The biggest challenge for most first time entrepreneurs is book-keeping. Book-keeping has always presented a challenge for the entrepreneur. It is astonishing to see so many entrepreneurs even experienced entrepreneurs who have a hard time keeping their financial records in place. This is especially true for entrepreneurs who haven't had a background in business.

First time entrepreneurs think, they can just outsource their accounting to an accountant and not worry about it. It is okay to outsource your book-keeping, in fact you should outsource your accounting to an accountant but you need to know what the numbers in your financial statements mean. If you have no idea how much money is coming in and how much money is going out then you are going to be in trouble. Remember, accounting is the language of business.

So, let's identify the objectives of book-keeping:

1: Track how much money is coming in and how much money is going out.

2: Track your profits, losses and revenues (sales).

3: Track how much you owe and how much you own.

To achieve these objectives, you need to understand 3 financial statements. These 3 financial statements are related to each other.

1: Cash flow statement

This is a statement that talks about how much money is coming in and how much money is going out. That is the purpose of this statement.

2: Profit and Loss statement (P&L)

The profit and loss statement also called the income statement tells you how much sales or revenues you have made for a given period, how much expenses you have incurred over a given period and what is the net profit after you have incurred those expenses. This is different from the cash flow statement in a sense that if you had cash coming in from investors, that would be recorded in the cash flow statement but not in the income statement.

3: Balance sheet

The balance sheet talks about how much you owe and how much you own. It lists your assets and your liabilities. Please remember all this is listed at book value. Book value means it is the purchase price – the priced you paid for that asset. If you paid $1 million for a piece of equipment, it will be listed at $1 million minus any depreciation even if the market value for that equipment might be only $100,000.

What are the other words you need to know about accounting so that you can communicate effectively with your accountant?

Accrual based accounting

According to investopedia “Accrual based accounting is an accounting method that measures the performance and position of a company by recognizing economic events regardless of when cash transactions occur."

So, what does this mean? Let's explain it with an example. For example, if you sold your product for let's say at $30, whether or not you receive payment from your customer, it is listed as sales on your profit and loss statement.

Accounts payable

This is money you owe to people. If there are certain unpaid bills, these bills will show up in the accounts payable that is listed in the liabilities section of the balance sheet.

Account receivable

This is money people owe you. Remember the previous example where you sold a product to your customer but the customer did not pay you, this shows up in the accounts receivable of your balance sheet. This is money your customer or anyone else needs to pay you.

Depreciation

Depreciation for accounting purposes is reducing the value of an asset over a period of time. Let's say, you buy computers worth Rs 45,000, this Rs 45,000 will show in your balance sheet as an asset. However, over a period of time your accountant will depreciate this in your balance sheet. The depreciation will show up as an expense. Let's say, your accountant decides to depreciate your computer at Rs 15,000 every year. After the first year, your balance sheet will show an asset at Rs 45,000 minus Rs 15,000, that is Rs 30,000. The depreciation expense will show up as Rs 15,000 as expenses in your income statement. This is not an actual cash outflow but a paper expense shown in your income statement.

This article talks briefly about the basics of accounting. It is very important that entrepreneurs start looking at financial statements not just as required for legal and tax purposes but look at them as statements that provide insights into the financial health of their companies.