

How to do bookkeeping



xero



Bookkeeping tasks explained

Bookkeeping includes everything from basic data entry to tax prep. Let's look at the core jobs and see how they're done.

1

Pages 1–4

***Bookkeeping for
small businesses***

2

Pages 5–8

***How to set up a
chart of accounts***

3

Pages 9–11

***How to do
bookkeeping
data entry***

4

Pages 12–13

***How to do bank
reconciliation***

5

Pages 14–15

***How to manage
accounts
receivable***

6

Pages 16–18

***How to manage
accounts payable***

7

Pages 19–21

***How to create
monthly financial
reports***

8

Pages 22–24

How to do payroll

9

Pages 25–27

***How to prepare
tax returns***

10

Pages 28–31

***Using
bookkeeping
software***

11

Pages 32–36

***Using professional
bookkeeping
services***





Bookkeeping for small businesses

Small businesses often do a lot of their own bookkeeping at the beginning. As they grow, they offload more and more jobs to professionals. We look at how you can find a balance.

How to handle bookkeeping in your small business

You may want to do some bookkeeping jobs yourself and get an expert to help with others. Perhaps you're still feeling your way with double-entry bookkeeping, or you're afraid of getting payroll wrong, or you're not cut out for chasing invoices. You can outsource any or all of those things.

We'll look at how businesses commonly break up bookkeeping jobs between themselves and professionals.

Common DIY bookkeeping jobs

Many small businesses look after their own:



Data entry

Nowadays, software can pull transaction data from banks and read photographs of receipts, so this has become a much smaller job.



Bank reconciliation

Most business owners take on bank reconciliation. While still not necessarily a favourite job, apps that allow you to do it on your phone have sped things up.



Accounts receivable

Preparing and sending invoices is straightforward if you have good templates and processes. You can always get professionals to help to chase overdue invoices.



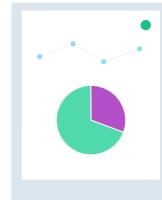
Small business owners may also keep payroll in-house if they have just a few employees and the capacity and skills to manage it.

Accounts payable

If a business has just a few suppliers and cash in the bank, paying the bills is simple enough. But professionals can really help if cash flow starts to become an issue.

Outsourced bookkeeping jobs

Even business owners who are comfortable with numbers will get outside help with:



Quality control and fix-it jobs

Bookkeepers can check your ledger for mistyped or misplaced entries, and generally make sure your books are reconciled.



Tax returns

Simple returns may be easy enough for a business owner to prepare but it's good to use a professional if there's any complexity. They may also find ways to lower your tax bill.

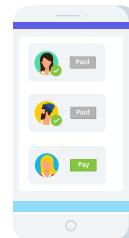


Understanding what all this stuff means

A bookkeeper can interpret financial reports for you, and tell you what they mean for your business. They can help you troubleshoot problems as well as plan for the future.

Financial reports

Profit and loss reports, balance sheets and the like determine your taxes and inform big decisions. You don't want to make mistakes here.



Payroll

Payroll gets hard fast, so it's a good idea to involve an expert at some point and perhaps outsource it altogether if staff numbers grow or your payroll is complex.

Hiring a bookkeeping service

Bookkeepers often allow you to choose from different service levels depending on your budget. That means you can start out with basic bookkeeping at a modest cost and add on more advanced services as your business grows.

[Learn more about professional bookkeeping services.](#)

What does software do?

For most small businesses, the choice between DIY and outsourcing comes down to time versus money: Which can you afford to give up? Software lessens the blow on both sides. It automates or streamlines time-intensive tasks like data entry, bank reconciliation, invoicing and some tax prep jobs. That cuts back labour which either saves you time, or lowers the fees that you pay to professionals.

[Learn more about bookkeeping software.](#)



How to set up a chart of accounts

If you're stepping up to do the bookkeeping in a new business, you may have to set up the chart of accounts. Done right, it will make all your other jobs so much easier.

What is the chart of accounts?

The chart of accounts sits just under the five main accounts in the general ledger. You can learn more about the main accounts in [our chapter on double-entry bookkeeping](#).

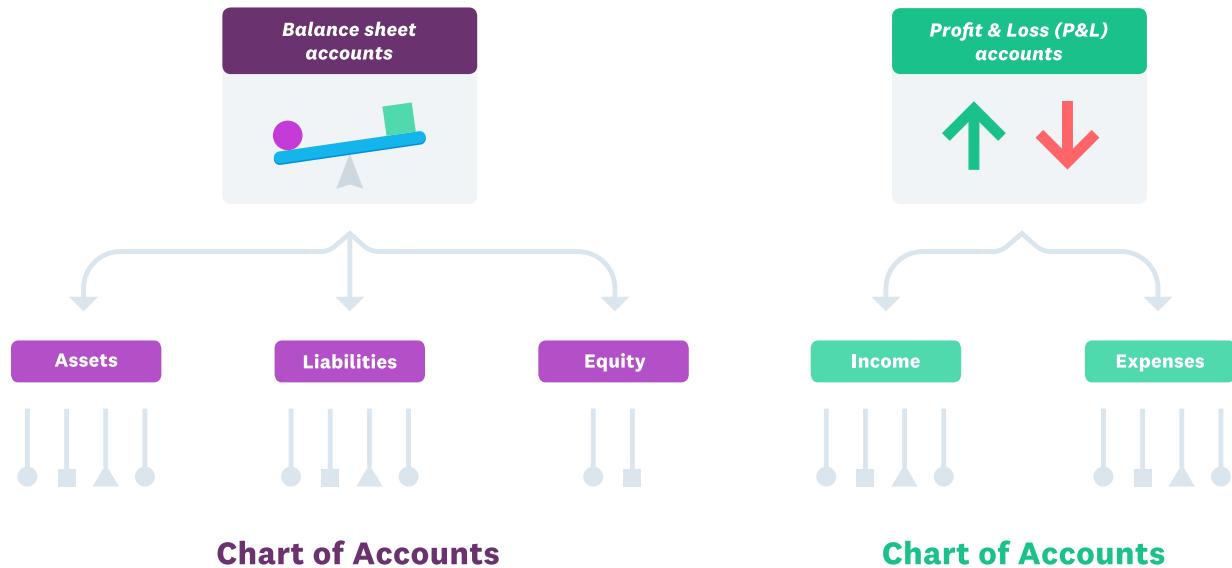
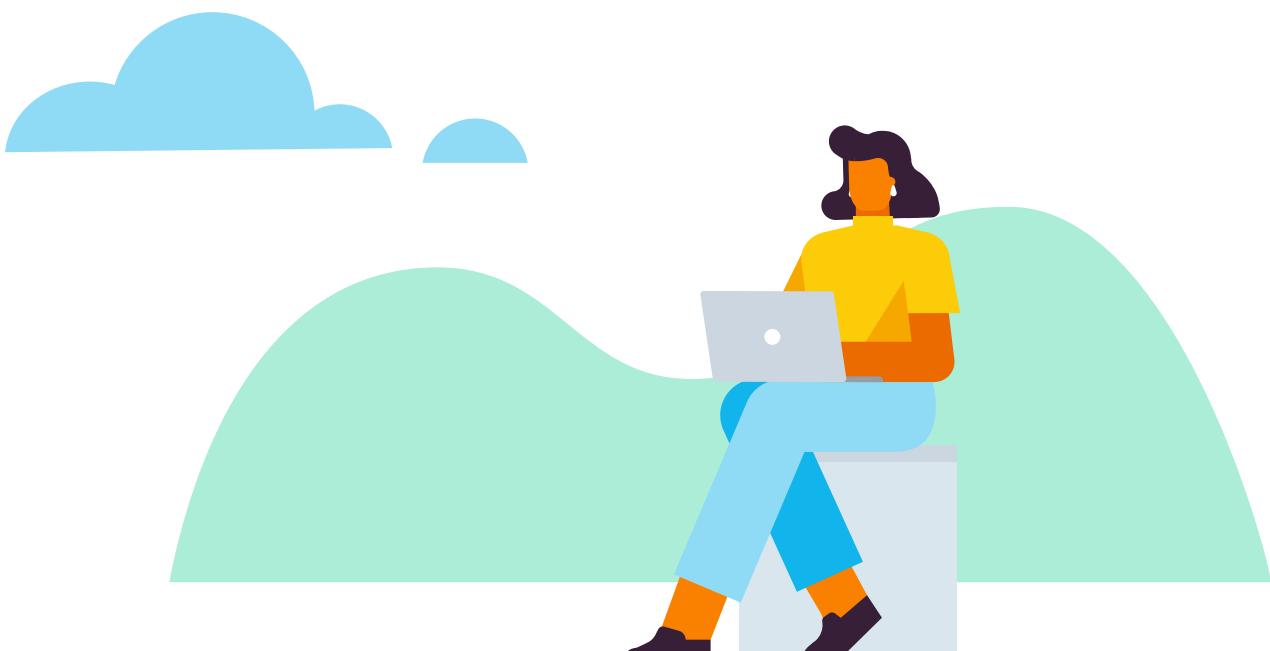


Figure 1, The five main accounts that make up a general ledger.

A business can create as many sub-accounts as it needs to categorise its transactions. However there are some standard accounts that are typically used across most businesses.



What is the purpose of a chart of accounts?

A chart of accounts groups together transactions of a certain type. This allows you to produce detailed reports into specific areas of the business and its finances.

Standard chart of accounts

A standard chart might look like this:

ASSETS

Title	Description
Cash	Bank account balance, cash
Accounts receivable	Amounts owed to the business for products sold or services performed
Prepayments	Amounts paid for goods or services not yet delivered
Inventory	Inventory purchased but not yet sold
Vehicles	Value of vehicles used by the business
Equipment	Value of equipment used by the business

LIABILITIES

Title	Description
Accounts payable	Amounts owed to suppliers
Payroll	Amount owed to employees but not yet paid
Loan	Amount owed on business loan
Tax	Amount of tax collected but not yet paid



Liabilities may be organised into current liabilities and non-current liabilities. Current liabilities are amounts owed in the current year. Non-current liabilities are amounts owed next year and beyond.

How to set up a chart of accounts

SHAREHOLDERS' EQUITY

Title	Description
Capital	The amount the owner has invested in the business
Drawings	The amount the owner has withdrawn for personal use

REVENUE

Title	Description
Sales	The amount earned from the sale of products or services
Other income	Interest earned on investments

EXPENSES

Title	Description
Salaries	The amount paid to employees
Supplies	Cost of goods sold
Overhead	Rent
Utilities	Cost for power, water, gas
Advertising	Cost of advertising

How is a chart of accounts used in accounting software?

The five core accounts are part of any accounting software and they're the same for every business. The categories that sit beneath them in the chart of accounts can be customised to suit your business. For example, you might create several accounts for sales revenue – one for each region you trade in, or one for each department of your business.

When you enter a transaction into your software, it may ask you where to record the opposing credit or debit. Or you can teach the software where to make the opposing entry and it will happen automatically.





How to do bookkeeping data entry

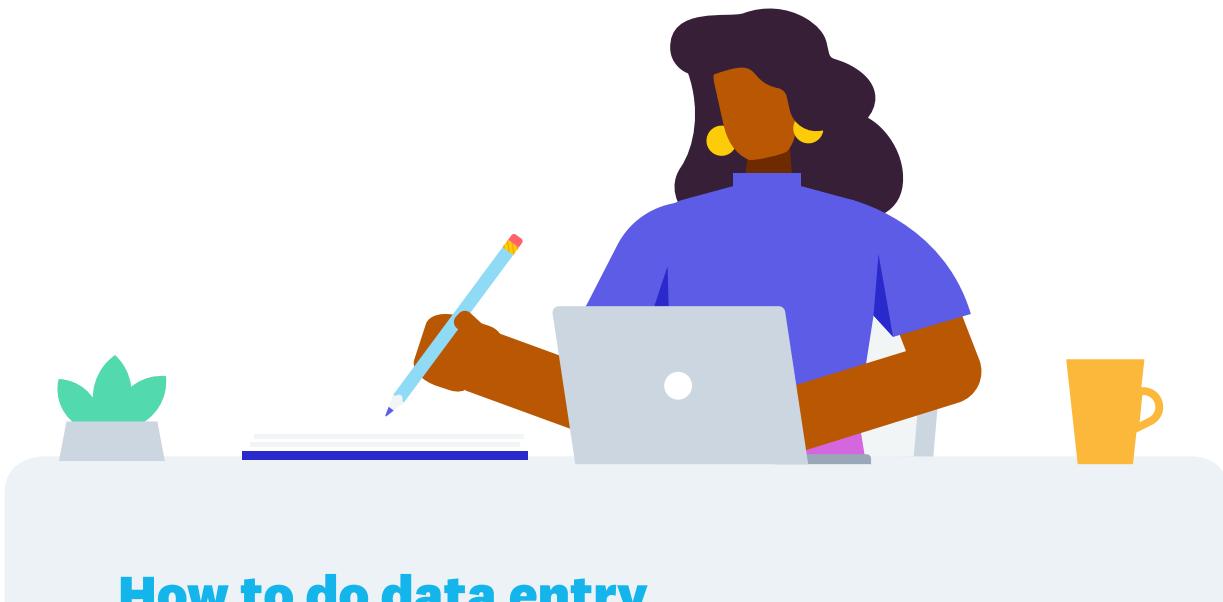
Data entry is the foundation of everything else in bookkeeping and accounting. You need to enter the right numbers into the right accounts to truly understand how the business is doing.

What is data entry?

As the name implies, data entry is the process of recording financial transactions – money coming into and going out of the business.

Why does it matter?

If you're not keeping a close eye on money in, money out, and things like debt, you'll soon lose sight of how viable and profitable your business is.



How to do data entry

For each sale or purchase, you generally want to:

1. Record details such as:

- the value and date of the transaction
- who it was with (though that's not always necessary for retail sales)
- what was bought or sold

2. Assign that transaction to the right [account in your ledger](#).

Purchases and sales data are often lifted from places like point-of-sale systems, business bank statements, invoice records, and receipts. You'll probably need multiple sources to get all the information you need.

Modern bookkeeping data entry

Nowadays you can bypass a lot of the manual data entry by linking all your business systems together so that information flows directly into your books from sales systems, bank accounts, and receipt scanners.

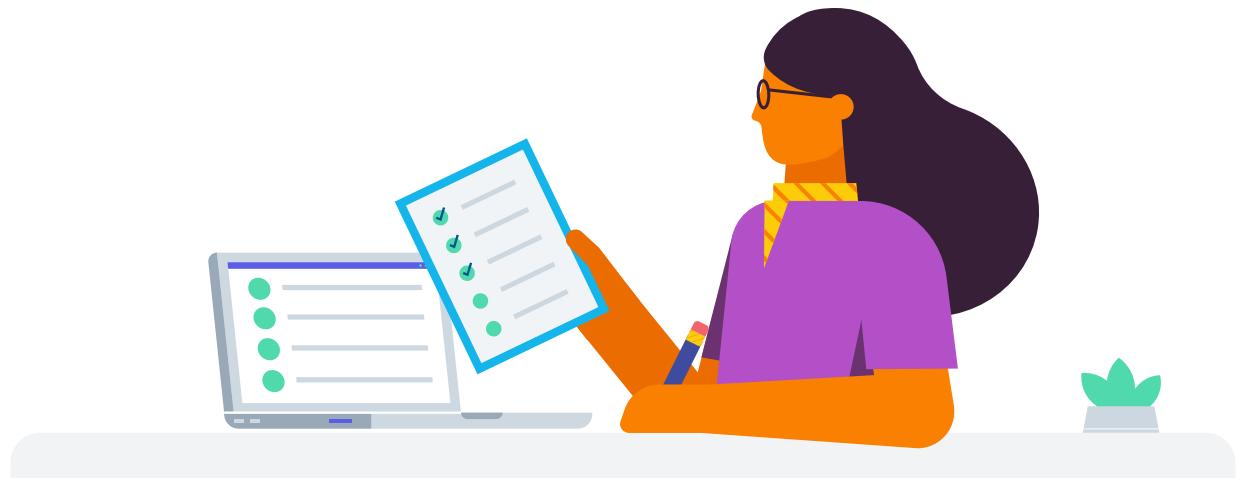


Figure 2, Data flows into accounting software from systems that are used to process sales or purchases.



How to do bank reconciliation

Humans aren't great at punching numbers. In fact, up to 90% of spreadsheets have keystroke errors in them. Bank reconciliation is a way to check and do quality control on your books.



What is bank reconciliation?

When you compare your record of transactions against your bank's, you're doing bank reconciliation. Your entries should match up with their records.

Why does it matter?

Bank reconciliation helps you find and fix data entry mistakes or missed transactions. It's also good for detecting wrong payments or fraud. As you run through the transactions, you can also assign them to the correct business account (if you haven't already) and flag tax deductible expenses for when you file a return.

How to do bank reconciliation

Bank reconciliation isn't complex. Many people open their business ledger on one screen and a bank statement for the same period, then cross-reference. If you can't find a match for a transaction, you need to figure out why and make adjustments so that both records mirror each other.

Modern bank reconciliation

Accounting software speeds up bank reconciliation by pulling transaction data directly from your bank through a secure online connection. That removes keystroke errors for a start.

The software then presents the transactions on a screen, asking you to verify them and assign each one to an account. The fields are often pre-filled based on past transactions or exact matches to sales invoices, purchase bills, or bank rules that have been set up for speed and consistency. You just have to click to confirm what's suggested.

BANK STATEMENT		MATCH	
29 Aug Wilson Online Rent payment	-\$49.90	29 Aug Wilson Online Ref: 49882	-\$49.90

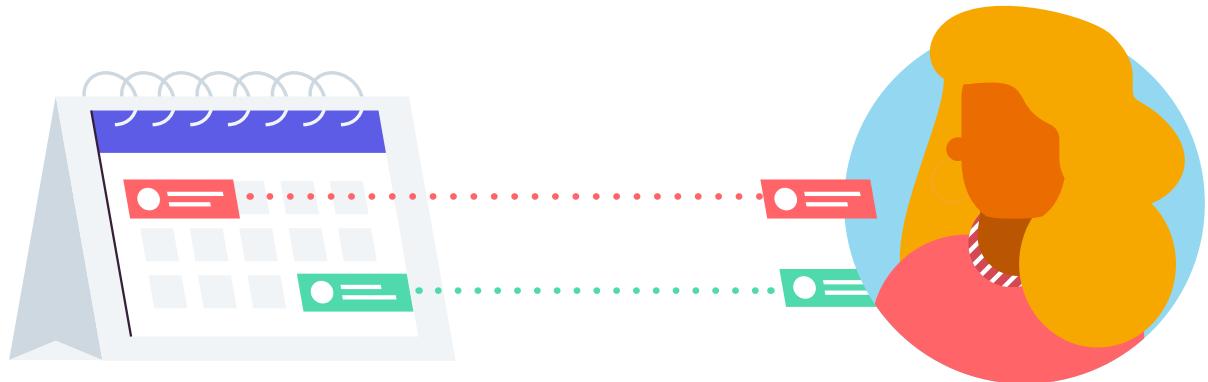
Figure 3, Modern software makes bank reconciliation a click-to-confirm job.

You can still manually enter things like expenses that aren't captured by the business bank account. And you can have the software retrieve transaction data from point-of-sale and invoicing systems, or receipt scanners.



How to manage accounts receivable

Many businesses issue invoices, which are requests for payment at some future time. If that's you, then you have accounts receivable and the money you're owed needs to be closely managed.



What is accounts receivable?

Accounts receivable involves invoicing customers and tracking payment of those invoices. It often requires you to follow up on overdue payments.

Why does it matter?

You're not a charity. You need to get paid. Fail to manage accounts receivable correctly and your business will rapidly run out of money.

How to manage accounts receivable

Decide how long customers will have to pay your invoices and commit it to writing. Share and agree on those payment terms before doing business with anyone new. Create and send invoices as soon as a sale is agreed (include the agreed payment terms on the invoice). Watch your bank account for payment and follow up immediately if they miss the due date. You can get more tips on accounts receivable in our [Invoicing Survival Guide](#).

Modern accounts receivable

Invoices can be created quickly on apps and sent with immediate payment options like credit and debit cards. Smart software can even check your bank for payments and keep a watchlist of unpaid invoices for you.

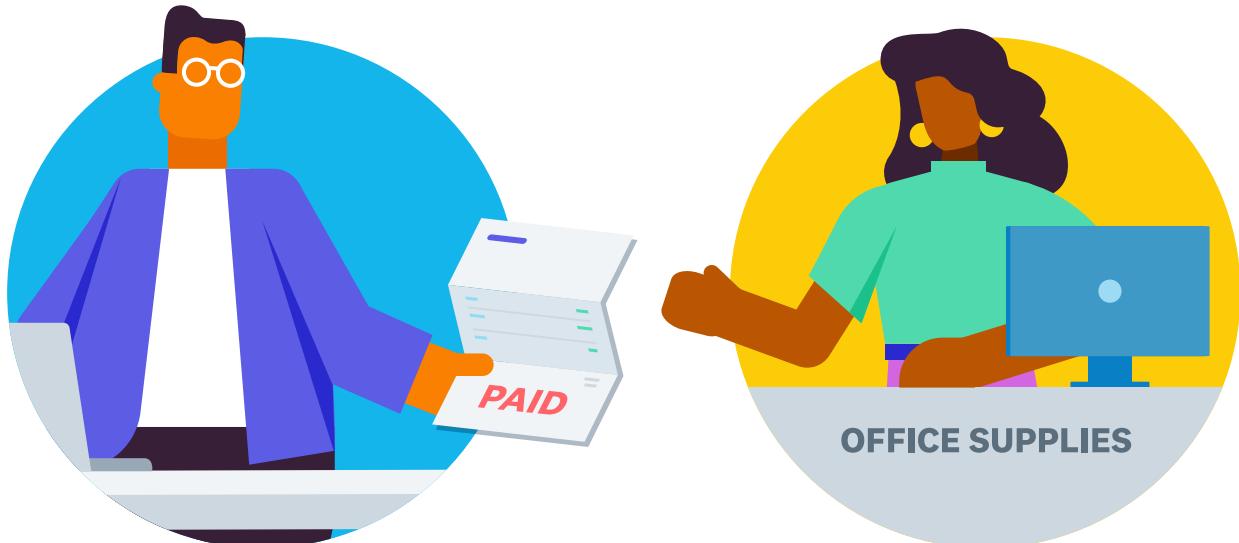


Figure 4, What's involved in managing accounts receivable.



How to manage accounts payable

Many businesses issue invoices, which are requests for payment at some future time. If that's you, then you have accounts receivable and the money you're owed needs to be closely managed.



What is accounts payable?

If you have bills, you have accounts payable. It's the opposite side of accounts receivable and the aim is to pay bills on time, without running your bank balance too low.

Why does it matter?

You want to maintain good terms with suppliers – if you're slow paying them, they may stop your credit or delay deliveries. You also need to think about cash flow.

Your bank balance could take a beating if you paid everyone at once. And that would leave you with little cash to cover other expenses, unexpected costs, or to fund business growth.

How to manage accounts payable

Bills from vendors are first recorded as money owed. They'll then go through an approval process, to make sure the goods or services were received. Once approved, payment is scheduled according to the vendor's payment terms.

The longer your payment terms are, the better for your cash flow. On the other hand, it's nice to take advantage of early payment discounts if they're on offer. When payment is made, the books are updated to show the bill isn't owed anymore.

Remember your balance sheet? It's also called your statement of financial position. It's best to ensure the amount of money owed to you as accounts receivable is more than what's owed by you as accounts payable.

Modern accounts payable management

You can enter bills into your ledger by typing them in or by emailing them to your accounting software. There are also clever software apps that read and extract data from bills and automatically send it to your accounting software. The accounting software creates the book entry and helps you schedule payments, then updates your ledger when the bill is settled.

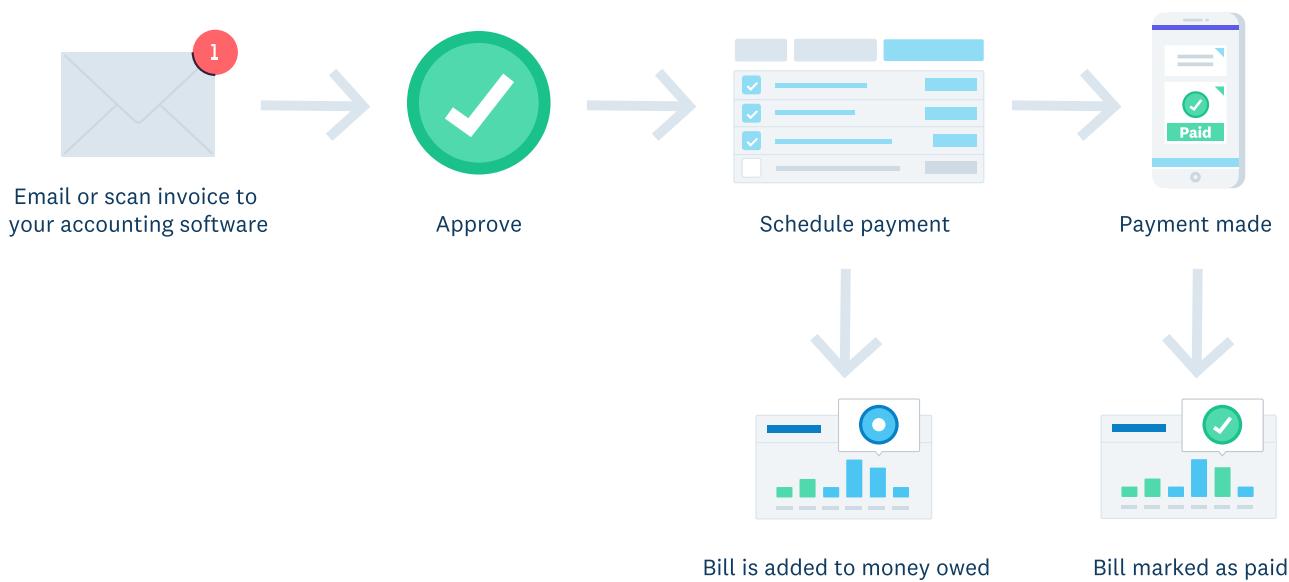


Figure 5, What's involved in managing accounts payable.

7

How to create monthly financial reports

There are dozens of different financial and accounting reports that you could create. But there are a few favourites that bookkeepers like to check every month or two to make sure the business is performing.

What are financial reports?

Balance sheet / Statement of financial position	What it tracks Value of things owned (including cash) vs things owed What it tells you If the business gained or lost value, and its current financial position	Profit and loss	What it tracks Money earned vs money spent What it tells you If you had a profitable month or ran at a loss
Cash flow statement	What it tracks How much cash the business earned What it tells you This is useful for businesses that sell things on credit because it shows how much spendable money you have.	Aged receivables	What it tracks Who owes you, how much, and when it is (or was) due What it tells you Which accounts to chase
Aged payables	What it tracks Who you owe, how much, and when it is (or was) due What it tells you Demands on your cash and any relationship risks you might be facing		

Figure 6, Reports that may be produced on a monthly basis to keep an eye on the financials.

Why does it matter?

Taken together, these reports tell you what your business is worth, how profitable it is, and if it has enough money coming in to keep trading.

The results can affect everything from your spending plans to pricing, forecasts, and customer payment terms. And, of course, the year-end versions of these reports show how much income tax you need to pay.

Who creates financial reports?

Monthly reports are traditionally created by a bookkeeper to help keep tabs on the business. The end-of-year reports tend to be created by an accountant, with a view to minimising tax and setting financial strategies for the year ahead.

How to create financial reports

If you were creating reports manually, here's what you'd need to do.

Balance sheet

Summarise the activity from the assets, liabilities and equity accounts.

Profit and loss

Summarise activity from the income and expenses accounts.

Cash flow report

Show how much actual cash was available throughout the period.

Aged receivables

Show which of your sales invoices have yet to be paid. For any that are overdue, show how many days you've been waiting.

Aged payables

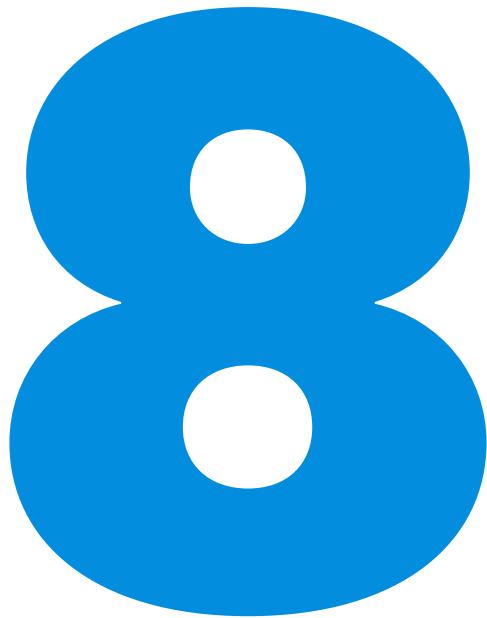
Show which of your bills you are yet to pay. For any that are overdue, show how many days the supplier has been waiting.

Modern monthly financial reporting

Bookkeeping software has made it possible for anyone to generate these reports at the press of a button. However, you first need to make sure all the numbers have been entered, coded to the correct account, and reconciled.

Some of these reports can be shown on a live dashboard in real time, which updates every day.

The year-end reports are generally prepared by an accountant, who may make some final adjustments to ensure the business doesn't pay more tax than required.



How to do payroll

If all you had to do was pay staff, payroll would be easy. But employers are responsible for taking out deductions such as tax as well as managing leave entitlements and other human resource issues. Here are the basics.

What is payroll?

Payroll involves calculating employee pay, deducting things like tax and retirement contributions, then distributing money to all the right people by the right dates. You also have to show all your workings to the government so they can make sure you're doing everything correctly.

Why does it matter?

Payroll is critical to keeping employees happy, but it's also important to keep the government happy. There are lots of regulations, and failure to comply can result in fines.

How to manage payroll

You start by calculating pay for each employee, according to the terms of their contract. And then you set about making deductions in the right order.

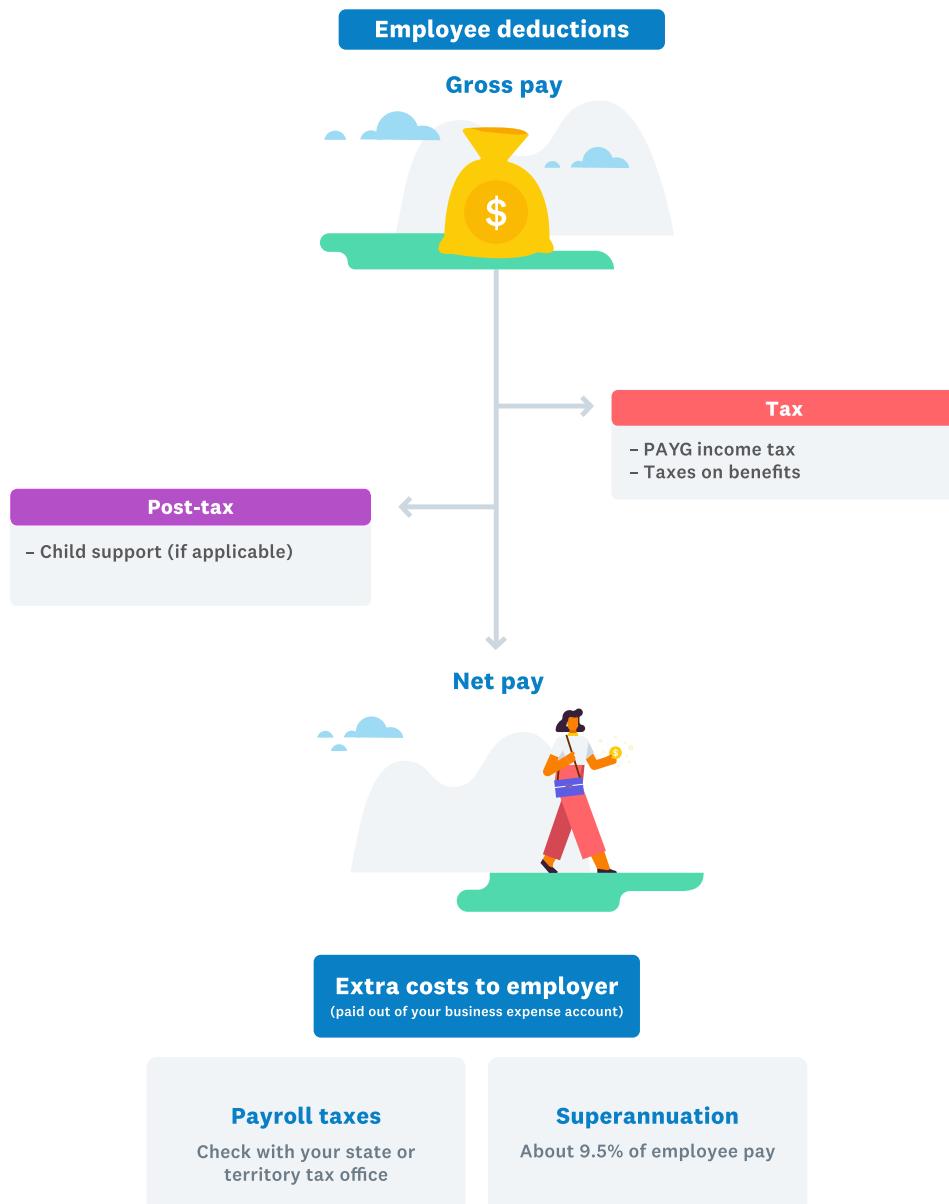


Figure 7, How employee pay is calculated each payday.

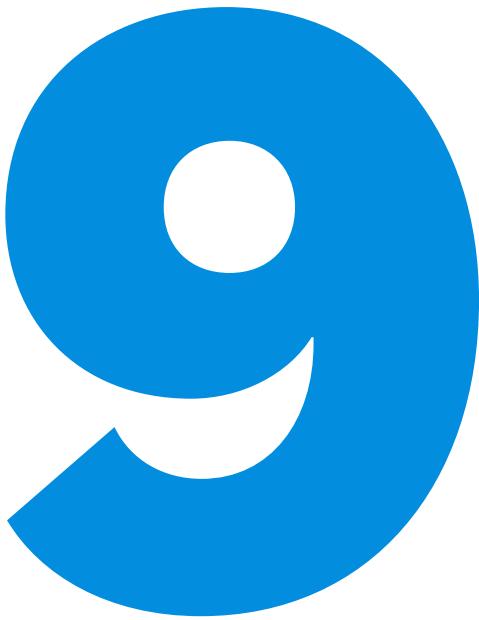
It's up to you to channel the money to all the right recipients by the agreed dates. Make sure you understand when the money is due to each party, and transfer it on time.

[Learn more about how to manage pay runs.](#)

Modern payroll management

Payroll software can automatically calculate pay and deductions, create payslips and generate reports for the ATO. If you pay by the hour, you can get employees to clock in and out of shifts on their phone and set up the app so the data flows into an online timesheet.

Because the tax status of individual employees can change for all sorts of reasons, payroll can become an admin headache. It's common for businesses to outsource payroll.



How to prepare tax returns

Tax can be tricky for small business owners. There are lots of deadlines to make, and even more rules to follow. Let's take a look at what it involves.

What is tax filing?

Businesses generally have to file three main types of tax return:

GST & BAS

This is a tax that you may have to add to your prices. The government expects you to collect that cash on their behalf and send it their way at set times.

Income tax

This is calculated as a proportion of your profits.

Employee-related taxes

You're expected to withhold income tax from your employees' wages and hand it over to the ATO. There may also be payroll taxes for the employer to pay.

Why does it matter?

Paying too much tax is like giving money away. Paying too little can get you in trouble. Getting it right greatly increases your chance of running a profitable and relatively trouble-free business.



How to file taxes

Filing taxes is the easy part. It can generally be done online, which is a huge step up from the days of paper returns. Preparing those returns is the trickier part.

GST returns

These are often handled by a bookkeeper or registered tax agent throughout the year. They'll keep tabs on what you've collected and make adjustments for the GST you've paid on purchases, then put together a GST report or BAS for the ATO. Any taxes due are generally paid when the report is filed.

Business income tax

This is calculated on profits. The higher they are, the more tax you pay. But there are ways to legitimately lower your profits in the eyes of the ATO. This is where things get technical, and the stakes are high because your returns will be checked by government tax experts. That's why most businesses get an accountant to prepare their income tax return.

Employee PAYG taxes

These are calculated and collected from employee pay at every pay run. At the same time, you must submit a report to the ATO saying how much you paid your employee and how much tax you withheld. The ATO will tell you when to pay the taxes to them.

Modern tax filing

Tax time isn't the ordeal it used to be. Accounting software can do a lot of the grunt work so filing time is easier for your accountant or bookkeeper. For example, accounting software can estimate taxes owed and quickly produce the reports needed to finalise a tax return. These efficiencies make tax season less stressful and less expensive.

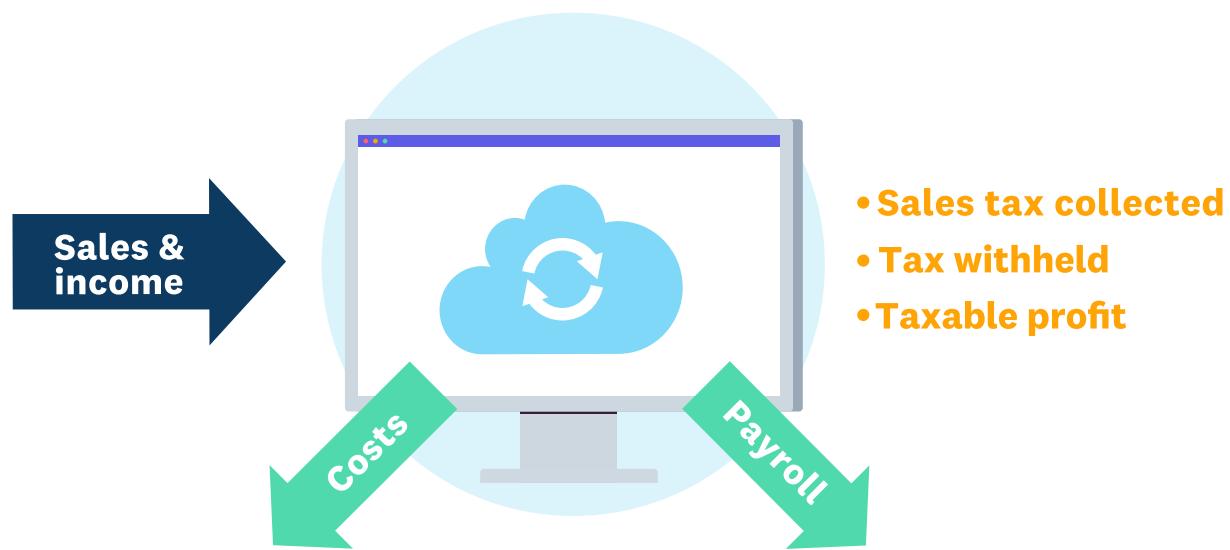


Figure 8, Data flows into your accounting system which then produces reports showing what tax you owe.



Because accounting software has a record of all the money coming and going from your business, it can quickly run the maths to estimate your taxes.

10

Using bookkeeping software



Whether you do a lot of your own bookkeeping or outsource it all, software can help. It automates a lot of the time-consuming tasks, so you're not wasting time or budget.

What is bookkeeping software?

Bookkeeping software – also commonly called accounting software – is designed to record and process business transactions. Think of it as a smart electronic ledger that automates double-entry bookkeeping.

Many bookkeeping products can also usually handle (or help with) tasks like billing, payroll, accounts payable, tax filing, and financial reporting.

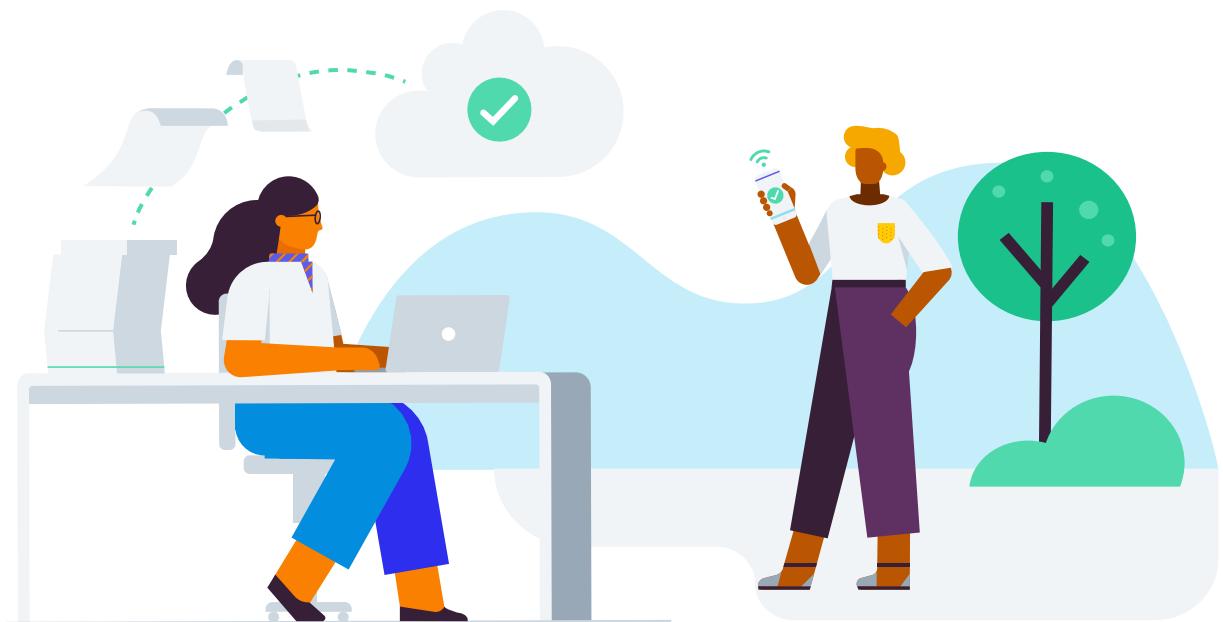
Online bookkeeping software vs desktop

Bookkeeping software comes in two forms. There's the type you install on your computer (or local network server) and the type you use online. As with most software services, online comes with some built-in advantages:

- Data lives online, so there's no need to back it up.
- You can view or work on your books from any location or device.
- You don't have to email your ledger to your bookkeeper — you can both log in.

- Transaction data can flow into the ledger from other online locations such as your bank.
- Real-time reporting allows collaboration between you, your bookkeeper and your accountant.

Online bookkeeping software also works well with other business apps. For example you can use third-party point-of-sale software to ring up a sale and the data will flow straight through to your online accounts.



What to consider before buying bookkeeping software

If you're going to invest in bookkeeping software, you need to think about the following:

Can you start off slow?

What tasks are a priority for you? If you only need a few functions, then that's all you should pay for. Make sure there's some pricing flexibility.

Can it grow with you?

Will it still be the right system for you in two, five or 10 years? You may eventually want to add inventory, payroll, or ecommerce functions. Check it gives you room to grow.

Is it secure and trustworthy?

You're required to keep some accounting records for years so make sure your software provider can keep and protect your data for the long haul.

Does it fit with other business systems?

Can it work with other business systems such as point-of-sale, time-sheeting apps, inventory control, or ecommerce? Can it accept data from your bank, and receipt scanners? Does your external accountant or bookkeeper know how to use it?

How easy is it?

Software should make your life easier. See what reviewers say about the products you're considering. You don't want to trade one problem for another.

Does it work with local tax systems?

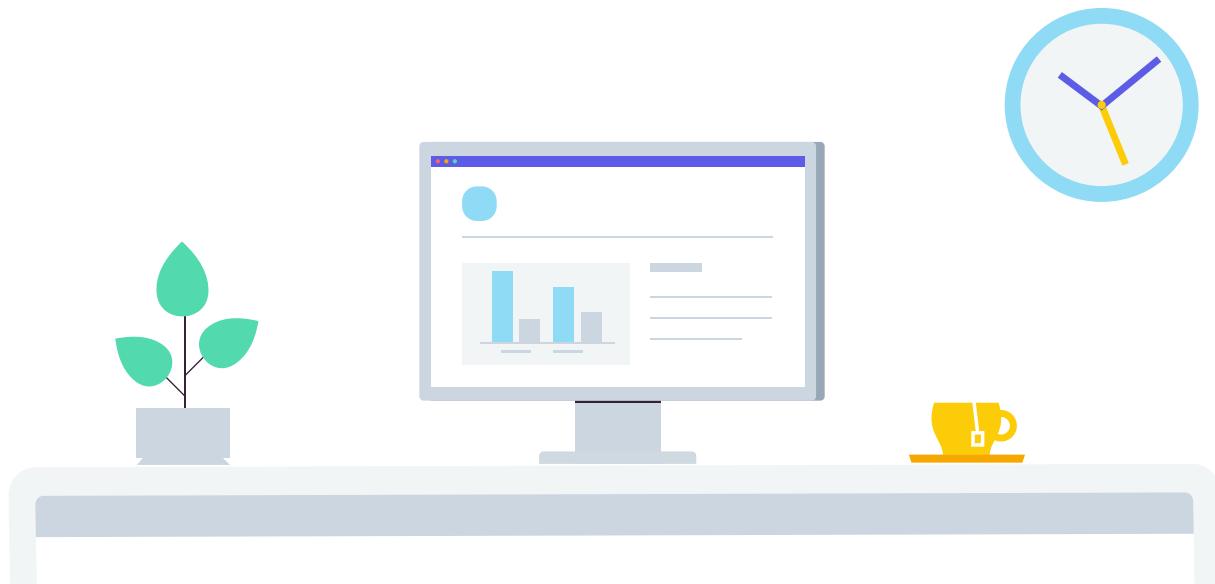
Does it fit with your tax system? It's no use buying software designed for another country.

Do you get customer support?

Is there somewhere to get help with queries? What's the availability of support? Do you have to pay for ongoing support on top of the software?

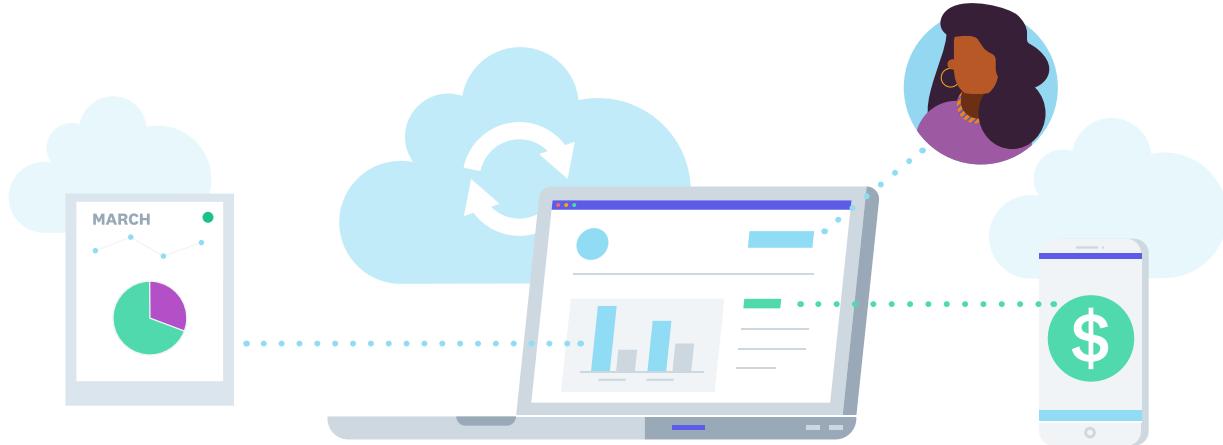
What's the return on investment (ROI)?

Work out how many hours it will save you each week, month, or year. A smart system should pay for itself many times over.



Bookkeeping software features to expect

Not sure what to look for when shopping for bookkeeping or accounting software? Here's a checklist of useful capabilities to keep in mind.



Bank connections

Your business transactions will stream straight into your accounts.

Online ledger

It's easier to work with partners and accountants when there's one single version of the books.

Dashboards

Get a visual summary of things like money due to come in, bills due to go out, and more.

Mobile notifications

Get alerts for things like overdue invoices or payments received.

Quotes

Send professional quotes with an 'accept quote' button to make customers' lives easier.

Online invoicing and payments

Complete and send invoices with online payment options.

Accounts receivable

Get notifications when customers open or pay your invoice, or if they go past the due date.

Accounts payable

Enter bills into the system simply by emailing them to your software.

Tax tools

Using smart reporting features can speed up tax prep and filing.

Payroll

Automatically calculates pay and deductions, and produces payslips.

Inventory

Keeps you informed about the volume and value of inventory and cost of goods sold.

Integrates with other systems

Check that it integrates widely with other time-saving financial and business apps.



Using professional bookkeeping services

If you don't have the time or confidence to take on bookkeeping, a professional can help. Let's look at what they do, how they charge, and how to choose one.

Why would you hire a professional bookkeeper?

There are many good reasons to hire a professional bookkeeper. Here are three of them:

- They save you a ton of time.
- They help you understand your business finances.
- They can take a lot of stress out of managing things like cash flow.

A bookkeeper can also offer support to business owners who feel like they're working alone.

What will a professional bookkeeping service do?

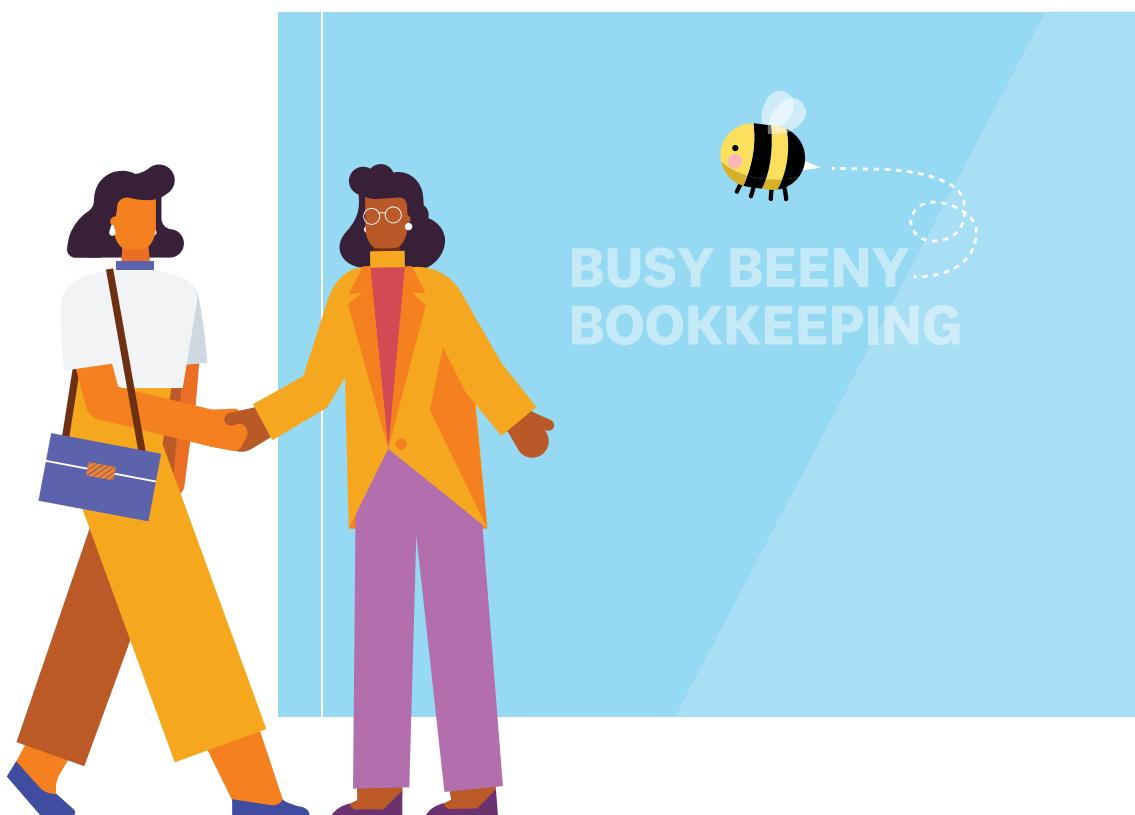
Bookkeepers will ensure all a business's accounts are accurate and up-to-date. And they'll report on those accounts regularly, so the owners and managers know where they stand financially. Plus well-maintained books make it easy for accountants to step in and do their thing at financial year end.

A bookkeeping service may also help you:

- fix up neglected accounts and build systems that help you from falling behind again

- recognise and begin to deal with recurring financial issues such as poor cash flow or mounting debt.
- identify the things that drive performance in your business (key performance indicators) and set up ways to measure and monitor them.

Bookkeepers increasingly use software to take care of recurring tasks. They will help implement these sorts of technologies, often taking care of setup and training your staff.



What does a bookkeeper cost?

You can find bookkeepers operating at all sorts of price points, and delivering all sorts of results. But there are now some very interesting pricing models that allow you to hire a consultant without taking a huge financial risk.

Three pricing models:

Flat rate

It's common for practices to charge a flat rate for a specific service, or combination of services. The cost stays the same regardless of the amount of time taken to perform the task. It eliminates some of the traditional uncertainty around hourly billing.

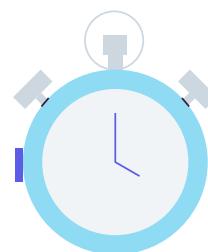


Subscription based

Other practices package services and deliver them for a flat monthly charge. It makes it much simpler to budget for bookkeeping. The service packages are often tiered, so you can start with a lower-priced subscription and move your way up if you like.

Hourly-based billing

Many bookkeepers charge by the hour. It's hard to anticipate what sort of value they'll deliver when you first start working together, but it can still be a good deal if you find an efficient operator.



Get prices

You can check out bookkeepers in your region and your industry in the [Xero advisor directory](#).

What should you consider when hiring a bookkeeper?

You need to know your requirements before you can go looking for a bookkeeper. Have a think about the following:

What type of business do you run?

Service businesses and retailers have different bookkeeping challenges to a manufacturing business. Look for someone with relevant experience.

What type of services do you need?

You may decide to keep some tasks in-house for now. But maybe you also want to have the flexibility to give them everything if you're too busy.

What type of software do you use?

If you're committed to a certain type of software you'll want to find a bookkeeper that also uses it.

What type of relationship do you want?

Are you looking for an advisor, a trainer, or just a doer?

How to find a bookkeeper?

Once you know your needs you can begin searching for a bookkeeper who'll be the ideal fit for your business. You're going to be sharing your financial data with them so you need to be comfortable and trust them. To narrow down your choices, here are some tips.

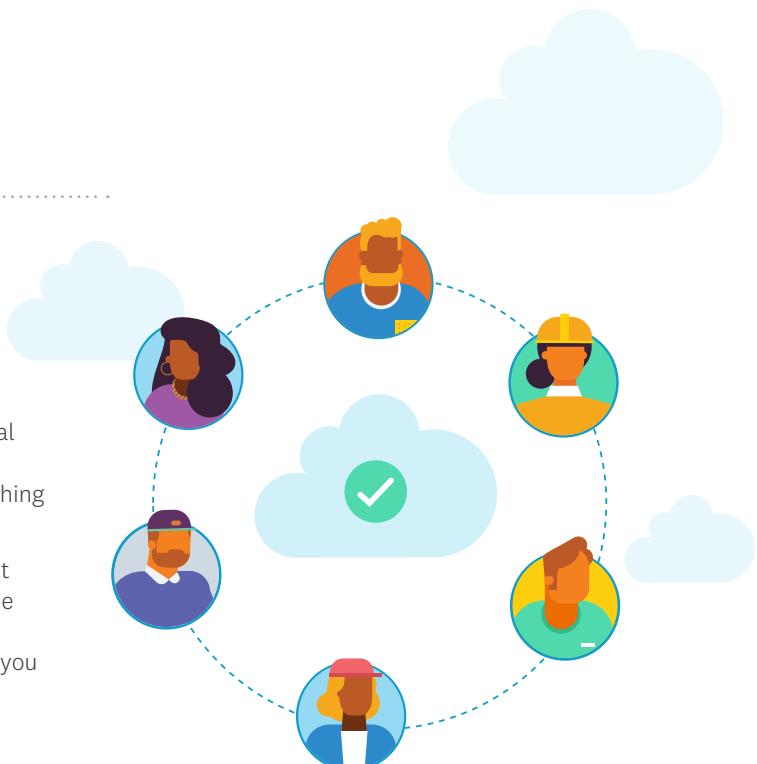
- Decide if you want a sole trader, a small consultancy or a larger company. Do they have enough personnel to deal with your needs?
- Do they offer general bookkeeping services, specialise in your type of business or industry, or offer more advanced services and solutions?

- Do you want face-to-face interactions or will you be happy with remote service? The services can be delivered remotely but you might want someone to come in to your business regularly.

Go to your networks

Talk to your friends, acquaintances and social networks – they may recommend someone. Your local business association may also give you some leads. Check if there is a bookkeepers association or something similar listed in your area.

If you already have an accountant, talk to them about who they currently work with. If you can find someone they're familiar with, it can make the relationship between the three of you even stronger, especially if you all use the same software.



Making the final decision

Once you've found some likely candidates, ask them some questions:

- To what stage do they take accounts: month-end management reports, trial balance, ready for year end?
- What are their qualifications and experience?
- Are they members of a professional body and do they undertake continuing professional development (CPD)?
- Do they have liability insurance?
- Have they worked with similar businesses to yours or know about your industry?
- How many clients are they handling and can they give you the amount of time and level of assistance you need?

If you're happy with their answers, then:

- contact their referees and talk to them about their experiences with them
- ask your accountant to meet with them and check they're up to the job

We can help get you connected with an experienced bookkeeper through the [Xero advisor directory](#).



Beautiful business

xero.com