Record-Keeping Methods

STATISTICALLY, the vast majority of small businesses fail within the first 10 years. Many of these businesses do not have business plans, nor do they maintain proper records. By knowing basic record keeping, you can take out some of the variables and risks of starting and growing a business. Proper record keeping generates financial statements that allow an owner to monitor the status of the business.

Objectives:

1. Define record keeper, and identify the basic financial transactional documents for which a record keeper is responsible.
2. Identify key concepts, and describe financial statements related to record keeping.

Key Terms:

accrual accounting
balance sheet
bank statement
cash-based accounting
cash-flow statement
check
credit
debit
deposit slip
double-entry record keeping
GAAP
income statement
invoice
journal
ledger
purchase order
record keeper
statement of account
supplier invoice

Basic Financial Transactional Documents

A **record keeper** (often called a bookkeeper) is an individual whose responsibilities include preparing and/or recording basic documents related to financial transactions. Unlike an accountant, who is responsible for broad oversight as well as source documents, a record keeper is involved with the daily detailed workings of a business.

An important document that a record keeper maintains is the invoice. An **invoice** is a detailed list of goods shipped or sold or of services rendered, with an account of all costs. For some small businesses, the invoice may be a receipt. As a customer, you have probably noticed that a business gave you a receipt and kept a copy. The copy is retained for record-keeping purposes.

FIGURE 1. A receipt sometimes serves as an invoice.

A **statement of account** is a summary, typically prepared monthly, of all transactions to date with a particular customer. Because we are all customers of others at some point, you are probably familiar with statements of account. The most common statements are for accounts that have balances existing longer than 30 days. A statement reminds you of your current balance and tells you how old that balance is. Doctors, dentists, newspapers, and credit card companies usually send statements of account.

A **purchase order** is a document that records items ordered and the account against which the purchase will be charged. The record keeper prepares purchase orders and keeps track of them. Purchase orders are also used to verify that orders have been filled correctly.

A **supplier invoice** is a record of anything purchased for the business. This document is basically a receipt that can later be used for tax preparation.

A record keeper is responsible for preparing checks. A **check** is an order to a bank to pay an amount from the depositor's account to another individual. The record keeper must keep careful track of checks and their details. Sometimes the details of a check are listed on its stub, which is detached from the check at a perforation. At other times an actual copy of each check is kept. The record keeper also maintains a log of canceled checks (checks that were cashed) so that cash-flow statements and bank statements can be reconciled.

FIGURE 2. A bank statement helps a business track all its transactions with the bank during a given month.

A **deposit slip** is a record, itemized by name and amount, of what was deposited into a bank account on a given date. The slip is prepared in duplicate and maintained for use in reconciling cash-flow statements and bank statements.

A **bank statement** is a document from the bank showing all the transactions for a given month and used to reconcile business records. A record keeper checks and verifies every detail listed on the bank statement.

Key Financial Concepts and Statements

GAAP (Generally Accepted Accounting Principles) is the standard set of guidelines and rules that bookkeepers and accountants are required to follow when recording transactions and preparing financial statements. Every country has its own set of guidelines and rules. When a record keeper wants to know the latest rule or rule nuance, he or she can refer to GAAP for the accepted description and application of the rule.

Two methods of accounting are recognized. **Cash-based accounting** is the method in which transactions are recorded according to actual cash flow. **Accrual accounting** is the method in which transactions are recorded in the period to which they relate, not necessarily in the period in which cash is exchanged. All businesses must choose either the cash-based or accrual accounting format. Most choose the accrual accounting format.

Once either the cash-based or the accrual method is chosen as the preferred format, a new business sets up journals and ledgers to record financial data. A **journal** is the book in which all transactions are recorded. There can be separate journals for customers, accounts, or even product lines. Details are important. Journal entries are coded or numbered so that every entry can be referenced. A **ledger** is the book of final entry for a specific account to which journal entries pertaining to that account are transferred.

All the entries in the journal as well as the ledgers use double-entry record keeping. **Double-entry record keeping** is a system in which every financial transaction requires two equal but opposite actions. For example, when you purchase an apple for $1.00, there is a decrease of $1.00 in your cash and an increase of $1.00 in your purchases.

Discussing journals, ledgers, and double-entry record keeping triggers another accounting topic: debits and credits. In accounting, these terms have unique, often confusing definitions. A **debit** (DR) is an increase to an asset or expense account or a decrease to a liability or income account. A debit is always placed on the left side of an accounting entry. A **credit** (CR) is an increase to a liability or income account or a decrease to an asset or expense account. A credit is always placed on the right side of an accounting entry.

FURTHER EXPLORATION...

ONLINE CONNECTION: The Importance of GAAP

GAAP (Generally Accepted Accounting Principles) is the standard set of guidelines and rules that bookkeepers and accountants are required to follow when recording transactions and preparing financial statements. Adhering to GAAP promotes credibility so that individuals who examine financial statements can have confidence that the documents accurately depict the financial status of the business. For more information on GAAP, visit the following Web site:

http://www.buzzle.com/articles/us-gaap-generally-accepted-accounting-principles.html

Four types of accounts are affected by financial transactions. They are:

- Asset
- Liability
- Expense
- Income

Financial statements are the last of the basic source documents that record keepers prepare and maintain. Three important financial statements are the balance sheet, the income statement, and the cash-flow statement.

The **balance sheet** is a statement listing what is owned (assets), what is owed (liabilities), and owner's equity (assets – liabilities = owner's equity) at a given time. Remember this important equation: assets = liabilities + owner's equity.

The **income statement** (profit-and-loss statement or P&L statement) is a statement summarizing income and expenses for a given period.

The **cash-flow statement** is a statement presenting cash inflows and outflows and reconciling opening cash totals with closing cash totals for the period. The cash-flow statement is prepared using the cash-based accounting method. Changes in cash flow directly influence the balance sheet.

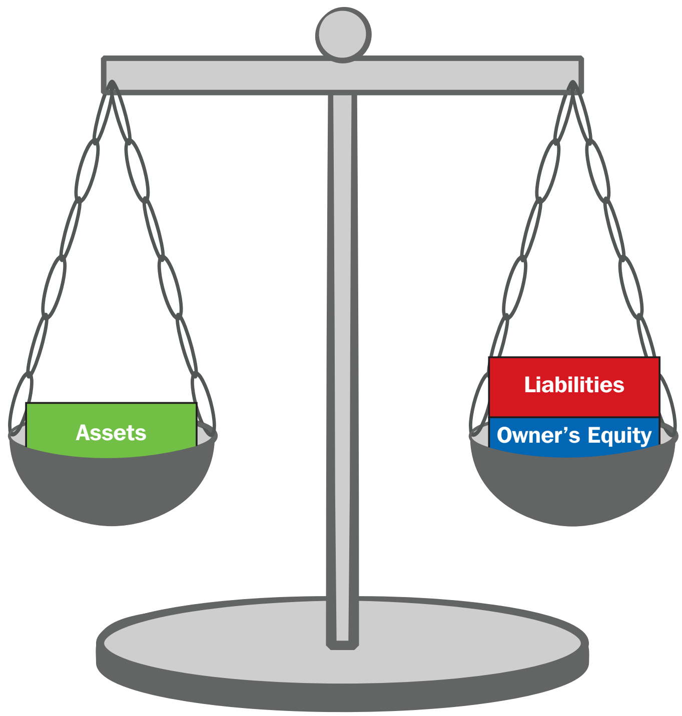

FIGURE 3. A balance sheet will show that assets = liabilities + owner's equity.

Summary:

Going into business is always risky, but you can greatly reduce your risk by acquiring some basic record-keeping and accounting skills. Proper record keeping generates financial statements that allow an owner to monitor the status of the business. Record keepers must be familiar with the preparation and maintenance of the basic source documents and with the accounting methods outlined by GAAP. Debits and credits don't have to be a mystery, but they do require some mastery.

Checking Your Knowledge:

1. Name and define three transactional financial documents for which record keepers are responsible.
2. What is the difference between an invoice and a supplier invoice?
3. What is the difference between cash-based accounting and accrual accounting?
4. Define double-entry record keeping.
5. Define debit and credit in accounting terms.

Expanding Your Knowledge:

Basic record-keeping is a must for a small business, but it is also very helpful for a household. Ask your parents if they have a system for recording cash flow, income, and expenses. Perhaps you can design a blank document for them to use in recording their information. Do this on paper or use Microsoft Excel.

Web Links:

Cash-Flow Statement

http://www.smallbusinessnotes.com/operating/finmgmt/financialstmts/cashflow.html

Investopedia®—Breaking Down the Balance Sheet

http://www.investopedia.com/articles/basics/06/balancesheet.asp?partner=answers

Set Up a Basic Record-Keeping System

http://www.businesslink.gov.uk/bdotg/action/layer?topicId=1073860617