



7 Essential Functions of an Accounting Department

An Accounting Audit – 30,000 Foot View

Before we dive in on the 7 essential functions of an accounting department, let's first set the stage. There is a key difference between daily accounting & accounting audits.



Daily accounting follows processes you've already set. You may already feel very comfortable in these processes, and we assume or know they are working well. But...it's likely you downloaded this guide because you've noticed some issues in your accounting and need to improve or audit these systems.

This guide is intended to give you a 30,000 foot view of your accounting departments to ensure you're covering your basis for overall accounting efficiency.

You should have controls in place for recording, monitoring, and updating these 7 essential functions of business accounting. These include:

1. Business Cost & Revenue
2. Accounts Receivable
3. Accounts Payable
4. Payroll
5. Financial Reporting & Analysis
6. Taxes & Compliance
7. Budgeting

An accounting audit takes a high-level look at these processes to ensure you are following best practices as well as looking for ways to make your life easier when doing your business accounting.

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Business Cost of Revenue

Business cost of revenue refers to the cost of producing your goods or services.

Cost of Materials is calculated by subtracting the ending inventory of your goods or services from your beginning inventory + the cost of purchases, direct labor, and other cost directly attributable to revenue.

Cost of Goods Sold (COGS) includes Cost of Materials plus indirect costs of payroll and manufacturing overhead (rent, utilities, warehouse supplies).



Why is Cost of Goods Sold determination important?

Revenue less COGS = Gross Margin and is typically separated stated on a financial statement.

Gross Margin is a key performance indicator for overall business efficiency. It is from Gross Margin that all fixed cost and profit are derived. First sign of problems is if there isn't enough Gross Margin to produce profit. If there is no profit, there is either an efficiency problem or a cost problem.

Errors occur in this calculation if there is ongoing miscalculation in any of the essential measurements of cost of labor, commission, or materials. The best way to avoid errors in this accounting essential is to ensure you have adequate checks & balances in place for each part of your accounting controls.



Accounts Receivable

Account receivable (AR) plays an essential role in the maintenance and growth of a company.



Why it's essential to have this process working correctly:

AR is considered a **current asset** account which demonstrates how quickly a company can resolve its debt within 12 months. This plays into the overall value and performance of your company.

AR is a vital part of your **customer relations and sales process**. Let your clients know exactly what your payment system looks like. Ensure on-time payments with clear invoicing, balance reporting, and credit limits. A smooth running AR department creates a pleasant experience for your business, your sales team, and your clients.

A common sign that your Accounts Receivable department needs an audit is when you're experiencing invoicing errors. Invoicing errors include:

- Setting the wrong payment amount
- Wrong budget limits
- Not accounting for previous payments/current balances
- Wrong invoice number
- Forgetting discounts
- Forgetting to send out the invoice
- Not following up on past due invoices

If these issues are coming from human error, it is important to sit down with your accounting department (or yourself) and consider if the work load is too high. If the mistakes are consistent enough across a long span of time, then you should either consider hiring a new resource or outsourcing some of your accounting to prevent these errors from continuing.

As mentioned above, AR is an essential part of your customer relations. If you are missing payments, it affects the quality of your relationships as well as impacts the overall valuation of your company. No one wants to be sent to collections, especially if they were unaware they were even behind on payments.

Ways to improve your AR process functions:



Ensure you have an automated process for sending repetitive and professional reminders to customers behind on payments. An automated system removes you from the equation, saving you time and effort.



Centralize your dashboard for AR data. If you're using multiple spreadsheets, saved on several accounts, then you are making the process more complicated than it needs to be.

- Either implement software into your AR department, or create an accounting process and best practices sheet to share with your account resources.
- Set clear outlines on where and how your AR data is entered.



Create a shared account for collaborating on this data so none of it is hidden or lost on personal computers.



As you can tell, we highly recommend you use a software system to improve your accounts receivable process. You can find accounting software options unique to your industry; although, there are general accounting software options available to suit any need.

Accounting software removes some of the human error from the equation; however, you may still notice repeat issues with manual entry. If this is the case, we recommend considering outsourcing your accounting.

An outsourced accountant can manage vital AR tasks such as:

- Invoice & Expense reporting
- Check processing
- Order processing
- Billing and payments
- Collections
- Cash flow forecasting
- Debt management

An outsourced accountant is hands-off and used as needed which can save you time from having to hire an additional full-time bookkeeping. Ultimately, you will find you've freed up time, money, stress, and liability from your company.

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Accounts Payable

Accounts payable is a document-heavy process. Depending on your industry, you may be dealing with a mountain of paperwork throughout almost daily purchase orders. For traditional, manual-entry processes, this leaves a large margin for human error which makes effective processes all the more important.

Why it's essential to have your Accounts Payable running smoothly:

- o AP is an essential component of your businesses profitability. AP factors into your overall debt and business valuation.
- o Bad AP leads to bad vendor experiences and poor business relationships.
- o Your average payable period is an indicator of your overall cashflow management & success.

What are common mistakes made with AP?

Just like with Accounts Receivable, if you're noticing a significant number of errors this could be due to an overworked employee. Common AP mistakes include:



Overpaying accounts

this could be because there was a change to the original invoice due to an error in delivery of the process or service. If accounting receives the original invoice but no notice of the pending change, they could submit the wrong payment.



Late or missed payments

this could be because there was a change to the original invoice due to an error in delivery of the process or service. If accounting receives the original invoice but no notice of the pending change, they could submit the wrong payment.



Unclosed purchase orders

Closing a purchase order indicates that there is no further follow up needed from AP. This typically happens when the quantity of product received aligns with the quantity ordered at payment is processed. As mentioned above, if there was a requested change to payment, this purchase order can remain open. Without adequate communication, completed payments or outstanding payments can be unaccounted for and the PO will remain open – wasting time and resources to resolve it later.

If your employee has too much on their plate, you'll likely see repeat errors in the above. It is common for accounting resources to wear many hats, which can eventually lead to them taking on more than they can handle.

Likewise, if you experience an unexpected turnover, you're facing taking on that work yourself while a new person is trained as a replacement. Outsourcing your essential accounting processes can provide an added safeguard to your finances.



Ways to Improve Your AP Process Functions:

- Stop using paper invoices. They're too unreliable and create too many avenues for error.
- Use a data capture software to import your invoices into your accounting software tool.
- Create payment reminders either via an automated software tool or internal process.
- Build up your cash flow so you can automate payments.
- Write an internal process for your accounting department that includes: how to enter invoices correctly, how to plan and monitor due dates for bills, and how to issue payments.

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Payroll

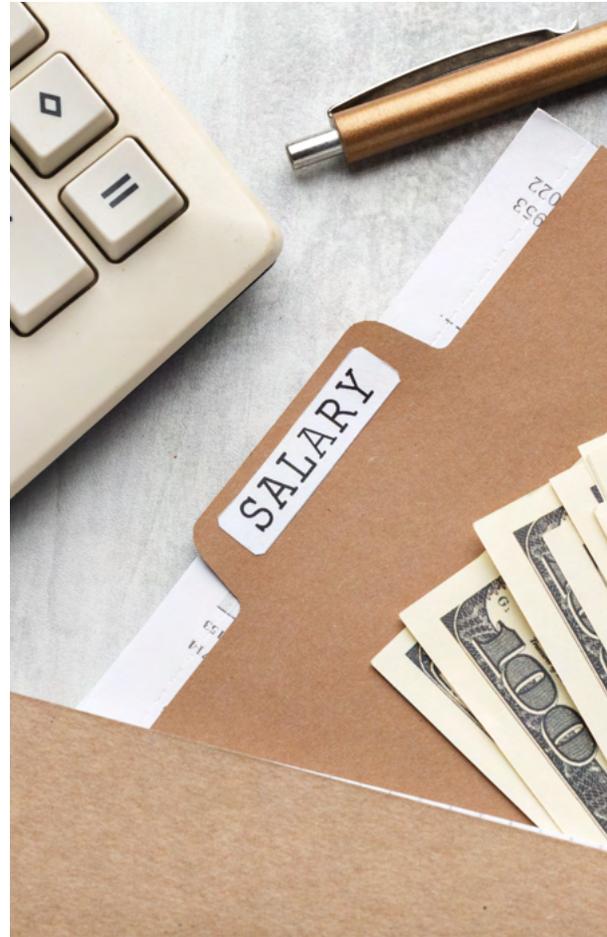
Payroll is often one of the top expenses for a business. Since it accounts for such a large percentage of your overall revenue, a well-functioning payroll department is essential for the success and growth of your business.

Why it's essential to have an excellent Payroll process:

- Smooth running payroll is a demonstration of your financial stability.
- Payroll that runs on time maintains employee confidence.
- Payroll has a heavy impact on overall cashflow and can bring added stress if not managed correctly.

Common payroll mistakes:

- Misparsing garnishments
- Missing federal deposit deadlines
- Misclassifying employees
- Labeling someone a contractor that is actually an employee
- Missing paychecks
- Incorrect payments



Depending on the size of your company, payroll errors could be substantial. Especially if the process is automated but still incorrect. A perfect example of how devastating an unchecked process can be is when Amazon underpaid (or worse, fired) hundreds of employees on medical or approved paid leave due to processing errors. It took them months to resolve past due payroll errors resulting in a PR nightmare. While it isn't likely that you're dealing with Amazon's 1 million + employees, it shows that not taking proper audit of your payroll can result in significant morale drops and ethical questions.



Ways to Improve Your AP Process Functions:

- If you guessed we were going to say something about having a clear process in place, then you're correct. Don't underestimate the value of a process document. If you've clearly outlined to your accounting department what steps should be taken throughout the payroll process, then there is no mistake. If an error does occur, you can walk through the process document to assess where the mistake may have taken place and provide further training to your employee to ensure it doesn't happen again. A process document is your safeguard and their resource.
- Create a detailed payroll calendar – A payroll calendar seems simple enough but automating reminders for upcoming due dates can ensure proper cash flow and help you avoid late fees.
- Don't cut corners on classifying your employees - Thoroughly evaluate the criteria that delineates an independent contractor from an employee. If you misclassify an employee, you could owe back taxes, wages, and fees. Also ensure that you are classifying your employee correctly as being exempt or non-exempt from overtime.
- Get your payroll automated or outsourced. Just like with Accounts Payable, it is good to build up your cashflow so you can automate payments to save you headache. Likewise, if you're noticing repeat issues in your automations, opt for outsourcing your payroll to minimize errors.



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Financial Reporting & Analysis

Financial reporting & analysis can include several reports such as:

- Balance Sheet
- Profit & Loss
- Income Statement
- Cash Flow Statement
- Return on Equity
- Operating Margin
- Ratios including:
 - o Financial
 - o Profitability
 - o Liquidity
 - o Current
 - o Debt

Why it's essential to have accurate and effective financial reporting & analysis:

- Depending on the type of company you run, you may be required to provide financial reports to stakeholders, investors, or regulatory agencies to assess the financial integrity of your company.
- Provides direction for overall company performance.
- Compare year-end reports to measure and predict growth.
- Set clear budgets based on overall performance and predicted performance.

Common Financial Reporting & Analysis mistakes:

- Data entry errors
- Error of omission
- Error of commission
- Error of principle
- Compensation errors
- Error of duplication
- Long-term debt disclosure

Ways to Improve Your Reporting & Analysis Functions:

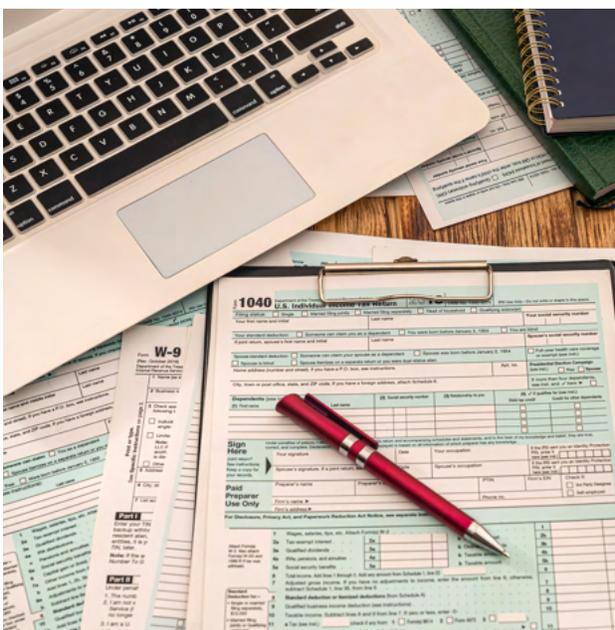
- Take the time to reconcile your accounts.
- Stick with your payment calendar.
- Outsource your accounting to ensure compliance, consistency, and dependability.
- Use an accounting software to help generate reliable reports.

Taxes & Compliance

Accounting for taxes is an essential part of a successful business. Allotting the correct amount for taxes and paying your taxes on time will ensure that your cashflow remains dependable and your profitability is realistic.

Common Tax Mistakes:

- Not separating personal expenses from business expenses – this is especially common if you use a personal card for business expenses.
- Not scheduling or delivery reports
- Data entry mistakes
- Not taking proper deductions
- Poor bookkeeping/record keeping



Ways to streamline taxes & compliance:

- Separate your personal and business finances by creating separate checking accounts and bank cards. Be sure to only use these business accounts for business expenses.
- Internal controls help not only detect but also prevent errors from occurring. Controls can occur on a monthly, weekly, or even daily basis for.
- Conduct a periodic 3rd party review of your accounting to ensure your processes are in compliance with GAAP (generally accepted accounting principles).
- Invest in a scanner to quickly digitize your receipts for paperless record keeping – you must maintain receipts for 3 years.
- Accounting software allows you to easily categorize your expenses for easier reporting and deductions at the end of the year. You can also connect your bank account and automatically import expenses – just be sure to also track the receipt.
- Ensure proper withholding of:
 - o Federal income
 - o Social Security
 - o Medicare taxes

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Budgeting

Have you set a budget for every department in your company? This includes things like:

- Fixed costs
- Variable costs
- Capital costs
- Non-operating expenses
- Cash flow budget
- Sales budget
- Marketing budget
- And more

Essentially, any cost within your business that affects your overall revenue should be assigned a budget and accounted for. Accounting software reduces the likelihood of errors eating into your bottom line. There are also industry-specific accounting software tools that could work for you. If you're still operating on an Excel spreadsheet then you are leaving margin for error.

Ensure you have a process for cash management and recording as these expenses can easily get lost – leaving you without essential deductions.

Overall, auditing your accounting department is a valuable piece of risk management. Aligning your department with best practices and ensuring issues are fixed before an audit or fee will save you time, money, and stress.

An accounting audit can also help ensure that you are keeping accurate records for reporting and compliance allowing you to set realistic goals for your business growth.

Bear in mind, some accounting audits should be (or are required to be) done by a 3rd party. In some cases, a controller must be hired to take a look at your CPAs work to ensure all details align.

While creating processes and standard operating procedures can be tedious, it is a valuable asset for your business in the long run. Processes and automated accounting software is worth the investment and will ultimately be your greatest ally when it comes to liability and overall growth.





Total Accounting Department Audit (TADA)