

Setting Up Your Own Business: **Records and Bookkeeping**

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This NebGuide outlines what principal business forms are used for bookkeeping and record keeping in a successful business.

Taking Action

A business record system is an important but often unappreciated part of a business management system. Whether you're starting up a business or have been operating a business for months or years, a good record system and disciplined bookkeeping are required for business success.

A good record system that's kept current and regularly summarized is the most reliable source of information about your business. Bookkeeping that's up-to-date and complete can tell you whether you're making a profit, barely breaking even, or "losing your shirt."

When you have a business, keeping records is like cleaning your store and restocking the shelves — for satisfactory results, it must be done in a disciplined manner. Further, you need good records for income tax purposes; the Internal Revenue Service requires "reasonable" records for your income tax returns and as the basis for your withholding and remitting payroll taxes for employees.

Why Keep Records?

Your records system and bookkeeping activities should provide both a constant flow of information about the state of your business and a quick and accurate mechanism for assembling, recording, and analyzing business unit and business operations data. Once you set up your system, keep a disciplined approach to bookkeeping. Your records must be complete and up-to-date for them to be reliable sources of management and tax information.

Information from your records will help you avoid potential financial mistakes — investing too much, spending too much, setting prices too high or too low, or paying too much or too little in taxes.

Without good information from your records, you may invest more than is justified; your sales data may be guesses instead of facts; deductible expenses may be too high, understated, or forgotten; and you may pay more or less income tax than you actually owe — more is a waste of resources, less can be a serious problem.

Whenever you begin thinking about starting a business, it's time to start keeping records. Initially, your records may be focused on information about business prospects. Before spending any money on your business start-up, set up a record system suitable for the business you intend to establish. Start making entries (keeping books) for your business with your first expenditure. Go on from there to enter everything you spend and receive before and after your business opens.

Document and record everything you spend in your business start-up. In your start-up expenditures record, include both operating expense and capital purchase spending prior to the business opening.

Typical expenditure categories include:

- legal and accounting services;
- remodeling and painting;
- shelving and display cases or tables;
- sign and display materials;
- utilities (heating, water, electricity);
- vehicle mileage; and
- the myriad of supplies and other expense items needed to set up and start operations.

Also, be sure you have complete records of your start-up inventory.

As soon as possible after receiving them, make copies of all leases, agreements, contracts, bids by suppliers or contractors and other similar documents from your start-up. Use the copies as information sources for management and decision making.

Keep the originals in a safe place away from your business to ensure you'll have them if you need them — a bank safety deposit box is an excellent location. If a fire, flood, break-in, tornado, or other disaster occurs, you'll need the originals if your business is to survive.

After your business opens, document all operating costs; the gross and net costs of additions to inventory; the dates, number of articles, and dollar value of each sale or return; and the dollar amount of daily, weekly, and monthly sales.

If you have employees, hiring and tax status information for each employee is required by Internal Revenue Service and U.S. Citizenship and Immigration Services regulations. Also,

you must keep records for each employee indicating hours worked, wages, and payroll taxes withheld and deposited, in accordance with applicable rules and regulations.

The discussion of categories of essential records provides brief descriptions of types of records most businesses need — your business may require records in all these categories and more. The records you will need depend on your business and business activity. Use the list of categories as a starting lineup and add to it, as needed, for your business unit and business activities.

Setting Up Your Record System

Deciding On A System

Your records system provides the framework for your bookkeeping, so you may need expert assistance in setting it up if you're unfamiliar with business records and bookkeeping procedures. If you're not experienced in keeping business records, check out your community college business management courses or find an online webinar on the topics you need. Just make sure the source is credible.

Today the best way to manage business records is by using a computer software package such as Quicken® or QuickBooks®. The software can be easy to learn, and most will include functions such as check-writing and shortcut methods of preparing reports, financial statements, inventory records, and other summary statements. Many have routines for preparing budgets and projecting costs. If you are serious about growing the business, consider learning and using this type of record keeping system. Make sure to include some type of regular backup system for your files as part of the purchase, perhaps a separate, portable hard drive.

As time goes on, your record system may need tweaking, upgrades or your business may outgrow the system's capacity. If this occurs, secure expert advice and assistance from an accountant or other qualified professional. In many situations, your income tax preparer can provide the advice and services you need. If not, find a professional such as a Certified Professional Accountant (CPA) who can give you sound advice. Then, implement that advice and make changes as required to ensure your business records are adequate for management and tax preparation purposes.

Single- vs. Double-Entry

The issue of single-entry vs. double-entry record systems is likely to emerge early in any discussion of business records. In double-entry systems, all business transactions are entered in a journal and then posted to accounts using procedures that allow excellent control of errors. Nearly all computer software systems are double-entry systems. You may want to consult with your business's accounting professional when you are initially setting up your computer business system.

Essential Records

The principal categories of records that provide the basis for income tax preparation and management decision-making are described here, and can help you understand the nature and purpose of principal record system components. The specific forms and entries used in your business records will depend on the nature of your business activities and the preferences

of the person or persons designing your record system. To provide a linkage with accounting terminology, the categories are referred to here as "accounts" or "ledgers."

Capital Assets Account — This account is a cumulative listing of purchases, sales/exchanges, and annual depreciation of all capital items (items with an expected life greater than one year) as purchased during your business start-up and operations. Purchases and sales or exchanges of land, buildings, equipment, vehicles, patents, other intangible assets, and other items with a multiyear expected life are recorded in this account.

Information from this account is used to calculate the "book value" of your business and to determine for income tax purposes, the annual depreciation deduction and the remaining cost basis for capital items used in your business.

If you are an accountant, these calculations are not difficult. However, if you're not accustomed to accounting procedures, you may need expert assistance in setting up and maintaining your capital assets account and calculating the data for your income tax return.

Inventory Account, also called **Inventory Ledger** — This ledger is your record of goods or products held for sale by your business. Inventory entries usually contain a count of items (physical inventory) and the dollar cost (inventory value) of those items. Purchases and sales are the primary entries. Returns to suppliers and returns by customers are entered as adjustments.

Periodically, conduct a physical inventory of goods or products held for sale. The interval between inventories will depend on the type of business and how fast the inventory changes. When the physical inventory is completed, adjust the inventory ledger to reflect the amounts of merchandise actually on hand.

Transactions Ledger, also called **Sales Ledger** — If you are selling tangible goods, this ledger is your record of sales and returns of merchandise.

If your business provides services, the ledger is your record by service and/or by customer (client) of the services you've provided, charges and payments for those services, and any refunds you've made. Usually, you'll prepare an invoice or will have a cash register entry for each sale or refund.

Depending on your daily volume of business and your records system, a transactions ledger entry may be a daily total from your cash register or it may be a record of each transaction. At any time, the accounting period balance of this ledger is your sales total for the accounting period. (Your accounts receivable ledger also provides this same kind of detail by client.)

If you calculate and collect sales tax as an add-on to each transaction, the ledger entry reflects the amount collected at the time of sale and its division into a sales amount and an amount of sales tax collected. If your sales prices include sales tax, the allocation is made according to procedures specified by the Nebraska Department of Revenue.

Refunds usually are treated as negative entries and may appear in your ledger in the chronological sequence of transactions, or they may be entered in a portion of the ledger set aside for refunds. Either approach is acceptable if used consistently. Regardless, be sure to record the refunded amount for merchandise and the amount of the

sales tax refund. Frequent totaling and balancing of your transactions ledger is desirable; doing so daily usually is a very good approach.

However, if your business volume is very small, you may decide to total and balance at somewhat longer intervals. Be sure to do so prior to making bank deposits as it will help you to detect and correct errors. Net transactions for the period covered by the deposit should balance against the amount of money, checks, and credit card slips deposited. This balancing helps to ensure accuracy in handling sales receipts.

Checking Account Ledger — If you have kept a personal check register, you already know the mechanics of the checking account ledger component of your business records. If your business is very small, this ledger may be the check register for your business checkbook. As your business grows, or as information needs grow, you may want to keep a separate ledger and more complete information (possibly with voucher copies) for each check and deposit. If you accept credit cards, be sure to enter adjustments for credit card discounts on each deposit containing the proceeds of credit card sales.

Many people do not regularly reconcile their personal checkbook registers against their bank statements, with the result of misestimating their bank balance and having a check returned for insufficient funds. This is embarrassing and often expensive but it's not excessively damaging to their personal standing and/or credit history.

Don't let this happen with your business bank account. An insufficient-funds check on a business checking account can be very damaging to your credit rating and may result in suppliers insisting they must be paid in cash for everything you buy.

Reconcile every bank statement with your checking account records as soon as the statement is received. You cannot afford an error that results in an insufficient-funds check being issued. Know your bank balance at all times. Online banking through your computer can make this task much easier.

Business Files — As a part of your record system, you should maintain a filing system for all of the deeds, licenses, permits, contracts, leases, agreements, insurance policies, personnel records, and other documents making up the legal foundation of your business operations. You need to be able to refer to these whenever needed, and to have easy access to the amounts and due dates of payments.

As previously discussed, many of these documents are vitally important to the future of your business. In event of any natural disaster, fire, or other catastrophic event you will need them. You also must have them for legal, insurance, and income tax purposes. Keep the originals in a safe place away from your business but keep photocopies of everything in your business files. The cost of photocopying is very small compared to the cost and difficulty of replacing the originals of these important documents.

Closing Summary

Like other aspects of business operations, your records system and bookkeeping activities are a means to the end of having a viable and profitable business. They also are tools you use to generate information, making it possible to comply with the many laws and regulations of our complex society. They are the sources of information you need to make your business a success.

Entries in your accounts and ledgers — the “books” for your business — are the basis for financial statements and data used in calculating ratios and other measures of your success in establishing, managing, and maintaining your business operations. Bookkeeping is part of the “chores” required of those who operate businesses. When your books are set up so they are appropriate for your business, bookkeeping is not excessively difficult. The rewards of good bookkeeping — good management information, clear understanding of the condition of your business, and accurate data for your tax return — make the required time and effort worthwhile.

Resources

Nebraska Department of Revenue Web site: www.revenue.state.ne.us/

Internal Revenue Service Web site: www.irs.gov

Nebraska Business Development Center Web site: <http://nbdc.unomaha.edu>

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