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Adequate Accounting Records: An Invaluable But Often Neglected Tool of Small Business

H. Claire Haines

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H. Claire Haines, CPA

In a letter to the Editor Miss Haines wrote -

"For some months I have been a member of the local chapter of the SCORE program of the Small Business Administration (Service Corps of Retired Executives). In most of the cases in which I have worked as a consultant, accounting or a lack of it has contributed to the owner's difficulties. It has been tragic to see a business fail because the owner did not know how deep his trouble was until it was too late to rescue him.

"I have been trying to think of ways and means by which accountants could help the situation and I have written the enclosed item which you might find worthy of publication in the THE WOMAN CPA. There is certainly a wide area in which something needs to be done; perhaps some of our members might come up with better ideas. It seems to me it is a matter that would offer good material for discussion."

Dun & Bradstreet's statistical study, "The Failure Record Through 1964," indicates that there were 13,501 business failures in the United States in the year 1964 with total failure liabilities of $1,329,223,000. The underlying cause of 91.9% of these failures is attributed to management - lack of business or managerial experience, inexperience in the line, incompetence, and so on. The report further shows that of the 13,501 failures, 6,295 or 46.6% had liabilities of $25,000, or less. Thus, almost half of the failures would be described as "small" business.

The big business of today was the small business of yesterday and has its roots in man's ingenuity and industry. There are many ideas for new and improved products and services incubating in someone's brain and there is no limit to what may lie in the industrial future of the United States. And so, as men pursue their dreams, there will be thousands of new enterprises started each year. A few will find quick success, some will fail because of management ineptitude or conditions beyond control, but many will find success after a fashion with persistence and hard work. With the tax gatherer's hand in his pocket and the inevitable paper work forced on him by government regulations and tax reporting, the little fellow has less and less incentive to go into business for himself but many will try it.

One of the most common difficulties of the small proprietorship revolves around the matter of records—no records at all, inadequate records, or failure to understand and interpret accounting records when they are available. The finest accounting system in the world will not, of itself, keep a business solvent, but the ability to read a financial statement might go a long way toward heading off trouble before it becomes serious. One often finds that the owner of a small business may have an uneasy feeling that something is wrong, but what it is or where it is, or what to do about it is beyond his knowledge. It has been this writer's experience in working in the Small Business Administration's SCORE program (Service Corps of Retired Executives) that the managers of many small businesses look upon record-keeping as a time-consuming nuisance which they avoid, if possible, and fail to realize the value that proper accounting records could be to them.

It is in this area that accountants may be missing an opportunity for service which may not have any immediate fees attached, but which might be of inestimable value to the business world and eventually to the accountants themselves. The very small proprietor with assets of under $25,000, let us say, and with profits that barely give him a living, may shy away from professional accountants and management consultants because they seem too expensive. He may use a bookkeeping service or have someone prepare tax returns for him, but often does not know where to turn for competent advice.

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ADEQUATE ACCOUNTING RECORDS

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Would it not be possible for AWSCPA and ASWA groups to try to help fill in the gap in the education of the many who will go into some small business in the future by sponsoring a series of educational television programs or public conferences? These should not be courses in the mechanics of bookkeeping, but rather, should be developed around the basic need for the fundamentals of sound accounting methods in any business enterprise, and the uses to which accounting records can be put as an aid to management. A project such as this would require a great deal of time and careful planning, but it need not necessarily cost a great deal of money. Assistance might be obtained from university continuing education departments, and from the Small Business Administration which has a big stake in the solvency of the thousands of small businesses throughout the country to whom it has made loans. We have the brains and the woman power needed to carry it out. Even if the program reached only a few small entrepeneurs it should have value to the business world and to women accountants themselves.

HOW CLOSE TO BANKRUPTCY ARE YOU?

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seriously impair business activities, just as a condition of anemia may have serious consequences for a human being.

In most cases, lack of working capital is a symptom of an advanced stage of business failure and not the cause of it; it is the result of poor managerial policies, unusual and unexpected losses, excessive operating expenses, too high interest and other fixed charges.

If the working capital has diminished to such a degree that the current liabilities exceed the current assets, a floating debt or a working capital deficit exists, which calls for an immediate diagnosis of the underlying causes and drastic remedies, if the enterprise is to be saved.

Weak Cash Position

Another condition, which is a symptom rather than a cause of business failure is a weak cash position. It may exist even though the company has seemingly sufficient working capital, but the portion of cash compared to other current assets is insufficient.

The actual amount of cash needed to keep a business on a healthy basis depends on factors like the size and character of the business, the phase of the business and operating cycle, the season of the year, the working capital turnover and others. In general, however, a cash fund equal from one to three months of operating expense (excluding depreciation and other non-cash expenditures) is considered adequate.

Over-Investment in Fixed Assets

The decision in regard to the amount of investment in fixed assets required and justifiable in the light of current and expected customer demand, is one of the most vital, key problems of management.

Besides the fact that over-investment in fixed assets ties up capital for a comparatively long period of time and deprives the enterprise from using it for advantageous current business opportunities and for the payment of current obligations, it may endanger permanently the over-all profitability of the business. The cost incurred in maintaining excess capacity may have to be absorbed by a smaller production or sales volume than intended, resulting in higher per unit cost and a continued drainage on profits.

Since the capital used to finance fixed assets will be tied up for an extended period, it is axiomatic to finance them by long-term obligations, such as bonds and mortgages, and through re-investment of earnings. To do otherwise is neither sound economics nor good business judgment and will result in serious financial difficulties.

Over-Investment in Inventories

This decisive factor in business failures may be due either to efforts to provide against inadequate supplies of raw material or merchandise, or to the desire to earn additional profits in periods of rising prices or general prosperity. It may result, however, also from lack of control, sudden style changes, partial obsolescence or other similar factors.

Excessive investment in inventories will not only impair an enterprise's working capital position by tying up a disproportionate amount of money, but it might also weaken its earning potential in various ways. The inventory carrying cost of the excess inventory on hand will increase overhead expenses unnecessarily and eat up profits. The disproportionate increase of inventories relative to sales will result in a slow-down of their turn-over and in adverse effects upon the rate of return. Losses may also be suffered when the firm attempts to liquidate such excess inventories because of possible decline in demand and prices, or because of the urgency to obtain cash or rights to cash and the consequent necessity of selling below the customary selling price or even below cost.

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