

75%  
  
m-m-m  
n-e-l-e  
m + n

TOTAL REVENUE - COST OF SALES = GROSS PROFIT

$\frac{\text{Inventory}}{\text{Cost of Sales}} \times 365$



UNITED NATIONS  
DEVELOPMENT PROGRAMME

BUSINESS ADAPTATION PROGRAMME

# Fundamentals Financial Planning E-Guide for MSMEs

Future-Tourism in the Eastern Caribbean

#FUTURETOURISM

# Acknowledgements

This guide will enable you to better understand finance in a business context and to become familiar with the development of a financial plan in order to **REFLECT, RE-START or to REVITALISE** your business and to adapt your business performance to the new market conditions.

These e-guides have been produced by the United Nations Development Programme (UNDP) Barbados and the Eastern Caribbean thanks to the generous contribution from the Caribbean Development Bank (CDB) and the technical support of the Frankfurt School of Finance & Management which collaborated on the development of the content and design.

Special acknowledgement goes also to the University of West Indies Open Campus and all the facilitators, e-tutors and mentors that made the Business Adaptation Programme of the UNDP Future Tourism Project possible. The Project played a pivotal role in supporting MSMEs in the Eastern Caribbean through the difficulties of the COVID-19 pandemic.

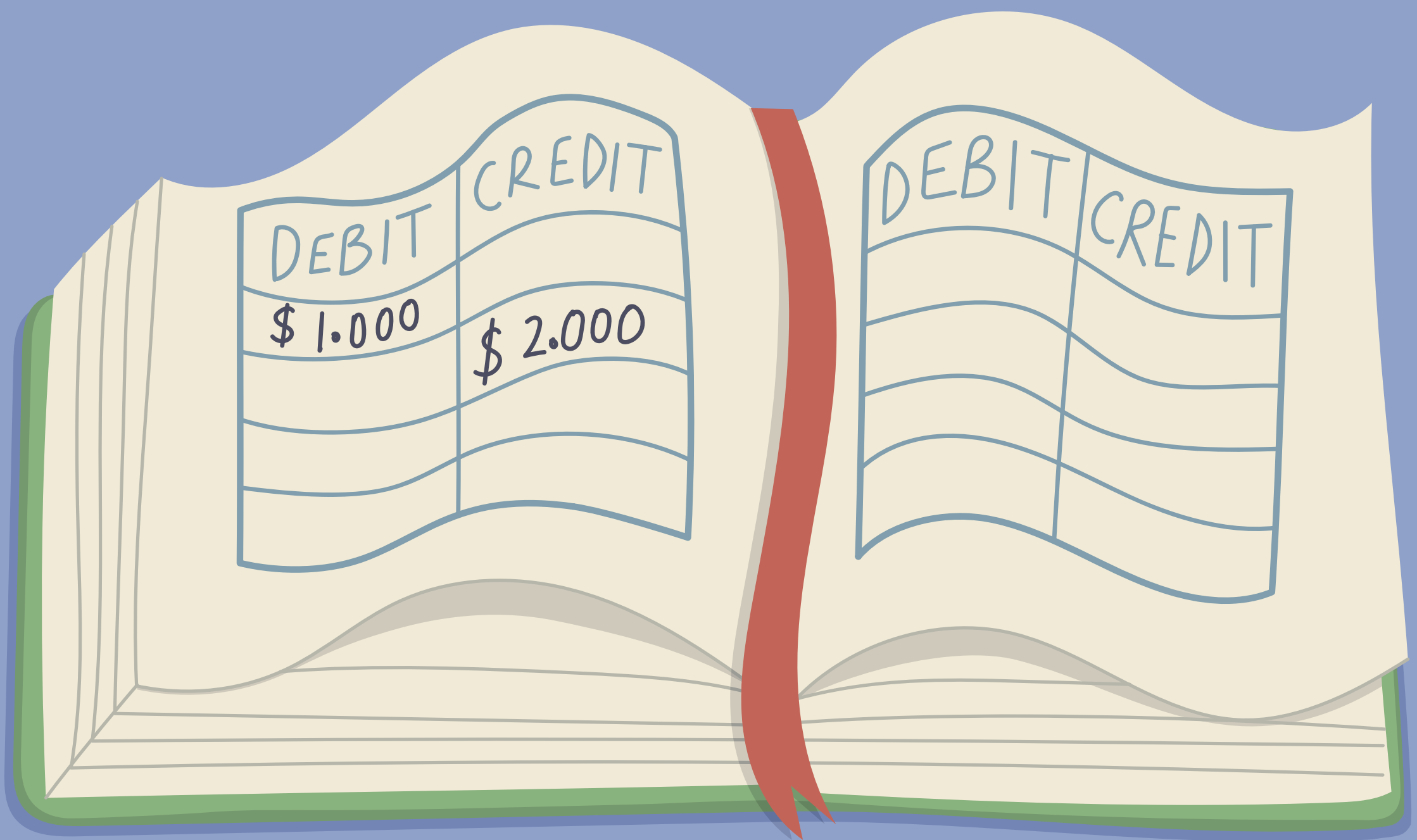
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# 1. What is Bookkeeping?

Bookkeeping is the process of recording daily financial transactions of a business in a consistent way and is key to gathering the financial information needed to run a successful business. It is the groundwork of a firm's accounting system.

## BASIC TYPES OF BOOKKEEPING

**Single entry bookkeeping:** One entry in a journal or log is a record for every transaction. This method is used for cash-basis accounting and usually for businesses with low volumes of transactions.

**Double-entry bookkeeping:** Every financial transaction is recorded using two corresponding entries, a debit and a credit side. For each transaction you debit one account and credit another account. Debit represents the receiving account; the credit represents the giving account. The sum of debits for all accounts will always equal the corresponding sum of credits for all accounts. If not, then something has gone wrong and allows for easy error-checking.

## WHAT IS THE DIFFERENCE BETWEEN BOOKKEEPING AND ACCOUNTING?

Bookkeeping and accounting are two functions which are extremely important for every business organization. Bookkeeping is the process of recording and reporting financial information, while accounting is the process of using such data to establish the business's financial position and make decisions about how the finances are managed.

### BOOKKEEPING

- Recording financial transactions
- Making payments (e.g. invoices, taxes)
- Collecting payments from customers and clients
- Posting debits and credits
- Invoicing
- Preparation of financial statements
- Managing payroll for employees

### ACCOUNTING

- Analysis of financial transactions
- Summary of statements and business records
- Preparing financial statements
- Completing income tax returns
- Reporting company financial conditions
- Financial analysis and strategy
- Tax strategy and tax planning
- Financial forecasting

Organised financial records and balanced finances prepared by an accountant, together with a wise financial strategy and a correct tax return by the accountant, directly contribute to the long-term success of any business.

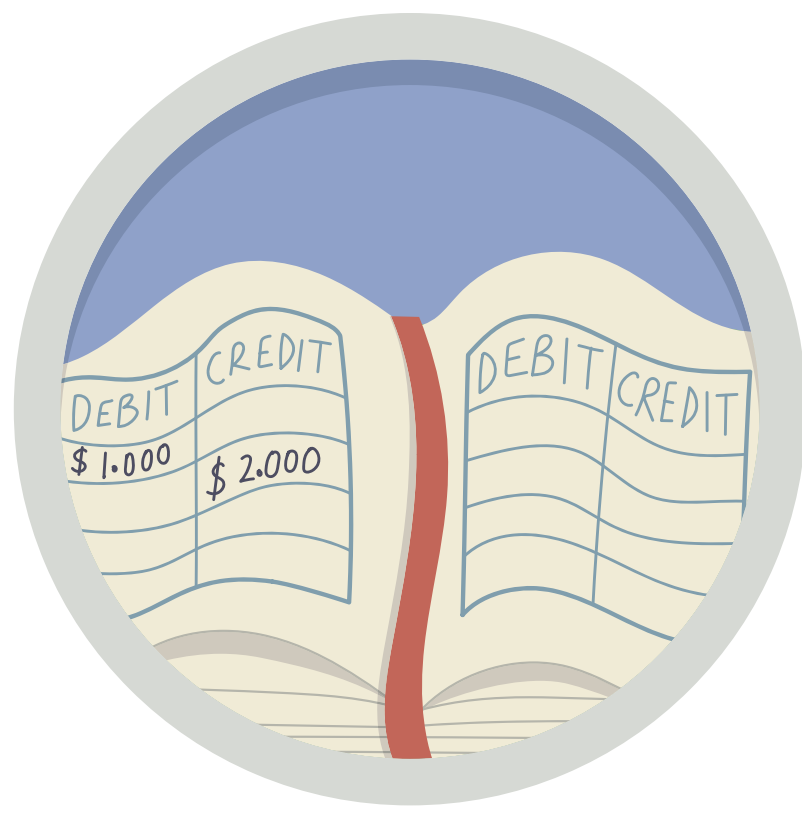


## 2. Methods of Accounting Systems

**Cash-basis accounting:** The transaction and revenue are recorded when cash is received from customers. Expenses are recorded when cash is paid to suppliers and employees. In other words, any time cash enters or exits your accounts, they are recognized in the books. It is the easiest accounting method for recording transactions.

**Accrual-basis accounting:** The transaction and revenue are recorded when earned and expenses are recorded when incurred, usually along with corresponding revenues. Unlike, cash-basis accounting, the actual cash does not have to enter or exit for the transaction to be recorded. You can mark your sales and purchases made on credit right away.

Both a cash and accrual basis accounting can work with single- or double-entry bookkeeping. In general, however, the single-entry method is the foundation for cash-based bookkeeping.



## HOW TO SET UP A BOOKKEEPING SYSTEM FOR YOUR BUSINESS?

When setting up your bookkeeping system, one of the first decisions you have to make is whether or not to use a cash or accrual accounting system. Mixing private and business funds is an absolute no-go, so a separate bank account should be opened for each business. Also, as a new entrepreneur, you need to decide whether you want to use of single-entry or double-entry bookkeeping. If your business is larger and more complex, you will need to set up a double-entry bookkeeping system. Two entries, at least, are made for each transaction. At least one debit is made to one account, and at least one credit is made to another account.

Most businesses use computer software to keep track of their journal with their bookkeeping entries. Very small firms may use a basic spreadsheet, like Microsoft Excel. To make your business viable, you need a way for customers to pay. If you sell to customers on credit, you need to send out invoices. The chart of accounts lists all the accounts in your financial statements and divides your money into five categories: Assets, Liabilities, Equity, Income (Revenues) and Expenses.

## HOW TO SET UP A BOOKKEEPING SYSTEM FOR YOUR BUSINESS?



Select an accounting method



Open a Business bank account



Determine how to record transactions



Determine how your business will get paid



Set up a chart of accounts



### 3. Understanding Assets, Liabilities, and Equity when balancing the books



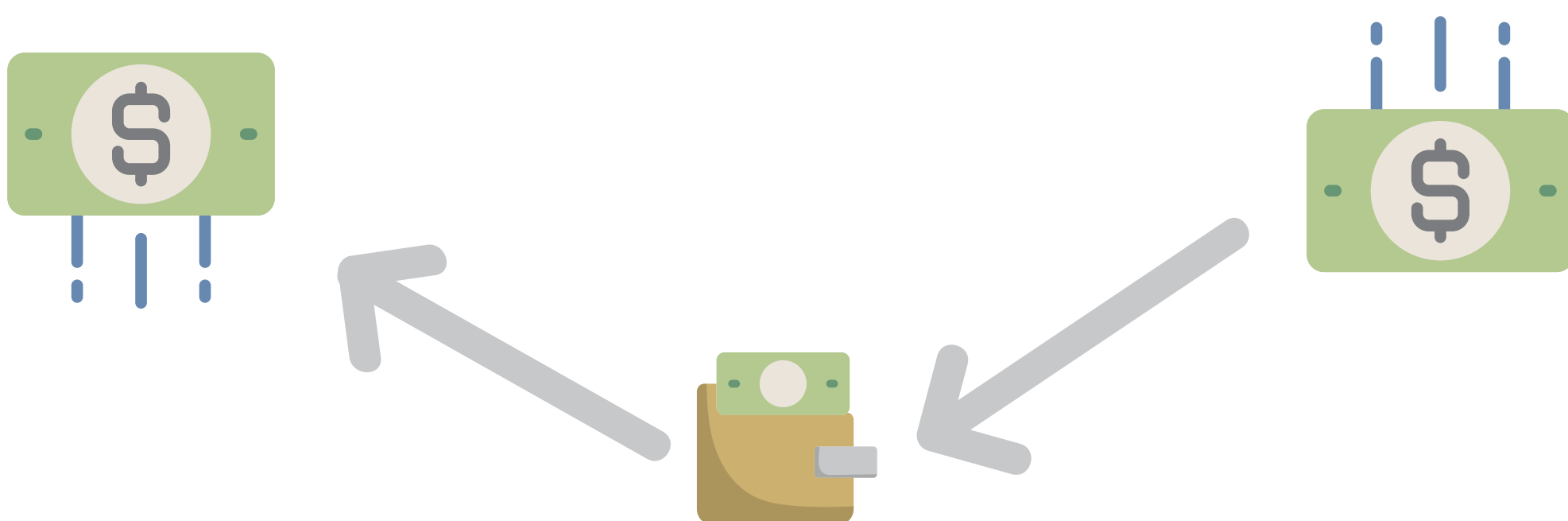
**Assets:** Assets are generally referred to as resources from which a business can derive positive economic benefits. Simply put, they are the things that the business owns. They can be tangible or intangible (things you can or cannot touch). An asset may be classified as a current or non-current (i.e. consumed within one accounting period or used over several accounting periods). Basically, assets are what the company owns.

**Liabilities:** Liabilities are present obligations of a business to transfer economic benefits as a result of past events. In other words, liabilities are what the business owes. It may owe a supplier cash for goods supplied on credit, tax payable to the Inland Revenue, outstanding utilities bill, a business loan etc. Liabilities are divided into current (to be paid within one year) or non-current (repayment takes longer than one year).

**Equity:** Equity is the net of assets after deducting liabilities. It is the remaining value of what the business owns after deducting its debts. Equity is the ownership share of owners and investors of a business. Equity can be the result of invested capital or profits that remain in the business.

**EXPENSES** are all costs incurred by the business to generate revenue. There are several categories of expenses: Cost of goods sold, operating expenses, non-operating expenses, and direct and indirect expenses.

**INCOME** is the revenue or sales generated by a business through the exchange of goods/services for money. The income that remains after deducting all expenses from gross income is called net income. If total expenses are higher than gross income, there is a net loss.



A **DEBIT** is an accounting entry that either increases an asset or expense account, or decreases a liability or equity account. It is positioned to the left in an accounting entry.

A **CREDIT** is an accounting entry that either increases a liability or equity account or decreases an asset or expense account. It is positioned to the right in an accounting entry.

| ACCOUNT TYPE | NORMAL BALANCE | INCREASED BY | DECREASED BY |
|--------------|----------------|--------------|--------------|
| Assets       | Debit          | Debit        | Credit       |
| Expenses     | Debit          | Debit        | Credit       |
| Dividend     | Debit          | Debit        | Credit       |
| Losses       | Debit          | Debit        | Credit       |
| Liabilities  | Credit         | Credit       | Debit        |
| Capital      | Credit         | Credit       | Debit        |
| Revenue      | Credit         | Credit       | Debit        |
| Gains        | Credit         | Credit       | Debit        |

► As previously mentioned, the double-entry requires at least two postings to two separate accounts. One should be debited and the other credited, the general rule of knowing when to debit and credit can be seen in the table.



## 4. Overview of the bookkeeping process

The bookkeeping process is essentially the detailed recording of all the business' financial transactions, which provides useful information and facilitates retrieval and analysis. Retrieval of transactions may be necessary if there are queries about payment or invoice items. Entries cannot be changed. If there is a posting error, a reversal entry will cancel out the original erroneous postings. You then create new entries with the correct information.

There are four main steps in accounting: **analysing transactions**, recording transactions in accordance with the **accounting equation**, **categorising transactions** by account, and posting transactions on a double-entry basis by **debiting one account and crediting another**.



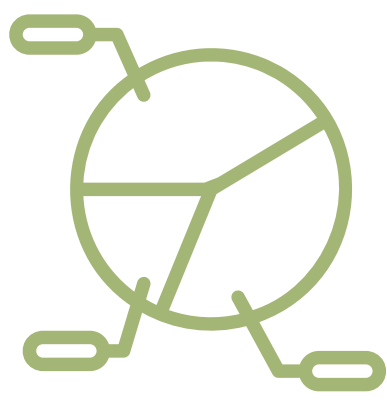
### ANALYZE TRANSACTIONS

- Measurable
- Third-parties
- Source documents



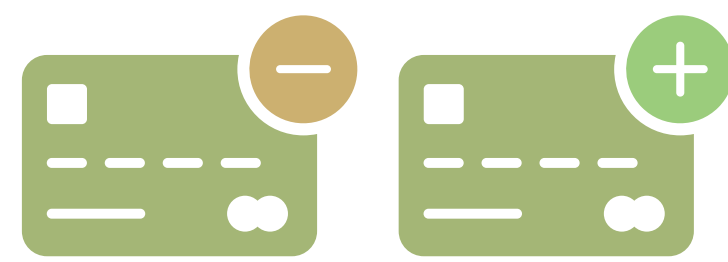
### ACCOUNTING EQUATION

- Assets
- Liabilities
- Equity



### CATEGORIZE TRANSACTIONS

- Balance sheet
- Income statement
- Statement of cash flow



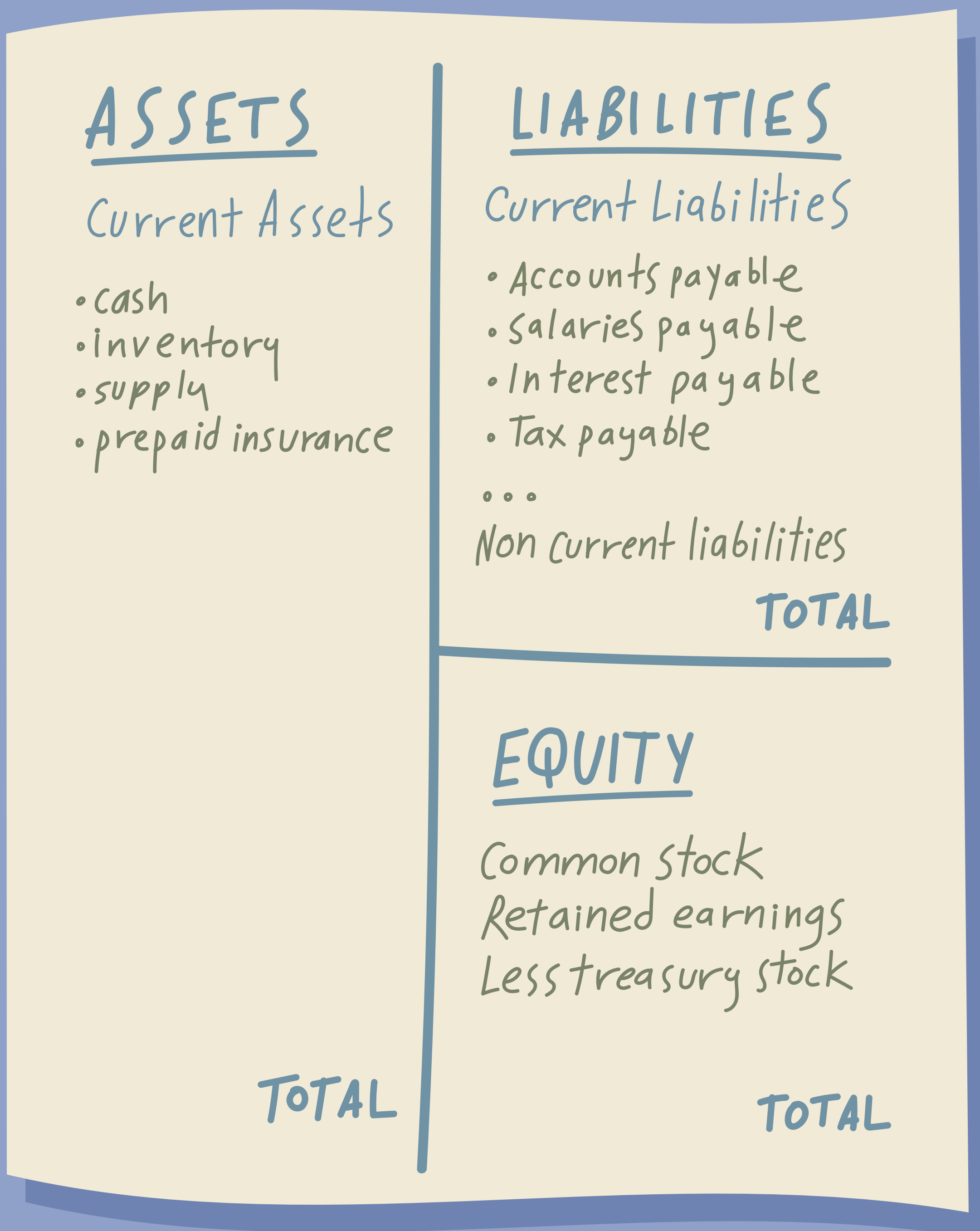
### DEBIT AND CREDIT

- Ledger
- T-Accounts
- Giver and Receiver

## THE ACCOUNTING EQUATION

The accounting equation is the foundation of double-entry bookkeeping. It teaches that for every debit there is a credit. If a business has assets, it must have financed them either through liabilities or equity. The relationship between the three is the glue that keeps the accounts balanced. Now you understand the term “balancing the books”.





## 5. What is a Balance Sheet?

A balance sheet is a financial statement that contains details of a businesses assets or liabilities at a specific point in time. It is one of the three core financial statements (income statement and cash flow statement being the other two) used for evaluating the performance of a business.

The Balance Sheet is made up of three types of accounts, namely: asset accounts, liability accounts and equity accounts. These three accounts are further broken into subcategories.

## HOW CAN WE USE THE BALANCE SHEET AS A FINANCIAL TOOL?



The balance sheet is more than just a list of assets, liabilities and equity. It tells a story at a point in time about each type of these three accounts. We can use simple ratios to tell if a business is able to pay off its debt in time. Also, how quickly customers are paying, how well your loans are serviced and how your assets are holding up from year to year and much more.



## 6. What is a Profit and Loss (P&L) Statement?

Also referred to as an income statement, the profit and loss (P&L) statement is one of the core financial statements that tells the financial performance of a business at a particular period in time. They include your business revenues, costs, and expenses within this time period.

The P&L statement displays the performance of a business by showcasing its net profit or net loss for a period. The equation for net profit / net loss is revenue less expenses. When revenue is greater than expenses, the business has performed profitably. When expenses are greater than revenue the business has suffered a loss.



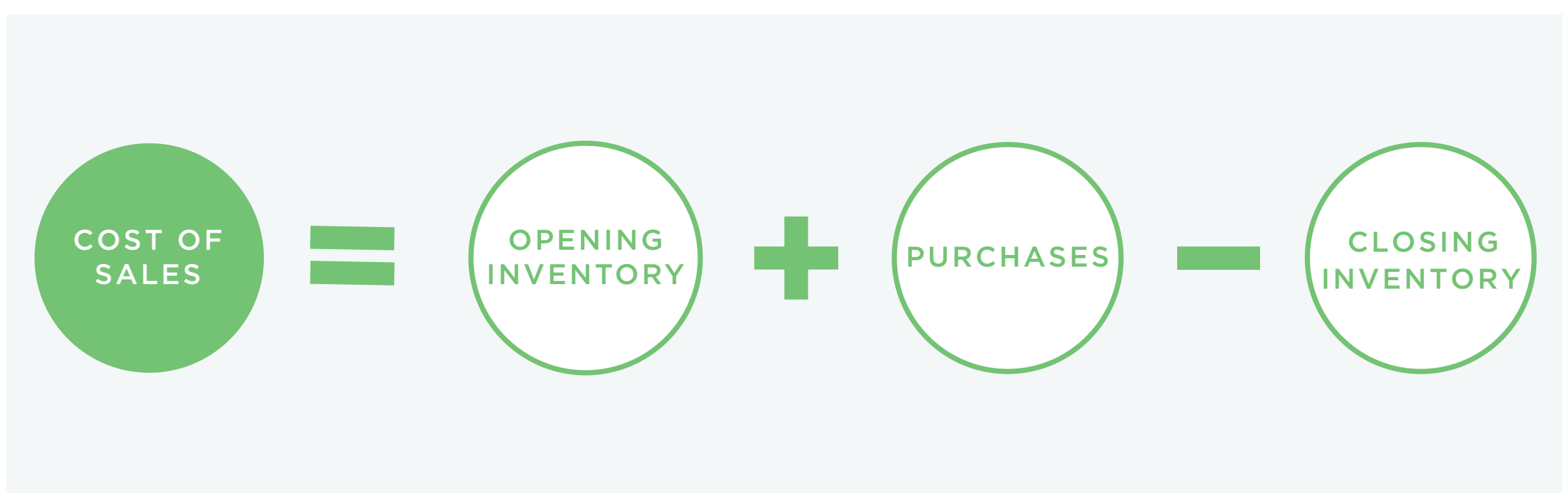
If you are not using an accounting software, you can create a document using a spreadsheet. The minimum you should have is a **profit and loss summary** with a breakdown by category to have a more detailed look at where your profit or loss come from.

If you need to apply for loans, financial institutions will often require a P&L statement as part of the application process. P&L statements are also useful when your business is seeking external investment (e.g., in the form of a debt or equity investment). P&L statements are required for tax purposes.



**REVENUE** is the income generated from the sale of goods and or services related to normal operations of the business. Other income is the name given to income generated from the sale of goods and or services that is not related to normal operations of the business.

**COST OF SALES** is the direct costs related to the manufacturing or purchasing of goods that are sold through the normal operation of the business.



**GROSS PROFIT** is the remainder of total revenue less cost of sales, where cost of sales is greater than total revenue the result will be a gross loss.



**NET PROFIT:** is the remainder of gross profit less total expenses, where total expenses are greater than gross profit the result will be a net loss.



## HOW CAN THE P&L STATEMENT IMPROVE YOUR BUSINESS FINANCE?

A profit and loss statement (P&L) is a tool that business owners use to analyze their company's financial performance.

P&Ls can be used to determine financial performance for your entire business, but they can also be a practical tool to analyse specific areas, such as the profitability of a product. They can also help you understand the strengths and weaknesses of your business so that you can make better strategic decisions.

Below are some tools that you can use to measure your business profitability.

**MARGIN RATIO** compares the other components of the P&L to total revenue. It measures the business' ability to generate sales profitably.

**GROSS  
PROFIT  
MARGIN**

$$\frac{\text{Gross Profit}}{\text{Sales Revenue}} \times 100\%$$

**NET  
PROFIT  
MARGIN**

$$\frac{\text{Net Profit}}{\text{Sales Revenue}} \times 100\%$$

**EXPENSE  
MARGIN**

$$\frac{\text{Expense}}{\text{Sales Revenue}} \times 100\%$$

**INVENTORY TURNOVER PERIOD RATIO** tells the average days it takes for inventory to be sold.

$$\frac{\text{Inventory}}{\text{Cost of Sales}} \times 365$$

**RECEIVABLE'S COLLECTION PERIOD RATIO** tells the average days it takes for credit customers to pay their outstanding invoices.

$$\frac{\text{Trade receivables}}{\text{Credit Sales}} \times 365$$

**PAYABLE'S PAYMENT PERIOD RATIO** tells the average days it takes for the business to pay its credit suppliers.

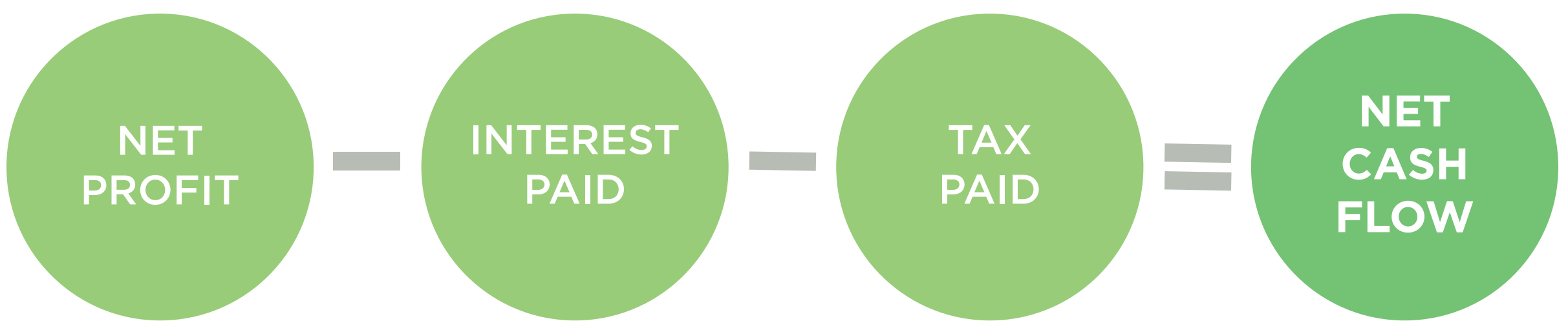
$$\frac{\text{Trade Payables}}{\text{Credit Purchases}} \times 365$$



## 7. What is a Cash Flow Statement?

A cash flow statement provides aggregate data regarding all cash inflows a business receives from its ongoing operations and external investment sources as well as all cash outflows that pay for business activities and investments during a given period. The inflow and outflows of cash and cash equivalent are categorised into three main areas: operating activities, investing activities, financing activities.

**OPERATING ACTIVITIES:** Cash flows from operating activities usually include three items: Cash generated from operations, interest paid and tax paid. This activity typically contains the highest net cash flow. This is where cash flow from the main operations of the business is measured.

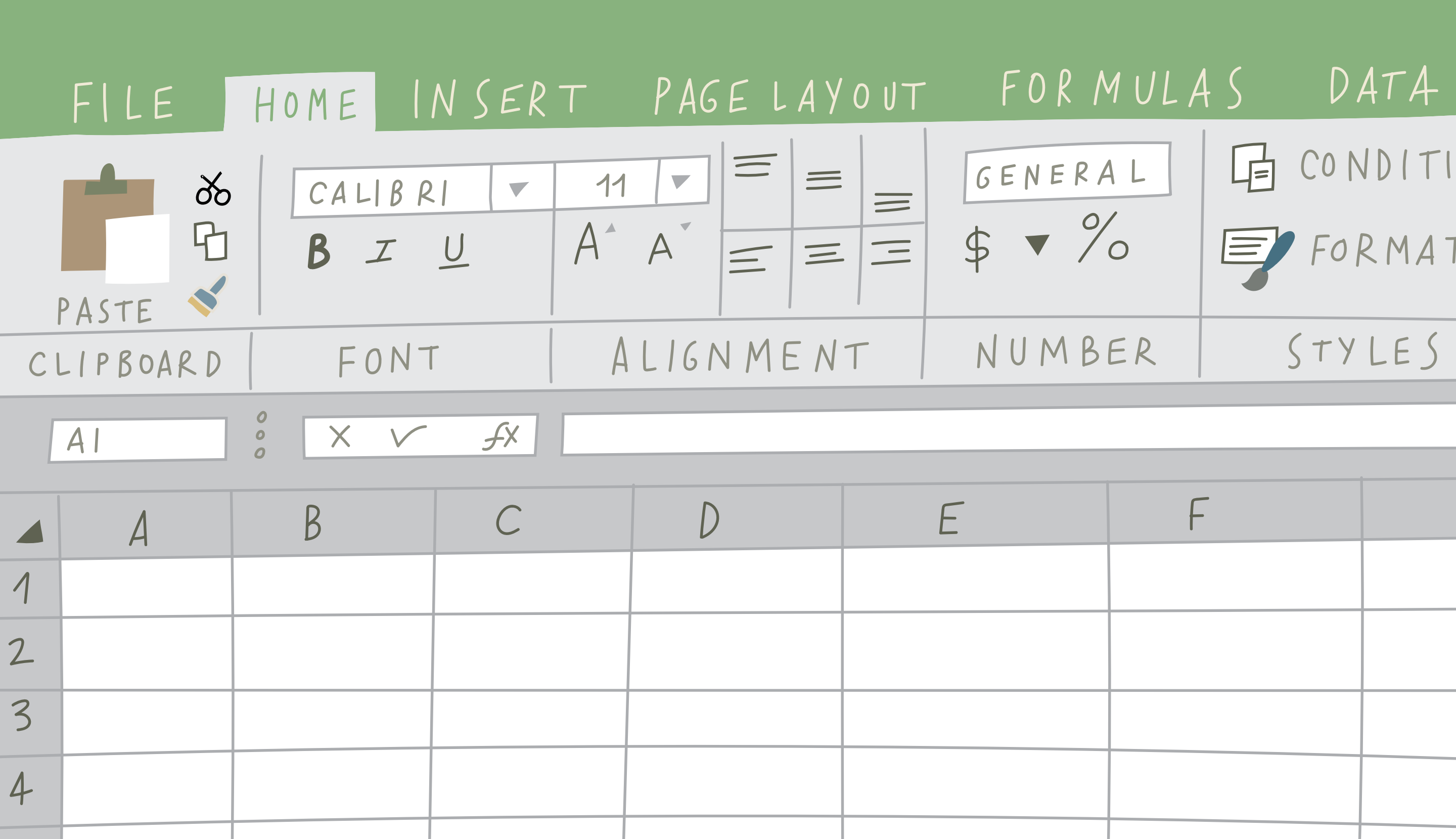


**INVESTING ACTIVITIES:** Cash flows from investing activities usually include cash paid to acquire non-current assets, cash received from disposal of non-current assets, cash paid as investment or loans to other businesses and cash received from other business in the form of a dividend.



**FINANCING ACTIVITIES:** Cash flows from financing activities generally include cash inflows from loans received and from issuing shares. While cash outflows are generated from repaying loan principal and payment to shareholders in the form of dividend paid.



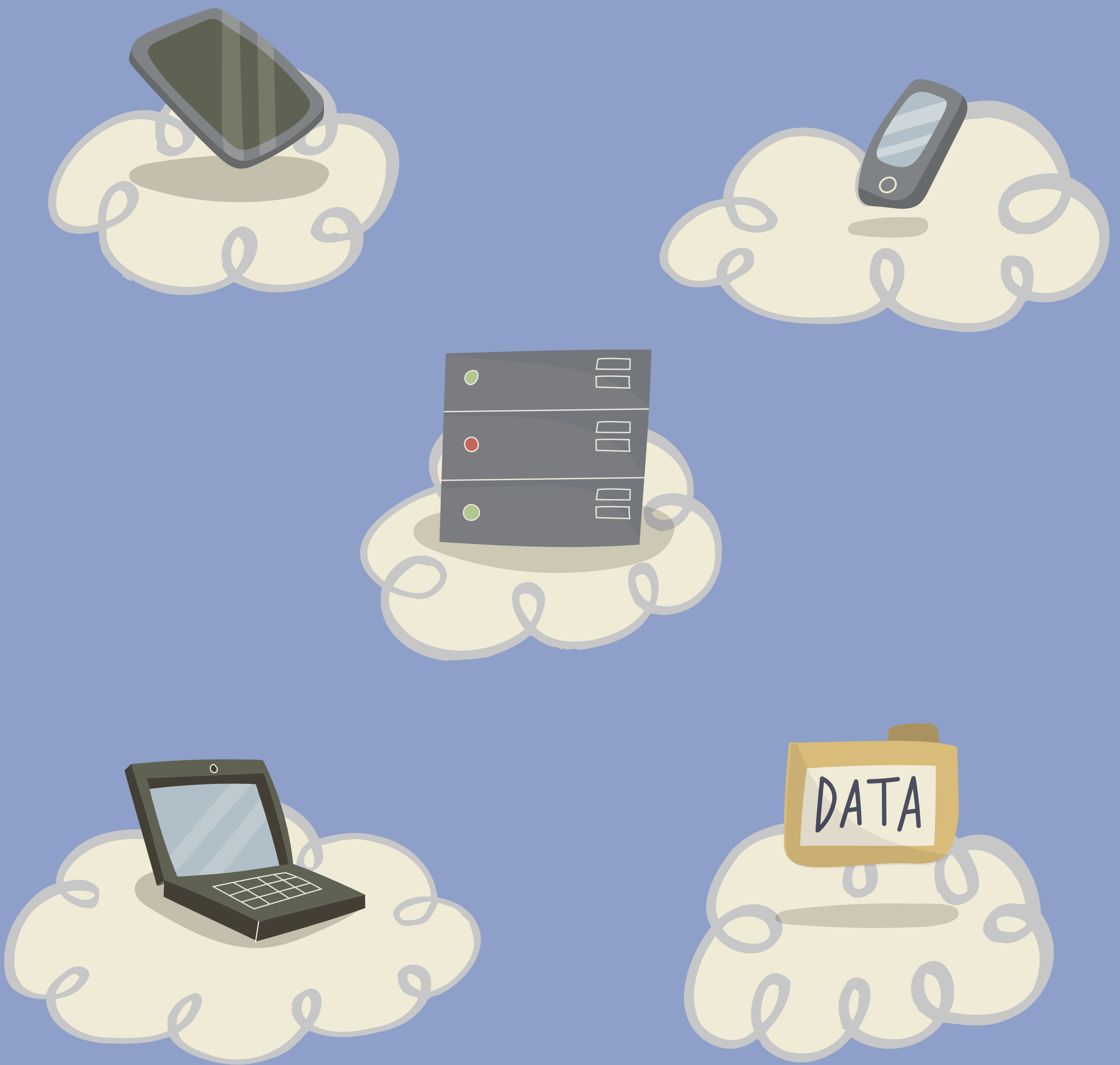


## 8. Benefits of digital bookkeeping and accounting

Digital accounting in simple words is an electronic format of the financial transactions. Using digital accounting software can also give you more control of your accounts payable, helping to make your business healthier and giving you a better overview of your financial position. Knowing a software, reduces manual tasks and can free up time for other business activities. Some benefits:

- Quick and easy access to data.
- Ability to convert data into meaningful reports.
- On-time reporting.
- Improves safety and security of data.
- Enhances collaboration in the workplace.
- Ability to work remotely.
- Improves accuracy and completeness of data.

There are different software solutions available from off-the-self desktop accounting software to customized desktop accounting software and cloud-based accounting software.



## 9. Cloud based accounting software solutions

No matter what device you are using, if you are connected to the internet you can access your files any time in the cloud based accounting software and your files are frequently backed up and offers more security features as in case you have all your data and records on your desktop. The software is constantly updated with the latest version, features and security.

## EXAMPLES FOR TOOLS SUITABLE FOR SMALL BUSINESSES:



Before deciding on an accounting system, you must first consider the needs of your business and accounting skills of your staff or yourself.







## **CONTACT US**

### **TELEPHONE:**

Tel: +1(246) 467 6000

### **EMAILS:**

[registry.bb@undp.org](mailto:registry.bb@undp.org)

[communications.bb@undp.org](mailto:communications.bb@undp.org)

### **WEBSITE:**

[undp.org/barbados](http://undp.org/barbados)

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