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## NF96-276 *Setting Up Your Own Business: Records and Bookkeeping* (Revised April 2005)

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

Cheryl Burkhart-Kriesel, Extension Specialist—Community Development  
Originally by Paul H. Gessaman, Retired Extension Economist

A business record system is an important but often unappreciated part of your business management system. Whether you are moving toward a business start-up or have a business that's been operating 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. When your bookkeeping is up-to-date and complete you'll be able to know whether you are 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 — 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 are intended to provide a constant flow of information about the state of your business. They should provide a quick and accurate mechanism for assembling, recording, and analyzing business unit and business operations data. Once set up, you will need a disciplined approach to bookkeeping — your records must be complete and up-to-date if they are to be a reliable source of management and tax information.

Information from your records will help you avoid mistakes that could damage your business — 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.

### Taking Action

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 you spend 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 and 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 record of start-up expenditures 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 of these documents if your business is to survive.

After your business opens, your business records should 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, your records must contain hiring and tax status information for each employee as required by Internal Revenue Service and Immigration and Naturalization Service 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 (next column) provides brief descriptions of types of the 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. Look at 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

Your records system provides the framework for your bookkeeping activities. You may need expert assistance in setting it up if you are not familiar with business records and bookkeeping procedures. If you're not experienced in keeping records for a business, taking a business records course at your community college or high school can be very useful. If a course is offered near you but you can't take it, ask the instructor or someone else who is experienced in setting up and maintaining business records for assistance and advice.

As soon as you start thinking about records it's likely that you will begin wondering whether you should keep records on paper or use a computerized record system. Depending on the level of your computer skills, your record-keeping experience, and the nature of your business, a computerized system may or may not be a good plan. Here are some general guidelines that may help as you decide:

- If your business is very small and/or you're not accustomed to using computers, it may be best to use a hand-kept record book. Look in a business supply store for business record books at reasonable prices. Before buying, use this checklist and local advisers (see above) to determine what records are essential for your business. Then, select a record book that will meet your needs. Many times people who have had hobbies that later grew into a small business went this route.
- If you are accustomed to using a computer and have access to one, it may be best to use any of several relatively inexpensive business software packages. The software is relatively 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 using a record-keeping system.

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. Despite the accuracy advantages of the double-entry method, most record systems — including nearly all computer software — are single-entry systems. Unless you have experience using the double-entry method, a single-entry system may be more feasible. Only you can evaluate the alternatives and decide what's best for your circumstances.

As time goes on, it may be that your record system needs improvement or that your business has outgrown the system's

capacity. If either occurs, it's time to 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 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.

### Essential Records

The principal categories of records that will provide the basis for income tax preparation and management decision making purposes are discussed here. These descriptions will 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 who design 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 in calculating the "book value" of your business and in determining 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, a physical inventory of goods or products held for sale is conducted with the interval between inventories depending on the type of business. When a physical inventory is completed, the inventory ledger is adjusted 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 customer (client) and/or by service of the services you've provided, charges and payments for those services, and any refunds you've made. Usually, you will 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

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.

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 are inclusive of 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 it is 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, when 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 receipts from sales.

**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 account checkbook registers against their bank statements. Some pay one or more fees from miscalculating their bank balance and having a check returned for insufficient funds. When this happens, it is embarrassing and usually is 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 that 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.

**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. Thus, it is wise to keep the originals in a safe place away from your business while retaining photocopies 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; and also 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.

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