Management audit for small service firms

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Management Audit

FOR SMALL SERVICE FIRMS
MANAGEMENT AUDIT
FOR
SMALL SERVICE FIRMS

by

Phyllis A. Barker
David H. Hovey
John J. Murphy

Small Business Administration
Washington, D.C. 1976
SMALL BUSINESS ADMINISTRATION

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CONTENTS

Section 1. Introduction ........................................... 1
Section 2. Strategic Profile ...................................... 5
Section 3. Organization ........................................... 10
Section 4. Personnel Management ............................... 13
Section 5. Accounting Information .............................. 18
Section 6. Budgetary Control .................................... 25
Section 7. Working Capital Management ....................... 28
Section 8. Plant and Equipment Management .................. 36
Section 9. Purchasing .............................................. 39
Section 10. Marketing .............................................. 42
Section 11. Location ............................................... 51
Section 12. Insurance .............................................. 54
Section 13. Taxes and Legal Obligations ....................... 57
Section 14. Long Range Planning ............................... 61
Section 15. Sources of Information ............................. 65
About This Booklet

The questions in this management audit are designed not as a test, but as a guide for self-appraisal. They point to areas that should be investigated.

The comments are not definitive answers to the questions they accompany. It would take a textbook to answer some of the questions. Instead, the comments give the "reasons why" for the questions and supply directions for further study, when that is needed. Both questions and comments can be used by the owner-manager of the small service firm to determine the strong points and shortcomings of his or her management practices.

The authors of Management Audit for Small Services Firms are Phyllis A. Barker, Professor of Accounting, David H. Hovey, Assistant Professor of Management, and John J. Murphy, Assistant Professor of Finance, at Indiana State University's School of Business. In writing this booklet, they have drawn on an extensive background obtained in both small business and education.

Management Audit for Small Service Firms is issued as part of the management publications program of SBA's Office of Management Information and Training.
Introduction

This book is for you, the owner-manager of a small service business. It is to help you audit the management of your business. Normally, when you think of an audit you think only of financial records, and in the past, that was the usual meaning. But it isn’t enough just to look at financial records. All that is shown by these records are the results of the operations of the business—good or bad. You need to know more. You need to know what caused the results to be good or bad. That is where this audit will help you.

Purpose

The purpose of this booklet is: first, to develop an awareness of the management policies and procedures used in a small service firm; second, to provide a means to measure the quality of those policies and procedures against proven methods; and third, to point out the need to assess, improve, and change such policies to respond to the changing conditions of business. The audit provided here is a starting point for improvement and specific guidance on what to look for in the firm.

By performing the evaluation of your business outlined in this audit, you are afforded an opportunity to address yourself candidly and frankly to the conditions, strengths and weaknesses, and outlook for your business. And, because you are performing the audit personally, the answers are private. None of the details need to be revealed to others.
Questions and Comments

This booklet covers a broad spectrum of management practices. You should answer each question as it relates to your business practices. From these questions, you should be able to draw specific conclusions about the adequacy of the planning, organizing, directing, coordinating, and controlling activities for your operations. Your responses should result in the pin-pointing of areas which require management attention both immediately and in the more distant future.

With each question is a discussion of some of the ramifications of the problem. The discussion should trigger your thinking as to methods to correct your weaknesses and to review your strengths. After all, your business practices may very well be the reason why your financial results are better than you had hoped or worse than you had expected.

Not all of the questions will pertain to your business. A “small” business may very well be a one person operation or one with many employees. Also, the service industry is characterized by a wide variety of activities. Questions that are critical to one type of business may be insignificant to another type of service. For example, the section on inventory may or may not be important to your operation. While a thorough study of the entire audit will be of great value, it is up to you to adapt the audit to meet the needs of your particular business.

Limits of the Audit

To a great extent, the attributes tested in this audit—your self-discipline, your aggressiveness, and your ability to organize and to meet changing business situations—are not suited to precise measurements. However, indications of their presence or absence are to be found in your answers to the questions asked.

In working with this “management audit,” you should keep in mind that it is not—

1. A financial or market analysis of your firm.
2. A psychological, physical, cultural, or social study of those responsible for the operation and policymaking of your firm.
3. A general economic study of your firm.

On the other hand, the answers to the questions will provide you with a method of measuring your managerial techniques.

The questions used in the audit are based on the following general assumptions:
1. There are broad, nonmonetary principles of good management.

2. When too many of those principles are not being followed, the financial condition of a firm is likely to suffer.

3. It is possible to identify areas in a firm which are not well managed and which, if unchanged, will impair the firm's financial structure.

4. It is frequently possible to identify these areas sufficiently in advance so that the owner-manager can take corrective action.

Interpretation

The owner-manager of a small service firm must be more than the doer of the day's work. As a manager, he or she has at least five distinct activities: planning, controlling, organizing, coordinating, and supervising the work of others. All of these activities are important and all are probed by questions in this audit. Planning, controlling, and organizing—the usual weak spots in a manager's capabilities—receive special emphasis.

It should not be concluded that positive answers to a great majority of these questions will assure you a profitable future or that no further study is indicated. The following reminders must be made:

1. Even if the results of the audit seem to indicate that you have a “clean bill of health,” you should understand this to mean only that no obvious weaknesses are apparent in your management structure, policies, or actions.

2. The audit is only a tool which seeks to indicate information about the effectiveness of your management that, without the questionnaire, would probably take much more time and effort to obtain. It merely points out some crucial management areas which may warrant your attention.

3. Where weaknesses are revealed, you may be able to rectify the situation and thereby improve your management policy and practice.

4. This management audit is not a substitute for financial or other analyses of your firm. Rather, it should be considered only as a useful supplement to other kinds of analyses of your operation; that is, financial audits, market research, and so forth. In most cases, it will tend to reinforce the judgement of those using financial data as their primary source of information about the firm.
5. This audit is not intended to replace your accountant, your attorney, or outside business consultants. They are professionals and are essential to your business. But, after reviewing this material you may be better able to understand some of the subjects they mention and better understand why they are essential to your operation.
Strategic Profile

The following questions are designed to help you more clearly to define what business you are actually in. The wording of a strategic profile should be kept general and emphasize only major areas of your business. With this profile as a general guide, you can then set more specific plans for action in the business environment. Further details can be obtained from later sections which deal with a specific functional area.

1. Do you have a written statement of your firm's basic mission or goal?  

   Yes   No

Small business can succeed in industry without a written statement of its basic mission partly because of the ease of communication between the owner-manager and employees. As the firm considers growth or new directions, an outline showing the basic mission of the firm becomes very useful. This outline provides a base for future planning, policy decisions, and perhaps more importantly, a means for orienting employees’ efforts toward specific company objectives. The remainder of this section provides a framework on which to build a strategic profile for a service company.
2. Are all your services known to customers and employees?

Although the main services of a firm are usually known, supplementary services may not be emphasized to the customer. The services of a business should be a total package designed to meet the needs of the target market. A written list of all services will help define a firm's sources of revenue. This list may also point out gaps or overlaps in the package of services. Opportunities for acquiring control of or producing your own raw materials may also become apparent.

3. Is there a written description of your company's market for its services?

No service will be demanded unless it provides a degree of satisfaction for its consumers. What is the general geographic region in which you are prepared to perform your service? What are the general characteristics of this region? What are the general characteristics of your current or potential customers? Where are they located in relation to your business? These are a few items of information a firm should compile about its market. A consumer profile, discussed in the Marketing section, can provide the owner-manager with criteria for advertising, penetrating a market, office location, and many other strategic or operational decisions.

4. Is meeting or exceeding competition a specific part of your strategic profile?

Competitive weapons are the distinct characteristics which set your firm apart from the competition. Some of these may be price, reliability, guarantee, speed of response, or personal interest in the customer and his problems. They may be used singly or in combination. But, the total package of service, market, and competitive weapons is the reason why a firm attracts customers and maintains a high repeat business. Careful attention should be placed on defining just what competitive advantage your firm has and then continuing to provide that edge until conditions in the competitive environment change.
5. Do the shop and office facilities contribute to the efficient provision of your service?  

Deciding on the particular method of producing a service will be covered in detail later, but the strategic profile should contain a broad statement of the basic process used. Although mass production facilities are not usually needed by small service companies, the choice between job shop or batch type operations is. Job shop operations usually fill customers' orders individually as they come in. However, is it possible to group similar customer requests over a period of time (one day, one week, etc.) and then perform the service for all of them? A batch type operation like this may be more efficient and increase profits.

6. Do possibilities exist for expanding sales or physical growth, perhaps to include another location?

Many times an organization will experience growth which strains its original facilities. When this occurs, you should consider segmenting the company's market into subgroups. Some alternatives would include: specialized services, different geographic coverage, and particular characteristics of customers. You should be very cautious about making this kind of a decision since a specialized market must generate enough sales to support increased costs. For example, suppose you initially located your firm in a high traffic density area, and it grew until the present facilities are inadequate. The decision to either expand existing facilities or locate in a different part of town must be weighed carefully. Another facility across town may divide your present sales, increase overhead and labor expense, and create coordination problems between the two plants. The opportunity to increase your market area, provide specialized service to specific customers, or possibly save money through volume purchases of raw materials should exceed these additional costs.

7. Are there daily, weekly, seasonal, or cyclical fluctuations in the demand for the services provided by your company?

Fluctuations in sales have been a continuing problem for many members of service industries. Sales or demand for service may be
too high at one time of the day and then so low at other times that personnel and equipment are not fully utilized. The same applies to days of the week, seasons of the year, and even periods of several years. You should try to identify these fluctuations in general terms, then specify detailed plans in the marketing policies for stabilizing sales. See Marketing section.

8. Have you established over-all as well as detailed objectives?  

Yes  No

In many instances, the objectives of the business remain in the head of the owner-manager. Thus, the employee faces the often difficult task of learning what the objectives really are from the owner's actions. Unstated objectives provide very little motivation or control. Objectives should be written and communicated to employees if the owner-manager wishes to obtain their participation. Several of the following examples could be used:

1. amount of profit
2. market share
3. total sales
4. return on investment
5. service calls per week or month
6. reduced costs
7. time spent per call or in performing each unit of service
8. amount of invoice per call or for service unit
9. supplementary product sales as a ratio to service units

Each objective selected for your firm should have two components: (1) a particular amount desired, and (2) a specific time period for accomplishment. Then, you and your employees know where to concentrate your respective efforts.

9. Are your plans consistent both internally and externally?  

Yes  No

Considering all of the above information, there should be consistency across all areas. For example, your service should match the needs of the customers within the specified geographic region. Your competitive weapons should be of paramount importance to that customer population. Your internal plans for producing the service should be consistent with resources available
to your firm. And, your target objectives should be within the firm's capabilities. These internal procedures should also match with future opportunities you see in the external environment. Decisions made today (short-run) may limit your ability to meet the demands of tomorrow (long-run) if these decisions are not consistent with your long range planning.
Section 3

Organization

This section on organization is immediately followed by a section on personnel to reflect the interdependency between the two. The approach for building an organization taken here is based on you knowing the strategic profile of your firm, breaking the total job to be done into specialized tasks and then coordinating the varied activities.

1. Do you have written job descriptions for each job to be performed and do they match with the objectives of the firm?  

   Yes  No

From the objectives of the company, you should know generally what types of jobs must be performed. A job analysis on each type of job should be performed using either the interview approach or by observation of present employees on their jobs. Using this information, you should be able to compile a reasonably specific job description stating the specific duties for each job. Then, you can analyze the collection of job descriptions in relation to company objectives to make sure there are no necessary tasks missing and no excess positions. This procedure should be followed either on a regular basis or as objectives change.
2. Are there job specifications for every job description? 

Job specifications are the human characteristics required for standard performance in each type of job in the firm. Some of the items included are physical specifications, skills, experience, and education. Usually these items are included with the appropriate job description to form the base for staffing, training, performance appraisals, and wage scales. The items included in the job specifications must be job-related.

3. Is there an organization chart for the firm? 

From the job descriptions and specifications, an organization chart can be drawn. In designing the organization chart, you should group related jobs according to some logical pattern. Business functions such as sales, accounting, operations, etc., specialized services, customer types, and geographic location are some bases for departmentalizing the firm. The decisions on which design to choose should be based on what purpose it is to accomplish. If you want to focus special attention on a particular type of customer, then the organization structure should reflect this decision. In any case, trade-offs will be apparent as you seek to optimize any of these objectives:

1. reduced costs
2. specialized attention
3. control of operations
4. effective communication and coordination
5. expert knowledge or skills.

4. Does the employee understand the responsibilities of his job? 

Problems have developed in service companies due to an employee's lack of understanding as to what is expected of him on the job. The job description and specification combined with his particular place on the organization chart can reduce some of
the ambiguities present in any business. The critical areas of job tasks, responsibilities, and authority relationships are contained in these documents. Much of their value, however, depends on how well the employee understands the information contained in them.

5. Have you delegated authority to lower levels in the organization? How much?  

Finding the “proper amount” of authority to delegate to lower positions is a necessary but difficult task. It is necessary because you cannot and should not perform all the activities yourself. Authority for performing day-to-day operations should be delegated to lower levels so that you will be free to plan and coordinate the activities. The difficulty comes when trying to decide how much authority you should delegate to subordinates. The job descriptions and specifications will help make this decision. An employee must have enough authority and the right kinds of authority to do the kind of job you expect of him. You can help yourself and your employees by stating some specific areas of subordinate authority. With the proper employee training, you might consider delegating the following: authority to commit the firm’s resources such as equipment and personnel; authority to specify delivery and repair dates; authority to price services to customers; and authority to make credit decisions.
As stated in the preceding section, personnel management is closely tied to the organization structure, so much so that it is sometimes impossible to consider one without the other. This section assumes the organization structure has been tentatively chosen, subject to personnel decisions. The following questions should help you design a personnel package which will assist your organization to achieve its objectives while simultaneously providing the means for employees to satisfy their personal objectives.

1. Do you use job specifications in hiring workers?  

As noted before, personnel are perhaps more crucial to the success of a small service firm than in other types of industries. Since the firm's organization is designed on the specific jobs to be performed, the hiring of workers should be based on the specific skills required. If you make this effort, you will realize the benefits of a competent work force, well-matched with the job to be done. This approach will also help you take positive steps toward establishing an affirmative action program required by the Federal Government.
2. Is there a written step-by-step procedure for orienting new employees?  

Some employees perform in a manner which is considered undesirable by the owner-manager simply because they were not started in the right direction. The orientation procedure you develop can be an important step in obtaining consistent, desirable performance from new employees. A small investment at the initial stages of employment can do much to avoid future problems. A personal orientation by "the boss" has proven to be the most effective orientation method. This personal touch is one of the strengths that a small business can capitalize on. However, you might not always be able to handle the complete orientation. Therefore, it might be wise to prepare a written procedure—both for your own use, to make sure you do not leave anything out, and for use by your assistant, when you are not available. Many firms use a check-list of steps in the orientation procedure. The job description, handbook of personnel policies, required personnel forms, work procedures, introductions to key personnel, and meetings with supervisors can be some of the steps.

3. Do you have a written statement of policies concerning items of interest to employees?  

An employee handbook or some other written policy statement is mandatory for firms to be in compliance with Federal, State, and local laws. A handbook provides the firm with a basis for consistent action in dealing with employees, and the employee can benefit from knowing what to expect from his employer. Since a service firm typically depends heavily upon people to meet its objectives, the handbook should reflect a considerable amount of your effort. It should be an integral part of orientation procedures. And, it should be reviewed every year and changes made as they are needed. Pay schedules, holidays, vacation policy, overtime, appraisal system, disciplinary procedures, employee suggestion plan, and employee benefit programs should be included.
4. Do you have an adequate training program and do you base your training needs on job descriptions and specifications? Yes No

Some service firms' selection policy requires that only experienced and skilled technicians be hired. In this case, an orientation to company procedures is all that is needed. However, other firms must hire personnel and then train them. Also, all service firms face changes in technology which necessitate re-training of existing personnel. You should recognize your commitment to your employees by providing this training. There are many different methods of training but the success of any program will depend on how specifically the objectives of the training program are stated. You should state in advance the specific skills (from job descriptions and specifications) to be obtained and the level of competence necessary to meet minimum standards of job performance. In this you might possibly be aided by a consultant, a manufacturer's representative, or an employee. You can then use these specific objectives to evaluate the success or failure of your training program.

5. Have you compared the wage and salary scales with other companies in the same industry and are they consistent with company objectives? Yes No

Effective wage and salary administration is most difficult and most critical to service firms. Unlike manufacturing companies, the service firm's labor expense can almost be the company's total expenditure. Therefore, your wage and/or salary scales can determine the success of your firm. Wages and salaries must be competitive with the prevailing local wage scale so the firm can attract and maintain an adequate work force. Also, the wages and salaries should be internally consistent. Higher wages should be paid to personnel performing jobs which require more skill or demand additional responsibility. Your job description and job specifications are the starting point for evaluating the worth of each job. The job evaluation may then be followed up by a wage survey sent to other companies or by referring to several Department of Labor publications (or to figures produced
periodically by trade associations) which cite ranges of pay scales per job. These methods will allow you to compare the firm's pay scales to prevailing rates. Such a comparison can provide clues for recruitment and turnover problems, excessive training costs, and motivation problems. You should also use this wage scale comparison to see how the firm's compensation policy is contributing to its strategic objectives. For example, many service firms use the professional quality of their work as a critical competitive weapon. If your compensation policy does not include a premium above the prevailing wage rates, you may not be able to attract, select, and retain the most qualified personnel. As a result, the firm's strategic objectives may not be met.

6. Are employee benefit programs a part of the total compensation package?  

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Today's employees desire something more than a pay check. A firm's commitment to benefit programs will help employees obtain some degree of security and personal confidence. These programs are now available to the small firm and the advantages of a stable manpower force can far exceed the costs. A reputable insurance agency can provide you with specific recommendations on such benefits as:

- disability insurance
- major medical
- hospitalization
- pension plans
- profit-sharing
- split dollar premiums
- keyman and buy-and-sell agreements
- group life insurance
- deferred compensation

7. Have you investigated the possibility of initiating a retirement program?  

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<th></th>
<th>Yes</th>
<th>No</th>
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Recent legislation has enabled the owner of a small business and his employees not covered by any pension plans to set aside a certain amount of their earnings for retirement. This amount is currently tax-exempt if set up according to legal requirements. Your insurance agent, bank, or attorney can help you provide this benefit for yourself and your employees under the Keogh Act or Employee Retirement Income Security Act.
8. Are all personnel records kept in accordance with Federal, State, local, and union requirements? □ Yes □ No

Problems can be created for small firms by ignoring the necessity of maintaining adequate personnel records for each employee. Personnel files should contain job application forms, orientation checklist, training appraisals, performance ratings, changes in jobs or job status, pay rates, employee benefit records, and disciplinary actions. An employee's file should be open to him and he should be able to question any part of the records. Some firms allow the employee to add his own written comments and/or explanation for specific items.
Accounting Information

Before beginning this section, you will need to ask yourself one question: "Is my recordkeeping system tailored for the specific requirements of my service business?" The service industry often contains elements of both manufacturing and retailing. If, for example, part of your service involves making a product, your records must capture the cost of materials and labor, which, among other items, you will need to refer to when you establish a unit price for your service.

Good accounting records serve two purposes: they provide internal control of the business and furnish financial information for outsiders. Let's look at the internal control function first.

Internal Control

Internal control of the assets of a business is of prime importance. No matter how much profit the firm makes, if it is dissipated by poor control, the firm cannot remain profitable.

Control of cash

1. Does one person handle the receipt of cash and also deposit the receipts in the bank?  
Yes ☐ No ☐

If you answered yes to this question—and it is someone other than yourself—you have a weak system of internal control. There
should be separation of duties. The person who receives the cash should not be the one who deposits the receipts in the bank and records collections. Because cash is the most liquid asset of a firm, it is also the most susceptible to abuse. All receipts, cash and check, should be deposited frequently—preferably daily or when a certain minimum amount is reached. Cash receipts should not be used for disbursements. When cash disbursements are necessary they should be made from petty cash which is replenished by drawing a check against the firm’s bank account clearly indicating the purpose. These procedures will minimize the temptation to abuse case and provide functional separation of transaction records.

2. If someone other than yourself writes checks for amounts owed, do they also sign the check?  

   Yes      No

3. If you answered the question above, “no,” and you sign all of the checks, do you make certain that the bills paid by the check are brought to you at the same time the check is brought in for signature?  

   Yes      No

The bills which are paid by the check written should all be marked paid, with check number and date in order to prevent duplicate payments.

4. Do you scrutinize the bills carefully to make certain that the check is to the same company for the correct amount and for goods or services which you purchased?  

   Yes      No

If you answered this question no, you could be exposing your employees to the opportunity to steal from you.

5. Do you, or your accountant, reconcile your bank statement monthly?  

   Yes      No

If you do not have a monthly reconciliation by someone other than the person who writes your checks, this represents poor internal control. The bank may send back some checks you have deposited because there was insufficient funds in the maker’s account; there may be checks on which your signature has been
forged, or several other items. An independent reconciliation will focus attention on any discrepancies.

6. Do you have any type of mechanical check protection, such as an imprinting machine which records the amount?  

A device such as this will make it more difficult for stolen checks to be cashed.

7. Is a separate petty cash fund maintained for small and regular disbursements?  

The use of petty cash will limit the temptation to use current receipts to pay small bills. Always be certain that vouchers are put in the petty cash box for any payouts, and that—if possible—the receipt is attached to the petty cash voucher. Limit the amount of petty cash to an average of one to two weeks expenditure. Replenish petty cash by writing a check for the amount necessary to bring it up to the amount set and keep the petty cash vouchers as detail for the transaction.

8. Do you deposit all of each day’s cash receipts in the bank intact and without delay?  

Cash should not be kept on the premises and it should be possible to trace the receipts for the day to the bank deposit for the same period. This prevents “lapping”—the use of the next day’s receipts to make up for money taken.

9. Are your checks prenumbered?  

Each check written—whether used or voided—should be kept in numerical sequence with cancelled checks. Any checks voided should have the signature torn off and should be kept in a safe place until the cancelled checks are returned by the bank. Then the voided check may be placed in its proper sequence.  

20
Control of sales and accounts receivable.

10. Do you use prenumbered duplicate sales checks, invoices, and receipts?  

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<th>Yes</th>
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If so, the prenumbered set can be controlled, you can indicate who is responsible for which numbers, and the person will have to account for the duplicates. From this you will have a control over payments received, and sales made.

11. Do you have a cash register which is adequate for your needs?  

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<th>Yes</th>
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You may need to contact a local dealer to find out what information could be gathered on sales through the use of a cash register. Once you find out what details a cash register can supply, it becomes a trade-off between cost of the machine and need for the data.

12. Do you maintain a control account for your accounts receivable?  

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If your outstanding accounts receivable are numerous you should have them reconciled to the control account on a monthly basis. This prevents an account from getting “lost,” either accidentally or on purpose. It also makes it more difficult for someone to keep the money collected on account.

13. Do you receive a periodic list of your accounts receivable showing those which are overdue and the length of time overdue?  

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“Aging” of accounts receivable is an excellent way to determine whether collections are current, and if not, where additional attention is needed. Slow payments may dictate some changes in pricing policy (offering discounts for prompt payment) or a review of credit granting policies. (See Budgeting)
14. Do you keep accounts payable filed by date due in order to take advantage of discounts offered?  

Yes  
No

Failure to take advantage of discounts has a two-fold effect. First, this reflects in your credit history, and second, discounts are an important source of funds. Consider a bill for $1,000 with credit terms of 2/10, net 30 days. Payment 20 days after the last discount date is equal to an interest cost of approximately 36 percent (2 percent for the use of money for 20 days equals 36 percent for 360 days).

15. Do you compare current bills for utilities, supplies, and other expenses with the amount budgeted for these items?  

Yes  
No

Any expense which is out of line with the amount budgeted for it should be investigated before payment is made. The billing may be incorrect, or it may call for a revision of the budget. (See Budgeting)

Control of payroll and payroll liabilities

16. Are time records kept on hourly employees?  

Yes  
No

The Wage and Hour Division requires that accurate records be kept on all employees covered under the Act. Overtime should be recorded accurately.

17. Are W-4 forms on file for all employees?  

Yes  
No

These forms are necessary in order that you may be able to determine the correct amount of Federal and State income tax to withhold from the employee’s periodic wage.
18. Are individual payroll records maintained which show the regular and overtime wage, the amounts withheld for social security, for Federal and State income tax, for any other deductions, and the net amount paid?  

Yes  No

There should be a cumulative record on this information for each employee for the entire year. (See Taxes and Legal Obligations.)

19. Are periodic payments made to a federal depository of taxes withheld from employees' pay?  

Yes  No

Failure to pay over payroll tax liability may result in substantial penalties and interest on the unpaid amounts. (See Taxes and Legal Obligations.)

20. Have you considered the use of an outside source to prepare the payroll and keep records on each individual employee?  

Yes  No

Your accountant, the local bank, or a computer service bureau may have such a service available at a relatively nominal charge. Failure to keep adequate records on your employees will make quarterly payroll reporting difficult.

Financial Information

Good accounting records makes it easy to develop financial information for preparation of financial statements, budgets, and tax returns. Poor records may cause the loss of tax deductions, make budgeting difficult, and result in misleading financial statements. You may want to refer to working capital management for additional uses for financial information.

21. Are your records kept on the double entry system?  

Yes  No

Use of the double entry system helps to assure that all receipts, disbursements, and purchases are accounted for. There are checks and balances built into a double entry system.
22. Are special journals used for sales, purchases, and disbursements?  
Yes  No

Use of separate journals permits work on financial information by more than one individual. It also permits detailed information to be developed as to sales by locality or by type of service and on purchases and expenses by type of item.

23. Do you receive a monthly income statement?  
Yes  No

Income statements should be prepared for a business at least on a quarterly basis. The income statement should show income for the current period, for the year to date, and how operations compare with the budget plan.

24. Are balance sheets (statements of financial position) and statement of changes in financial position prepared at least once a year?  
Yes  No

A full set of financial statements are usually desired by your bank or a major creditor at least on an annual basis. These should be comparative statements. Such comparative statements will permit the development of trends and ratios. You should also consider the use these statements may be to you in developing comparative ratios, or similar data, on other firms in your industry.

25. Do you analyze your financial statements to determine any trends which may be developing?  
Yes  No

You should have expenses expressed as a percent of sales. This will permit you to review each month, or quarter, or year to determine shifts in expenses. You should determine your current and quick ratios to estimate your debt paying ability. You should check the turnover of your inventory—if you carry one. And you should estimate the days sales which are uncollected in your accounts receivable. These are the minimum analysis which should be done. Your accountant should be able to assist you with other meaningful analysis.
Budgetary Control

A budget has two purposes, it forces you to consider what you expect to happen in the next period, and it gives you a benchmark against which to measure your expectations with the actual events. Most small business owners believe they just have to wait for sales to come, that budgeting is of no value because they don’t know what the sales will be. But you can’t wait, you have to plan, you need to know whether you should even remain in business.

1. Have you analyzed your sales for the past years to determine whether they are rising, remaining constant, or decreasing?  

   - Yes
   - No

Don’t forget that a rise in sales dollars may not necessarily indicate an increased number of sales, it might really reflect the fact that the service cost had simply increased through inflation. You should analyze the number of service calls, the number of customers for your service, or whatever yardstick is applicable.

2. Can you give a realistic estimate, based on the analysis above, of what you anticipate your service units to be this year?  

   - Yes
   - No

Attempt a realistic estimate. If your business is a seasonal one, attempt to express your estimate in terms of time: monthly or quarterly. This will help you in the rest of your budgeting.
3. When you set your budget data, do you discuss your estimate with your key employees? 

Yes  No

Remember that your employees may see your business in a more realistic light than you do. If your budget is unrealistic the employees may ignore it. Discuss your plans with the ones responsible for making the budget work.

4. Have you analyzed the costs of your business that are fixed for the period, such as rent, salaries of clerical and supervisory people, etc? 

Yes  No

Knowing what costs you have to meet each period will help you to determine whether you can afford to remain in business. It will also help you when you get ready to project your cash flow, and determine when, and if, you need to borrow for short periods.

5. Have you figured out how much each service call, or each customer serviced, costs you in direct cash outlay? 

Yes  No

If your charge for service is not sufficient to cover the cost of servicing the customer plus an amount left over to take care of the fixed costs and profit, you should not be in business. When determining your direct costs, for example, you might consider the example of a television repair company. The hourly charge for television repair must be sufficient to cover the direct labor cost, the transportation, the fringe benefits of the employee, and the costs of the shop as well as the profit for the owner.

6. Do you know how much your fringe benefits cost you per employee per hour? 

Yes  No

First you should list what kind of fringe benefits you have: vacation, hospitalization insurance, work uniforms, life insurance, pension plan, etc. These should then be expressed as an amount per hour, or as a percentage of hourly wage. This helps you, when setting your fees, to arrive at a realistic cost per hour.
7. Have you determined how much you should be making, considering your investment in your business and your own time spent?

Most owners forget this cost. It is the cost of not doing something else. How much could you make working for someone else? How much interest could you earn on your investment if you had it in a bank? This cost should also be built into your budget.

8. Have you attempted to construct a break even model for your firm?

A break even model will focus your attention on the costs which must be met before a profit may be attained. First: Review all of your costs which vary with the number of customers served. These costs should be expressed in terms of your service unit (per hour of employee time, per hour of machine time, etc.). Second: Subtract your direct costs (computed in step one above) from your billing rate per service unit. This will give you the profit per unit which will be available to meet your fixed costs. Third: Review all of your fixed costs per period, such as rent, insurance, depreciation, etc. Add to these the cost of using your investment and the salary you have foregone. Divide the profit per service unit (computed in step two) into the total of these costs. This will give you the number of service units you must bill in the accounting period to break even. Beyond that, you have a profit.

9. Have you looked at industry figures from your trade association?

You should compare your operation with published figures of others to find out if your costs are in line with your competitors. Such information is usually available from business and government.

10. At the end of the period do you review your actual operations and your forecast together?

If you see where your original budget was wrong—if it was—you are better able to build a succeeding budget and make your targeted costs and profits more accurate. It may take several periods to be able to forecast accurately, but you learn a great deal about your business just by making the effort to do so.
Working Capital Management

Working capital not only includes the cash you have on hand, but it also includes those current assets that will be converted into cash in a relatively short period. Such assets—cash, inventories, and accounts receivable—represent an investment of capital and resources on your part. Of course, the dollar size of this investment will depend on several factors. But over time, your firm's success will depend on your ability to generate cash to meet your obligations, acquire new and improved assets, and provide an adequate return on your investment.

Current assets provide the greatest flexibility for management in meeting short term and subsequently long term business objectives. To understand the importance of working capital management, you must have a solid understanding of the way cash flows into and out of the business and how each asset is converted into cash to meet your needs.

Cash Management

Cash represents the most liquid and hence most flexible of the current assets. A cash account is maintained for expenditures for daily operations and reserves for emergencies and faulty estimates.
1. Do you prepare a cash budget?

A cash budget is a forecast of cash receipts and disbursements. This forecast should show by month for the next 6 to 12 months both when and how much cash will be flowing into and out of your business. By forecasting the receipt and disbursement of cash in advance, you will be able to plan for large disbursements, such as taxes or equipment purchases, either by having enough cash on hand or by borrowing it. The budget provides you with another means of controlling your business, for if cash receipts fall below the expected level, you can take immediate action to correct the situation.

2. Is your checking account balance excessive?

Excessive cash balances in checking accounts are just as much a sign of poor cash management as inadequate funds. You rarely receive an indication of excessive balances as you do for insufficient amounts. Analyze your monthly statement for receipts and disbursements timing. Proper timing of disbursements could allow you to reduce your balance while at the same time maintaining enough to meet service charges and bank minimum compensating balance requirements.

3. Are you frequently notified of overdrafts, returned checks, or insufficient funds?

Make sure in advance that either receipts or borrowing (preferably a line of credit) are adequate to cover the checks you write. Notice of insufficient funds both by the bank and your customers reflects on your management and jeopardizes your credit standing and supplier relations.

4. Can you use lines of credit and insurance to decrease the demands for cash?

By insuring against large unexpected loss, such as thefts, fire, or vandalism, the amount of cash necessary to continue operations can be reduced. Established lines of credit will enable you to take
small set-backs in stride and also provide you with the necessary cash to take advantage of unexpected opportunities to buy equipment and other assets.

5. Have you reviewed the terms offered by your vendors recently?  

Proper use of vendor terms enhances a firm’s credit standing and is in effect a price discount.

6. Have you discussed with your accountant, financial advisor, or banker the structure and costs of short term borrowing? long term borrowing?  

In order to keep abreast of business conditions the manager must seek information and advice. Those individuals familiar with your firm are a ready source of information with regard to capital and therefore cash utilization. They can provide expert advice and are concerned with the firm’s continued success.

7. Do you invest seasonal excess cash productively?  

Cash is an unearning asset if you allow it to build to large balances in a checking account. Explore short term or marketable security investment to provide returns if and when you temporarily have more funds than you need.

Inventory Management

The objective of inventory management is to minimize shortages and lost sales while at the same time to avoid carrying excess quantities. The correct inventory level will balance the savings possible from quantity discounts, reduced stockouts and leadtimes, and increased sales appeal against the additional costs of insurance, storage, handling, and funds required.

8. Do you periodically reconcile the physical inventory with accounting records?  

It is difficult to plan purchases and cash requirements without first knowing what you already have. Inventory figures that differ
significantly from the actual inventory distort profits, taxes, and could endanger the long run health of the firm.

9. Do you have a high frequency of stockouts on certain essential items?

Too little inventory is as much a sign of poor inventory control as too much. A high frequency of the stockouts indicates that you are carrying an inadequate inventory for the current level of sales. Frequent backordering, special orders, and less than economic order quantities create higher costs.

10. If you maintain parts stocks or similar items necessary for your services, does your inventory turnover compare favorably with similar businesses as compiled by such firms as Dun and Bradstreet?

Another sign that inventory levels should be examined is when the inventory turnover for your firm is out of line with similar firms. Unless there is an explanation for the differences, the level of inventories deserves closer examination.

11. Have your cost of supplies remained a relatively constant proportion of sales?

If your cost of goods sold has been steadily increasing as a percentage of sales, it may mean that an increase in inventory levels has been occurring. You should closely examine your inventory for lax purchasing, receiving, counting, waste, or pilferage.

12. If you maintain an inventory, do you know, by what means, your inventory is valued?

For accounting purposes inventory is valued in anyone of four ways—first-in, first-out (FIFO); last-in, first-out (LIFO); specific identification; and average cost. The method chosen affects turnover computations and profitability. Review the impact of each with your accountant.
13. Do you know what it costs to purchase, process, handle, and stock the product or products used in your services? Yes  No

An important variable in controlling your inventory is how well you know what it costs to acquire and maintain it. Without a thorough knowledge of these costs, your pricing more than likely will not adequately reflect them and hence not recover your full investment.

Accounts Receivable and Credit Management

Accounts receivables result from the extension of credit to your customers. The purpose in extending credit is to expand sales and hence increase profit. The decision to extend credit or to offer improved terms must involve a trade-off between the increased profits on sales that might result from such a change in policy and the costs—bad debt, financing, etc.

14. Are the terms of sale you offer consistent with the expected life of the services you offer? Yes  No

Your credit terms should not outlast the buyer's use or benefits of your services. If they do, you are increasing the chances that the customer will not repay his obligation.

15. Do your credit terms differ significantly from those offered by your competitors? Yes  No

If you offer terms that are significantly more generous than your competition, you in essence are offering greater price discounts than they do. If your sales volume does not increase correspondingly, your profits will be lower.

16. Do you consider the nature and composition of your clients or customers when setting up credit terms? Yes  No

Before extending credit, consider the proximity, nature of operations, financial strength, and character of the buyer. The terms offered must strike a delicate balance between the buyer's desire to buy and his willingness to pay.
17. Do you allow cash discounts for pre-payment or charge penalties for late payments?  

When terms are specified, they should provide an incentive to prepay and adequate compensation for your added investment if payment is not received within the specified time period.

18. Are the terms of sales clearly specified to the buyer at the time of the sale?  

Cost of credit for both you and the customer must be clearly understood if it is to be used wisely. This cost includes both the discount foregone and the penalty for any late payment for the buyer. The cost of a discount for you is the revenue given up to receive an early payment. Should you attempt to recover this lost revenue by quoting higher prices to potential customers, you could lose sales to competitors who are quoting at prices not including cash discounts.

19. Have you ever attempted to measure the impact of credit on your sales revenues?  

Many times credit terms are offered to buyers purely in response to competitive pressures. Under these circumstances it is important to know the impact of such terms. This will allow you to evaluate accurately whether or not you can afford the expense of meeting the competition head-on or if there is some alternative more appropriate.

20. Does your firm have a strong financial condition? wide profit margins? low unit price?  

The stronger your financial position, the better your capacity to accept the risk of customers defaulting. Likewise, the wider your profit margins are, the less you have invested in the purchases of any one customer and the fewer sales you must make to recover any losses. Low unit priced services also can be sold to a wider range of customers than high priced units, both due to the amount of the investment and the higher turnover of the buyers.
21. Do you have a specific procedure used to classify the risk involved in selling to each customer?  

To control your investment in accounts receivable, you must set up a clear and concise procedure to evaluate the customer to whom you will extend credit.

22. Do you take advantage of credit rating information that's available to you from your banker? trade associations? local credit groups and services?  

23. Do you request and promptly receive financial statements or similar data from potential as well as existing customers?  

You can determine the risk involved in extending credit to a customer on the basis of your past experience with the customer, credit data from independent sources, and material supplied directly by the customer.

24. Are there limits to the dollar amount of sales which are approved for credit on all initial orders? on all subsequent sales as determined by some rating system?  

By fixing the initial amount on which all credit sales will be automatically accepted, your intention of increasing sales revenues is met while at the same time your investment is limited. A followup credit investigation of the customer can then be undertaken without delay or inconvenience. You may then decide how much credit to extend the customer based on your assessment of risk.

25. Do you request some form of protection against default in special situations?  

As with all policies there will be exceptions. When conditions or circumstances warrant the extension of credit which you would otherwise reject, you might be able to reduce your risk by
alternative means such as getting security or requesting payment of prior sales before a new sale.

26. Do you systematically and consistently follow-up on your invoices or billing—generally five days to two weeks after due? Yes No

No sale is complete until the cash is received. Once credit has been extended to a customer, any delay in attempting collection just increases the probability of a default. A firm and fairly administered collection policy will encourage timely payments and display good management.

27. Have you established an efficient and effective method to identify delinquent accounts? Yes No

Before you can collect your past due accounts, you must first know who they are. Accounts receivable aging by customer or some similar technique will detect those needing additional attention.

28. Do you have an established and progressively stronger collection procedure? Yes No

Once an account is identified as delinquent, you must establish some means to collect it. Initially the technique must be such that the client is not offended should an honest error or oversight have occurred. Subsequent follow-up should be progressively stronger and more direct. Legal or third party collection of the account is the final step in collections. Once established these procedures should be applied uniformly and without delay.

29. Could you lessen the risk of extending credit by using credit insurance? factoring of accounts receivables? bank or similar credit card systems? Yes No

Sometimes it just costs too much to establish and maintain credit operations. In many instances these costs may be avoided with insurance or a third party providing the credit function for a fixed fee.
Plant and Equipment Management

The operations layout and equipment selection are critical factors in the efficient operation of your business. You must select and arrange personnel, materials, and supporting services to provide the needed quality and quantity of services. At the same time, the plant and equipment layout must meet the needs of the employees, management, and customers.

1. Does your layout minimize both the cost and time required to locate, process, and deliver the materials used in your operation?  

   Yes  No

Materials handling and processing costs are among your largest expenditures and can range from 25 to 75 percent of your expense. Careful consideration, therefore, of how you store, move, and ultimately deliver materials used in your services can drastically alter your profitability.
2. Do you promote orderliness, cleanliness, and good housekeeping in your operations? Yes No

A neat, orderly site and operation will diminish fire hazards, reduce accidents, conserve space, and improve morale. A clean attractive site, equipment, and policy will also favorably impress customers and their opinion of your service and its quality.

3. Do you consider both customer and worker safety and welfare in the selection of equipment? operations layout? materials used? work procedures? Yes No

Occupational Safety and Health Administration and state regulations have highlighted the continued need to insure the health and safety of both employees and customers against occupational and environmental hazards. In choosing a particular layout, piece of equipment, or work procedure, you should strive to minimize hazards. Such action might require guard rails, work area clearances, equipment guards, ventilation, or personnel training.

4. Do you attempt to:

   a) balance work stations? Yes No
   
   b) balance work loads? Yes No
   
   c) minimize interferences? Yes No
   
   d) provide flexibility? Yes No

By arranging equipment, tools, and materials in the correct positions to perform the services you provide, customer delays and bottlenecks can be avoided. Also by insuring that each employee has a balanced and adequate work assignment, you are able to provide rapid, good quality services without delays.
Minimizing interferences such as noise, dust, vibrations, fumes, heat, etc., will reduce your employee fatigue and lessen customer dissatisfaction. Be sure that your layout provides sufficient flexibility to accept changing customer requirements and improved equipment and techniques.

5. Does your operations layout provide attractive and pleasant surrounding for both your employees and customers? adequate lighting? an uncluttered appearance?  

A good layout should create a favorable environment for the development of employee morale and customer esteem. Sometimes simple changes are all that are necessary. Placing reports, records, and materials in filing cabinets or bins rather than stacking can go a long way in this direction.

6. Do you effectively use the current space you own or lease?  

Your facility may represent a very large percentage of your investment. Also, space is a fixed expense which must be paid, whether it is used or not. To realize an adequate return on your investment and to maximize the sales revenue per dollar of expense, your layout must minimize the amount of floor space and overhead space poorly or ineffectively used. Such poor utilization can result from improper storage, excessive inventories, or poor work station layout, to mention only a few causes.
Purchasing

Purchasing includes the buying of all materials for maintenance, and repair, the buying of operations parts and services; the buying of office supplies and administrative services; the buying of janitorial supplies and services; to mention only a few. The fact of the matter is that anything the company must obtain from an outside source generally falls into the category of purchasing. The smaller the operation, the larger the percentage of outside goods and services that will likely be purchased. Likewise, the smaller the firm, the more likely that the purchasing function will be splintered and require a greater and greater portion of the manager's time and efforts to control and direct.

1. Do you have specific policies and procedures regarding who is authorized to purchase goods or services? receive salesman's calls? place requisitions? process records?  

   Yes  No

   □  □

In a small firm the manager will usually do all the purchasing. However, this may not always be possible. Therefore, the manager must control the purchasing function to prevent possible deception or fraud. The first step toward control is to carefully select the person authorized to do the buying. Then, records to indicate need, receipt of purchase, and subsequent payment should be maintained.
2. Have you ever reviewed existing purchasing procedures to see if they meet your needs?  

3. Have you ever discussed your purchasing function with other firms or with local trade associations to obtain suggestions and/or techniques?  

An easy way to develop a working purchasing method is to review your needs. You do not need an extremely sophisticated procedure if you purchase only a few or relatively inexpensive outside products or services. Good sources of data or ideas are the local purchasing association, a business similar to your own, and trade or craft associations.

4. Do you request prices from several vendors for each product or service you purchase?  

Prices do differ from vendor to vendor because of their cost structure, quality of materials and services, location, and so forth. To obtain the best price consistent with quality and service, you should shop around.

5. Have you ever visited or investigated your existing or potential vendors to verify that they can meet your requirements in terms of price, quality, quantity, and service?  

Your commitments to your customers are quite often, if not entirely, based on the promises your vendors make to you. Therefore, it is essential for you to know your vendors' limitations and strengths. If they continually delay or provide inferior quality products, this will reflect on your services and must be corrected.

6. Does your volume of purchasing for any particular item warrant your dealing directly with its manufacturer?  

If the key ingredient to the service you offer is some manufactured product, you might consider direct buying to reduce the
costs associated with middlemen. Communications with regard to technical problems may also be made easier.

7. **Do your vendors have regular and competent sales personnel?**

   Yes  No

A salesman is more than just a nice guy. If he knows his products, he can be an aid to you and make recommendations when you encounter special problems. He won’t waste your time either but will make himself available when you need him by helping you with expediting and order follow-up.

8. **Have you had problems with suppliers in regard to shortages? backdoor selling? delivery delays? unsolicited favors and gifts?**

   Yes  No

The ethical supplier will rarely intentionally ship shoddy merchandise. But, on occasion, he may ship substandard material due to error or failure of his internal production processes. On the other hand, if your supplier makes a habit of questionable or unethical selling practices, you can also be certain that you are paying for it in the form of inferior goods or services, inflated prices, or some other similar fashion.
Marketing

MARKETING A SERVICE requires essentially the same processes as marketing a product. Advertising, personal selling, service line, sales appeals, pricing, and customer or consumer profiles are parts of the marketing process for service firms. The following series of questions and comments are intended to allow the owner/manager to assess his marketing policies and their consistency with his over-all strategy.

Customer and Consumer Policies

1. Do you know who your customers are and who your consumers are?  

Customers are the people who buy your service; consumers are the people who actually use the benefits from your service. In many cases they are the same, but sometimes your service will be a part of another firm’s product or service which is then sold to the final consumer. This distinction is important because advertising, sales appeals, credit terms, etc. could be different depending on whether they are directed at a customer or at a consumer.
2. Do you maintain a customer and/or consumer profile?  

Yes  No

Most service firms do not possess the resources necessary to be “all things to everyone.” In implementing strategic objectives, a customer/consumer profile can help define the firm’s specific market. Some elements of this profile would include:

1. Location of customers/consumers  
2. Ages  
3. Incomes  
4. Buying habits  
5. Education  
6. Leisure activities  
7. Credit rating  
8. Occupation  
9. Sizes of order  
10. Family size  

Maintaining this type of data base can aid you in determining the groups most likely to be interested in your service. Then, you can make decisions concerning advertising media, market share or penetration opportunities, credit terms, and ability to pay.

3. Do you analyze marketing data on a regular basis?  

Yes  No

Assumptions or “gut feelings” about the service firm’s relevant market can sometimes lead to substantial problems which seem insolvable. Even a small amount of market research can provide you with the data you need to make decisions which could lead to increased profits. You will want to design your own information system but it should include some of the following:

2. Customer/consumer attitudes toward the reputation of your service.
3. Reactions to prices, quality, dependability, convenience, and advertising.

Analyzing these data can pinpoint problem areas, help determine profitability of certain markets, and point to opportunities for future markets.

4. **Do you follow a stated credit policy in dealing with requests from customers?**

   ![Yes][1] ![No][2]

You should choose the conditions and procedures for allowing credit very carefully. Too tight a credit policy may hurt your sales, but too lenient a policy may seriously affect your cash position. The trade-off should be carefully balanced between lost sales and uncollectible income. More details about managing receivables can be obtained in the section on accounts receivable management.

5. **Do you have a stated adjustment policy?**

   ![Yes][1] ![No][2]

Service firms are particularly vulnerable to consumer demands for either re-doing work or for adjustments in bills. You can reduce complaints and gain goodwill by having a reasonable adjustment policy. However, the costs of the policy should be monitored to determine whether or not the benefits derived are worth the added expense. Such monitoring can also provide you with a method of controlling workmanship if quality is an important competitive weapon for the firm.

**Service Line Policies**

6. **Do you and your employees know precisely what services your firm will offer to customers?**

   ![Yes][1] ![No][2]

Knowing the precise services you can offer will help you segment the market thus aiding decision-making on the profitability of a particular service, target customers/consumers, promotion, etc. Your employees will also benefit by knowing which services you can offer and which you cannot.
7. Does the customer recognize how your service is differentiated from your competitors? [Yes] [No]

The differences in your service and the competition on dependability, quality, or speediness may be very apparent to you, but is your customer able to recognize these differences? Some customers may not be knowledgeable enough in your business to know whether or not a particular brand of part or type of service is superior in quality. If they are not, they may be unwilling to spend the extra money.

8. Do you periodically review your firm's line of services? [Yes] [No]

Rapid change has become a way of life for most owner-managers. The service industry perhaps leads all industries in this regard. You should set aside time each year to acquaint yourself with possible additions in the line of services you can offer for the next year. Activities in this regard may include trade shows, technical reading, and/or calls by vendor's salespeople. The changes should be consistent with the longer range strategic objectives set out in the strategic profile.

9. Are changes in offered services adequately communicated to employees? [Yes] [No]

Your employees must be informed of changes in the service line since job descriptions, specifications, and training needs may also change. A detailed plan to communicate changes to employees should be included as part of the review process.

10. Have you noticed any consistent patterns in the demand for your service? [Yes] [No]

In the strategic profile, daily, weekly, and seasonal fluctuations in sales were mentioned as a particular management problem in most firms. You should try to identify these consistent patterns in order to more fully utilize your productive facilities and person-
nel. Some of the methods you can use to stabilize sales are discounts during slow periods, special package sales before and after peak periods, increased personal attention at off times, coupons, and increased promotion. For example, some heating and air-conditioning service firms will offer special price packages to customers who request routine checkups early in the season. Service firms may also bid maintenance-type contracts at above variable costs but below total costs in order to keep a positive cash flow and retain valuable employees at off-times during the year.

Pricing

11. Have you taken a survey of similar services offered in your general market area?  

   □ Yes  □ No

12. Can you identify specific differences in your service that make it superior/inferior to the same or similar service of others?  

   □ Yes  □ No

While a number of factors play important roles in determining prices, the most important is the distinctiveness of the service. The more distinctive, the more flexibility you will have in pricing.

13. Is the price objective for your services to achieve

   a) a target return on an investment?  

      □ Yes  □ No

   b) a stabilization of price and gross margin?  

      □ Yes  □ No

   c) a target market share?  

      □ Yes  □ No

   d) a maximization of income?  

      □ Yes  □ No

   e) a reduction in/or stabilization of competition?  

      □ Yes  □ No

It is necessary to recognize that the setting of a basic price is related not only to the external market environment in which you
are operating but also to the goals which you have established. These goals will not always be clear-cut and singular; you may have several goals and their relative importance will shift over time.

14. Have you attempted to test or experiment with new services or items (or variations of old) prior to a full commitment of resources?  

The utility of the service offered to the buyer will help determine its price. If you hope to capture a market or dislocate an existing competitor’s service, you must offer some increased utility in the form of eased work load, time saved, increased satisfaction, etc. Likewise, you must make sure that a sufficient need or demand exists for improved or increased utility if you hope to price at a level to recover your investment and make a profit.

15. Do you allocate overhead costs, such as depreciation, space, and administrative expenses on a standard volume of business when setting prices?  

16. Do you attempt to recapture initial start-up expenditures and efforts from your initial sales?

17. When setting prices do you use estimates of your future costs rather than present ones in arriving at the appropriate price to charge?

While costs may be viewed as the floor which prices cannot go below, you must recognize that there are several cost floors to choose among. In deciding what costs are appropriate, two factors must be considered. First, in most cases, over the long run all revenues generated must be sufficient to cover fully allocated costs and provide a reasonable profit. Second, even though a price initially does not cover “full cost,” it may be a good price because the price may have promotional or alternative objectives that will lead to more profitable operations in the future.
18. Do you charge all your customers the same price without regard to the
   a) volume of business?  

   Yes  No

   b) type (commercial, individual, or other) buyer they are?

   Yes  No

   c) distance from you?

   Yes  No

   d) industry policies?

   Yes  No

Do you offer discounts in return for services or products which the buyer offers you?

   Yes  No

Do you periodically reevaluate and modify your prices?

   Yes  No

The pricing strategy one selects ultimately depends on the product or service, the competition, the nature of the market, and the demand. More important than all of these however is the customer. If the prices discourage his buying, you lose twice: from the lost sales revenues and from the funds spent on investment and promotion.

Promotion

19. Do you know who makes the decision to buy your service?

   Yes  No

The customer/consumer profile should contain the characteristics of the people who actually purchase your service. The profile will contain clues as to who actually makes the decision to buy your service. In some cases, a purchasing agent or a maintenance supervisor may make the decision. In other cases, the decision may be made by a man or a woman or another family member. Knowing who actually makes the final decision can mean the difference between an effective and an ineffective promotional program.
20. Do you know how the final decision to buy your service is made?  

Yes ☐  No ☐

Knowing the person or group that retains your service can also help you determine the critical factors that are considered in the buying process. Some customers may consider only price; others may look at quality while others consider convenience. The firm's reputation, availability of credit, speed of service, and guarantees may also influence the buying decision. In promoting your service, you should try to match the relevant factors to the decision-maker. This will ultimately lead to the choice of the most effective promotion alternatives.

21. Do you have a clear purpose in mind for your advertising?  

Yes ☐  No ☐

Before you choose a medium of advertising, you should know the specific purpose of the advertising. Some suggested specific purposes and matching media of advertising are:

1. Building demand for a specific type of service offered by you—newspapers, television, and radio most effective.
2. Producing customer traffic to your place of business—newspapers, window displays, direct mail, circulars.
3. Direct customer orders—telephone, special mailings, customer reminders, yellow pages.
4. Reputation building—television, local magazines and newsletter, community activities.

You may choose different media for a specific purpose from those suggested above, but the particular advantages of each medium should match the intended purpose of the advertising. The media firms should be able to help you decide by providing an audience profile for their stations or readership.

22. Is personal selling a part of the firm's promotional efforts?  

Yes ☐  No ☐

Before saying "no," take a closer look at how your service firm attracts and maintains a steady flow of customers. All businesses depend on personal selling to some extent. Service personnel,
clerks, repairmen, etc., all reflect on your firm. You should train all your employees on how to meet customers, how to communicate with them (which includes listening), and how to handle complaints. And, you should instruct your employees on how to suggest to customers other services the firm has to offer.

23. Do you have a method of evaluating the effectiveness of your promotional efforts?  

Yes  
No

If you do not pinpoint a response to promotional efforts to the specific purpose and medium, you are wasting your money. For each medium of advertising you use, you should include a way of measuring its effectiveness in reaching the intended audience. Personal selling is relatively easy to measure since it is direct. Evaluating the effectiveness of advertising is more difficult. Some techniques are:

1. Asking customers how they found out about your service.
2. Using different methods at different times or in different sections of your market and measuring the results from each method.
3. Using coupons in newspapers and magazines.
4. Checking customer’s addresses, and/or license plates.
5. Measuring a response to different specials advertised through alternate mediums.

There are other techniques but the essential reasons for measuring effectiveness are to see if you are reaching your target market and to determine if the benefits per method are worth the costs.
Location

The choice of location for a business vitally influences its future performance and success. This influence is felt by a manager in two major aspects. First, the site chosen for operations will directly influence the costs of operations and effectiveness of the marketing efforts. Second, once the decision has been made to locate at a particular address it is a relatively permanent decision and any change can only be made at a substantial cost either in actual expenses or lost patronage.

1. Is your operation convenient and easily accessible to your target market? Yes No

When the customer must come to your location to purchase your service, then the customer's convenience must be a major consideration in selecting a business site. If you pick up and deliver, then these costs must also be considered.

2. Is your service custom tailored for each client? Yes No

In these circumstances, close contact with customers is important, since most of the services are unique and subject to alterations during output or rendering.
3. Are your sources of materials and supplies reliable and convenient?

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If your primary business is redistribution or servicing of others' products, you must have a steady dependable source of such items. The proximity to your supplies increases the ease with which you can deal with exceptional situations.

4. Are transportation facilities such as access, parking, loading and unloading, public transportation, lighting, etc., well developed at your selected location?

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It is critical that either you have access to your customers or they to you. Nothing will discourage a buyer more than not being able to reach your operation easily and quickly. Likewise, you must be concerned with your ability to reach your clients when the need arises.

5. Is a trained labor supply available? vocational schools and programs? federal and local training support or programs?

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If at sometime in the future you wish to or must expand, the availability of trained personnel will allow rapid action at a low cost. A trained labor supply also makes it possible to remain abreast of recent technical changes in products and processes.

6. Have you reviewed your present or prospective operations site with regard to the following factors:

<table>
<thead>
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<th>a) size and expansion possibilities?</th>
<th>Yes</th>
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<th>b) water supplies?</th>
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<th>No</th>
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<th>c) utilities?</th>
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<th>d) waste disposal?</th>
<th>Yes</th>
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52
e) drainage and soil conditions?  

f) land and development costs?

The impact and importance of each of these items will vary from one operation to the next. However, every business must investigate and consider all of these factors. If any one of these items is not satisfactory, you may want to reject that site.

7. Have you noted any recent trends relative to your location such as population shifts to other geographic areas? increased growth of shopping complexes? hours of operations? traffic flow? property maintenance?

A sudden or even gradual change in any of the factors above can signal significant future impact on your operations at its present location. Be aware of those variables which affect your business and be prepared in advance to take corrective action early once a trend is indicated. Catching up is always much more expensive than anticipated action.
Insurance

Insurance for the small service firm is a necessity. Very few firms have the resources and expertise to assume the responsibility for being self-insured. Most owner-managers rely on insurance companies to underwrite the risks of managing or owning a business. Insurance should never be an afterthought; it should be fully included as one of the essential business expenses.

1. Do you have a stable relationship with an insurance agent?

The process of selecting an insurance agent is possibly the most important part of establishing an insurance program. You should set specific selection criteria and then search for the agent who is best qualified. The criteria for each firm will vary but some general ones are:

1. Demonstrated expertise—for general business insurance an agent should possess or be associated with someone who is a Chartered Property Casualty Underwriter. For employee benefits programs which include insurance, the agent or his partner should be a Chartered Life Underwriter. (Chartered Property
Casualty Underwriter and Chartered Life Underwriter are designations awarded to agents who have passed a series of examinations).

2. **Years in insurance field**—try to avoid agents with less than three years in the field unless closely supervised by another agent whom you feel is competent. Usually the longer an agent has been in the insurance field, the more likely he is to remain in your locale and the more experience he can bring to designing a program that fits your needs.

3. **Personal references**—a competent insurance agent should be able to furnish you with at least three references from other businesses which he serves. Ask these owner-managers about claim service, policy restrictions, attention given to their account, advice, etc.

2. **Are you assuming unnecessary risks?**

   ![Yes][1] ![No][2]  

The purpose of any insurance program is to avoid exposing yourself to risks which might cripple your business. Although being in business is itself a risk, the competent owner/manager will take appropriate action in reducing the risk borne directly by him. The question of how much insurance coverage is “adequate” to reduce direct risk is very difficult to answer. At least a minimum coverage on liability, fire insurance on contents, fire insurance on building if owned by you, burglary and robbery, business interruption, and workmen's compensation if you have employees should be included. Other types of insurance which can be added as needed might include plate glass, money and securities, valuable papers, employee dishonesty, etc.

3. **Have you taken advantage of all premium cost-cutting possibilities?**

   ![Yes][3] ![No][4]  

Insurance premiums for full coverage are understandably much higher than for programs including deductibles and co-insurance. You can reduce insurance premiums by using large deductibles and
also by assuming some of the risk through co-insurance. If you use these methods in your insurance program, some provision should be made to cover your part of the assumed risk; accounting reserves can provide this coverage.

4. Do you periodically review your insurance program?  

Once a year the total insurance program of the firm should be reviewed. Be sure that you are not assuming more risks than you desire due to changes in values of equipment, building, and inventories. Also changes in customers, labor laws, safety regulations, and wages can cause insurance needs to increase or decrease in specific areas of your business. Your insurance agent should be able to help you assess these changes and recommend appropriate policy adjustments.
Taxes and Legal Obligations

The requirements for reporting to the local, State, and Federal tax authorities require that more detailed records be kept than for any other governmental body. If you do not have a knowledgeable accountant and/or attorney who will make certain that the reporting requirements are complied with on a timely basis, you will find that the cost for failure to comply will exceed the cost of competent advice.

Taxes

1. Do you keep adequate individual payroll records to insure that quarterly payroll returns for State and Federal tax authorities may be completed without undue difficulty?  

   [ ] Yes  [ ] No

You might wish to refer to internal control section for the discussion of payroll records. Failure to file these returns on time will bring penalties and interest charges. Penalties are not deductible for tax purposes, and the interest costs are now equal to the cost of borrowing money elsewhere.
2. Is the person (or persons) who prepares your payroll kept up to date on maximum wages for payroll tax purposes?  

Since the maximum wage subject to social security, and to State and Federal unemployment tax differ, you might be overpaying your payroll tax.

3. If your payroll withholding is above the minimum amount, are you making timely deposits with a Federal depositary?  

A sudden increase in the number of individuals on the payroll or an increase in wages might require more frequent deposits than normally have been required. You should be certain that your portion of the payroll tax, as well as the amount withheld from the employees, is deposited regularly.

4. If some of your sales are subject to State and/or local sales tax, do your records adequately differentiate between taxable and non-taxable sales?  

Taxing authorities may set up additional taxes on all unreported sales if you do not keep adequate records of those which are and are not subject to tax. Sales to an out-of-state destination may be subject to tax in that state so you may need to keep current information on the state tax laws in other states so you may collect and remit taxes where applicable. Each state with a sales tax has auditors in other states and you might find your company liable for sales tax which should have been collected. Ask your lawyer or accountant to find out how this requirement affects you.

5. Do you have detailed equipment records, giving the date purchased, basis of the asset (cost or otherwise), estimated useful life, method of depreciation, accumulated depreciation, and location of the asset?  

Such information serves more than one purpose. First, as each new asset is put into service, investment credit may be taken against current year taxes, and an accelerated depreciation method may be used to reduce income. Second, these records
may be used for local taxing authorities if your State has a personal property tax. Third, it will be useful for insurance purposes and also to prevent loss of the asset. Fourth, if the asset is lost or stolen the information may be used to substantiate a deduction on the Federal tax return.

6. Have you discussed with your accountant and attorney ways in which you may reduce your Federal income tax?  

Yes  No

For example, it may be possible, if you have children, to arrange that a portion of the business may be given to them. This depends upon the type of business and the extent of personal activities of the owner. Such a division is legal if it is not intended solely as a method of tax avoidance.

7. If your business is a partnership or a corporation, have you arranged for continuity of the business in the event of your death?  

Yes  No

You should seek advice on the advantages of key man insurance, buy-sell agreements, and testamentary trusts. If your corporation is a tax-option corporation, you should know some of the pitfalls of this type of a corporation.

8. If your business is a corporation, is your stock Sec. 1244 stock?  

Yes  No

Your attorney should have set up the corporation with this type of stock, so that if you do go bankrupt the loss will be an ordinary one, not a capital loss.

Legal Obligations

9. If you have a pension plan or a profit sharing plan, have you conferred with your attorney regarding the reporting requirements to the Government and to the employees?  

Yes  No

The recent revisions of the pension laws through the Employees Retirement Insurance Security Act of 1974 has imposed new obligations upon the employer. In fact, if you have any employee welfare benefits such as vacation, hospitalization insurance, sick
pay, or other benefits, they must be disclosed to employees in easily understandable language. Assistance from your accountant and attorney is almost a must under these circumstances.

10. If you provide service warranties, have you had your attorney check the wording of these warranties to comply with current laws?  

Yes  No

There have been recent changes in the laws due to the consumerism movement which may require fuller disclosure of the terms of your warranties, simpler language, and more prominent display of the warranty itself.

11. If you offer credit, have you arranged to give customers the notice required under the Consumer Credit Protection Act?  

Yes  No

You will need to check with your attorney as to the exact information required under this act which must be given to your customers.

12. Have you considered whether another type of business organization, for instance a corporate form, would limit your legal liability?  

Yes  No

Not all professions may incorporate due to their code of ethics, most service firms may do so. Incorporation has advantages, but it also may have some disadvantages. Understanding of the advantages and disadvantages will permit you to make a more informed decision as to the type of organization for your company.
Long Range Planning

The necessity for long range planning even for the small business becomes more evident each day. Product life cycles are becoming shorter, technological changes are occurring at a staggering pace, and government regulations increasingly occupy a major portion of the owner-manager’s time. These factors combine to affect all businesses but may place many small businesses in the position of reacting to rather than acting before the changes. The following questions should help you anticipate the potential restrictions on your firm. They should also provide you with ideas about possible new opportunities accompanying the changes.

1. Is your attitude toward planning:

   a) it must be done for successful growth?  Yes  No

   b) It is nice but not necessary?

   c) it is not needed at all since my operation is too small?

Excuses given for not planning could fill more pages than we have available here. Some are valid and pertain to circumstances
outside the control of the firm, some are just excuses. The fact remains that if you are ever to grow and prosper you must anticipate conditions and not just react to them.

2. How do you predict future developments:

   a) by personal observations of informal (non-numerical) methods? Yes No

   b) by formal (numerical) methods? Yes No

Selection of a predictive technique depends in large part on whether it is for:

1. a stable business condition.
2. a sharply changing situation.
3. a new concept, project, etc., with no previous performance record.
4. a change or decision involving over-all company strategy.

Some methods are more effective than others in sensing changes and alerting the owner that differences from historical patterns are probable. The occurrence of an event in the past is no guarantee that it will happen again. Change can come to any business situation regardless of the previous record. Nevertheless, you must give some thought to probable changes and judge which technique is most applicable.

3. Do you categorize the elements of your firm's environment into manageable groups? Yes No

The major areas of any company's environment are economic trends, technology, competition, social trends, and Government.

4. Did you predict the present economic conditions? Yes No

There are many elements of your firm's economic environment that could be used for predictions. However, you should select only those which are meaningful to your business and industry.
Examples are GNP, housing starts, disposable income, income distribution, bank demand deposits, employment and interest rates.

5. Do you plan for future technological changes which may affect your business?  

   Yes  No

Along with the rapid growth of service firms in our economy, technological changes have been altering the way a firm conducts its business. You should try to forecast different technological advances and their effect on your firm. New models of the present service line may affect the skills required of your employees and necessitate a training program. Energy conservation may have a great effect not only on the methods of doing business but also on the target market for your service. The process of miniaturizing computers could provide you with opportunities which were not possible before now.

6. Do you actively assess your competitors for clues as to what they will do next?  

   Yes  No

Few companies enjoy the luxury of having little, if any, competition. You must try to forecast not only what actions your present competitor will take, but also the possible actions of potential competitors.

7. Do you consider current social trends?  

   Yes  No

The changes in American society over the last 30 years have accounted for much of the rise in service firms. These social trends will continue to affect businesses. The changes in the work force may cause a shift in your planning as young people become more educated, more mobile, and more inclined toward unionism in white-collar jobs. Age distribution shifts may expand or shrink your target market. Migration patterns to the suburbs have already been felt; will it continue to affect your firm? Increased leisure activities and non-working time continuously provide opportunities for some firms.
8. Have you made predictions on how changes in Government policies may affect your business?  

[ ] Yes  [ ] No

Government presence in the business sector has been increasingly felt. Purchases by local, State, and Federal Governments comprise an increasing share of GNP. Government employment competes with private business for manpower. Regulations on pollution, personnel, taxes, etc. all affect a business. You should analyze the potential changes not only for restrictions but also for opportunities in different areas.
Sources of Information

There are a number of publications available that would further amplify the concepts we have discussed in this publication. However, space limits the number of sources that we may list. Therefore, omission of a publication implies no slight to the author.

The publications listed below should be available at a local or college library. They may also be ordered directly from the publisher. In addition to these sources, you should also keep abreast of current business trends by regularly reading a general business periodical and a trade journal for your particular field.

Books


An accounting text which develops the type of information management may utilize in the decision making process.


A compilation of information designed to provide direct and practical answers to the businessman’s questions and problems. Topics include: how to write sales letters, training salesmen, collection methods, partnerships.
A detailed listing of primary subjects of interest to managerial personnel with a record of source books, periodicals, organization directories, handbooks, and bibliographies of each topic.

Over 200 contributors have prepared a total of more than 300 alphabetically arranged entries. Topics range from advertising to electronic data processing and PERT. Longer articles contain selective bibliographies for additional reading. References to pertinent journals and to standard texts on the subject are included.

A very understandable treatment of a complex management tool. Many different approaches are presented which can be used for predicting markets, populations, cash needs, inventory levels, etc.

An elementary accounting text which covers the basic accounting functions, records, and information.

Brings together in a single publication the latest available information on all aspects of consumer related statistics. These deal with such subjects as population characteristics; labor force, employment, and earnings; consumer income and expenditures; ownership of homes, cars, and household durables; and the production, retail sales, advertising, prices, and price indexes of consumer goods and services.

A very readable text which examines the impact of income taxes on the managerial decision making process. It emphasizes research for tax and accounting strategy.

A comprehensive guide to basic materials of value to the businessman. Covers: finance, automation, management, statistics, personnel, industrial relations, etc.

U.S. Government Publications

The following publications are available free from local offices of the Internal Revenue Service or from U.S. Treasury Department, Internal Revenue Service, Washington, DC 20224.

Employer's Tax Guide (Circular E). Published annually. This publication provides information on payroll taxes to be withheld from the employee's wages, payroll tax expense, due dates, and other information which the employer will require.

Tax Calendar and Check List—Publication 509. Published annually. Lists dates when tax payments are required.

Tax Guide for Small Business—Publication 334. Published annually. Instructions to assist in preparations of the individual, partnership, and corporation business tax returns, payroll tax returns, and escise tax returns.

The Small Business Administration publishes several series of management assistance publications to help small business owners keep abreast of modern management techniques and maintain efficient management policies. These publications deal with problems of interest to management and present facts and figures in brief, readable, nontechnical form.

Of particular interest to owner-managers of small service firms are the following series.

Small Marketers Aids—guides for retail, wholesale, and service firms. Free.


Small Business Management Series—more comprehensive discussions of special management problems of small business. For sale.

For complete listings of both free and for-sale publications and ordering information, write to your nearest SBA field office and request lists 115–A and 115–B. Consult your local telephone directory for the address of the SBA field office nearest you.

### SBA FIELD OFFICES

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<td>Aguna, GU</td>
<td>Fargo, ND</td>
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<td>Fresno, CA</td>
<td>Newark, NJ</td>
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<td>Albuquerque, NM</td>
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