



**THE ULTIMATE GUIDE**  
To Franchise Accounting

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# THE ULTIMATE GUIDE

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The purpose of this guide is to give you a basic understanding of the mechanics and purpose of accounting in general. After, we will dive into the niche accounting topics every franchisee needs to know. Our real goal is to bring all of this information to you in a short, concise and easy-to-read format. We want to reach as many franchisees as we can with this free guide, so if you know any others, please share!

The main things we will cover in part one of this book are 1) how to keep yourself organized, 2) what metrics every franchisee needs to pay attention to, and 3) how to energize your cash flows. Continue reading for tips and insights on boosting your overall business performance.

Congratulations on your decision to take a bite out of the fat of the land and purchase a franchise. I like to look up at the sky and imagine all the trillions of dollars changing hands every day. Money is flying from consumer to producer...from passenger to airline, from customer to restaurant, from client to financial planner, from your customers...to you! And of all those trillions, if we can even take just .0001%...we are sitting on a wildly profitable business. So why not us? Why not you?

It's important to dream, to think big, and to never forget why you started your franchise in the first place. Maybe you were sick of the 9-5 job, or maybe you just knew you could do more and do better. Whatever the reason, you're absolutely right for making the decision you did.

While keeping our heads in the clouds, it's important to keep our feet on the ground at the same time. This is where the soundness of your accounting comes into play. So let's get started!

## **Why is my accounting important?**

Would you like to...

- 1) Buy a house?
- 2) Have other investors buy in to your business?
- 3) Start a side business or [open a new franchise location](#)?
- 4) Sell your franchise (and get a GOOD price for it?)
- 5) Pay very little to [have your taxes done](#)?
- 6) Pay very little in taxes?
- 7) Be able to put your finger on the pulse of your business in real time, at any time?

All of the items above require your accounting records to be in perfect shape. Some people can motivate themselves to get in shape, other's benefit greatly from having a trainer. Which type of business owner are you?

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The Ultimate Guide to Franchise Accounting covers a number of topics vital to healthy, successful franchise ownership, including:

- Appropriate business entity type
- Accounting Method
- Assets Vs. Liabilities Vs. Owner's Equity
- Key Financial Statements and How to Read Them
- KPIs
- How to Stay Organized
- Vital Daily, Weekly and Monthly Tasks

We had one window coverings franchisee client out of Lee County, Alabama who did not listen to us at all regarding his accounting. He decided to do it all on his own and to figure it out on his own. Six months after he started, his business was a mess. He had no idea if he was making or losing money, who he owed, who owed him, how to handle his taxes...things were bleak. He ended up paying us much more than he would have had he either A) used us from the beginning or B) took the time to really learn franchise accounting. He inspired this guide. We do not want anyone to go through the stress and anguish that our client did.

**“ Don't ever let your business get ahead of the financial side of your business. Accounting, accounting, accounting. Know your numbers. - *Tilman J. Fertitta***

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## Picking an Entity Type

If you are just starting your franchise, you will first need to register a business in the state where your operations will be located (typically the state where you live). You will also need to [register your business with the federal government](#).

You have a few different types of business to choose from, which include (in order of commonness):

- **LLC (Limited Liability Company):** Business is separate from you, the owner. Therefore, the liability of the Company is limited to the Company's assets. Your Company's creditors cannot go after your personal assets in most cases.
- **Sole Proprietorship:** You are the business and assume full liability.
- **Partnership:** You and one or more other people are the business and you all, the partners, share liability.

- **C-Corporation:** Business is its own entity and can make decisions as if it were an actual person. Your liability as an owner is limited. However, C-Corporations are subject to double taxation.
- **S-Corporation:** Similar to the LLC, but with shareholders instead of interest holders.

## Benefits of Picking the Right Entity Type

- ✓ Avoid legal liability
- ✓ Pay less taxes
- ✓ Maximize cash flows
- ✓ Increase ease of investor buy-in

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## So what might we find in your accounting records?

**There are four main categories: Assets, Liabilities, Equity, and Revenue/Expenses.**

### • Assets

Assets are what your franchise owns. Examples include: Cash, accounts receivable, inventory, supplies, vehicles, buildings, land, copyrights, patents, trademarks, franchise fee, and other investments.



### • Equity

If assets are what you own, and liabilities are what you owe, you can think of equity as the difference. In other words, let's say you have \$100 in assets. You own \$100 worth of various items. You owe \$70 to your creditors, such as your credit cards and vendors. Then, \$30 is your equity. It is what is left over that belongs to you, the franchise owner. As you successfully operate your franchise, this number should go up, not down.

### • Liabilities

Liabilities are what your franchise owes. When you purchase a good or service but will "pay later", you have created a liability for your franchise. Examples include accounts payable, credit cards, payable, lines of credit, and debt/mortgages/loans.



### • Revenues/Expenses

Revenues are what your franchises earns, and expenses are what your franchise spends. Watch both these numbers, as low revenues could indicate a lack of customers or poor pricing; high expenses could mean you're buying more than what your franchise needs.

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## Why are My Expenses So Darn High?

**Keeping an eye on your expenses is Critical to running a successful franchise.**

Expenses are a way of tracking what your business is spending. You want this number to be low, as high costs could be indicative of inefficiencies in your business.

Expenses could be high because you are:

- 1) Spending too much on inappropriate ads for your business
- 2) Not taking advantage of vendor discounts
- 3) Highly indebted, resulting in high interest expense
- 4) Not tax planning, resulting in high tax expense
- 5) Stuck on subscriptions you don't even use anymore
- 6) Spending too much on inefficient team members
- 7) Not taking advantage of automation in your business
- 8) Spending too much on inventory, resulting from not taking a just-in-time approach

..The list is endless.

Figuring out the above and more reasons your business is high in costs and low in revenues are what an accountant, and more specifically, what a CPA does.

Your business could be losing \$100,000 a year or more from such inefficiencies.

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## Key Financial Statements For Franchisees

The following are documents you will be able to produce from your accounting records that spell out the financial health and performance of your franchise.

### • Income Statement / Profit & Loss Statement

Your income statement shows you the net income of your business over time (i.e. for the year ended 12/31/2018). The statement calculates net income by taking your revenues for the period and subtracting your expenses. The result is your net income, or what you really earned at the end of the day. This is often called your “bottom line”. Your focus as a franchisee should be to boost your bottom line as much as possible, while reducing any increase in taxes that would result.



### • Statement of Cash Flows

Your statement of cash flows, as the name implies, is all about cash. It shows what made cash go up and what made cash go down during a period of time. Types of cash flows include operating (day-to-day business activities), investing (large purchases or sales of assets), and financing (borrowing or paying back money).



### • Balance Sheet

Your balance sheet shows you the assets, liabilities and equity of your business on a single date (i.e. December 31, 2018). Your assets will always be equal to your liabilities plus equity (since your assets go to either your creditors (i.e. liabilities), or you! (i.e. equity)). Later in this text, we will go over some key metrics you want to pay attention to when reviewing your balance sheet.





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## Key Performance Indicators

So now we know the types of accounting information (assets, liabilities, equity, and revenue/expenses), and where to find them. Let's use this information to make decisions. Using these numbers, we can determine if our franchise is healthy or not.

### • Gross Margin

Your gross margin is your revenues less the costs of your goods or services sold. This number as a percentage is gross margin divided by sales. All things equal, this number should remain very consistent. If you see a decrease in gross margin percentage, there is something seriously wrong that should be resolved.



### • Current Ratio

Your current ratio is equal to your current assets divided by your current liabilities. The word "current" in this sense means assets and liabilities that can be converted to cash and must be paid within one year, respectively. If this number is above 1, you are able to cover your upcoming debts. If it is less than 1, you will be unable to cover your upcoming debts. Keep an eye on this figure.



### • Accounts Receivable Turnover

Your accounts receivable turnover is equal to accounts receivable divided by sales. This figure indicates how many times each year you collect your entire average accounts receivable balance. A high number means you are very good at staying on top of customer collections. A low figure means you are not being paid very timely by your customers and should look to improve collections.



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## Staying Organized

In order to tracking your financial information, produce financial statements, and calculate key performance indicators that help you make actionable decisions, you need to stay organized! Keep every receipt, book every expense, record every transaction. This is the most time-consuming aspect of accounting; expect to spend 60+ hours per month on organizing your accounting, should you decide to go it alone.

### • Key periodic documents (keep for three years)

- Receipts
- Credit Card Statements
- Cancelled Checks
- W-2 and 1099s for employees/contractors
- Financial statements
- Royalty statements/calculations

### • Long-term documents (keep for franchise term)

- FDD
- Loan agreement(s)
- IRA Agreements (i.e. ROBS)
- Articles of Incorporation/Organization
- SS-4/EIN
- Operating/Partnership/Owner Agreement



### • Why it matters

If the IRS decides to audit you (and they can, even randomly), you need to have all of these documents ready to present. If you do not, it could mean costly additional taxes, penalties, and interest due. In addition, you need these documents to be able to look back and remember key transactions throughout the term of your franchise. Finally, future potential buyers, including the franchisor, will want to see proof to back up your financial statement numbers.



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## Key Periodic Tasks

So how do you make sure you stay on top of your accounting? Complete these tasks in the time frame indicated.

### **Record and pay royalties (Weekly/Monthly)**

Every franchise is different. Some require a weekly royalty payment while others only require a monthly payment. In any case, to avoid a franchise audit, you need to accurately record and timely pay your royalties.

### **Schedule bill payments (Weekly/Monthly)**

Staying on top of vendor bills, like customer invoices, is vital to the success of your franchise. Your vendors are critical to get the goods/services you need to ultimately service your customers. Late payments can mean penalties, additional fees, and even lost vendor relationships.

### **Accounting review (Weekly)**

We recommend that at least once a week you go back and review your accounting entries. This self-review is critical to ensure your accounting is accurate. The longer you wait to review your accounting, the more likely pervasive errors will not be caught and will affect your analysis of your business performance. Significant errors can also lead to problems with the franchisor and the IRS come tax time.

### **Cash Checkup (Monthly)**

Cash is the lifeblood of your franchise. If you do not have enough cash, you can fall short and end up being late on important vendor/regulatory payments. If you let too much cash sit, then you are not investing and maximizing it to grow your franchise. At the beginning of every month, we recommend you review your cash position and compare it to your budget. Where do you stand? Will you make enough cash during the month so that your total cash can cover your total liabilities?

### **Follow Up With Late Customer Payments (Monthly)**

If you let customer invoices go too long without payment, eventually your customers will forget they even owe you anything. It is vital that you, on a monthly basis, go back and send invoice reminders to late customers. Your cash flow will thank you for it!

### **Plan for the Future (Monthly)**

On a monthly basis, you should predict your business's future by comparing current performance to your long-term goals. Where do you see your business in one month? Six months? One year? If you do not forecast your franchise's performance, you are simply floating and not actively controlling your destiny.

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## Maximizing Your Franchise's Cash Flow

Why did you buy a franchise in the first place? To make cash! Here are ways to make sure you are getting the most cash out of your franchise.

### **How to Get More Cash out of your Franchise**

#### **Who is buying your goods/services?**

Get a deep understanding of who your top customers are and market specifically to them. You'll boost your cash flows from customers in your territory by using laser-focused marketing techniques.

#### **Are you buying too much inventory? (if applicable)**

It is key to use a Just-In-Time approach to inventory where you only have the goods on hand that you need to supply to your customers. To determine this, you need to use expert inventory-tracking techniques. Take a look at your stock and sell off anything covered in dust at a discount. Purchase only the inventory that customers are actually buying.

#### **Tax Plan.**

You are almost certainly paying too much in taxes. In fact, out of the hundreds of franchisees we have services, 100% of them were paying more in taxes than they needed to. By using advanced tax-planning strategies, you can **legally** reduce your annual tax bill by thousands of dollars, which prevents a negative cash flow. The best part is these are cash flows that are not subject to royalties.

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## So what is the best route?

### Should you go it alone, or get help?

This is a decision you must make on your own. Our experience shows that franchisees spend 60+ hours per month trying to manage their own books. They spend 100+ hours per year trying to do their own taxes, and, as we mentioned above, they overpay in taxes by thousands of dollars. You can take our advice in this book and try to manage it all on your own.

While making this decision, reflect on all of the information you read in this book. Do your franchise accounting and taxes seem like something you can effectively manage, while also managing the operations of your franchise?

Benefits of using expert assistance with your franchise accounting and taxes include:

- ✓ Save 60+ hours monthly and up to 1,000 hours annually
- ✓ Spend the time you save to sell, sell, sell! Boost your revenue while your expert manages the financial side of things.
- ✓ Save tens of thousands of dollars every year on your tax bill through advanced legal tax strategies
- ✓ Sleep soundly knowing your accounting is done right. Be compliant and never worry about IRS or franchisor audits.
- ✓ Have your expert advisor on speed dial whenever you run into questions or concerns.



To speak to a franchise accounting expert, click the link below to get started.

[www.MyFranchiseCPAs.com/appointments](http://www.MyFranchiseCPAs.com/appointments)

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