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6 BOOKS
IN **1**

- Basic Bookkeeping
- Bookkeeping Day to Day
- Additional Monthly/Quarterly Bookkeeping Tasks
- Bookkeepers and Accountants Working Together to Prepare Financial Statements
- Accountants: Managing the Business
- Accountants: Working With the Outside World

Jane E. Kelly



***Bookkeeping
& Accounting***

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Edited by Jane Kelly, ACMA

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Bookkeeping & Accounting All-in-One For Dummies®

Published by: **John Wiley & Sons, Ltd.**, The Atrium, Southern Gate, Chichester, www.wiley.com

This edition first published 2015

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Registered office

John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, United Kingdom

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A catalogue record for this book is available from the British Library.

ISBN 978-1-119-02653-2 (paperback); ISBN 978-1-119-02660-0 (ebk); ISBN 978-1-119-02661-7 (ebk)

Printed in Great Britain by TJ International, Padstow, Cornwall

10 9 8 7 6 5 4 3 2 1



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Introduction

Welcome to *Bookkeeping & Accounting All-in-One For Dummies!* This book explains the different roles that both bookkeepers and accountants take on within a business. If you're a one-man or one-woman band, however, don't worry; within these pages you too can find out how to do the bookkeeping basics and see the ways in which an accountant can assist you further.

About This Book

This book aims to help you understand the bookkeeping tasks that need to be done within your business and to demonstrate how an accountant can help your business to set targets that will hopefully expand and grow.

Bookkeeping & Accounting All-in-One For Dummies is divided into six separate books. Each book is split into several chapters that tackle key aspects of bookkeeping and accounting functions. The Table of Contents gives you more detail of what is contained within each chapter. Each chapter presents information in a modular fashion so that you get all the information you need to accomplish a task in one place. You don't need to remember things from different parts of the book; if another chapter has information relevant to the discussion at hand, you'll find a cross reference telling you where to find it, so you don't have to read the chapters in order. You can read the chapters or sections that interest you when it suits you.

If you end up reading all that there is to read in this book, but find you still want more, check out the extra information in these *For Dummies* titles (all published by Wiley):

- ✔ *Bookkeeping For Dummies* (Jane Kelly, Paul Barrow & Lita Epstein)
- ✔ *Understanding Business Accounting For Dummies* (John A. Tracy & Colin Barrow)
- ✔ *Accounting Workbook For Dummies* (Jane Kelly & John A. Tracy)

Foolish Assumptions

Bookkeeping & Accounting All-in-One For Dummies makes some key assumptions about who you are and why you picked up this book, and assumes that you fall into one of the following categories:

- ✔ You're a member of staff in a small business who's been employed to undertake the bookkeeping and accounting function.
- ✔ You're a small business owner who currently doesn't have the funds to employ an individual. Therefore, you need to understand the basics of bookkeeping to enable you to deal with the day-to-day paperwork, with a view to perhaps using an accountant at year-end.
- ✔ You're a small-business owner who is thinking of employing a bookkeeper but wants to know the differences between what a bookkeeper can do for your business and what an accountant can offer.

If any – or all – of these assumptions accurately describes you, then you've come to the right book!

Icons Used in This Book

Every *For Dummies* book uses icons to highlight especially important, interesting or useful information. The icons used in this book are:



Look at this icon for practical information that you can use straightaway to help you to run your bookkeeping and accounting systems in the most effective way.



This icon indicates any items you need to remember after reading the book – and sometimes throughout it.



This icon calls your attention to examples of specific tasks that you can undertake to help you perform the bookkeeping or accounting skills explained in this book.



The paragraphs next to this icon contain information that is, er, slightly technical in nature. You don't *need* to know the information here to get by, but it helps.



This bombshell alerts you to potential problems you may create for yourself without realising it. Don't ignore this icon!

Beyond the Book

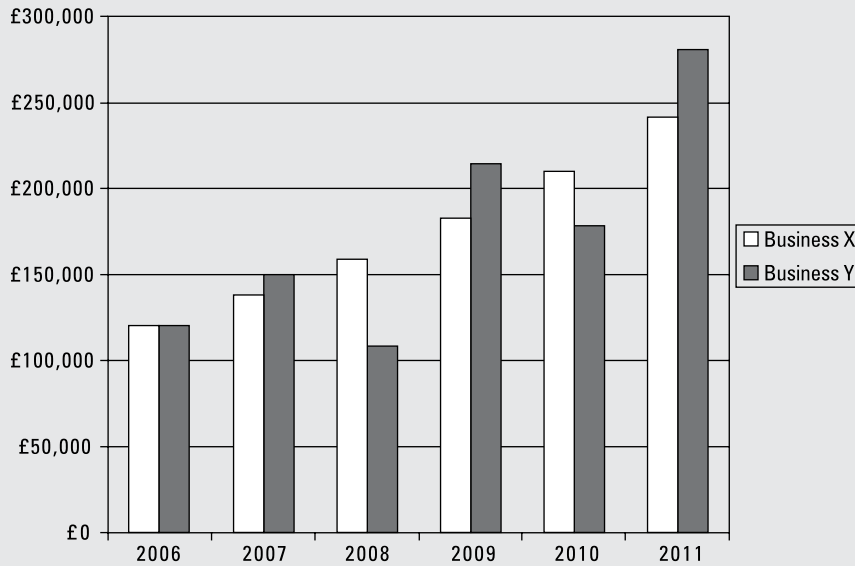
At www.dummies.com/extras/bookkeepingaccountingaio you can access some online extras, just in case you need a bit more help and guidance! You can also find the handy cheat sheet at www.dummies.com/cheatsheet/bookkeepingaccountingaio.

Where to Go from Here

You're now ready to enter the world of bookkeeping and accounting. If you're a complete beginner, starting at the beginning and gradually working through from there is probably the best approach. If you have some experience, but are a little rusty in certain areas, you can pick and choose the chapters that are most relevant to you. After all, this book is designed for you to dip in and out of as you like. I hope that you find it a useful tool for developing and managing your business.

Book I

Basic Bookkeeping



For Dummies can help you get started with lots of subjects. Visit www.dummies.com to discover more and do more with *For Dummies* books.

In this book...

- ✔ Get to grips with the basic bookkeeping terminology.
- ✔ Take a look at the double entry rules of bookkeeping.
- ✔ Understand the Chart of Accounts to see how it impacts on the Profit and Loss and Balance Sheet.
- ✔ See how the different ledgers work together to make your accounting system work for your business.

Chapter 1

So You Want to Do the Books

In This Chapter

- ▶ Introducing bookkeeping and its basic purpose
 - ▶ Maintaining a paper trail
 - ▶ Managing daily business finances
 - ▶ Making sure that everything's accurate
-

For many small business owners, while they love working in their chosen field using the skills they know and love, they don't always like to perform 'bookkeeping' duties. Most company owners prefer to employ the skills of a qualified bookkeeper. Some may, perhaps, prefer to give their bag-full of receipts to their accountant and simply hope that a useful set of accounts comes out of the end of the accounting sausage machine!

In this chapter we help to demystify the role of a bookkeeper. It may be that you're just starting off in business and, as a result, can't afford the services of a bookkeeper just yet! Think of this chapter as a checklist of jobs that need to be done.

Throughout the book, we introduce Have a Go sections, which are practical exercises aimed at helping you understand the bookkeeping principles we discuss. Feel free to draw all over these sections of the book; we want it to be as useful for you as possible.

Delving into Bookkeeping Basics

Like most businesspeople, you probably have great ideas for running your own business and just want to get started. You don't want to be distracted by the small stuff, like keeping detailed records of every penny you spend; you just want to build a business with which you can make lots of money.

Well, slow down there – you're not in a race! If you don't carefully plan your bookkeeping system and figure out exactly how and what financial details you want to track, you've absolutely no way to measure the success (or failure, unfortunately) of your business efforts.



Bookkeeping, when done properly, gives you an excellent measure of how well you're doing and also provides lots of information throughout the year. This information allows you to test the financial success of your business strategies and make any necessary course corrections early in the year to ensure that you reach your year-end profit goals.

Looking at basic accounting methods

You can't keep books unless you know how to go about doing so. The two basic accounting methods are *cash-based accounting* and *accrual accounting*. The key difference between the two methods is the point at which you record sales and purchases in your books. If you choose cash-based accounting, you only record transactions when cash changes hands. If you use accrual accounting, you record a transaction on its completion, even if cash doesn't change hands.

For example, suppose that your business buys products to sell from a supplier but doesn't actually pay for those products for 30 days. If you're using cash-based accounting, you don't record the purchase until you actually lay out the cash to the supplier. If you're using accrual accounting, you record the purchase when you receive the products, and you also record the future debt in an account called Trade Creditors.



HM Revenue & Customs, who has an interest in every business in the UK, accept only the accrual accounting method. So, in reality you can't use cash-based accounting. However, a special concession for smaller businesses allows them to use a form of cash-based accounting for value-added tax (VAT) purposes (which is covered in Book III, Chapter 1). In essence, you can complete your VAT return on a cash-based accounting method, which HM Revenue & Customs refers to as cash accounting.

We talk about the pros and cons of each type of accounting method in Book I, Chapter 2.

Understanding assets, capital and liabilities

Every business has three key financial parts that must be kept in balance: assets, capital and liabilities. Of course, for some of you these may be alien concepts, so maybe a quick accounting primer is in order.



We use buying a house with a mortgage as an example. The house you're buying is an *asset*; that is, something of value that you own. In the first year of the mortgage, you don't own all of it, but by the end of the mortgage period (typically 25 years) you will. The mortgage is a *liability*, or a debt that you owe. As the years roll on and you reduce the mortgage (liability), your *capital* or ownership of the asset increases. That's it in a nutshell.

- ✓ **Assets** include everything the business owns, such as cash, stock, buildings, equipment and vehicles.
- ✓ **Capital** includes the claims that owners have on the assets based on their portion of ownership in the business.
- ✓ **Liabilities** include everything the business owes to others, such as supplier bills, credit card balances and bank loans.

The formula for keeping your books in balance involves these three elements:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

Because this equation is so important, we talk a lot about how to keep your books in balance throughout this book. You can find an initial introduction to this concept in Book I, Chapter 2.

Introducing debits and credits

To keep the books, you need to revise your thinking about two common financial terms: debits and credits. Most non-bookkeepers and non-accountants think of debits as subtractions from their bank accounts. The opposite is true with credits – people usually see credits as additions to their accounts, in most cases in the form of refunds or corrections in favour of the account holders.

Well, forget all you think that you know about debits and credits. Debits and credits are totally different animals in the world of bookkeeping. Because keeping the books involves a method called *double-entry bookkeeping*, you have to make at least two entries – a debit and a credit – into your bookkeeping system for every transaction. Whether that debit or credit adds or subtracts from an account depends solely upon the type of account.

We know all this debit, credit and double-entry stuff sounds confusing, but we promise that this system is going to become much clearer as you work through this book. We start explaining this important concept in Book I, Chapter 2.

Charting your bookkeeping course

You can't just enter transactions in the books willy-nilly. You need to know exactly where those transactions fit into the larger bookkeeping system. To know where everything goes, you use your *Chart of Accounts*, which is essentially a list of all the accounts that your business has and the types of transactions that go into each one. (We talk more about the Chart of Accounts in Book I, Chapter 3.)

Discovering different business types

Before you start up in business, you're wise to sit down and have a think about the structure of your business.

For example, if you're a window cleaner, and only ever see yourself doing your own rounds and not working with anyone else, then sole trader status would be more than adequate. However, if you're planning to be much bigger and take on staff, then you need to read Book V, Chapter 1 to see how you should structure your business and what sort of advice you may need.

Planning and controlling your activities

Many businesses just start up and trade from day to day, without any real planning or control of the activities they undertake. Often, businesspeople become so busy that they're fire-fighting continually and lack any real direction. We like using checklists, because they help to organise your bookkeeping activities in a methodical and orderly manner. This level of organisation means that you can pick up and put down the accounts from day to day or even week to week. You can always start from where you left off, quickly and easily, by simply adopting some of the hints and tips contained within Book II, Chapter 1.

Instituting internal controls

Every business owner needs to be concerned with keeping tight controls on business cash and how that cash is used. One way to institute this control is by placing internal restrictions on who can enter information into your books and who has the necessary access to use that information.

Keeping an accurate paper trail

Keeping the books is all about creating an accurate paper trail. A computerised accounting system would refer to this trail as the *Audit Trail*. You want to keep track of all your business's financial transactions so that if a question comes up at a later date, you can turn to the books to figure out what went wrong. We're big fans of using checklists, so you know exactly where you are in the monthly accounting cycle. We introduce our monthly checklist in Book II, Chapter 1.

All your business's financial transactions are summarised in the Nominal Ledger, and

journals keep track of the tiniest details of each transaction. Information can be gathered quickly by using a computerised accounting system, which gives you access to your financial information in many different report formats. Controlling who enters this financial information into your books and who can access it afterwards is smart business practice, and involves critical planning on your part. We address all these concepts in the following sections.

You also need to control carefully who has the ability to accept cash receipts and spend your business's cash. Separating duties appropriately helps you to protect your business's assets from error, theft and fraud. We talk more about controlling your cash and protecting your financial records in Book II, Chapter 1.

Defining and Maintaining a Ledger



You may get confused by terms such as *books*, *ledgers*, *journals* and *accounts*. Most of these words evolved from traditional bookkeeping methods, where accounts were handwritten in huge leather-bound ledgers. These looked like books, hence the name *bookkeeping* – simply, keeping financial records in the books!

The books are also known as *journals* or *ledgers* (we told you it was a bit confusing!). You'd normally have one book for your sales, one for purchases and then a general one used for everything (often known as the *General Ledger*). Sometimes, businesses would also keep a separate cash book, which would record cash received and cash paid.

Nowadays, most people use computers to do their accounts (anything to make our busy lives easier). The most simplistic set of accounts can be done on a spreadsheet, although we don't recommend it because mistakes can

easily be made and you'll struggle to find an efficient way to make sure that the books balance.



In this book we demonstrate the use of ledgers using Sage 50 Accounts. However, it's worth pointing out at this stage that if your budget is low and you're a micro business (for example, a one-man band), you may find Sage One useful. Sage One is a new online accounting service developed by Sage that's simple and easy to use. Refer to *Sage One For Dummies* by Jane Kelly to find out more.



Most computerised accounting systems use the term *ledger*, so you usually find the following:

- ✔ **Sales Ledger:** A ledger that holds all the individual customer accounts and their balances. This ledger is sometimes known as the *Customer Ledger* or the *Debtors Ledger*.
- ✔ **Purchase Ledger:** A ledger that holds all the individual supplier accounts and their balances. This ledger is sometimes known as the *Suppliers Ledger* or *Creditors Ledger*.
- ✔ **Nominal Ledger:** A ledger that includes balances and activities for all the Nominal accounts used to run the business. We discuss Nominal accounts in Book I, Chapter 4. This ledger is also known as the *General Ledger*.
- ✔ **Cashbook, or Bank:** In Sage, in particular, you can have numerous Bank current accounts and Petty Cash accounts all under the general 'Bank' heading. Any cash received or paid is recorded in this part of the accounting system.
- ✔ **Accounts:** Simply a collective term for all the ledgers.

The pinnacle of your bookkeeping system is the *Nominal Ledger*. In this ledger, you keep a summary of all your accounts and the financial activities that took place involving those accounts throughout the year.

The sum of each Nominal Ledger account can be used to develop your financial reports on a monthly, quarterly or annual basis. You can also use these account summaries to develop internal reports that help you to make key business decisions. We talk more about developing Profit and Loss statements and Balance Sheets in Book I, Chapter 3, when we introduce the *Chart of Accounts*.

We explain more about developing and maintaining the Nominal Ledger in Book I, Chapter 4. We also discuss the importance of journals and talk about the accounts commonly journalised in Book I, Chapter 4.