

Chart of Accounts
The Foundation to Understanding Financials
Air Conditioning Today – March 2004



Many small contractors, those with annual sales under \$500,000, find it difficult to obtain good financial advice. Its not that advice is not available within the trades, it's just that it always seems to be focused towards larger businesses.

I was recently speaking to an owner about his small HVAC company. It was apparent that he was seriously dedicated to the trades and to his business. During our conversation, he was quick to point out that he “came up” through the trades and knew very little about accounting. That’s really nothing to be ashamed about, I explained, people study accounting for years in college. Why should anyone be expected to understand accounting naturally?

He proceeded to tell me that he was not even sure if his chart of accounts was set up correctly. So let’s discuss the chart of accounts. But first, what is a chart of accounts? A chart of accounts is nothing more than a listing of different types of sales and expenses (“accounts”) that make up your income statement. Accounting software packages, like QuickBooks, enables the user to easily customize the chart of accounts to fit the types of sales and expenses associated with user’s business.

But why is it so important to have a list of different types or catagories of sales and expenses on your income statement? Without different types or catagories of sales and expense, it will be impossible to understand your income statement. As an example, say you are running a \$450,000 a year HVAC business that performs three different services – let’s say \$150,000 of maintenance, \$250,000 of installations and \$50,000 of ductwork. If your chart of accounts contains only one catagorey - “sales” you will never know how much of each of the three different services your business performs. Your income statement at the end of the year will simply read:

Sales \$450,000.

However, if your chart of accounts is set up with the following accounts - “Maintenance”, “Installations” and “Ductwork”, your income statement at the end of the year will read:

Sales:

Maintenance	\$150,000
Installations	\$250,000
Ductwork	<u>\$50,000</u>
Total Sales	<u>\$450,000</u>

When trying to understand what service produces the highest sales, which example gives the best information? Do you now see how a good chart of accounts enables you to understand your financial statements?

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This works equally as well for expense items. Having several specific types of expenses in your chart of accounts will enable you to understand your income statement and watch when specific expenses grow out of line. In addition, when setting up a chart of accounts, accounting software packages enable the user to break expenses down even further into sub accounts. As example, instead of having the following:

Advertising Expense - \$50,000

Consider the following:

Advertising Expense:

Yellow Pages -	\$20,000
Direct Mailers -	\$15,000
Newsletters -	<u>\$10,000</u>
Total Advertising	<u>\$50,000</u>

Again, the more detail your chart of account is, the better you can understand where you are spending your money.

If your goal is to understand your financial statements better, a basic step is to take a long hard look at your chart of accounts and determine if the sales and expense accounts are appropriate for your business and to add additional accounts if you want greater detail. After determining how you would like your chart of accounts to read, setting up or revising it is easy in accounting software such as QuickBooks.

Brandon Jacob operates *Contractors Financial Opportunity* (www.Contractorscfo.com), a financial consulting business in which he calls upon his fifteen years as a CPA and an industry expertise gained as a valuation analyst and acquisition specialist in the HVAC, plumbing and electrical trades. A graduate of Texas A&M University, Mr. Jacob brings big business experience and expertise to small business owners who would otherwise never have access to such resources. To contact Mr. Jacob, call him at 713/426-4041 or email him at BGJacob@aol.com.

