What is bookkeeping?

Understanding the basics

Whether you've taken up bookkeeping to help the family business, or you're planning a career of it – this is a good place to start learning what it's all about.

This guide is intended as general information only. Always check with a professional for advice.

Contents

1

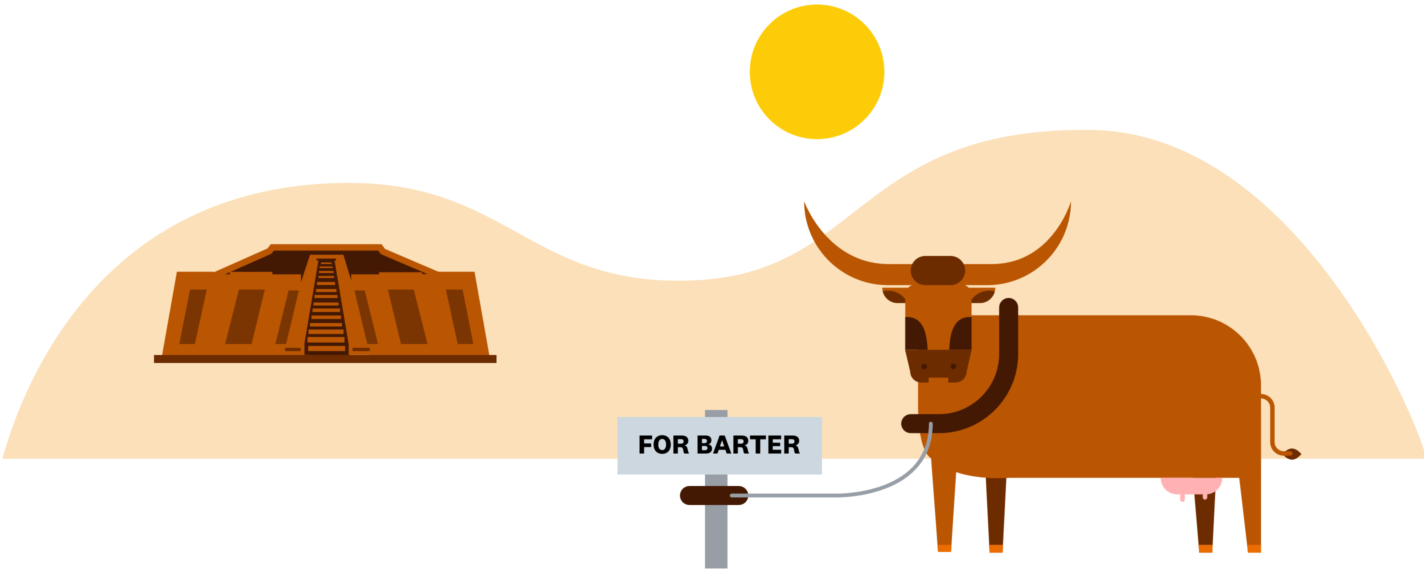
Introduction to bookkeeping

What does bookkeeping involve? Where does it come from? What's the end product? And how does it compare to accounting? We take a look.

Bookkeeping definition

Bookkeeping is the practice of recording and tracking the financial transactions of a business. Bookkeepers regularly summarise this activity into reports that show how the business is doing. They may also perform wider tasks such as invoicing, paying bills, preparing tax returns, monitoring key performance indicators, and providing strategic advice.

You can learn more about those tasks here.



History of bookkeeping

Assyria as far back as 7000 BC. Archives have been discovered, showing the recording of accounts from farm produce in ancient Greece as well as from the Roman Empire.

But it's in the 15th century that the roots of modern bookkeeping can be found. And fittingly, there are two entries in the history books for who documented the double-entry system. Some credit Benedetto Cotrugli and his 1458 book *Of Commerce and the Perfect Merchant*.

But most regard Luca Pacioli as the father of bookkeeping, for his 1494 book *Review of Arithmetic, Geometry, Ratio and Proportion*.

An Italian mathematician and Francisan monk, Pacioli wrote the first popular description of the double-entry system and the use of various bookkeeping tools such as journals and ledgers. His book became the teaching tool for bookkeeping and accounting for the next several hundred years. Bookkeeping became a recognised profession in the UK and US in the 1800s.

An introduction to bookkeeping basics

Here are some basic bookkeeping concepts and definitions that you should know. They're central to the methods and processes that a bookkeeper follows to create accurate accounts:

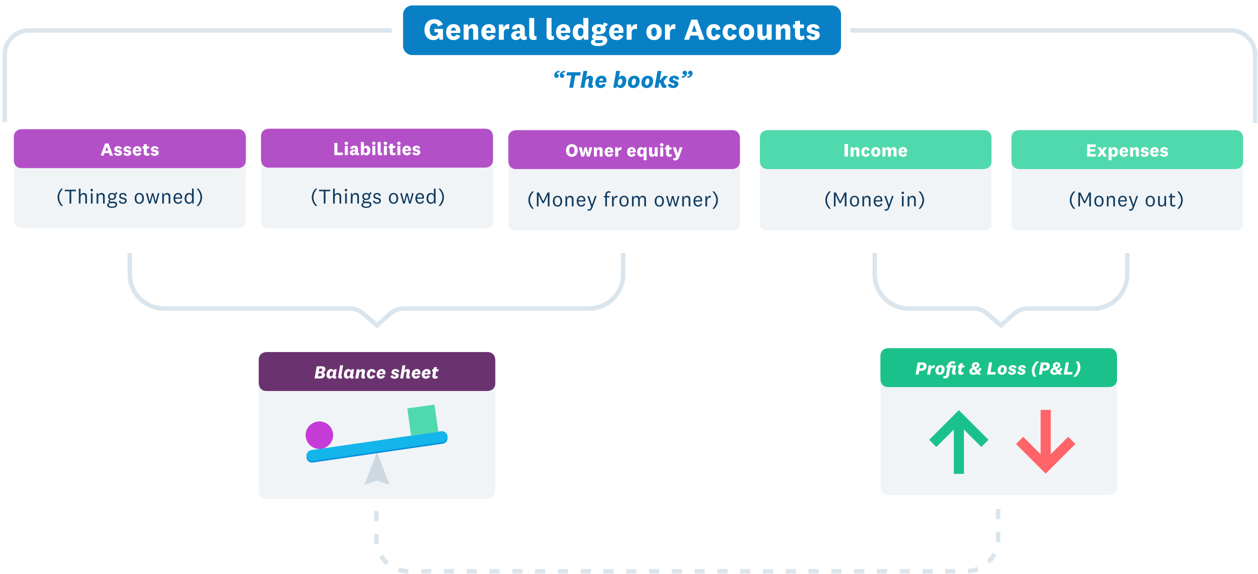


Figure 1, The five main accounts that make up a general ledger.

Ledger: The place where business transactions are recorded and categorised.

Accounts: The categories under which all business transactions fall:

- Assets: Things the business has bought and owns (or part-owns), inventory, and money owed to the business as accounts receivable.
- Liabilities: Amounts the business owes in unpaid bills, taxes, wages, or loans.
- Owner/shareholder equity: Money introduced and withdrawn by the owner or shareholders.
- Income: Money received (mostly from sales).
- Expenses: Money spent.

Financial statements: There are many financial statements but two main ones – the:

- Balance sheet lists the things your business owns and their value, plus the amounts your business owes.
- Profit and loss (P&L) totals the income and expenses for a set period of time and demonstrates how the business is trading.

Chart of accounts: Accounts are the basis of all transactional coding and double-entry bookkeeping. They help categorise types of assets, liabilities, income and expenses. They're also called general ledger codes.

Journal entry: The name given to any record made in the accounts.

The difference between bookkeeping and accounting

Bookkeeping traditionally refers to the day-to-day upkeep of a business's financial records. Bookkeepers used to simply gather and quality-check the information from which accounts were prepared. But their role has expanded over time, and we'll look at how in the next chapter.

Accounting refers to the analysis, reporting and summarising of the data that bookkeepers gather. Accounting reports give a picture of the financial performance of a business, and determine how much tax is owed.

An accounting degree requires deep education and training in tax and other laws with which businesses need to comply, plus finance and business management. While some bookkeepers may have developed similar skills, that level of training isn't required to be called a bookkeeper.

There are professional associations that can provide bookkeeping training and certification. Bookkeepers have to be BAS certified before they can lodge tax returns.

Learn more about training to become a bookkeeper.

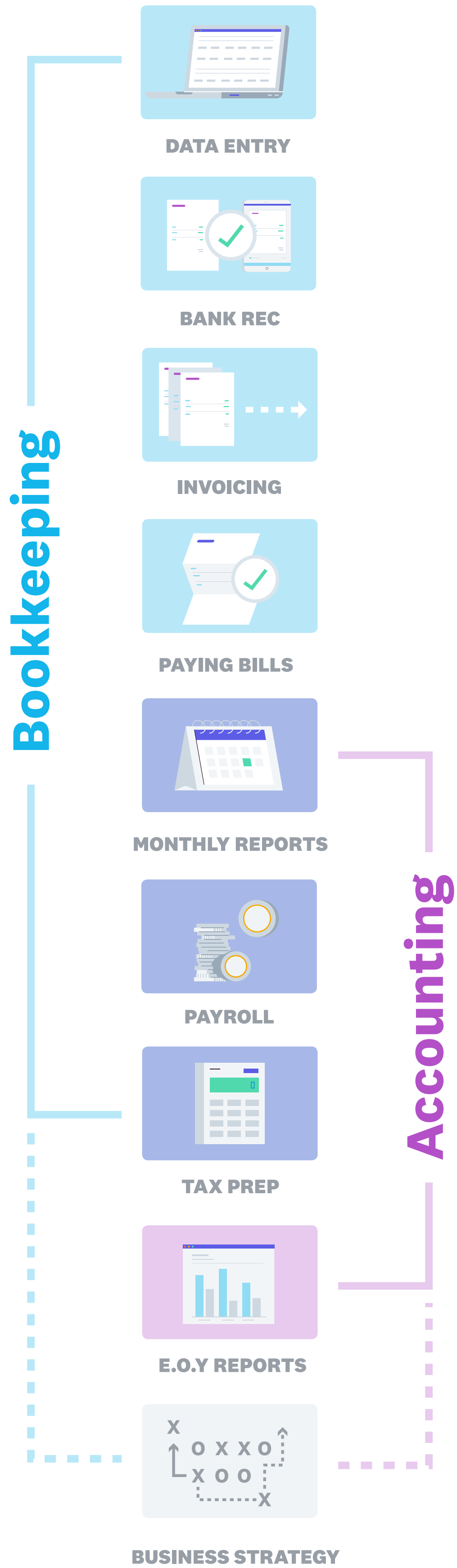


Figure 2, Bookkeeping and accounting have a lot of overlap depending on the specific skills and focus of the people who fill the roles.

2

Double-entry bookkeeping explained

With double-entry bookkeeping, you create two accounting entries for each of your business transactions. But why? Are there always two? And where do the entries go? Let's break it down.

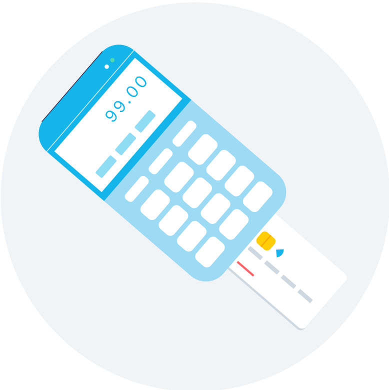
Why is there double-entry bookkeeping?

Double-entry bookkeeping is designed to reflect the greatest truism of business – you don't get anything for nothing. If something comes into your business, it's because you gave something up.

For example, for each of these ways you gain cash, there is an opposite action:

Sold goods

It means you gave up inventory you owned.



Sold a service

You paid wages of service provider.

Took a loan

It means you now have a debt.

Got an investor

It means you gave up equity in your business.

You need to acknowledge both sides of each transaction, and reflect it in your books. And of course you have to make an extra entry to do that – hence *double-entry* bookkeeping.

Are there always two entries?

Double-entry bookkeeping gets its name because there are at least two entries for every transaction. There may be more. For example, a sale may:

- increase income
- lower inventory
- create a tax liability on the GST you collected

And it can get bigger than that. The more complex the transaction, the more entries there are.

How to do double-entry bookkeeping?

Double-entry bookkeeping aims to track all the knock-on effects of a business transaction and reflect them in your business accounts. But what does that mean on a practical level?

To get a sense for it, you need to understand a little about:

- how business accounts are structured
- where the chart of accounts fit in, and
- what happens during a transaction

How the accounts are structured

The books – or ledger – for a business are made up of five main accounts, which are split into groups.

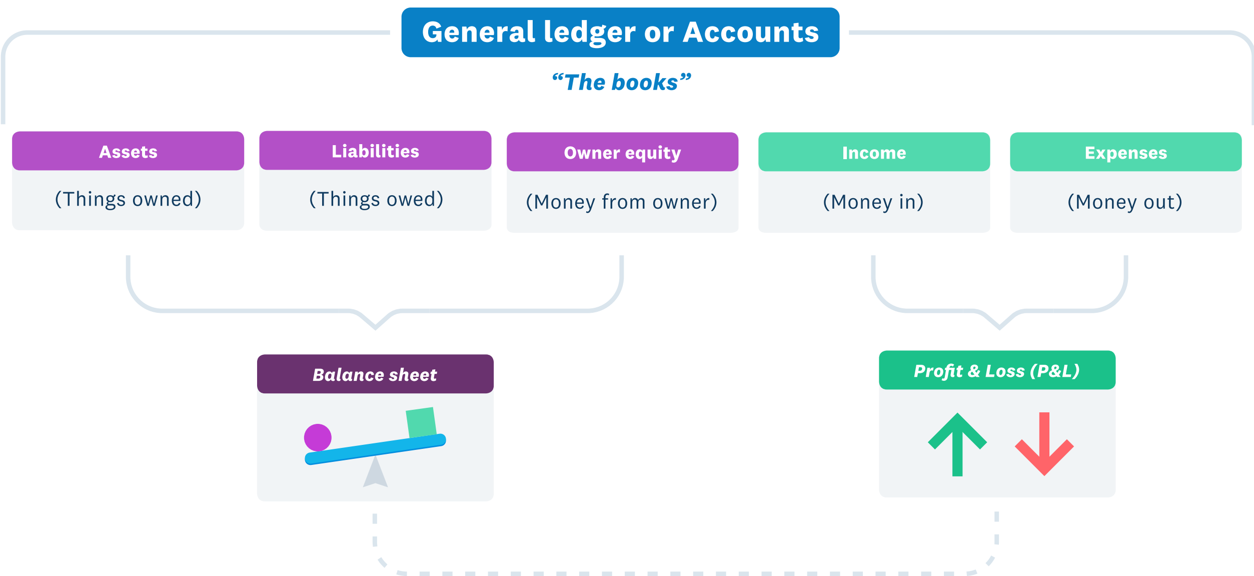


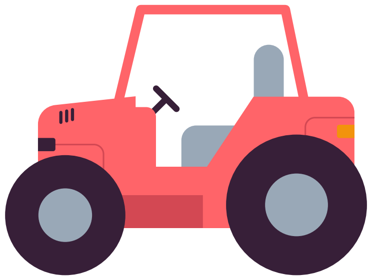
Figure 3, The five main accounts that make up a general ledger.

These accounts are the same for every business – from a freelance worker to a multinational. Let's learn a little more about them.

What is an asset?

Something of value that the business owns, or part-owns.

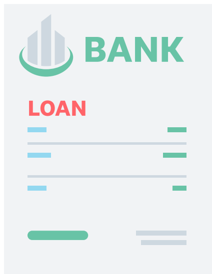
Examples: Cash and things that can be converted to cash, including land, tools, accounts receivable and unpaid sales invoices.



What is a liability?

Something (usually money) the business owes.

Example: Loans, unpaid bills, or taxes.



What is income?

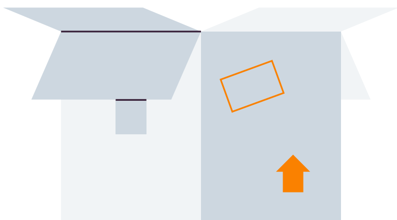
Money coming into the business.

Examples: Sales and sometimes interest or dividends on investments.

What is an expense?

Purchases made to keep the business running.

Examples: Inventory, equipment, office supplies and, often, payroll.

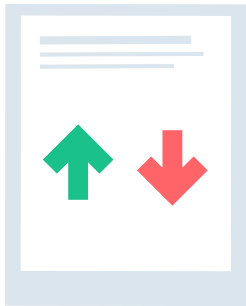


Why the accounts are set up this way

These accounts ultimately filter down into your key financial reports.

The balance sheet

Assets (things owned) – Liabilities (things owed)
= Value of the business.



The profit and loss

Income (money in) – Expenses (money out)
= Profitability

Where the chart of accounts fits in

A trained bookkeeper can quickly see how a transaction affects the five big accounts, but it doesn't come naturally to most of us. That's where the chart of accounts can help. It's a handy link between daily business activities and the five accounting buckets.

The chart of accounts is a bunch of more meaningful and intuitive categories for your business transactions – like sales, supplies, wages, and loans. When you classify a transaction to a chart of accounts code, it will filter into the right accounting bucket – and ultimately into the right report. [Learn more about the chart of accounts.]

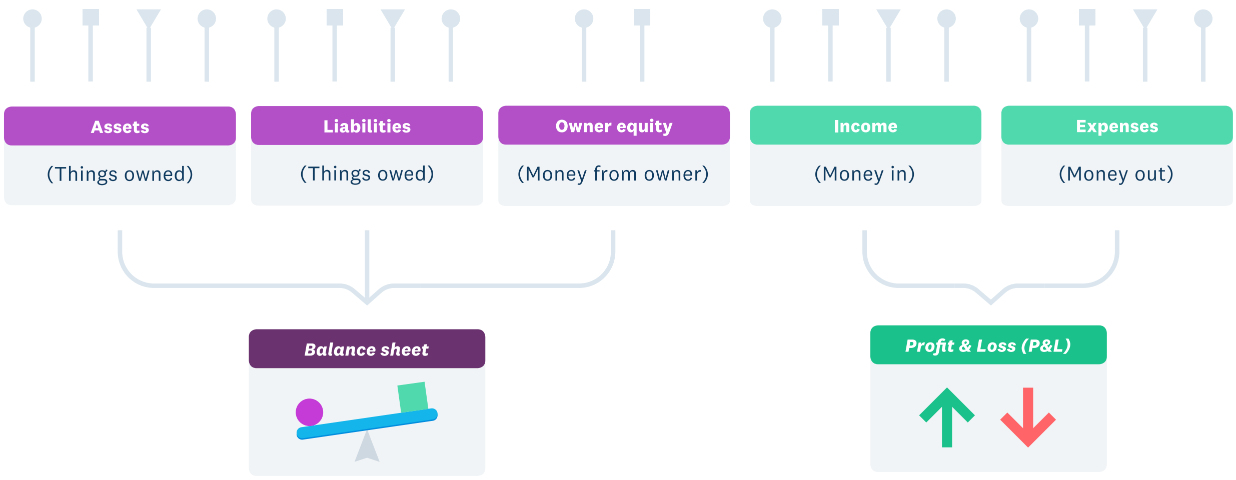


Figure 4, Transactions are coded using the chart of accounts which then feed into the financial reports that reveal how your business is doing.

What happens during a transaction?

The most important rule of double-entry accounting is that nothing ever happens in isolation. When a transaction takes place, you record it in the obvious category of the chart of accounts and then you ask – what else has changed?

Sales	Inventory	GST owed
↑ $11	↓ $5	↓ $1

Figure 5, Think about where value comes and goes from when you do business.

A professional will see the ripple effect of a transaction immediately. A novice bookkeeper can get the knack of it eventually. Or you can use accounting software and set up rules for how the accounts interact. When you assign a transaction to one account, the software automatically knows what else is affected and records it too.

3

What does a bookkeeper do?

Keeping the books is just one of the tasks modern bookkeepers might handle. Depending on the business they work with, their duties can be quite diverse.

Responsibilities of a bookkeeper

Bookkeepers are responsible for providing accurate, up-to-date financial information about a business. They're always taking the pulse of a business.

Most often, their reports go to business owners and managers to help them make decisions. Some bookkeepers, however, are actually involved in strategy development.

Bookkeepers may also share some jobs with accountants, such as the preparation of annual financial reports and tax returns.

Bookkeeping duties

The two foundational tasks in small business bookkeeping are data entry and bank reconciliation. Without these, all other bookkeeping tasks fall over. Let's walk through the core duties, common additional duties, and advanced bookkeeping.

Core duties

Data entry

Recording financial transactions and balancing the books. Learn more.

Bank reconciliation

Cross-referencing the books against bank statements and other source documents to confirm accuracy. Learn more.

Monthly reports

Summarising the business's financial position. Learn more.

Additional duties

Accounts receivable (and credit control)

Creating and sending invoices, and following up to get them paid. Learn more.

Accounts payable

Making sure invoices from suppliers are accurate and paid in a timely manner. Learn more.

Payroll

Calculating pay and deductions. Learn more.

Advanced duties

Tax filing

Preparing tax returns. Learn more.

End of year reporting

Assisting with annual profit and loss and balance sheet reports.

Business strategy

Creating budgets and forecasts, and advising on how to improve the business.

Business process
Reviewing, researching and implementing software solutions and internal controls to streamline the business and enhance performance.

Training

Working with staff on best practice bookkeeping and use of software solutions.

Virtual office

Providing a full-service virtual office, for example telephones, postal address, and email communications.

Liaison
Meeting with accountants, on behalf of their clients, about financials and tax queries. Acting on behalf of the client with the tax authorities.

4

What types of bookkeeper are there?

Given the huge variety of skills and tasks that go into bookkeeping, it should come as no surprise that they're a diverse bunch. You might even be one and not know it.

Bookkeeper roles

Bookkeepers can serve a wide range of functions, from standard data entry to advising on business strategy. They come from all walks of life too.

Here are some of the types of bookkeepers that keep businesses running today:

Unofficial 'kitchen table' bookkeeper

This might be the small business owner, their spouse, partner or family member. Or it may be someone with another role in the business who ends up working on the accounts by default. They're doing the basic tasks of data entry, bank reconciliation, invoicing, payments, and filing the paperwork for the accountant. They're probably self-taught.

Sole trader

This is a one-person bookkeeping firm. They may have started out as a kitchen table bookkeeper and loved it, or maybe they left a big firm. Now they've set up business and taken on a few clients of their own through referrals from friends, colleagues and other people who've heard they're bookkeeping. They're likely to have some training and certification.

Bookkeeping practice

Just as there are accounting firms, so there are bookkeeping firms. They often sell off-the-shelf service packages ranging from basic bookkeeping, all the way up to strategic advice.

Department in accountancy firm

Some accounting firms have a bookkeeping department that keeps your accounts up to date and produces monthly reports. These people may also be called accounting technicians.

In-house bookkeeper

These bookkeepers work in a business doing the full spectrum of bookkeeping duties. They often report directly to the owner (or management) and they may work with an external accountant to deliver all of the business's accounting needs.

Virtual bookkeeper

Virtual bookkeepers deliver their service remotely by using online accounting software and meeting mostly via video conference. Doing business this way allows them to keep their prices down. They might be a sole trader, inside a practice, or be based offshore as an outsourced service.

Bookkeepers are generally good with people. They like breaking down concepts such as finance and tax so that any business owner can understand them. They're also interesting characters. Meet some of them in our series of [accountant and bookkeeper stories.]

Beautiful business

xero.com