TRACKING YOUR COSTS

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We know you want to make money. How will you make sure that that happens? One way is to be able to track and analyse your expenses. There are two techniques that can help you: cost accounting, and budget-actual comparisons. *Cost accounting* refers to being able to associate specific expenses with particular sources. For your firm, you will want to differentiate between two types of expenses:

a) *Contract expenses*
These are expenses you incur because of a particular contract for client work and are also known as *variable expenses*. If you didn't have the contract, there would be no expense. At a minimum, you want to have these expenses reimbursed by your client.

b) *Operational expenses*
These are your general overhead expenses (e.g., rent, payroll, office supplies, equipment repair, etc.), known as *fixed expenses*, that you have to pay whether you have paying clients or not.

The other analytical tool that can help you is comparing your budgeted figures against your actual expenditures each month. When you have expenses (such as licence fees) that only come due one or twice year, there will, of course, be a difference between what you have budgeted per month and what you have spent. But, for most expenses, you can use the comparison to spot when costs are getting higher than expected.

The financial information available to you is controlled by the *Chart of Accounts* set up typically by your accountant without any discussion of the types of revenue and expense categories that would be of assistance to you. Their decisions are typically driven by the tax reporting categories set out by your government. Those categories are often more aggregated than would helpful to you as a manager. It is important that you determine what questions you want to answer with your financial data. For example, are you satisfied to know simply that your revenues are more than your expenses? If you provide more than one type of service, would it help you to be able to see which services bring in a profit and which may cost money to provide? If the latter, then you need to have a Chart of Accounts that works for managerial accounting.

In setting up a "managerial accounting" Chart of Accounts, we are talking specifically about the categories of revenues and expenses that would be reported on an Income Statement. There are four basic principles to keep in mind:

1. Revenues should be disaggregated into the main services that you want to track.

2. Expenses should be reported in two main categories: Contract Expenses and Operational Expenses.

3. Contract Expenses are the *variable* expenses that you incur in order to deliver a particular service. If you did not deliver this service, the expenses would disappear. You want expense subcategories that will help you match the expenses to the relevant revenues.

4. Operating Expenses are the *fixed* expenses that you have – i.e., the expenses that continue even if you have no incoming revenue. Typically these expenses are rent, insurance, salaries, utilities, electronic mail, phones, business development travel, etc. You want these to be disaggregated in into subcategories that are meaningful to you from a cost management point of view. For example, if you spend little money on postage or couriers, you could group these expenses with supplies and name it office costs. However, if you do large mail-outs, you might want to track postage separately.

The bottom line is that, as long as you have the minimum categories required for tax reporting, it is your call what your Chart of Accounts looks like so make sure that it helps you manage your costs.

