

Managing finances

Understanding your financial statements

One of the most important tasks when in business is to manage the finances effectively. This can be a daunting prospect if you aren't a numbers person, but it is crucial to make sure that your business will be successful.

The following sections will take you through the main elements of financial management that you need to understand to keep on top of your cash and profitability. Remember, these things don't need to be complicated but they are something you should look at regularly.

Bookkeeping

What is it?

Bookkeeping is the recording, on a day-to-day basis of the financial transactions and information pertaining to a business. It is concerned with ensuring that records of those individual financial transactions are accurate, up-to-date and comprehensive. Accuracy is therefore vital to the process.

Bookkeeping involves organising and managing all business transactions in a company so that each transaction whether a purchase or sale, loan or repayment is recorded in the books as an individual activity.

How to do it?

Historically bookkeeping was done by hand in a set of 'books' or on a spreadsheet, but accounting systems have streamlined this process. There are now both online and

desktop versions of accounting systems. Online accounting software can link up to your bank account and help you record the transactions quicker and more accurately. All this helps you get away from your desk and out doing the more enjoyable parts of running your business!

In principle, and to keep on top of things, transactions should be recorded regularly in the books or on the system. To be complete, for each transaction there must be a document that describes the business transaction, for example, a simple sales invoice, sales receipt, a supplier invoice, a supplier payment, bank payment or journal.

Who does it?

Bookkeeping is usually performed by a bookkeeper. A bookkeeper is usually responsible for writing the “daybooks”, which consist of purchases, sales, receipts, and payments, and for ensuring all these transactions are recorded in the correct daybook or ledger.

Bookkeeping provides the information from which accounts are prepared but is a distinct process and separate to accounting. The bookkeeper brings the books to trial balance, at which stage the accountant may then prepare the financial statements – the income statement and balance sheet – using the trial balance and ledgers prepared by the bookkeeper.

Bank reconciliation

A Bank reconciliation is the process of matching and balancing figures in the accounting records with those displayed on a bank statement.

If a transaction appears in the accounting records but does not appear on the bank statement, or vice versa, then it is ‘unreconciled’. The unreconciled items represent possible discrepancies between the accounting records

and the bank statement, and they will need to be resolved.

Bank reconciliation discrepancies could include:

- Cheques documenting a different amount than the amount received by the bank,
- Money that was received but not recorded in the accounting records, or
- Payments made from the bank without having been recorded in the books.

Performing a bank reconciliation regularly can drastically reduce the amount of errors that can occur in an accounting system and make it easier to find missing purchase and sales invoices.

Cashflow

What is it?

A cash flow is an estimation of a business's cash inputs and outputs over a specific period of time.

How to do it?

You can create a cash flow by showing anticipated revenues, operating expenditures, sale and purchase of assets, and admission or settlement of debt over time. The cash flow may be set up weekly or monthly but either way will estimate when the cash will actually come in and be paid out.

What to do with it?

The cash flow will help a business:

- determine when more cash resources are needed and when there will be an excess of cash
- estimate whether or not it has a sufficient amount of cash to fulfill regular payment operations
- determine whether too much of a company's cash is being spent in unproductive ways
- know whether or not it has enough cash to operate
- establish the amount of credit that it can extend to

customers without having problems with liquidity

- avoid having a shortage of cash during periods of heavy expenses

Remember, if a business cannot pay its expenses because it has a cash shortage, it must resolve this problem right away by bringing in more revenue, deferring or eliminating some costs or finding additional sources of finance, for example, an overdraft or loan from a bank.

Balance Sheet

The purpose of the balance sheet is to provide an idea of the company's financial position along with identifying what the company owns and owes.

The balance sheet is divided into two parts that, based on the following equation, must equal each other. The main formula behind balance sheets is:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

As the balance sheet is a snapshot at a single point in time of the company's accounts, the balance sheet, along with the income and cash flow statements, is an important tool for investors to gain insight into a company and its operations.

Profit & Loss Statement

The Profit and Loss Statement (sometimes referred to as the P&L) shows the profit or loss of a business over a given period of time. It shows what net profit or loss your business has made within an accounting period after deducting all expenditure from all income. A net profit is earned if total expenditure is less than the sales and a net loss if it is greater.

An essential objective of a business is to make a profit. The P&L statement shows the extent to which it has been successful in achieving this objective.

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