

# ClerkBooks Closing Tools Module

In this article, I will discuss three topics:

- why we created the Closing Tools module
- why you need to run the Closing Tools
- what each tool does

## Why we created the Closing Tools module:

QuickBooks is the world's #1 accounting software for **small business**. However, it was not designed for **municipal Fund** accounting. It does not follow Governmental Accounting Standards Board (GASB) directives. Therefore, the database structure and the coding does not complete all the necessary accounting steps. ClerkBooks has done everything we can within the QuickBooks software to make it meet GASB directives. We have:

- added a custom chart of accounts designed specifically for each state and streamlined for every municipality
- added custom Items for utility billing and payroll to match the custom chart of accounts
- added custom reports for Council, Auditor, and State reporting

However, this is still not enough.

## Why you need to run the Closing Tools:

To see why this isn't enough, we must understand why Governmental Fund Accounting is much more complex than what QuickBooks was designed to handle. Different than small business accounting, GASB demands that we group expenses by Function, Activity and Object. For example, we have a Function called Public Safety. Within Public Safety we have Activities such as Emergency Management, Police, Fire, Ambulance, etc. We must be able to group all the expenses for each of those Activities. In other words, we must be able to tell the State how much money we spent in Emergency Management individually (as a department) versus how much we spent in the Police Department versus how much we spent in the Fire Department, etc. We must then be able to report how much we spent in the Public Safety Function versus the Public Works Function, or the General Government Function, etc.

We then get to add Funds to the mix. A Fund is a segment of the municipality that has its own set of accounts and maintains its own balance from year to year. There are required Funds such as: General, Special Revenue, Debt Service and Proprietary/Enterprise. Then there are required and optional sub Funds such as: Special Revenue/Road Use Tax or Special Revenue/FEMA Grant, etc. Every Function and Activity we discussed above may be able to use money from various Funds. For instance, Public Safety/Emergency Management might use money from the General Fund and might also use money from the Special Revenue/FEMA Grant Fund.

Sound complicated? Let's now add in the Objects. Objects are what most people think of as expenses: Office Supplies, Payroll Wages, Postage, Supplies, Vehicle Repairs, etc. Every single Activity, within every single Function, within every single Fund have the same list of Objects.

Now compare that to regular accounting. QuickBooks comes with multiple templates for a chart of accounts. No matter which one you choose, there is only one account for Payroll wages. There is only one account for Payroll taxes. As you can see from the description above, Municipal Fund Accounting (when following GASB directives) may have over a hundred Payroll Wage accounts (Objects). The more sub-Funds a municipality has, the more activities a municipality has, the more complicated the accounting becomes.

Let's now apply this knowledge to each of the closing tools. We will show you what the problem is in QuickBooks that we are fixing with each closing tool. We will also describe what the closing tool does to fix the problem.

## What each Closing Tool does:

First, the Closing Tools module does not change (edit or delete) any existing transaction. Each tool simply creates a journal entry on the date that you designate when you Set Report Dates.

Second, the Closing Tools module does not make a judgement as to the validity of your existing transactions. Each tool is designed to balance something. However, it balances each account or Fund according to the transactions you have entered. For example, if you allocated wages to the wrong Activity, it would allocate matching payroll taxes to the wrong Activity. (you'll see more detail on that next)

Third, the Closing Tools module, if ran properly, will complete and produce the following reports:

- Profit & Loss by Fund
- Balance Sheet by Fund
- Trial Balance by Fund

Without running the Closing Tools, or creating manual entries to accomplish the same task, these three reports will never be correct. There is nothing you can do within QuickBooks, other than creating journal entries, to make these three reports accurate. Now, let me explain.

### **Closing the Profit and Loss statement**

The first tool corrects issues with QuickBooks payroll expenses on the Profit & Loss report.

The issue: When we create a paycheck in QuickBooks, we can split out gross wages by Function, Activity, Object and Fund. There is no problem with gross wages. However, we cannot do the same for City paid taxes and benefits. Remember, QuickBooks was designed to only use one Payroll Taxes account. Therefore, when we setup Social Security, Medicare, Retirement, Health Insurance, AFLAC, etc., every amount of the expense can only be assigned to one Function, Activity and Object. There is no way around this issue. QuickBooks tries to break out taxes into each Fund, according to the Funds assigned to wages, but it cannot assign it to more than one account. Oddly enough, QuickBooks doesn't even try to break out other benefits – those all land in the "unclassified" Fund. Meaning QuickBooks does not give that amount a Class.

Not the best solution: Some cities will work around this limitation by only allocating one Function, Activity, Object and Fund to each paycheck. For instance, they pay their maintenance person out of the Roads Department for 4 months, Water Department for 4 months, Sewer Department for 2 months, and Public Works for 2 months. Accounting wise, this does work. (if you also switch payroll tax and benefit items when you switch your wage item and Fund) However, the downside is related to monitoring the budget. If all the wages for the maintenance person are allocated to Roads for the first 4 months of year, then Council members may believe they have more money to spend in the other Funds than what they really have. They might also think they don't have any money in the Roads department since you are taking an annual expense and slipping it into 4 months. There are ways around this issue if you have 4 or more employees of relatively equal hours and pay, however we have a better solution.

A better solution is to split the wages up on every paycheck, so the Council can see an accurate picture of the year-to-date expenses for every Function, Activity, Object and Fund. Then let the Closing Tool do the heavy lifting for you.

What does the tool do? The tool will look at every account that has wages in it. It will then calculate what the tax should be, according to the wages it finds. It then looks at how much tax has already been allocated to that spot. It then makes an entry to take it out of the account it shouldn't be in, and put it into the account it should be in.

After the tool is run, you should be able to find any wage expense account (Object), in any Function, Activity and Fund, and multiply it by the tax rate, and see that number has been applied to the correct location. Otherwise you are probably allocating too much expense to one position (probably the General Fund City Clerk's budget) and not enough in each position that truly deserves it.

The second Profit & Loss tool sends the monthly portion of net income or net loss to the balance sheet equity section.

Remember in Fund accounting, according to GASB, each Fund must have its own balance that carries over from year to year. They even go further to break that Fund balance into 4-6 categories such as: reserved, restricted, unrestricted, etc. However, remember that QuickBooks was designed for small business. Small business only deals with 2 Equity accounts, net income and retained earnings. Therefore, by default, Net Income/Net Loss shows up on the Balance Sheet automatically every month. However, it is then automatically transferred to Retained Earnings after the end of a fiscal year. The issue is that we need to break it out by type of Fund balance, rather than leaving it in Retained Earnings. In fact, Governmental Funds do not ever have Retained Earning Equity accounts. Only Proprietary/Enterprise Funds do, and only in some States.

Plus, some State Auditors request what is called a Treasurer's Report. This report starts by showing the beginning Fund balance, then shows a line that adds in total Income, then shows a line that subtracts total Expense to finally show a line with the calculated ending Fund balance. This is done for every Fund and many sub-Funds.

The solution: the Closing Tools module uses an Other Expense account on the Profit and Loss report to zero out Net Income on the Profit and Loss report and then adds Total Income (in one journal entry) and Total Expense (in another journal entry) to the appropriate Equity account on the Balance Sheet.

Now most CPAs will say that entry should not be made until after the end of the fiscal year. Technically they are correct. However, by doing this at the end of every month, we can create the Treasurer's Report for each month. And, by doing the entry to an "Other Expense" account, we can still see the month-end and year-to-date Net Income/Net Loss in a line on the Profit and Loss report called "Ordinary Net Income".

The other advantage of using this Closing Tool is that after running the tool, the Profit and Loss report shows all zeros at the bottom of the report. This is valuable for fraud prevention. If anyone goes back into a previously closed period and changes a transaction, the report will no longer show all zeros across the bottom. This makes it easy to see if someone is trying to alter the financials. It also makes it easier to find mistakes.

### **Closing the Balance Sheet statement**

Other than the payroll tax and benefit issue we described above, QuickBooks really does a pretty good job with the Profit and Loss statement. However, the biggest issues are within the Balance Sheet.

The first 4 balance sheet tools fix similar issues, just within 4 different balance sheet account groups. The principals are the same, so I will save us all some time by only explaining one of them in detail.

The problem: QuickBooks was not designed to split the Balance Sheet, and in turn, the Trial Balance report out by Fund. It was designed to show a combined Balance Sheet with all parts of the company in one column. For instance, let's look at Accounts Receivable.

When you create an Invoice, you can assign the income for the Profit and Loss report to a specific income account. For instance, we can create an Item that points to an account called "Water Charges for Services" and a different Item that points to "Sewer Charges for Services". When we add them to the invoice, we can then point them to an appropriate Fund (using QuickBooks Classes). The Profit and Loss by Fund report looks great at this point. However, the Balance Sheet by Fund report lacks information.

You will notice on the Invoice data entry forms, there is only one Class drop down box allowing you to choose one Fund. This means that QuickBooks will take the amount of the invoice and add it to Accounts Receivable in only that one Fund. The correct accounting would add the water portion to the water Fund, and the sewer portion to the sewer Fund. However, the only way to do that in QuickBooks would be to create separate invoices for each Fund. Therefore, if you have water, sewer and garbage services, each customer will get 3 utility bills, one for each Fund. Not a good situation.

You can check that I am telling the truth by opening an invoice, clicking on the Reports tab (in the invoice window, not the main menu bar), then click on Transaction Journal. This will show you all the debits and credits happening behind the scenes.

Then let's look at taking a customer payment. The accounting for the payment all takes place on the Balance Sheet. There is no accounting that takes place on the Profit & Loss report. QuickBooks subtracts from Accounts Receivable and adds to Undeposited Funds (a temporary account used to hold money before it is added to a deposit slip with other payments). When you look at the payments window, unless you have the Enterprise version, you will not find a place to enter a Fund at all. So, QuickBooks subtracts from Accounts Receivable without assigning a Fund. (Enterprise allows you to assign one Fund to the payment – again, not a complete solution)

Again, you can double check me by opening a payment, clicking on the Reports tab (in the payment window, not the main menu bar), then click on Transaction Journal. This will show you all the debits and credits happening behind the scenes.

So, at this point, if we look at a Balance Sheet by Fund report, you will find a large positive number in one goofy Fund column (usually Proprietary – Other) from all the invoices, and a large negative number in the “Unclassified” column. Neither of these Funds are GASB Funds and must be allocated properly.

The solution: The Closing Tools module runs through the records in QuickBooks. It pulls out all the unpaid invoices and all the unapplied credit memos and overpayments. It totals up how much has been invoiced or is on credit memos to each Fund, water, sewer, garbage, etc. It then allocates all unapplied payments and splits that balance up by the % of balances from invoices and credit memos. (since overpayments have no Fund to apply to until the payment is actually applied) It then looks at the existing balance in each Fund. It calculates the difference between what the current balance is and what it should be. It then creates a series of entries to make that adjustment.

Unfortunately, QuickBooks does not give you an easy way to double check the ending numbers. You would need to literally open every invoice that hasn't been paid, and all credit memos that haven't been applied, and total up the charges for each Fund, then decide where to apply overpayments, in order to make the adjustments yourself.

### **Accounts Payable Adjustment**

Accounts Payable works almost the same way as Accounts Receivable. Bills allow you to expense to the Profit and Loss report properly, but you cannot assign a Fund to the Accounts Payable liability account on the balance sheet report. Bill payments also do not allow you to assign a Fund at all.

The Closing Tools module fixes Accounts Payable in the same way it fixes Accounts Receivable

### **Accrued Payroll Tax Adjustment**

Payroll taxes and benefits on the balance sheet work the same way as AR and AP. When you create a paycheck, balances for taxes are sometimes automatically split out by Fund, but other benefits cannot be assigned a Fund. When you go to pay the liabilities, by default they are not assigned a Fund. However, you can assign a Fund to the liability accounts after the liability check is created, if you know the splits you need to make. If you pay the tax or benefit before the next payroll, this is possible, but tricky and time consuming. If you pay the tax or benefit in the next month or next quarter, it is very tricky and very time consuming.

The Closing Tools will do all the allocation for you.

### **Sales Tax Payable Adjustments**

There is a similar issue with Sales Tax. When you create a Sales Receipt or an Invoice, QuickBooks does not assign a Fund to the sales tax portion of the transaction. Unless you are in Iowa or have multiple sales tax rates per invoice – in

that case we cheat the system and this tool is no longer ran. Otherwise, the closing tool allocates the unclassified portion of Sales Tax payable to the correct Fund.

### **Other Balance Sheet Adjustments**

This adjustment is different than the previously described adjustments. The previous adjustments pull transactions out of QuickBooks and total up all the details of those transactions to find out what the proper balance is in each Fund and sub-Fund. The Other Balance Sheet Adjustment just looks at the total balance for the remaining accounts and assigns that entire amount to a pre-defined Fund.

For instance: If the Water Fund has a savings account, many of the transactions running through QuickBooks will not assign a Fund to the balance that goes into or out of the bank accounts on the balance sheet. When you create a check, the expenses can be assigned to the profit and loss report correctly, but the amount that comes out of the bank account will not be assigned a Fund. However, since we know this bank account only belongs to the Water Fund, the tool automatically moves any amount that is not in the Water Fund over to the Water Fund.

This tool requires that all the accounts it is adjusting be designated to only one Fund. Therefore, it cannot appropriately split balances out to a shared Water/Sewer savings account, since those are typically two different Funds.

### **Operating Account Adjustments**

Finally, we come to the last adjustment.

This is an interesting adjustment. This is the final balancing adjustment. In accounting, balancing the books refers to balancing the Balance Statement. To be in balance, Total Assets must equal Total Liabilities plus Equity. Up to this point we have done everything within our power to make sure that every account on the balance sheet is correct. Not only as a total for the City, but as a total for each Fund and Sub-Fund.

Since we trust the previous closing tools, we then split the Operating Bank account so that each Fund and sub-Fund balances. Assets equal Liabilities plus Equity.

This is an important step for fraud prevention as well. Remember we can tell if anyone tries to edit a closed period on the profit and loss because the net income line would no longer have all zeros across the bottom. After running this tool, we will know if anyone tries to edit the financials because the balance sheet will no longer be in balance for each Fund.

By default, QuickBooks will always be in balance, as a whole. If you look at a combined Balance Sheet, Assets will always equal Liabilities plus Equity. However, until you run this tool, General Fund, Special Revenue Fund, Water Fund, Sewer Fund, etc., will not be in balance. There will also be balances in "Unclassified" that belong in real Funds. If the Balance Sheet is out of balance, it does not meet GASB or GAAP requirements.

Side note: none of the Balance Sheet Closing Tools change the amount in any account. They only move appropriate balances from the wrong Funds into the correct Funds. QuickBooks cannot do this for you.

### **Final words**

In closing, we created the Closing Tools as a way to convert QuickBooks from a small business accounting system to a GASB compliant Governmental Fund Accounting System. It is up to you to decide whether to run the tools or not run the tools. They are there to help you. Either way, these types of adjustments must be made.

But closing the books is about more than running the Closing Tools. When you run the Closing Tools, there are instructions on what else to do in the books before and after running the tools. For instance, before starting you must reconcile all bank accounts. You should also double check your profit and loss reports to make sure you haven't assigned

water wages to the general Fund, and vice-versa. You should also balance your payroll liabilities and make sure the amounts due are the amounts actually due. Steps like this are just as important as running the Closing Tools.

Closing the books also means that after closing, nothing will ever change in that closed period ever again (unless an auditor tells you to make a change AND you re-publish the financials that have been adjusted). And because of Open Records laws, you should never publish (give to the Council, post at the post office, send to the newspaper etc.) any financial report for a period that hasn't been closed.

We understand this is a lot of information. We also understand the closing process can be confusing and frustrating. There are several ways we can help:

- We can schedule some one-to-one training with you to walk you through the closing process
- We can schedule time to explain the closing tools to your CPA and/or Auditor
- We can do the closing process for you (and thereby add another layer of checks and balances)

Thank you for choosing ClerkBooks. We are all in this together. Let us know how we can help.