Guide to Basic Bookkeeping

What is Bookkeeping?

Bookkeeping is the process of recording and classifying business financial transactions, or to put it another way, the process of maintaining the records of a business's financial activities. The objective in bookkeeping is to create a useable summary of financial transactions, which provides a snapshot of the business's financial stability.

Types of Bookkeeping Systems

The most basic form of accounting is the **single-entry system**. In this system, you record each transaction only once, as either a deposit or as an expense. This system is generally used to determine the profit/loss of a business.

However, the preferred system is the **double-entry system**. The double-entry system is more accurate, and has built-in checks and balances. In this system, each transaction is recorded twice, in each "account" it affects. This is a more thorough method of keeping a business's financial transaction in order.

Basic Elements of Bookkeeping

There are three basic elements of bookkeeping: assets, liabilities, and net assets.

Assets are all items used in the operation or investment activities of a business. This category includes all property, or items of value, owned by a business. Examples include cash, buildings, land, vehicles, tools, inventory, office supplies, furniture, investments, and accounts receivable (any funds owed to the business).

Increases in assets are called **debits**. Decreases in assets are called **credits**. Generally, various assets are referred to as **debit accounts**.

Liabilities are claims by creditors to the assets of a business, or debts owed by the business to others. Types of liabilities include loans, notes payable, and lines of credit.

Net assets are the equity earned by the business. Net assets are the value of the business once all liabilities have been paid. It can also be called **owner's**

equity, **capital**, **net worth**, **profit**, or **proprietorship**.

Increases in liabilities or net assets are called **credits**, and decreases in liabilities or net assets are called **debits**. Generally, a company's liabilities and net assets are referred to as **credit accounts**.

There are also several other things to keep in mind when considering a company's net assets:

- **Revenue** is the increase in net worth resulting from the operations and other activities of the business. Revenue includes income earned through the business's services, interest earned on investments, and contributions from individuals or foundations. Although net assets are considered to be credit accounts, sources of revenue are actually considered to be debit accounts.
- **Expenses** are the costs of doing business. This includes the cost of goods, fixed assets, and services/supplies used in the business's operations. Examples of expenses include salaries, rent, travel expenses, and the costs of supplies and utilities. Expenses are credit accounts.
- Net assets are calculated by subtracting total expenses from total revenue, on a yearly basis. Whenever revenue is received, net assets increase. Whenever expenses are paid, net assets decrease.

The Bookkeeping Equation

The basic elements of bookkeeping can be expressed in a simple equation:

Assets = Liabilities + Net Assets

In other words, the property of a business must be equal to the claims against that property. A bookkeeper wants to track not only the properties acquired by the business, but also how those properties were acquired and from whom.

Another way to think of this equation, which is helpful when considering bookkeeping documents, is: **Assets – Liabilities = Net Assets**

Types of Business Transactions

All business transactions result in at least two changes to the bookkeeping equation. In other words, a transaction that changes a business's assets must also change that business's liabilities or net assets.

Some transactions *increase* accounts. If a business's assets increase, then there must also be an increase in either liabilities or net assets.

For example, Business X has $5000 worth of assets, which is equal to $2000 worth of liabilities plus $3000 worth of net assets.

$5000	=	$2000	+	$3000
(assets)	=	(liabilities)	+	(net assets)

Business X then borrows $2000 from the Bank. This is a liability, because it is a debt owed to the Bank. The transaction could be expressed thusly:

$5000	=	$2000	+	$3000
+$2000	=	+**$2000**	+	-0-
$7000	=	$4000	+	$3000

Later, Business X receives a $5000 grant. This is a new asset, as it is an item of value now owned by the business. The new equation would be:

$7000	=	$4000	+	$3000
+**$5000**	=	-0-	+	+$5000
$12000	=	$4000	+	$8000

Other transactions can *decrease* accounts. If a business's assets decrease, so must either its liabilities or its net assets.

Business X decides to pay back half of the amount it owes the Bank ($1000). The new equation is:

$12000	=	$4000	+	$8000
- $1000	=	-$1000	+	-0-
$11000	=	$3000	+	$8000

Recording Transactions: Journals

A **journal** is the first book in which complete information about a transaction is recorded. A business often keeps multiple journals, which are categorized based on the type of transaction. These journals include:

- **Cash Disbursements Journal**, in which to record all checks written or all cash spent;
- **Cash Receipts Journal**, in which to record all cash or checks deposited by the business;
- **General Journal**, in which to record all non-cash transactions (such as acquisition of furniture or supplies);
- **Payroll Journal**, in which to record all payroll-related transactions;
- **Accounts Payable and Accounts Receivable Journal**, in which to record all income and expense accruals

The general journal is the type of journal most often used by a business.

Each page of each journal should be numbered. Each page should contain a chart, with the following column headings: complete date (month, day and year); name of the account credited or debited; posting references; amount debited; and amount credited. Furthermore, all entries should be in chronological order.

Debit accounts should always be written down first when recording transactions in a journal. For example, if Business X were to receive a $1000 donation, the journal entry would look as follows:

Date	Account Title	PR	Debit		Credit	
mm/dd/yy	Donation		1,000	00		
	Revenue and Expense Summary				1,000	00

Debit accounts are always listed first in a journal. Remember, a debit account is either an asset that increases, or a liability or net asset that decreases. Because the $1000 donation increases Business X's assets, the transaction is recorded first as a debit. But, per the accounting equation, this donation also increases Business X's net assets (as it is a source of revenue), and therefore must be secondarily recorded as a credit.

Posting to the Ledger

A **ledger** is a book that contains the accounts of the business. Each debit or credit account should have its own section in the ledger.

Periodically, transactions originally recorded in the business's journals should be transferred to the ledger, in a process called **posting**.

Every account in the ledger should be numbered. Assets generally begin being numbered at 100. Liability accounts begin at 200; net assets begin at 300, revenues begin at 400, and expenses begin at 500.

Each page of the ledger has multiple columns. On the left half of the page, there are four columns: date, transaction title, posting reference (which is the journal page number on which the transaction originally appears), and debit. On the right half of the page, there are also four columns: date, transaction title, posting reference, and credit.

Because the journal contains entries for both debits and credits, so must the ledger. As such, a single transaction will be recording in two sections of the ledger – on the page for whichever debit account (or asset) it affects, and on the page for whichever credit account (liability or net asset) it affects. The posting reference column in the ledger allows the bookkeeper to easily tie the two parts of the transaction together.

Thus, using the same example as above (a $1,000 donation), Business X's ledger would contain the following pages:

Page 1 (of the Asset section)

Cash							
Account #101							
Date	Transaction	PR	Debit	Date	Transaction	PR	Credit
Mm/dd/yy	Beginning Balance	--	$10,000				
Mm/dd/yy	Donation	1	$1,000				
	Balance		$11,000				

Page 1 (of the Revenue section – remember, revenue is a subset of net assets)

Donations							
Account #400							
Date	Transaction	PR	Debit	Date	Transaction	PR	Credit
				Mm/dd/yy	Donation	1	$1,000
					Balance		$1,000

When posting the ledger, a bookkeeper will enter all transactions from the journals into their appropriate categories in the ledger.

Trial Balance

Once posting is completed, the bookkeeper should total up both the debit and credit columns on each page to determine the balance for each account. Because this calculation is temporary, for now, using a pencil is important in case any changes must be made.

On each page, the bookkeeper should add up both the debit and credit column, and note the total at the bottom of each column. This is called **footing the ledger** – the penciled-in totals are called **pencil footings**.

Next, on each page, the bookkeeper should subtract the smaller number from the larger number. The resulting total should be written below the pencil footings, on the appropriate increase side. That is, the total for a debit account will be written on the debit side of the page, whereas the total for a credit account will be written on the credit side of the page.

Finally, on a separate sheet of paper, all accounts should be listed in their numerical order. The corresponding total for each account should be entered in either a debit or a credit column, depending on the type of account it is (debit or credit).

Once all accounts are listed, the bookkeeper should total up the debit column, and then the credit column. If everything was entered correctly in the ledger, then the two columns should be equal.

If they are not equal, the bookkeeper should first double check all of his or her calculations. If all of the calculations are correct, the bookkeeper should then go through the ledger to make sure that both parts of each transaction were entered correctly. The bookkeeper should then adjust the trial balance to reflect any corrections.

When a mistake is found, DO NOT erase or otherwise alter the entry. Simply cross out the entry and write the correct figure above it.

This process is complete once the two columns are equal.

The Balance Sheet

After the trial balance is completed, the bookkeeper will prepare a **balance sheet**. The balance sheet is a financial statement or business form that lists all assets owned and all claims against these assets, and their values. This important document provides a snapshot of the business's financial stability.

Balance sheets are prepared monthly, after the ledger is posted and the trial balance is completed. As well, a larger, more comprehensive balance sheet should be prepared at the end of each business year.

SAMPLE BALANCE SHEET

Business X					
Balance Sheet					
[date]					
Assets			Liabilities		
Cash	400	00	Bank	1000	00
Truck	1000	00	Office Furniture Company	300	00
Supplies	200	00	**Total Liabilities**	1300	00
Office Furniture	500	00			
Total Assets	2100	00	Net Assets		
			Net Assets of Business X	800	00
			Total Liabilities and		
			Net Assets	2100	00

A balance sheet should be identified with a header containing information about WHO the document is for (i.e., Business X), WHAT the document is (i.e., Balance Sheet), and WHEN it was created (i.e., [date]). Assets are listed on the left side; liabilities and net assets are listed on the right side. The final dollar amounts on both sides are double ruled, and should be identical.

Assets appear on the left-hand side of the balance sheet, and show all increases by debits. Liabilities and net assets appear on the right-hand side of the balance sheet, and show all increases by credits.

Dollar symbols, commas and decimal points are not used on balance sheets.

Final Steps

After posting the ledger and preparing the financial statement each month, the bookkeeper should begin the process all over again for the new fiscal period. The same books may be used, but the new fiscal period should be clearly marked.

Disclaimer

This guide is intended to illustrate basic bookkeeping tasks that can be performed by anyone who wishes to document a business's financial situation. A

professional bookkeeper or accountant uses many more advanced techniques that are not described in this document. Please see the bibliography section if you are interested in learning about these more advanced bookkeeping tasks.

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So, You Want to Learn Bookkeeping! 2006. Dave Marshall. 12 Jan. 2007 <http://www.dwmbeancounter.com/tutorial/Tutorial.html>.

Other Recommended Reading

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