General Ledger Setup

Presented By:

Jim Lee

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Overview

Definition and Purpose of the General Ledger

The General Ledger (GL) is the repository of financial transactions that are created as you perform various tasks in SedonaOffice, such as:

- Receiving parts on purchase orders
- Entering vendor bills
- Issuing parts to jobs and service tickets
- Entering technician time and sales representative commissions on jobs and service tickets
- Invoicing jobs, service tickets and recurring charges
- Entering general journal entries

Most transactions are recorded automatically by SedonaOffice as you perform a task. Other transactions are entered manually and require that you have the requisite knowledge to record the transaction according to your company accounting policies.

The primary purpose of recording financial transactions in the GL is so that financial statements can be created for both management and tax purposes. The basic financial statements typically prepared by security companies and companies across all industries include:

- Balance sheet
- Income statement
- Cash flow statement

These statements can present current year data, prior years data and budget data if available. Here's a snapshot of the heading of a typical income statement:

ABC Alarm

ABC Alarm Company
Consolidated Statement of Operations
March 2011

	MTD				YTD				Prior YTD	
	Actual	%	Budget	%	Actual	%	Budget	%	Actual	%
Revenues:										
Installations:										
Commercial Installations	150,000	17.1%	138,000	15.5%	500,000	18.3%	475,000	17.4%	351,634	14.2%
Residential Installations	40,000	4.6%	42,000	4.7%	130,000	4.8%	145,000	5.3%	141,396	5.7%
	25	0.0%	0	0.0%			0	0.0%	625	0.0%
	25,672	4.1%	37,505					4.1%	96,058	3.9%

Double-Entry Accounting

Each GL transaction must be dated and have at least one debit amount and one credit amount. The transaction date must fall in a defined accounting period, which is a calendar month within your company's fiscal or calendar year. Each line item must be coded to a GL account number. The total debits and total credits must equal each other.

Here's an example of a GL entry with the required elements of date, GL account and amounts (debit and credit):

Date	GL Account	Account Name	Debit	Credit
7/15/12	620450	Wages expense	3,000.00	
7/15/12	620430	Payroll tax expense	300.00	
7/15/12	220100	Wages payable		2,700.00
7/15/12	220210	Federal payroll taxes payable		450.00
7/15/12	220220	State payroll taxes payable		150.00

Note that the total amount of debits ($3,300) equals the total amount of credits ($3,300). This method of accounting has given rise to the term *double-entry accounting*.

Elements of the SedonaOffice General Ledger
In addition to the basic requirements of double-entry accounting (dates, GL accounts, offsetting debits and credits), the SedonaOffice General Ledger also requires that all transactions must be coded to a branch, and income statement items must also be coded to a category.

The SedonaOffice requirements for each GL entry are:

- Date (must fall in a valid fiscal year and period that is also open)
- GL account
- Amount (either debit or credit)
- Branch
- Category (for income and expense accounts)

Here's an example of a complete GL transaction in SedonaOffice with all of the required elements:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/15/12	620450	Wages expense	1,000.00		Atlanta	Installation
7/15/12	620450	Wages expense	1,000.00		Atlanta	Service
7/15/12	620450	Wages expense	1,000.00		Atlanta	G&A
7/15/12	620430	Payroll tax expense	100.00		Atlanta	Installation
7/15/12	620430	Payroll tax expense	100.00		Atlanta	Service
7/15/12	620430	Payroll tax expense	100.00		Atlanta	G&A
7/15/12	220100	Wages payable		2,700.00	Atlanta	
7/15/12	220210	Federal payroll taxes payable		450.00	Atlanta	
7/15/12	220220	State payroll taxes payable		150.00	Atlanta	

Note that the total amount of debits ($3,300) equals the total amount of credits ($3,300), all line items are coded to a GL account and branch, and the items coded to expense accounts are also coded to a category.

Your GL Structure
A company's GL structure in SedonaOffice refers to how the following elements are defined:

- Branches
- Categories
- GL accounts

In the following sections of this presentation, we'll look more closely at each element of the GL structure so that you may determine a structure that would work well for your own company.

Keep in mind that there is not a single "right" GL structure that fits every security company. Rather, a company's GL structure is considered appropriate and useful if it provides sufficient information to help you manage the unique characteristics of your business.

The key to structuring a good financial reporting system is knowing what you want out of the system. **BEGIN WITH THE END IN MIND!**
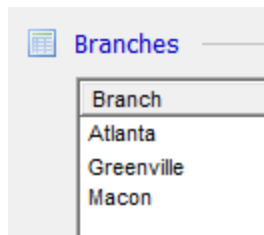
Branches

If you don't care to report financial results separately by branch, then you may need only one branch in SedonaOffice. Call it Corporate or Main or the name of your city; it doesn't matter what you name it and you can always modify the name later on.

However, there are a number of situations where it makes sense to set up additional branches in SedonaOffice.

Operating Branches

It's usually good practice to establish a branch for each physical office from which your company operates. For example, an Atlanta-based company with operating branches in Macon, GA and Greenville, SC would have three branches at a minimum:

Using multiple branches simplifies accounting. For example, say you have GL account #6520 for Office Supplies, and transactions to this account are normally coded to the G&A category. As you purchase office supplies for each branch, you would use the same GL account and category for each line item and simply choose the appropriate branch. You would not create a different GL account or category for each branch. At the same time, this GL structure provides flexibility to easily view consolidated or branch specific financial results.

Now, let's say this Atlanta-based company opens a small office on the other side of Atlanta, resulting in the following branches:
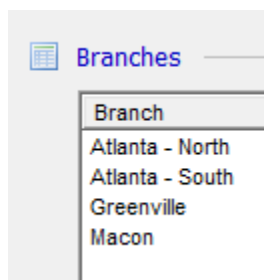

Financial results could be viewed for each Atlanta branch separately or combined.

Using a Corporate Branch
Continuing with the Atlanta example, it would be common that corporate administrative functions as well as sales, installation and service activities would be performed in Atlanta from within the same building/offices. If transactions related to all of these activities were booked to the Atlanta branch, then the operating results of Atlanta compared to the other branches would not be on the same footing (i.e. not apples to apples.) The Atlanta branch's administrative expenses would be disproportional to the other branches.

Consequently, many companies set up a Corporate branch for the purpose of tracking corporate administrative functions separately from those of the operating branches.
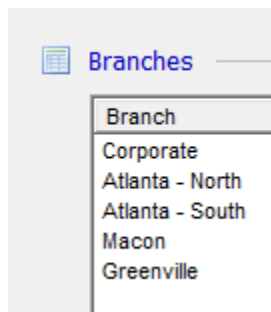

Basically, using a Corporate branch provides a convenient mechanism for tracking overhead expenses so that they may be allocated to operating branches.

Branches Used for Billing Purposes
SedonaOffice provides the means to process cycle billing separately by branch. This is particularly useful if you have a group of customers that are invoiced on a special invoice form.

A "billing branch" is normally rolled up with the related operating branch for financial reporting purposes. For example, the Macon-Special Billing branch shown below would be rolled into the Macon branch in the branch financial statements.
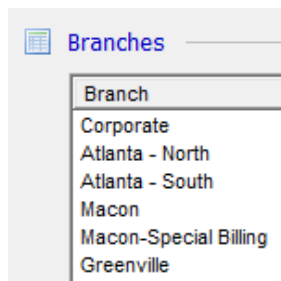
Branches Used for Legal Entities
Things usually get more complicated if you operate two or more legal entities from the same location with the same administrative and/or operating staff. From a legal and tax standpoint, you must maintain a separate set of books for each entity and have the ability

to generate separate balance sheets and income statements. Additionally, you would probably want to allocate overhead between the entities.

To accommodate two or more legal entities, you can either create a separate SedonaOffice database for each entity or create a separate branch within a single SedonaOffice database. While extenuating circumstances may favor one approach over the other, it's usually much simpler to create a separate branch for each entity in the same database. You'll be able to share technicians, inventory and other resources between the branches, and SedonaOffice will automatically book inter-branch transactions.

Categories

Basic Category Structure

On its face, the concept of using categories in SedonaOffice is straight-forward. Most security alarm companies do installations, service and monitoring. Categories can be used to track results of operations (i.e. revenues, costs and gross margin) for each of these "profit centers". Categories can also be used to track selling and administrative expenses. Consequently, we often see a list of categories that looks something like this:
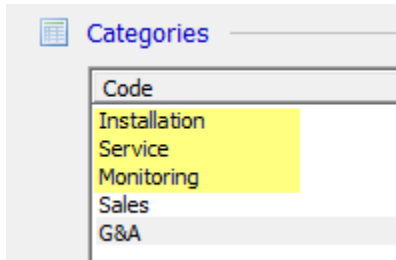

This is what we'll call a basic category structure. Installation revenues, costs and expenses are booked to the same category in this structure (Installation). Service items are booked to Service and Monitoring items are booked to Monitoring.

Some companies expand the list of categories by adding additional "profit centers" for jobs and service. For example, they may want to see financial statement results for residential installations separate from commercial installations. Another company may want the installation of leased commercial systems to be reported separately. Yet another company may further expand the scenario by separately reporting equipment sales (sometimes called "parts & smarts").
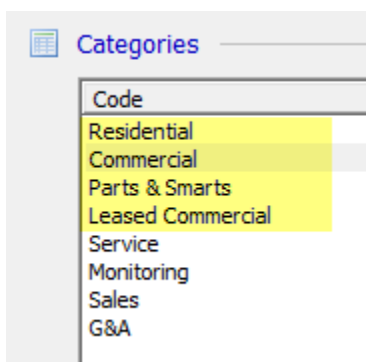
As for service, it is common that security companies want financial statements that show results for time & material service calls separately from service contracts. Likewise, many want to see inspection results separate from service results.

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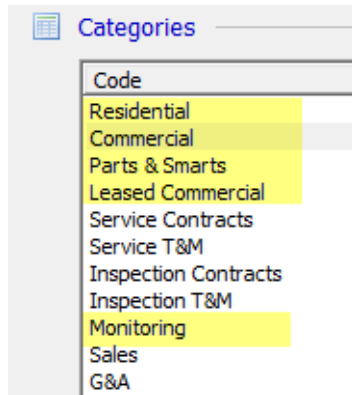
Using a basic category structure, Residential revenues, costs and expenses would be booked to the same category (Residential), Commercial to Commercial, Service Contracts to Service Contracts, and so on.

The accounting challenge with using a basic category structure is in booking technician "labor costs".

Accounting for Labor

When a technician works on jobs and service in multiple categories, Labor Costs must be allocated to the appropriate category so that a contribution margin (i.e. revenue less direct costs) can be calculated for each category. This sounds simple, but it can be a challenging accounting task. Fortunately, SedonaOffice makes it easy on you.

What should be included in Direct Labor Cost? Should it include direct wages only? Should it include payroll taxes and benefits? Should it include the cost of vehicles and phones? Should it include field support (i.e. warehouse, scheduling, field management, etc.). Should it include down-time for holidays, vacation, sick days, travel, training, etc?

If you decide that Direct Labor Cost should include only wages, then your labor cost rate might be $15 per hour (or lower) for less experienced technicians and higher for the experienced technicians. If you decide that Direct Labor Cost should include all expenses related to technicians (taxes, benefits, vehicles, phones, etc.) and account for down-time (travel, shop, holiday, vacation, sick time, etc.), your labor cost rate might be $50 per hour or more on average. It would be even higher if you include field support.

One important consideration in setting your direct labor cost rate is that this will be the rate used in calculating the Actual Labor Cost presented on the Job Costing screen, which is compared to Estimated Labor Cost before closing a job. Obviously, it's easier when comparing apples to apples.
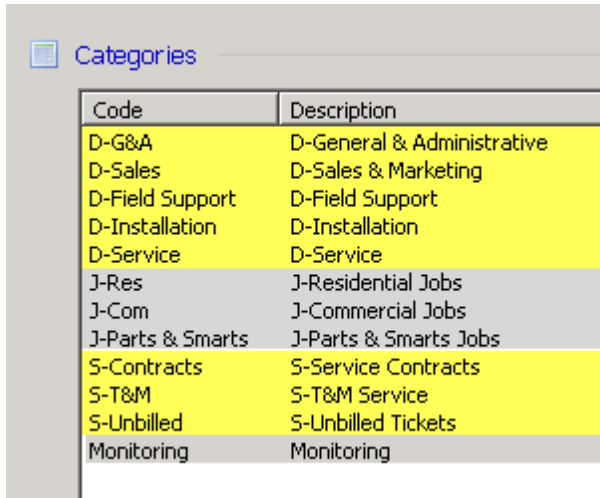
Once you decide on your definition of Direct Labor Cost, then you have the accounting task of allocating those costs to the appropriate profit center.

Some companies track technician hours on time sheets by job and service category and input these hours to their payroll system. The payroll journal becomes the source document for allocating wage expense by category. Other expenses (taxes, vehicles, phones, etc.) and down-time (travel, shop, holiday, vacation, sick time, etc.) are usually not allocated, which means they will not be part of Direct Labor Cost and will be characterized on the income statement as Indirect Costs or Labor Overhead.

The following section explains how Direct Labor Costs, regardless of how you define it, can be easily accounted for in SedonaOffice by using separate categories for profit centers and departments.

Profit Center/Department Category Structure
Consider the following categories:

In the above example, there are what we call "profit center" categories and "department" categories. The three job profit categories start with J-. The three service profit categories start with S-. Monitoring is a profit center. The five department categories start with D-.

In this category structure, 100% of an installer's actual wages and related costs (i.e. payroll taxes, benefits, vehicle, phone, etc.) are booked to the D-Installation category. 100% of a service tech's actual wages and related costs are booked to the D-Service category. Administrative employee expenses are booked to D-G&A, sales employees expenses are booked to D-Sales and field support employee expenses are booked to D-Field Support.

As you enter technician time into jobs and service tickets, Labor Cost (calculated by multiplying hours times the labor cost rate) is "pulled" from the appropriate department category and moved to WIP-Labor, or Labor Cost if you do not use WIP. When jobs and service tickets are closed, WIP-Labor is moved to Labor Cost and into the appropriate profit center category for the underlying job or service ticket.

For example, an installer's actual wages and related expenses are booked to the installation department category (D-Installation). As jobs and service tickets are processed, Labor Cost is allocated automatically from the department category to the appropriate profit center categories.

Here are the GL entries for labor costs when using a profit center/department category structure.

1. Actual expenses are charged to Department categories through payroll journal entries, A/P bills, etc.:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-Installation
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-Service
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-G&A
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-Installation
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-Service
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-G&A
7/15/12	220100	Wages payable		2,700.00	Atlanta	
7/15/12	220210	Federal payroll taxes payable		450.00	Atlanta	
7/15/12	220220	State payroll taxes payable		150.00	Atlanta	

2. Entries are automatically created when an installer's time is entered to a job and a service ticket:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/15/12	122120	WIP-Job Labor	200.00		Atlanta	
7/15/12	122220	WIP-Svc Labor	100.00		Atlanta	
7/15/12	242100	Deferred Labor - Jobs		200.00	Atlanta	
7/15/12	242200	Deferred Labor - Svc		100.00	Atlanta	

3. Entries are automatically created when a job is closed in SedonaOffice:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/20/12	510002	COS-Job Labor	200.00		Atlanta	J-Residential
7/20/12	122120	WIP-Job Labor		200.00	Atlanta	

4. Entries are automatically created when a service ticket is closed in SedonaOffice:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/16/12	520002	COS-Svc Labor	100.00		Atlanta	S-Service T&M
7/16/12	122220	WIP-Svc Labor		100.00	Atlanta	

5. A manual journal entry at month-end clears Deferred Labor to the appropriate department category:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/15/12	242100	Deferred Labor - Jobs	200.00		Atlanta	
7/15/12	242200	Deferred Labor - Svc	100.00		Atlanta	
7/15/12	690100	Labor Cost Entries		300.00	Atlanta	D-Installation

To summarize, when using a profit center/department category structure to account for labor costs:

- 100% of an employee's wages and related expenses are booked to their respective Department category, which makes it easy to create a department expense statement such as the following.

	Field	Sales &	General &	
	Techs†	Support††	Marketing	Admin	TOTAL
Wages	200,000	60,000	180,000	350,000	790,000
Taxes & Benefits	40,000	5,000	30,000	60,000	135,000
Vehicles	20,000	0	10,000	10,000	40,000
Other	80,000	3,000	60,000	180,000	323,000
	340,000	68,000	280,000	600,000	1,288,000
Direct labor cost entries	(335,000)	0	0	0	(335,000)
	5,000	68,000	280,000	600,000	953,000

- The costing functionality in SedonaOffice allocates Labor Cost to the appropriate profit center category…**no fancy payroll or journal entries required!**

- The difference between actual expenses in a labor department category less the job labor cost entries is usually called Labor Variance or Labor Overhead and is deducted from Contribution Margin to determine Gross Profit (see next page).

Wage vs. Burdened Labor Cost Rate

Whether you use a cost rate that approximates the hourly wages paid to technicians or a burdened rate that includes all or some portion of technician-related expenses, gross profit remains the same before timing differences for WIP are considered. See the "Accounting for Labor" section above regarding considerations for establishing your direct labor cost rate.

		Wage Rate		Burdened Rate	
		Current	%	Current	%
Revenue		2,240,000	100%	2,240,000	100%
Direct costs					
	Installation	455,000		573,000	
	Parts	247,000		247,000	
	Labor	*83,000*		*201,000*	
	Commissions	90,000		90,000	
	Other	35,000		35,000	
	Service	112,000		184,000	
	Parts	40,000		40,000	
	Labor	*62,000*		*134,000*	
	Other	10,000		10,000	
	Monitoring	240,000		240,000	
	Contribution margin	1,433,000	64%	1,243,000	55%
Indirect costs					
	Parts overhead	10,000	0%	10,000	0%
	Labor overhead†				
	Technicians	195,000	9%	5,000	0%
	Wages	200,000		200,000	
	Taxes & Benefits	40,000		40,000	
	Vehicles	20,000		20,000	
	Other	80,000		80,000	
	Direct labor cost entries	*(145,000)*		*(335,000)*	
	Field support††	68,000	3%	68,000	3%
	Gross profit	1,160,000	52%	1,160,000	52%
Expenses					
	Sales & marketing	280,000	13%	280,000	13%
	General & administrative	600,000	27%	600,000	27%
	Net operating income	280,000	13%	280,000	13%
Other income (expense)		(15,000)	-1%	(15,000)	-1%
	Net income	265,000	12%	265,000	12%

GL Accounts

After defining your branches and categories, you are ready to define your GL Accounts (Chart of Accounts).

A good Chart of Accounts will be well-organized, such as shown here:

- Balance Sheet Accounts
    - 1xxxxx – Assets
    - 2xxxxx – Liabilities
    - 3xxxxx – Equity
- Income Statement Accounts
    - 4xxxxx – Revenues
    - 5xxxxx – Cost of Sales
    - 6xxxxx – Indirect Expenses
    - 7xxxxx – Overhead Allocations
    - 8xxxxx – Non-Operating Income and Expense
    - 9xxxxx – Income Tax Expense

Balance Sheet Accounts

Balance sheet accounts should be numbered keeping in mind that you will most likely want to group certain accounts for presentation in a custom balance sheet.

For example, the following list of current assets indicates that all cash accounts will start with 10, such as Cash-Operating (100100) and Cash-Payroll (100200).

Current Assets	
Cash	10*
AR	1101*
Allowance for Bad Debt	1102*
AR Clearing	1103*
Inventory	120*
WIP	122*
Prepaid Expenses	130*
Employee Advances	132*
Deposits	134*
Pre Pay AP	138*
Due from Related Parties	140*
Notes Receivable	142*
Other Current Assets	144*

Using this structured numbering convention, cash accounts can be easily grouped in a custom balance sheet:

Income Statement Accounts

The same principle of grouping applies to income statement accounts. For example, the following revenue accounts start with 410.

410210	Residential Installations
410220	Commericial Installations
410230	Parts & Smarts Sales

Likewise, the following cost of sales accounts start with 510.

510001	COS - Jobs (Parts)
510002	COS - Jobs (Labor)
510003	COS - Jobs (Commissions)
510004	COS - Jobs (Install Subs)
510005	COS - Jobs (Permits)
510006	COS - Jobs (Equip Rent)
510007	COS - Jobs (Engineering)
510008	COS - Jobs (Per Diem)
510009	COS - Jobs (Travel)
510010	COS - Jobs (Misc)
510011	COS - Jobs (Wire & Supplies)
510012	COS - Jobs (Performance Bond)

In a custom income statement, Installation revenue and costs are easily grouped using a structured numbering convention.

ABC Alarm
Income Statement
All Branches, All Categories
9/30/2011

	Month-to-Date	% of Revenue	Year-t
Revenue			
Installations	148,512	46%	1,4
Service & Inspections	73,336	23%	69
Monitoring	119,765	37%	1,094
Other	(19,165)	-6%	204,
	322,449	100%	3,443,
Direct Cost of Sales			
Installations	83,224	26%	82
Service & Inspections	12,764	4%	3
Monitoring	30,257	9%	
Other	2,382	1%	
	128,627	40%	
Contribution Margin	193,822	60%	2,

Categories play an important role in structuring your income statement Chart of Accounts. For the most part, you do not need to create separate, redundant GL accounts when a category can be used more effectively.

Here's the example entry used earlier in the presentation:

Date	GL Acct	Account Name	Debit	Credit	Branch	Category
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-Installation
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-Service
7/15/12	620450	Wages expense	1,000.00		Atlanta	D-G&A
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-Installation
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-Service
7/15/12	620430	Payroll tax expense	100.00		Atlanta	D-G&A
7/15/12	220100	Wages payable		2,700.00	Atlanta	
7/15/12	220210	Federal payroll taxes payable		450.00	Atlanta	
7/15/12	220220	State payroll taxes payable		150.00	Atlanta	

Note that Wages are coded to the same GL Account (#620450) but that each entry is coded to a different Category.

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Final Word

Setting up your General Ledger in SedonaOffice requires that you have a good understanding of the three key elements:

- Branches
- Categories
- GL accounts

First, determine the branches to set up. The possibilities include operating branches, a corporate branch, billing branches and branches for legal entities.

Second, determine the categories to set up. Identify the profit centers that you want to report on in the financial statements. Review your organization to identify your company departments. Decide if you will use a basic structure or a one-to-many category structure.

Finally, set up your GL accounts. Make sure it's well-organized, uses a structured numbering system and avoid setting up redundant accounts.

Setting up your GL is the basis for a sound financial reporting system. Done well, your financial reporting system can be a tremendous asset to your company. Done poorly, it can become a tremendous burden.

To get the results you want, **ALWAYS BEGIN WITH THE END IN MIND!**