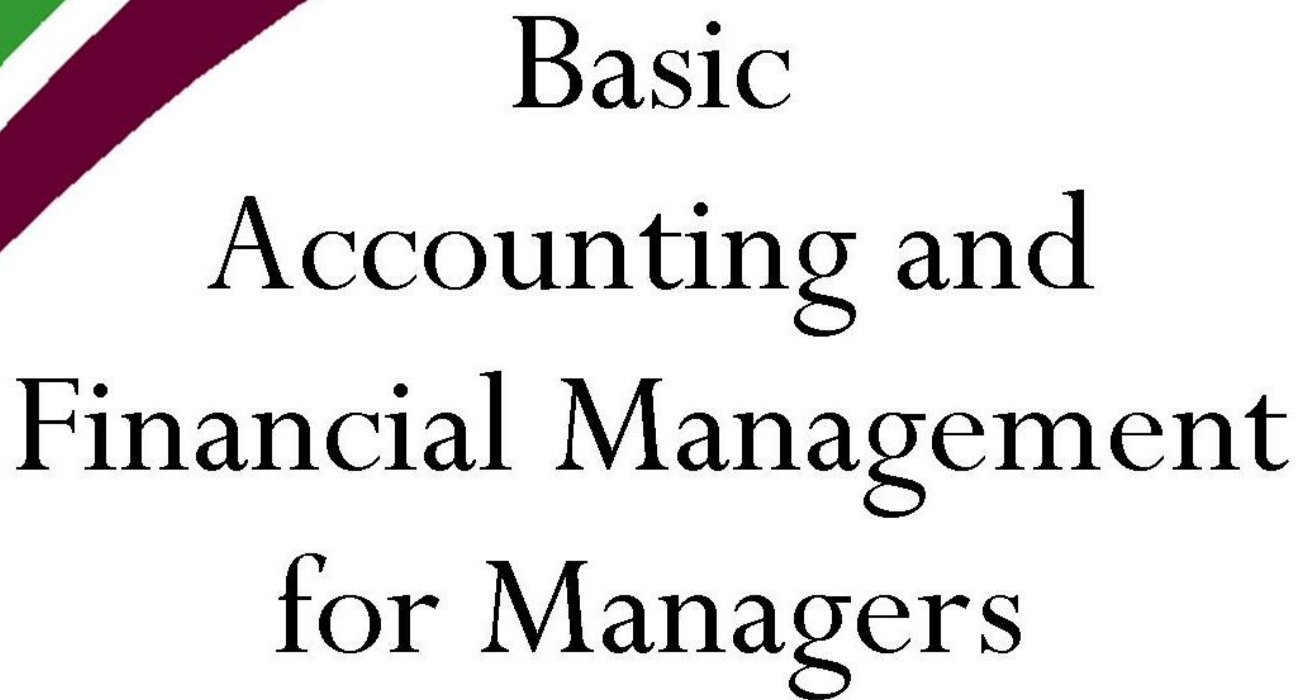

Basic Accounting and Financial Management for Managers

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INTRODUCTION

Accounting, when taken in the totality of its purpose, disciplines, and jargon, can seem a bewildering thicket of confusion for the layman. Everything from Generally Accepted Accounting Principles, to debits and credits, to balance sheets seem designed to be as obscure and confusing as possible. Yet the underlying purpose of accounting is quite simple – to record and "account" for all the business transactions of an enterprise.

In an effort to demystify accounting and to provide a basic understanding of the most prevalent accounting activities in clubs, Club Resources International has developed this handbook for managers and supervisors.

The underlying premise of this handbook is to put all of the accounting activities with which our managers encounter in the pursuit of their duties into the simplest terms possible. Whenever appropriate we do this by comparing them to something we each do routinely; that is, to keep track of our personal finances.

We hope that this material will be helpful and will make a sometimes confusing subject a little bit clearer. As you progress through your career and have more exposure to the principles and terms of accounting, you will find that much of it will become second nature, but the foundation for your understanding will be the basics presented here.

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I – ACCOUNTING BASICS

As we get started in our review of basic accounting practices and terminology, there are some basic things we must understand.

Bookkeeping

Bookkeeping is the exacting discipline underlying accounting. In its most basic form, bookkeeping is the recording of detail for every business transaction. In terms of your personal finances it is the faithful and exact recording of every check you write from your personal checkbook. While some people do a sloppy job of entering the amount of checks written and subtracting the amount from the balance in their checking account, in the business world, bookkeeping (or the recording of each transaction) must be done carefully and exactly. This is so because the flow of money being recorded, unlike the bookkeeper's personal finances, does not belong to the bookkeeper; rather it belongs to the owner(s) the business who expects care and accuracy in accounting for their funds.

Debits and Credits

Debits and credits are probably the most basic, but also the most confusing part of bookkeeping, except for those trained and experienced in their daily use.

Debits are accounting entries that increase Asset or Expense accounts and decrease Liability and Income accounts. They always appear on the left side of an accounting entry.

Credits are just the opposite. They decrease Asset or Expense accounts and increase Liability and Income accounts and are found on the right side of an accounting entry.

For the most part, managers and supervisors do not need to concern themselves with this detail of bookkeeping as the determination of debits and credits is either done by computers (the Point of Sale system or Accounting software) or by the Controller.

Double Entry Bookkeeping

Given the detail that must be recorded in each business transaction and the large number of daily transactions, bookkeeping is prone to data entry errors. In the early days of business accounting, a system was devised to "prove" the accuracy of entries by requiring the debits and credits of each transaction to be equal. This double entry balanced revenues and expenses with changes in the business' assets, liabilities, and equity.

Keeping your personal checkbook is a single-entry system in that you enter the amount of your check once. A variation of this personal checkbook is the One-Write Check writing system, a simplified business account system where you record the amount of a check twice – once in the cash (or funds) expended column and the second time in one of the expense category columns. The "check" on accuracy is that the total of the cash expended column must equal the total of all the expenses category columns.

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Cash or Accrual

There are two ways to account for the flow of money through a business – on a cash or accrual basis. In cash accounting, a transaction is recorded at the time money is received in payment for goods or services rendered or when money is paid by the business for goods or services received. It is the same as when you write a check for groceries – you record the expense in your checkbook on the date you write the check under the expectation that the check will be presented to your bank and the funds for the groceries will be moved out of your account and into the grocer's account on or about that date.

When a business' funds are accounted for on an accrual basis, an effort is made to record expenses in the period that they were incurred and to match revenues with the expenses incurred to generate them. The best example of this is payroll expense. Let's say a business pays its employees bi-weekly (that is, every two weeks on Friday). Each monthly accounting period is made up of a little more than two pay periods or 28 days (excepting February during non-Leap Years). Because of the year to year variations of the calendar, most often the last day of a particular month does not fall on a the last day of a pay period. This requires the business to allocate the cost of partial pay periods to the appropriate accounting period.

> Example: The second pay period in May ends on Friday, May 29th. Two days of the following pay period fall into the May, while 12 days fall into the June accounting period. While the payroll expense of the pay period will not be paid to employees until the middle of June, the payroll cost for May 30th and 31st must be accounted for, and thus accrued, in May.

Profit Center vs. Costs Center

The operating departments of a club are either a profit center or cost center. Those departments that generate revenues, as well as the associated departmental expenses, such as Golf, F&B, Activities, Tennis, etc., are profit centers. Those who do not generate revenues, but incur expenses, such as GC Maintenance, Membership, Administrative and General, etc., are cost centers.

Bottom Line Responsibility

Bottom line responsibility is the financial accountability that a manager has for the operation or portion of the operation for which he or she is responsible. For the General Manager of a club, he or she has bottom line responsibility for the entire club operations. For the Department Head – say the F&B Director – he or she is responsible for the bottom line performance of the F&B Department.

General Ledger

The General Ledger is the accounting record that summarizes chronologically all the transactions that occurred since a business began operating. This ledger is the historical record of all the business' transactions.

The accounting department can print out the General Ledger detail for a department's accounts for any specific accounting period or range of dates which summarizes all income and expenses transactions affecting the department's performance during that period.

Chart of Accounts

The Chart of Accounts is a listing of a business' entire ledger accounts used to classify all of the activity of that business. These accounts are categorized according to the business' balance sheet and operating statement – asset accounts, liability accounts, stockholders' (or owners') equity accounts, income accounts, and expense

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accounts. All monies received and spent by the business must be classified (coded) to an existing account to be properly accounted for. Each account in the chart of accounts will have an account name and number to identify it. The name briefly describes the account, while the account number fosters accuracy.

The following are definitions of the account categories:

- **Assets** are economic resources.
- **Liabilities** are creditors' claims on the resources of the firm.
- **Stockholders'** (or owners') **equity** is the stockholders' (or owners') claim on the assets of the firm. Stockholders' equity is generally comprised of two parts:
  - **Contributed capital** reflects the assets invested by the original owners in exchange for ownership interest, and
  - **Retained earnings** represent the earnings, or profits, realized by a firm since its formation in excess of any dividends (or funds) distributed to shareholders (or owners).
- **Revenues** are a measure of the inflow of assets (or the reduction in liabilities) from selling goods and providing services to customers.
- **Expenses** are a measure of the outflows of assets (or increases in liabilities) used up in generating revenues.

Accounting Periods

Accounting periods are the periods of time by which a business' accounts are balanced and reported – usually monthly and summarized annually.

Fixed versus Variable Expenses

Expenses are broadly classified as either fixed or variable. A fixed expense is one that you incur whether or not you have any customers walk through the door. Examples of fixed expenses would be management salaries, the basic charges for the club's phone system, lease payments on vehicles and equipment, the cost of the club's business and liquor licenses, and debt service (payments made to retire any debt of the club). On the other hand variable expenses are those expenses incurred as a result of the use of the club by members. Examples would be that portion of utility costs attributable to varying levels of activity, consumables supplies such as dishwashing chemicals, and hourly wages of line employees.

Volume versus Average Sale

Revenues at a club can be considered to be made up of two components: How many members visit the club and how much each member spends on average during each visit. The reason that breaking down sales into these two components is important is that should sales decline, it is important to know if it's because fewer members are visiting or they are spending less on each visit. Since the solution to each of these problems is different, knowing whether the problem is declining volume or average sale is critical to turning things around.

Classifying Revenues and Expenses by Category

While most of us have one source of income (our paycheck) and make no effort to classify our personal expenses by category (for instance how much we spend for food or utilities or on operating our car), the theory and discipline of operating a business demands that both revenues and expenses be categorized to provide a better understanding of where the money comes from and where it goes.

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One way you might do this on a personal level if you had multiple sources of income, would be to open up a separate checking account for each source and to write checks from the different accounts to pay those bills associated with each income. For instance, let's say you had a side business building decks for customers. Not only would you have a separate checking account to deposit your earnings in, but you would pay for building materials by writing checks from that account.

In the business world, you don't have separate checking accounts for each revenue source, but you must carefully account for the flow of money and classify revenues and expenses by categories just the same.

Point of Sale System

A Point of Sale (POS) system is an automated business transaction recording device where sales transactions are recorded (rung up) at the point of sale on a computer terminal. A point of sale system is made up of the hardware (computer terminals) and software to record the detail and summary of all sales transactions. It is linked electronically to the business' accounting software and greatly improves the accuracy and timeliness of tracking sales transactions.

II – FINANCIAL STATEMENTS

Financial Statements are **summary** reports that provide information to owners, management, and other stakeholders about the financial performance of a business. There are basically two forms of financial statements with which you should be familiar – the Balance Sheet and the Operating (or Income) Statement. Sometimes the Operating Statement is called the Profit and Loss Statement (or P&L, for short).

Balance Sheet

The balance sheet is a snapshot in time that reflects the assets and liabilities of the club as of a specific date. It is equivalent to an individual's Statement of Net Worth – how much they are worth when all liabilities (money owed) are subtracted from all assets (money and value of possessions owned).

The basic formula for a club Balance Sheet is:

Assets = Liabilities + Stockholders' Equity

This formula is computed at specific moments in time (the end of monthly or annual operating periods) and is a snapshot of the club's value at that time.

Operating Statement

The operating statement is a report covering a particular accounting period that shows whether the club made money or not. It would be equivalent to individuals adding up all income in a given month and subtracting all the month's expenses to see if they were living within their means.

The basic formula for the operating statement is:

Income – Operating Expenses = Profit or (Loss)

While this formula represents the basic operating statement format, clubs typically expand upon this formula to break expenses down into the more significant expense categories – Cost of Goods Sold (for retail operations), Payroll and Related Expenses, and Other Operating Expenses. The format for a typical club operating statement is as follows:

Income

***Less* Cost of Goods Sold**

= Gross Profit

***Less* Payroll and Related Expenses**

***Less* Other Operating Expenses**

= Net Operating Income (or Loss)

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Departmental Schedules

In order to give more operating detail to the managers with bottom line responsibility for their departments, the club's monthly operating statement breaks down the club's income and expenses into the respective profit and cost centers.

For profit centers, the departmental schedule provides the following categorized statement:

Income

***Less* Cost of Goods Sold**
(for those departments with retail sales)

= Gross Profit

***Less* Payroll and Related Expenses**

***Less* Other Operating Expenses**

= Net Income

Cost centers have a schedule that categorizes expenses as follows:

Payroll and Related Expenses

***Plus* Other Operating Expenses**

= Total Expenses

There can be some variation in these common formats from club to club. If you have any questions about report formats, see your Controller.

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III – SUMMARY OF MANAGERS' FISCAL RESPONSIBILITIES

Managers are responsible for the financial performance of their clubs/departments. There are a number of specific elements associated with this responsibility, which we have broken down into the following broad categories:

Budgeting – Budgeting is the process of establishing a financial operating and capital plan for a future fiscal year. Budgets are formulated using past history, benchmarks, knowledge of upcoming events or trends, and one's best professional judgment.

Comparing Actual Performance to Budget – Once approved, budgets are the fiscal plan for the year. Managers are responsible for comparing actual performance to budgets on a monthly basis and intervening as necessary to achieve budget goals.

Achieving Revenues – Achieving revenue projections is one of the two primary means of meeting budgets (the other being controlling expenses). Managers are responsible for monitoring revenues and aggressively intervening when revenues fall short.

Controlling Cost of Goods Sold – Departments with retail operations (Golf, Food, Beverage, and Tennis) also must control the cost of goods sold and investigate high cost of goods sold by Cost of Goods Sold Analysis. Managers can do this by ensuring accurate Monthly Resale Inventories, carefully tracking Departmental Transfers and Adjustments, and using an Annual Retail Buying Plan.

Controlling Payroll Costs – Payroll is the single largest expense in Club operations. Payroll costs are the most significant expense that Managers must control. The Pay Period Summary Report, CRI Form 229, and the Departmental Payroll Summary Analysis, CRI Form 230, are effective tools to compare actual to budgeted payroll costs.

In order to control payroll costs, it is essential that Managers have timely and accurate data regarding their departmental payroll cost. Essential to getting this data is correctly following timekeeping procedures, setting schedules to meet forecasted levels of business, and the dogged determination to track payroll expenses closely to ensure that budgets are not exceeded.

Controlling Other Expenses – Other Expenses comprise all of the other departmental operating expenses. Managers can control these expenses by carefully reviewing expenditures on a monthly basis, using Tools to Beat Budget to monitor expenses by expense category, and by periodic in-depth reviews of significant expense accounts.

Benchmarking – Benchmarking is the act of measuring operating performance. Each Department Head is required to track detailed benchmarks for his or her area of the operation

Pricing – The starting point for meeting revenue projections is proper Pricing of Products and Services to ensure a sufficient markup to cover associated expenses. Pricing should be reviewed on a periodic basis to ensure that budgeted margins are being maintained.

Purchasing – Managers are responsible for purchasing materials, supplies, and inventories for their departments. Managers must be familiar with all purchasing policies (Accounting Policies – 4000 Series) to properly fulfill these responsibilities.

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Expense Coding – Managers are responsible for ensuring that invoices for all purchased items are coded to appropriate expense accounts in a timely, accurate, and consistent manner.

Inventory Management and Security – Given that high inventory levels tie up capital that might be put to better use elsewhere, managers must use common sense and good business judgment to maintain inventories at levels that balance business demands, lower pricing for bulk purchases, perishability of stock, and available warehousing space.

Inventories must be kept secured with access limited to as few individuals as possible. Storerooms must be kept neat, clean, and organized to facilitate physical inventory counts and minimize damage and spoilage.

Merchandise inventories should be purchased using an Annual Retail Buying Plan, and by constant monitoring of inventory levels and product mix while minimizing markdowns. All special sales of merchandise during the year should be noted and marked down items analyzed in comparison with the Annual Retail Buying Plan to ensure that lessons are learned from buying mistakes.

Asset Management – Managers are responsible for protecting the assets assigned to their departments and in their care.

Inventories – Periodic inventories are required for various assets. See inventory policies (Accounting Policies – 4500 Series) for more information.

Internal Controls – Managers are responsible for ensuring the efficiency of their operations and the security of all assets in their care. Further, they must ensure they follow all requirements of the club's internal controls (Accounting Polices – 9000 Series).

Point of Sale Transactions – The initial entry for all revenue data is through point of sale systems. Managers are responsible for training their employees to correctly use the POS system and to retrain as necessary when a pattern of errors is evident in their departments.

Accounting Policies and Procedures – Managers should be familiar with all aspects of the club's Accounting Policies and Procedures. Managers are expected to follow all Accounting Policies and Procedures and recommend changes as necessary.

Reference: Accounting Policy, A-1004

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