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LESSON 1 SCOPE & NATURE OF BOOKKEEPING

***Aim:** Examine the scope and nature of bookkeeping and why it is an essential business function.*

INTRODUCTION

Bookkeeping involves keeping records of the incoming and outgoing monies relating to a business or legal entity.

A legal entity can be a person or organisation that is recognised by law – as such they can legally enter into a contract; if they fail to meet the legal requirements of the contract, they can be open to litigation (be sued).

Bookkeeping allows us to track the ownership of money, property or even intangible things such as services.

WHAT IS BOOKKEEPING?

Bookkeeping involves the collection, preparation and recording of financial data so that informed decisions can be made, implemented, and evaluated.

The bookkeeping system can be tailored to the needs of any individual, non-profit organisation, small or large business. This course will concentrate on the needs of a small business. A business is an economic entity created for the purpose of increasing the wealth of its owner or owners by generating profits from the provision of goods and/or services. A small business is one where all major decisions are the responsibility of one, two or a few people who are usually the owners.

Suggested Tasks: ▼

Throughout this course you will be provided with suggested tasks and reading to aid with your understanding. These will appear in the right hand column. Remember: these tasks are optional. The more you complete, the more you will learn, but in order to complete the course in 20 hours you will need to manage your time well. We suggest you spend about 10 minutes on each task you attempt, and no more than 20 minutes.

Financial transactions are often referred to as 'economic events' where there has been an exchange of something of value between two or more entities. For example, a common business transaction could be the sale of a good or service by a business to an individual in exchange for cash.

Keeping accurate financial records allows a business to manage and control assets, liabilities and incoming and outgoing money. A business can help control its financial future by utilising its bookkeeping system to make informed business decisions. Information relating to financial transactions can be used to prepare budgets, set financial goals and make essential business decisions about the running of the business. Businesses need this information to help answer a number of questions, such as:

- Will the business have enough cash to pay its bills and wages?
- How much are the assets of the business worth?

- Can the business afford to borrow money?
- Is the business financially sound enough to expand its operations?
- Should the selling price(s) be changed? Are the price points being charged suitable for maximum profit and financial gains? Do these price points need to be adjusted?
- Does the company have too much stock it needs to sell to make more money?
- Are there any ways in which the company can cut costs?
- How does the business make plans to grow or contract in the future based on the current profit or losses it is making?
- Are sales goals and business goals and targets being met?

The purpose of a business is to make a profit ultimately, bookkeeping helps businesses keep track of their money to make informed decisions in order to make a profit.

WHY IS RECORD KEEPING IMPORTANT IN BOOKKEEPING?

Record keeping is essential in any bookkeeping practice. Keeping track of money that is coming into and out of a business by keeping a paper trail is essential to accurately track transactions.

Legislation also stipulates that companies lodge their profit and losses and submit a tax return annually. The kinds of records that are kept may differ from paper receipts and ledgers to electronic copies of receipts and utilising online accounting software. Legislation also mentions that records need to be kept for a certain amount of time.

The most basic reason to keep a paper trail in bookkeeping is to ensure that there are sufficient records and information for any audit that might be required. There are lots of ways you can electronically keep paper receipts including phone apps and online software.

WHAT ARE THE BOOKS?

A business's books can be described as its financial paper trail. Essentially, they are a series of spreadsheets that display the financial position of the business. The term 'books' refers back to the days when a company's financial information was stored in heavy and substantial hardback books, with a different title for each of the ledgers or journals required.

Although you can still buy hardback accounting books in stationery suppliers, these are becoming less common. The expectation from businesses, tax agents and accountants alike, is that the books will be computerised, stored and (where relevant) shared electronically. Although you may choose to keep some (if not all) your books as hard copies, these will need to be transferred to an electronic version for your accountant's purposes.

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Suggested Tasks

Research the record keeping and reporting requirements. What records do you need to keep? How long do you need to keep the records? What kind of information will the Tax Office need from you for reporting income/ losses?

There are a range of bookkeeping/accounting software packages currently available. Four of the most commonly used accounting software packages are Sage, QuickBooks, Xero and MYOB. While these software solutions share some features, they also offer distinctive differences. Generally, you can expect to have a facility for logging expenses, linking these to the company accounts, producing statements and invoicing customers. Accountants will have preferences about how you should present your accounts.

If the software options are too confusing or require too steep a learning curve, Excel or a similar spreadsheet pacakage will allow you to format your financial books adequately and share them with your accountant. There are lots of apps and online alternative spreadsheets available - both at a cost and for free.

A business's list of books includes the following:

- **General Ledger** – this is a summary sheet which shows all of the business account positions and summarises the transactions that occurred. It provides an overview of the business's financial position.
- **Chart of Accounts –** this is a list of all the accounts used by the business with a description of what the account is used for. These descriptions tell you where to record any transactions. The chart of accounts is always done in a specific order: it starts with everything required to make the *balance sheet* and follows with everything required to complete an *income statement.*
- **Balance sheet** – this shows your detailed financial position at a specific time. The balance sheet shows both your income and your expenses. It's called a balance sheet because it is based on this equation:

  Assets = total equity + total liability

  Where assets are all the items owned by the company, liabilities are all the debts owed by the company, and equity is the money invested in the company by owners or shareholders.
- **Income Statement –** this shows your income. Your income statement will appear slightly different depending on whether you run a cash based or an accrual system**.** The income statement shows what you have earned, minus the cost of goods sold (any discounts) and any expenses. At the end of the income statement, you can identify the net profit and loss for the business.
- **Expenses statement** – this provides details of your expenses at any one time.
- **Profit and Loss statement –** this shows how much the business has made or lost during any time period. It frequently includes details of all the expenses made in any category

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Suggested Tasks

Which software solution is best for you?

Search online for 'accountancy software' and compare the features and benefits of two or three accountancy software packages. Then talk to a few friends who have experience with running a business – ask them about what they have used in the past and if they are still using that now. Finally, talk to an accountant (or your accountant, if you have one) about what they would recommend and why. Outline your findings and justify your choice. Write 1-2 paragraphs.

TERMINOLOGY AND THE BOOKKEEPER'S WORLD

Bookkeepers operate in a world of finance. It is important for people working in bookkeeping to understand finance terminology and terms of reference.

Bookkeepers need to communicate with both:

- People in the world of finance such as bankers, taxation officers, accountants, financial advisors; and
- People who are not in the world of finance, such as business owners, managers and operations staff.

A good bookkeeper needs to cultivate communication skills and be able to accurately interact with everyone they work with, in order to properly and accurately gather and disseminate the information needed for the business function and to do an effective job.

Understanding the Language

Although accounting standards and terminology may change from time to time, the concepts and language of bookkeeping remains consistent. It was formulated from a long history of accounting standards, set down by various bodies over many years - both as national and increasingly as international standards. Bookkeepers know the importance of learning the correct terms whilst also keeping pace with new standards or legislative requirements as they are introduced. This is important knowledge that bookkeepers must learn and use to communicate with people in the world of bookkeeping and accounting.

Accounting standards are discussed later this lesson.

Terminology

- **Accounts receivable/debtors**: the money owed to a business by a customer, after they have been sent an invoice, for the products or services they were supplied on credit.
- **Accounts payable/creditors**: the money owed by the company for good or services supplied to them.
- **Accruals**: bringing forward the cost of goods or services or the receipt of monies owed against an invoice into a current accounting period, even though you may not have paid for the goods/services received or received payment for goods/services you supplied.
- **Cash accounting**: accounting system that does not recognise accruals – in other words it only recognises the debts and credits for a specified accounting period.
- **Assets**: items of value to a person or a business that can be easily transferred to cash.
- **Current assets**: Cash and other resources that a company expects to either use up or to turn into cash within the following year of the date on the balance sheet.
- **Fixed assets**: an asset that is not sold off (or consumed) during the normal course of trading within a business.

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Suggested Tasks

Think about your existing or planned business. Will it be in your interest to have a cash accounting system or to consider accruals? Discuss this with your friends with business experience. What will work best for your business and why?