Why You Need to Get Quick Books Under Control

Because QuickBooks is based on what is known as a double-entry, always in balance system, by not recording all your transactions OR by recording them in some ad hoc account system, it becomes an automated check register, not a business system. It also leads to the kinds of errors I showed you. That is why I suggest you set up a Chart of Accounts that will tell you every month where you are and where you're going. This structure also supports why your lines of credit have to be recorded as payables so you can determine your net worth and make sense out of each month's Profit and Loss Statement and Balance Sheet.

This is a brief outline of what is happening in the system when you use Quick Books for your accounting.

The Basis of Accounting: The Balance Sheet

All accounting is based on the concept of double-entry bookkeeping. For every debit (an entry on the left side of the scale), there has to be a credit (an entry on the right side of the scale).

The "scale" is the balance sheet. Think of it as a T with debits on the left and credits on the right.

BALANCE SHEET	
ASSETS	LIABILITIES
	NET WORTH

Your assets are balanced by your liabilities and your net worth. Where assets are more than liabilities, you have a positive net worth. Where assets are less than liabilities, you have a negative net worth.

Example 1:	Assets	100,000	Liabilties	40,000
			Net Worth	60,000
Balance		100,000		100,000
Example 2:	Assets	100,000	Liabilities	120,000
			Net Worth	(20,000)
Balance		100,000		100,000

Accounts Receivable and Payable

If someone owes you, it's an asset called Accounts Receivable

If you owe someone, it's a liability called Accounts Payable

An Account Payable can be Sales Tax, Payroll, or a Line of Credit.

Accounts Payable are generally categorized as short and long-term payables.

Short-term payables such as Lines of Credit are short-term because they do not have a preset payment and a preset pay off date. Long-term payables are also known as Notes Payable. A Note Payable has a set payment schedule and a set pay off date.
Within each side of the Balance Sheet, the accounts are also treated as T accounts, but the increase or decrease to the account will depend on which side the account lies.

Asset Accounts

Cash		Accounts Receivable		Inventory	
Plus	Minus	Plus	Minus	Plus	Minus

Liability Accounts

Accounts Payable		Net Worth	
Minus	Plus	Minus	Plus

Sales and Expenses

Sales and Expenses are considered as part of the Net Worth side of the Balance Sheet because they contribute to Net Worth (Sales) or take away from Net Worth (Expenses). The total for each account is added to or subtracted from Net Worth when a Balance Sheet is developed. This plus and minus to Net Worth does not occur with each transaction, only at the end of each month when the effect of sales, expenses, purchases, inventory changes, and other activities are totaled.

The plus and minus sides for Sales and Expense accounts relate to how they increase or decrease Net Worth. Remember that a positive for Net Worth is on the right side (the total is added to Net Worth). A negative for Net Worth is on the left side (the total is subtracted from Net Worth). For this reason, a Sales Account for Returns would have the plus and minus on the same side as Expense accounts because the total of that account is decreasing the Net Worth

Sales Accounts		Expense Accounts	
Minus	Plus	Plus	Minus

Sales Returns	
Plus	Minus

Examples:

A Sale for $10,000 would increase Net Worth by $10,000 so the entry would be on the right side of Sales.
A Sales Return of $5,000 would decrease Net Worth so the entry would be on the left side of Sales Returns. Again, this is for illustration sake since the affect on Net Worth is not

known until the end of each month when Profit and Loss and Trial Balance Statements are calculated.

How Transactions are Recorded Through Double-Entry Bookkeeping

Each transaction must have a debit and a credit, i.e. an entry on the left side of the T and an entry on the right side of the T. Where these entries go depends on the transaction.

For example, **purchasing inventory** has an entry on the left for Inventory (Asset account) and an entry on the right for Cash (another Asset account). Both entries keep the Asset side in balance.

The same transaction, **if done on credit**, would have an entry on the left for Inventory (Asset Account) and an entry on the right for Accounts Payable (Liability account). In this case, both entries keep the Balance Sheet in balance.

A **cash sale** has an entry on the left of Cash (Asset account) and an entry on the right for Sales (Net Worth account). Again, both side of the balance sheet are in balance.

Some transactions may affect multiple accounts such as when tax is charged. An entry on the left for Cash (Asset) for the total collected then on the right for Sales (Net Worth) for the price of the product and on the right for Sales Tax Payable (Liability) for the tax collected that has to be sent to the State.

Some transactions may affect Assets and Expenses, as when you pay cash for a FedEx delivery (an entry on the left for Delivery Expense and an entry on the right for Cash). If you paid for it on credit, the entry would be left for Delivery Expense and right for Short-Term Payable (Liability).

Taking the Sale and Sale Return example from the previous section, a Sale for $10,000 would increase Net Worth by $10,000 so the entry would be on the right side of Sales. The corresponding "T" entry would be an increase (left entry) to Cash or Accounts Receivable.

A Sales Return of $5,000 would decrease Net Worth so the entry would be on the left side of Sales Returns. The corresponding "T" entry would be a decrease (right entry) to Cash or Accounts Receivable.

With the Line of Credit, a transfer to Cash is an entry on the left for Cash. The right side entry is to increase Accounts Payable.

Conclusion

Setting up a Chart of Accounts, defining balances and restarting your company's engine is not the problem. Redirecting all the misdirected entries is the problem. We can do the Chart of Accounts with balances and basically start from scratch or I can fix all the entries for the past ten years so you know what actually happened and why you seemed to show profits that didn't translate into money. The latter route will be at least ten times more effort than the former but that is your choice.