

Appendix

Working With Your Accountant

It was stressed throughout this manuscript that you should work closely with your accountant in setting up your chart of accounts, handling depreciation transactions, and managing your taxes. QuickBooks does not replace your accountant!

You will find that most accountants are very familiar with QuickBooks. In fact, you can even email a special copy of your QuickBooks company file to your accountant. She/he can make necessary adjustments and email the corrections back to you. You can then install these changes back into your QuickBooks company file. Again, QuickBooks was designed with accountants in mind.

We recommend you read the chapter ***Information to Share with your Accountant*** in your QuickBooks manual. In it you will learn how to set up accounting preferences, produce reports and graphs for your accountant, allow your accountant to make changes, and make general journal transactions.

We suggest you schedule a meeting with your accountant prior to using QuickBooks to discuss how to set up QuickBooks for your farm. Your accountant may want to use your existing chart of accounts to start your new fiscal year. Or he/she may want to use our set up file and may have a number of other suggestions that you should follow.

To change accounting preferences click on ***File*** and then ***Preferences***. Scroll down until you see the accounting icon. Double click it. Select the tab ***Company Preferences***. There are three options that you may elect to use:

1. Use account numbers.
2. Use class tracking.
3. Use audit trail.

Most accountants use DOS-based software programs that require account numbers to identify various financial accounts. You can elect to have QuickBooks recognize account numbers as well as a description and account type. This is one tool that will help you work better with your accountant.

Class tracking is another alternative discussed in the chapter on enterprise accounting. This should be selected if you are going to denote every financial transaction by class or enterprise. If you select this option, QuickBooks will display a **Class** field on every invoice, cash sale, bill, check and general journal entry.

A final preference is audit trail. This option will instruct QuickBooks to maintain a record of all changes made to transactions. You can then review the audit trail report with your accountant.

QuickBooks can also produce a number of financial statements (profit and loss, balance sheet, cash flow budget) that your accountant may want to review. In addition, most of the financial statements will allow you to provide greater transaction details (i.e. for the profit and loss statement, select *Itemized*).

QuickBooks produces other reports of interest to your accountant such as:

1. General Ledger
2. Trial Balance
3. Journal
4. Transaction Journal
5. Transaction History
6. Audit Trail

As discussed earlier, your accountant will likely be very familiar with QuickBooks. In fact, they may use it in their office. So why then would you need to provide your accountant with a hard copy of your records? Shouldn't they be able to read your records from a diskette? Or better yet, can't they make changes or corrections electronically to your QuickBooks files? The answer is yes!

The Accountant's Review™ feature of QuickBooks was designed to allow an accountant to make changes in a special copy of your QuickBooks company file. You can continue to make entries in your master company file while your accountant is correcting or changing the special copy. Then, when your accountant is done, you can merge these changes into your master company file. This is helpful when your accountant is entering depreciation charges or end-of-the-year entries for tax purposes.

Review your QuickBooks manual for instructions in creating an Accountant's Review copy of your company.

Understanding the Mysteries of Dual Entry Accounting

In this appendix you will learn the basics of dual entry accounting. In particular we will present an overview of bookkeeping. Bookkeeping is the proper entry of financial information into your accounting system. QuickBooks can act as your electronic bookkeeper provided you understand basic accounting principles, set up your books properly, and enter the financial information correctly. We will present a brief overview of how your accounting system works behind the scenes in QuickBooks. This information will serve as a prerequisite to the preceding chapters where you will learn the details of how to set up your system.

Your accountant will be impressed with the detail QuickBooks provides. Each month you will be able to print information about each account in your business and prepare professional financial statements at the touch of a keystroke. And, you will see that daily bookkeeping chores are actually very easy in QuickBooks. The benefit here is that you will have a more up to date understanding of the financial structure of your business since you understand all the details.

The Old Dusty Ledger

Not too long ago bookkeeping for most businesses was a very tedious chore. One individual was usually assigned to keep all of the financial transactions for the company. These daily transactions were recorded in chronological order in a big thick book called “the general ledger.” Then, once a month, all of these transactions were physically posted to special accounts where they were summed up and verified. Then they were compared to bank records, edited and recalculated. This chore took hours to perform and often involved numerous errors that had to be later corrected. From this information the financial statements were constructed. The bookkeeper held a special place in the business since she/he was the only person who knew where the financial information was and was able to develop financial statements.

Small businesses today often cannot afford to hire a full time bookkeeper and many use accounting services. They use accounting services to prepare financial statements just once a year from records placed in their shoebox. The valuable information provided by these financial statements is used to report the financial health of the business to creditors and business partners, and to prepare tax statements. The problem here is that many farms may never really understand how their business is doing until tax time.

All of this is beginning to change with the advent of the personal computer. Properly developed, software programs can carry out all of the tedious chores previously performed by the bookkeeper or the accountant. The posting of financial records from one set of books to another, tallying up monthly totals and closing the books each month can now be done quickly and efficiently by the computer.

In this appendix we will discuss the basics of accounting as a prerequisite for the other chapters. As a reference to this discussion, We would suggest reading *Bookkeeping Made Simple* by Louis W. Fields. It provides a lot of information in a very compact book.

Financial Transactions

Every time you sell milk or write a check you are creating financial transactions that must be recorded in your accounting system. In QuickBooks, each financial transaction requires two entries. This is referred to as “double entry accounting.” That compares to single entry accounting used to keep track of your personal checking account. Your checking account only requires one entry in order to record a bank deposit, a check, etc. While this is very simple to use, single entry accounting is limited in its ability to develop financial statements. A more detailed approach is required to ensure the integrity of your accounting system.

Double entry accounting is a much more accurate and reliable system that links your profit/loss statement to your balance sheet. These financial statements are essential to operating a healthy business.

Double entry accounting requires the use of both debits and credits to record financial transactions. In the old days, the bookkeeper would open the dusty old ledger and record each financial transaction by hand. She/he would use a ruler to divide each page in two. Entries recorded in the left column were called “debits,” and entries recorded in the right column were called “credits.” Thus debits and credits referred to the position in the bookkeepers ledger. The

bookkeeper would make sure each month that the sum of all the debits equaled the sum of all credits.

Today, however, we do not have to use an old dusty book to record our financial transactions. Since we are using QuickBooks and a computer, we need only remember that a debit is a positive number and a credit a negative number. A positive number refers to the left side of the bookkeepers ledger, and a negative number the right side. It's just that simple! What makes bookkeeping a challenge to learn, however, is to know when to use a debit and when to use a credit for different financial accounts. In most cases, QuickBooks already has this figured out for you!

Accounting Equations

It would be helpful to understand basic bookkeeping before you start using QuickBooks. QuickBooks can produce meaningful financial statements provided you enter all of your financial transactions properly in the computer. Entering financial transactions in QuickBooks is simple because the program provides a nice interface for depositing sales and writing checks. You do not even see any of the bookkeeping details. But every once in awhile you will need to use debits and credits. Therefore, you need to understand the basics of dual entry accounting. And it is really not that hard to understand.

The key to understanding bookkeeping is two fundamental accounting equations. The first is:

$$\text{Assets (A)} = \text{Liabilities (L)} + \text{Equity (E)}$$

This equation basically reflects the balance sheet.

Owner's equity is linked to profitability since earnings can improve owner's equity. Thus the second important accounting equation:

$$\text{Revenues (R)} - \text{Expenses (E)} = \text{Net Income (NI)}$$

A positive net income will improve the profit and loss statements and will result in a rise in owner's equity in the form of retained earnings.

All financial transactions under a dual entry accounting system affect one or both of these two fundamental accounting equations. Each equation must be in balance at any point in time in order for the system to work. Thus whether you are paying rent on land, selling milk, or paying off a loan, you are recording financial transactions that will increase cash (an asset), lower debt (a liability), raise expenses, etc.

Whenever you record a sale, pay a bill, or withdraw equity from your business, you are altering the balance of these two important accounting equations. In order to record these changes, we use debits and credits in the appropriate financial accounts. Then, at the end of the accounting period (i.e. a month, quarter, etc.), QuickBooks will post all these transactions to the appropriate accounts, add them up and produce the balance sheet and Profit and Loss statement.

Accounts

Note that each row of financial statements reflects one or more financial accounts. Those financial accounts have a description and in some cases a number. An account is simply information in an accounting system. They are like folders in your filing cabinet. Inside each folder you have lots of information, and each folder is unique. You may group folders in drawers. The top drawer may be bills due, the second drawer bills paid, and the third drawer expense information.

Your bank sends you a financial statement each month for your checking account, listing all transactions that occurred during the month. This is a good example of your cash account. Another account may be feed inventory. This account will list all purchased feedstuffs, feed fed, and inventory adjustments. All of your financial transactions will affect various accounts, either raising or lowering them. Your accounts are classified according to the two equations above: assets, liabilities, equity, revenue, and expenses.

Whenever you pay a bill, you lower your cash account and raise another account balance, either an expense or liability account. Rent is one example of an expense account. When you pay your rent, you affect two accounts: cash and rent expense. Remember, using a dual entry accounting system will require two entries to record each financial transaction.

The chart of accounts is the backbone of your accounting system. It is a list of all the account names, numbers and descriptions used in your accounting system. It is organized by account type: assets, liabilities, equity, revenue, and expenses.

Debit/Credit

Remember our discussion of the old dusty ledger? In the old days the bookkeeper would use the general ledger where all of the companies financial transactions were recorded. Each page in the book was for a different account and was divided into two columns. The left side was called the debit column and the right side the credit column. These two sides were used to determine increases or decreases in each account according to rules discussed below. This is from where our modern accounting system developed. QuickBooks uses these same basic accounting rules.

Let's begin a discussion of debits and credits. This is where most beginners experience fear and humiliation. "I'll never remember all those rules," is a common cry. But remember, about 95 percent of all your financial transactions in QuickBooks will be handled automatically! It provides a nice interface that allows you to avoid debits and credits. All you need to do is enter the information that QuickBooks wants. The rest is automatic!

We cover the details of bookkeeping because of three reasons. First, you need to understand what QuickBooks is doing. Second, you need to understand how to set up your accounts in QuickBooks. And third, you will most likely be responsible for entering the other five percent of your financial transactions in a general ledger account. So hang in there for our debit/credit discussion.

Debits and credits are analogous to slots in the mailroom. Ever been in a mailroom? The objective here is to accurately deliver the mail. But in order to do that, someone has to sort the

mail and place it in the appropriate slot. From there someone else delivers the mail to the appropriate person. The use of debits and credits is like those slots. You must record each financial transaction in the proper account and on the proper side of the account (left or right, debit or credit).

Now what happens if you put the mail in the wrong slot? It does not get delivered, right! The same thing is true with debits and credits. If you record a financial transaction on the wrong side of the ledger, or to the wrong account, your financial statements at the end of the month will be wrong. So let's learn to do things the right way!

Recording Debits/Credits

QuickBooks uses debits and credits to record financial transactions the same way they did with the dusty old ledgers. The only difference is that today, with the advent of the computer, a debit is simply a positive number and a credit a negative number. The computer and QuickBooks recognize the left side of a bookkeepers journal as a positive number (debit), and the right side as a negative number (credit). What you have to learn is when to use a debit or a credit, and which accounts to apply these to.

For example, suppose you have a bill due with a vendor in say 30 days. When you write a check, you reduce both cash and accounts payable (a liability account). In the old days you would record a debit on the left side of the accounts payable journal to record a reduction in liability, and a credit on the right side of the cash journal to record a reduction in the checking account. But with QuickBooks, you simply use the accounts payable journal. It automatically records a debit (positive number) to accounts payable and a credit (a negative number) to cash.

You must understand that a positive number may or may not increase the dollars in an account. This is perhaps the most confusing thing about debits and credits. For example, a debit will increase an expense account, but decrease a liability account. Also, a credit will reduce your cash account but increase your sales accounts. So here are the rules for using debits and credits:

Assets & Expenses:	Liabilities, Equity & Revenue (Sales):
<i>Increase with debits</i>	<i>Increase with credits</i>
<i>Decrease with credits</i>	<i>Decrease with debits</i>

If you want to increase either an asset or an expense account, use a debit (positive number). Likewise, if you want to decrease the value of an asset or expense, use a credit (negative number).

On the other hand, if you want to increase a liability, equity, or revenue account, use a credit (a negative number). Or, conversely, if you want to decrease the value of these accounts, use a debit (a positive number).

At this point this must be very confusing. But really it is not. It makes a lot of sense once you understand what is going on. We will provide common examples used in agriculture to illustrate how to use accounts and debits and credits to record your financial transactions.

When you sell farm-raised goods you should record two distinct financial transactions: cost of goods sold and sales. Suppose you sold corn for \$1000 that cost you \$800 to produce. Here is how you would record the transaction:

sale of corn:

debit cost of goods sold (E)	\$800	
credit inventory (A)		-\$800
credit sales (R)		-\$1000
debit cash (A)	\$1000	

First we recorded our cost of goods sold by converting an asset (A) into an expense (E). We did this by debiting (using a positive number) cost of goods sold to record the expense, and crediting (using a negative number) inventory to reduce our level of inventory. Remember, you increase expense accounts with a debit and decrease assets with a credit. You now have less corn inventory and have recorded the expenses for raising corn via cost of goods sold. Then we recorded the sale by crediting sales (R) and debiting cash (A). We increase the revenue account (sales) using credits and increased the asset account (cash) with debits. These transactions also implicitly record a farm profit of \$200 (\$1000-\$800).

People get really confused at this point since we are using a negative number to record an increase in sales. Remember, a negative number is simply a modern way for your computer to recognize a credit. A credit reflects the right side of the bookkeeper's journal. If you are looking at a sales journal, that is where you physically record all sales. Again, go back to the rules above to see how this works.

Next we will record an invoice from a vendor with whom you have net 30 credit (total invoice due within 30 days from the date of the invoice). The invoice lists \$100 for feed inventory and \$5 for freight. You would record the invoice as follows:

debit inventory (A)	\$100	
debit freight (E)	\$5	
credit accounts payable (L)		-\$105

You debit an asset account (feed) and an expense account to show an increase in both inventory and freight. Both assets and expenses increase with debits. Also, since you have net 30 credit with the vendor, record a credit of \$105 to accounts payable, a liability account. Now, suppose it is 30 days later and you are ready to pay off this bill. Use the following transactions:

debit accounts payable (L)	\$105	
credit cash (A)		-\$105

Use a debit to reduce a liability account and a credit to reduce cash.

Now, let's suppose you make a term payment on a loan. The invoice from your bank is \$150 for principal and \$100 for interest. Here is how you would record these financial transactions:

debit note payable (L)	\$150	
debit interest expense (E)	\$100	
credit cash (A)		-\$250

We use a debit to reduce notes payable, a debit to increase the expense account for interest, and a credit to reduce the cash account by the amount of the payment. Again, debits are used to record a reduction in liability.

Now suppose you get your monthly bank statement and find you were charged \$50 for bank service fees and had \$100 deducted to cover the cost of ordering checks. Your accountant would instruct you to make these entries in your general ledger:

debit bank service fees (E)	\$50	
debit bank service fees (E)	\$100	
credit cash (A)		-\$150

Here you would use two debits to increase the bank service fee account for bank fees and the cost of checks and a credit to reduce the cash account.

Another example is to record a loan from the bank for \$1,000. This is reflected as follows:

credit note payable		-\$1,000
debit cash	\$1,000	

Use a credit to increase the liability account and a debit to increase the cash account since the loan proceeds were deposited in the checking account.

A final example is to record a cash infusion from the owners of the business. Suppose you invested \$10,000 in the business. This would be recorded as follows:

credit capital stock		-\$10,000
debit cash	\$10,000	

Used a credit to increase the equity account for capital stock and a debit to increase the cash account.

The beauty of the dual entry accounting system is that each financial transaction affects two offsetting accounts. This ensures the integrity of the entire system. Use a credit to reflect an increase in a liability, equity or revenue accounts. And, use a debit to reflect an increase in asset and expense accounts. Note that a credit really does not mean an increase or decrease, it just reflects the right side of the bookkeepers journal. And, whether it increases or decreases your account balance depends on what kind of account it is.