

Guide to Bookkeeping Concepts



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Table of Contents [\(click to navigate\)](#)

Introduction to bookkeeping	3
Accounts	3
Journals	4
Ledgers	4
Debits and credits	5
Double-entry bookkeeping	6
Trial balance	7
Bookkeeping equation	7
Accrual method vs. cash method	8
Adjusting entries	8
Adjusting entries – accruals	9
Adjusting entries – deferrals/prepayments	10
Adjusting entries – other	11
Reversing entries	11
Accounting principles	12
Balance sheet (or statement of financial position)	13
Income statement	14
Statement of cash flows	15
Statement of stockholders' equity	16
Common financial ratios	16
Bank reconciliation	16
Petty cash	17
Accounts payable	17
Accounts receivable	18
Internal control	18

Introduction to bookkeeping

Bookkeeping is involved in the recording of a company's (or any organization's) transactions.

The preferred method of bookkeeping is the **double-entry method**. This means that every transaction will have a minimum of two effects. For example, if a company borrows \$10,000 from its bank...

1. An increase of \$10,000 must be recorded in the company's Cash account, and
2. An increase of \$10,000 must be recorded in the company's Loans Payable account.

The accounts containing the transactions are located in the company's **general ledger**. A simple list of the general ledger accounts is known as the **chart of accounts**.

Prior to inexpensive computers and software, small businesses manually recorded its transactions in **journals**. Next, the amounts in the journals were posted to the accounts in the general ledger. Today, software has greatly reduced the journalizing and posting. For example, when today's software is used to prepare a sales invoice, it will automatically record the two or more effects into the general ledger accounts.

The software is also able to report an enormous amount of additional information ranging from the detail for each customer to the company's financial statements.

Accounts

General ledger accounts are used for sorting and storing the company's transactions. Examples of accounts include Cash, Account Receivable, Accounts Payable, Loans Payable, Advertising Expense, Commissions Expense, Interest Expense, and perhaps hundreds or thousands more. The amounts in the company's general ledger accounts will be used to prepare a company's financial statements such as its balance sheet and income statement.

Within the general ledger, a corporation's accounts are usually organized as follows:

- **Balance sheet accounts**
 - Assets
 - Current assets
 - Long-term investments
 - Property, plant and equipment
 - Other assets
 - Liabilities
 - Current liabilities
 - Noncurrent liabilities
 - Deferred credits
 - Stockholders' equity
 - Paid-in capital
 - Retained earnings
 - Treasury stock
- **Income statement accounts**
 - Operating revenues
 - Operating expenses
 - Nonoperating revenues and gains
 - Nonoperating expenses and losses

The **balance sheet accounts are known as permanent or real accounts** since these accounts are not closed at the end of the accounting year. Instead, the balances are carried forward to the next accounting year. (If the company had Cash of \$987 at the end of the accounting year, it will begin the next accounting year with Cash of \$987.)

The **income statement accounts are known as temporary or nominal accounts** since these accounts are closed at the end of the accounting year. In other words, the balances in the accounts for revenues and expenses will not carry forward to the next accounting year. Instead, the balances in these accounts are closed by transferring the end-of-year balances to Retained Earnings. Since the income statement accounts will begin each accounting year with zero balances, they will report the company's year-to-date revenues and expenses.

A list of all of the individual balance sheet and income statement accounts that are available for recording transactions is the **chart of accounts**. The chart of accounts can be expanded as more accounts become necessary for improved reporting of transactions.

Journals

Under a manual system (and in many bookkeeping textbooks) transactions are first recorded in journals and from there are posted to accounts. Hence, journals were defined as *books of original entry*.

In manual systems, there were special journals (or day books) such as a sales journal, purchases journal, cash receipts journal, and cash payments journal. With bookkeeping software the need for these special journals has been reduced or eliminated. However, the **general journal** is still needed in both manual and computerized systems in order to record adjusting entries and correcting entries. The following entry shows the format that is used in the general journal:

Date	Account Name	Debit	Credit
Mar. 1, 2016	Interest Expense	2,000	
	Interest Payable		2,000

Ledgers

In addition to the **general ledger** (which contains general ledger accounts), manual bookkeeping systems often had **subsidiary ledgers**. The details in a subsidiary ledger's accounts should add up to the summary amounts found in the related general ledger account. Subsidiary ledgers were common for the following general ledger accounts: Accounts Receivable, Accounts Payable, Inventory, and Property, Plant and Equipment. When a subsidiary ledger is used, the respective general ledger account is referred to as a **control account**.

Debits and credits

The words *debit* and *credit* are similar to the words used 500 years ago when double-entry bookkeeping was documented by an Italian monk. Today you should think of debit and credit as follows:

- *debit* indicates that an amount should be entered on the left side of an account
- *credit* indicates that an amount should be entered on the right side of an account

In short, debit means left, credit means right.

An increase in an asset account is recorded with a debit amount. In other words, the amount should be entered on the left side of the account. (Three examples of asset accounts are Cash, Accounts Receivable, and Equipment.)

A decrease in an asset account is recorded with a credit amount. In other words, the amount should be entered on the right side of the account.

To illustrate an increase and a decrease in asset accounts let's assume that a company pays cash for equipment which has a cost of \$20,000. The company should record a debit of \$20,000 in its asset account Equipment (since this asset increased) and it should record a credit of \$20,000 in its asset account Cash (since this asset decreased).

Expenses are recorded as debit amounts.

When a company pays \$1,000 for its monthly rent, a debit of \$1,000 needs to be entered in the account Rent Expense (and a credit of \$1,000 needs to be entered in the asset account Cash).

Revenues are recorded as credit amounts.

To record a cash sale of \$700, the account Sales needs a credit entry of \$700, and the account Cash needs a debit entry of \$700.

An increase in a liability account is recorded with a credit entry. In other words, the amount will be entered on the right side of the account. (Two examples of liability accounts are Accounts Payable and Loans Payable.)

A decrease in a liability account is recorded with a debit.

To illustrate an increase and decrease in liability accounts let's assume that a company borrows \$5,000 from its bank in order to pay one of its accounts payable. A debit of \$5,000 is entered in Accounts Payable (since this liability decreased) and a credit of \$5,000 is recorded in Loans Payable (since this liability increased).

An increase in a stockholders' equity account is recorded with a credit entry. In other words, the amount will be entered on the right side of the stockholders' equity account. (Two examples of stockholders' equity accounts are Common Stock and Retained Earnings.)

A decrease in a stockholders' equity account is recorded as a debit. For example, the dividends declared by a corporation will mean a debit is recorded in the Retained Earnings (and a credit to another account).

The following is a **summary of debits and credits** and their effect on the general ledger accounts:

Type of account	Normal Balance	To increase	To decrease
Assets	debit	debit	credit
Liabilities	credit	credit	debit
Stockholders' equity	credit	credit	debit
Revenues	credit	credit	debit
Expenses	debit	debit	credit
Gains	credit	credit	debit
Losses	debit	debit	credit

Learn more about [Debits and Credits](#).

Double-entry bookkeeping

Double-entry bookkeeping (or double-entry accounting) means that every transaction will result in entries in two (or more) accounts. A minimum of one amount will be a debit (entered on the left side of the account) and at least one amount must be a credit (entered on the right side of the account). In other words, every transaction must have the total of the debits equal to the total of the credits.

To illustrate double entry, let's assume that a person invests \$100,000 in exchange for 10,000 shares of the common stock of a new corporation. The corporation will debit the asset account Cash for \$100,000 and will credit the stockholders' equity account Common Stock for \$100,000. (We are assuming that the stock does not have a par or stated value.)

For a second example, let's assume that the company has utilized a consultant at a cost of \$3,000 with the amount due in 30 days. The company will debit Consulting Expense for \$3,000 and will credit Accounts Payable for \$3,000.

If every transaction is recorded with the debit amounts equal to the credit amounts and there are no posting or math errors, the total of all of the account balances with debit balances will be equal to the total of all of the account balances with credit balances.

Trial balance

The trial balance is an internal document that lists any account in the general ledger which has a balance. If an account has a debit balance, the balance is entered in the column that is headed “debit.” If an account has a credit balance, the balance is entered in the column that is headed “credit.” Each column is summed and the total of the debit column should be equal to the total of the credit column. If the totals are identical, we say that the trial balance is “in balance.”

When bookkeeping was done manually there were usually errors in writing, posting, and tabulating amounts and balances. Hence, the trial balance was routinely prepared in order to detect and correct the incorrect account balances. However, today’s software is written/coded to prevent such errors from occurring. As a result, it is usually assumed that a trial balance from a reliable computerized system is in balance.

Note: Even if the trial balance is in balance (the total of the debit balances is equal to the total of the credit balances) it does not guarantee that the general ledger is error free. For example, if an entry was completely omitted, the total of the two columns will still be equal. The same holds true if an entry was recorded twice. The trial balance will also be in balance if an incorrect account was debited (or if an incorrect account was credited).

Bookkeeping equation

The bookkeeping equation (or accounting equation) for a corporation is:

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

This equation must always be in balance under the double-entry bookkeeping method.

The bookkeeping equation is also helpful in understanding debits and credits. For example, **asset accounts** normally have debit balances (and assets are increased with a debit entry). Recall that the term *debit* means the left side of an account. As you look at the bookkeeping equation you see that **assets are also on the left side of the equal sign.**

Note that **liabilities are on the right side of the bookkeeping equation.** Recall that earlier we said that **liability accounts** normally have credit balances (balances on the right side of the account).

Stockholders’ equity accounts are on the right side of the bookkeeping equation and these accounts will also have credit balances.

Since the stockholders’ equity account Retained Earnings will normally have a credit balance it is logical that:

- **revenues will have credit balances since revenues will cause Retained Earnings (and therefore stockholders’ equity) to increase, and**
- **expenses will have debit balances since expenses cause Retained Earnings (and stockholders’ equity) to decrease.**

Your understanding of bookkeeping will be enhanced if you keep in mind that:

- revenues cause stockholders' equity to increase, and
- expenses cause stockholders' equity to decrease.

In effect the income statement is providing details on how the corporation's operations had caused stockholders' equity to change. (There are also other transactions that will cause stockholders' equity to change such as issuing additional shares of stock, declaring dividends, and other transactions.)

Learn more about [Accounting Equation](#).

Accrual method vs. cash method

The *accrual method* is the best bookkeeping or accounting method for:

- measuring a company's net income for any accounting period, and
- for the complete reporting of assets, liabilities, and stockholders' equity.

The reasons that the accrual method is better than the cash method are:

- revenues and the related assets will be reported when they are earned (and not when the cash is received), and
- expenses and the related liabilities will be reported when the expenses actually occur (and not when the cash is paid).

Hence, the accrual method results in more complete and accurate income statements and balance sheets.

[The cash method is simple, but is not effective in reporting accurately a company's net income for a period of time or the financial position as of a specified date. In the U.S. there may be some income tax advantages for eligible companies to use the cash method. Since we do not cover income taxes, you should consult with a tax expert or visit IRS.gov.]

Adjusting entries

Adjusting entries are necessary to bring a company's records **up-to-date under the accrual method**.

For example, a business expense may have occurred but it may not have been recorded as of the end of the accounting period. Another transaction may have been recorded, but the amount needs to be expensed over two or more accounting periods.

Adjusting entries almost always involve:

1. an **income statement account**, and
2. a **balance sheet account**.

For example, if an **expense** occurred but it was not recorded as of the end of the accounting period, an adjusting entry is needed to:

1. **debit an expense account, and**
2. **credit a liability account.**

Adjusting entries are typically **dated as of the last day of an accounting period**. In this way, the adjustments will be included in the amounts reported in the company's balance sheet and income statement. (The accounting period could be a year, quarter, month, or other period of time.)

The concepts behind adjusting entries are:

- match expenses with revenues when there is a cause and relationship effect,
- report expenses in the accounting period in which they are used up or expire, and
- report the correct amount of assets, liabilities and stockholders' equity as of the end of an accounting period.

Adjusting entries are often categorized as:

1. accruals
2. deferrals (or prepayments)
3. other

Adjusting entries – accruals

Accruals or accrual-type adjusting entries pertain to:

- expenses (and the related payables or liabilities) that have been **incurred but not yet recorded**
- revenues (and the related receivables) that have been **earned but not yet recorded**
- losses (and the related liabilities) that occurred but have **not yet been recorded**

Common **expenses** that will need an accrual-type adjusting entry (or need to be accrued) include:

- electricity used
- wages earned by hourly-paid employees
- interest on debt

In each of these examples the company had incurred an expense before it received a bill or other documentation. For example, the electric utility will provide electricity and at the end of each month will read the company's meter to determine the kilowatt hours used. The bill will be prepared and the company will likely be given several weeks in which to pay the bill. Without entering an adjusting entry, the company's expenses and liabilities will not be complete for the period in which the electricity was used.

Revenues may need to be accrued as well. The electric utility had provided electricity and earned revenues before it prepared the bills. Therefore the electric utility will need to accrue revenues and receivables for the amount it earned even though the electric bills were not yet prepared or the meters read as of the end of the accounting period.

The accrued expenses and accrued revenues may require estimated amounts. Using estimated amounts will get the financial statements closer to reality than ignoring the revenues and assets that have been earned and the expenses and liabilities that have been incurred.

Another fact associated with accruals is that the actual bill, invoice, or other documentation will be received or will be generated shortly after the accrual-type adjusting entries are recorded. For instance, the actual electric bill will likely be sent by the utility and received by the customer within a couple of weeks after the accrual entry. Hence, bookkeepers must be aware of potentially double-counting accrued revenues and accrued expenses. Later we will discuss how reversing entries can assist in avoiding the double counting.

Adjusting entries – deferrals/prepayments

A deferral or prepayment-type adjusting entry is needed when a transaction has been recorded but the amount involves more than one accounting period. A classic example is a payment on December 1 for six months of property insurance. Part of the payment needs to be expensed during the month of December and part of the payment needs to be deferred to the balance sheet until it is expensed in the following year.

The company's payment on December 1 poses a similar bookkeeping problem for the insurance company that receives the payment. One month of the payment is part of the insurance company's revenues for December while the remainder needs to be deferred to the balance sheet until it is earned and reported as revenues in the following year.

As with all adjusting entries, the concept is to

- get the expenses and revenues matched
- have each period's income statement report the proper amount of revenues
- have each period's income statement report the proper amount of expenses
- have each balance sheet report the proper amount of assets, liabilities and stockholders' equity

This means that at the end of each accounting period the unexpired insurance premiums paid by a company will be reported as a current asset. The insurance company that has received the insurance premiums will report the unearned amount as a current liability.

Adjusting entries – other

Depreciation is an example of an adjusting entry under the category of *other*. Depreciation is similar to a deferral in that a transaction (such as the purchase of equipment to be used in a business) has been recorded but the cost will be expensed over several accounting periods. The adjusting entry will include:

- a debit to the income statement account Depreciation Expense, and
- a credit to the balance sheet account Accumulated Depreciation.

Depreciation is covered as a separate topic on AccountingCoach.com.

Another example in the “other” category of adjusting entries involves Accounts Receivable. Instead of waiting to learn of a specific uncollectible account receivable, a company could *anticipate* that some of its receivables will not be collected. In this situation the company estimates the amount and

- debits Bad Debts Expense, and
- credits Allowance for Doubtful Accounts.

This adjusting entry is preferred by accountants but is not allowed for U.S. income taxes. (Accountants believe that entering an estimated expense or loss in its accounting records is better than ignoring the likelihood that some accounts will not be collected in full.)

Learn more about [Adjusting Entries](#).

Reversing entries

Reversing entries are usually associated with accrual-type adjusting entries.

Accrual-type adjusting entries were made because:

- the company had incurred an expense but had not yet received the invoice or other documentation, or
- the company had earned revenues but had not yet billed the customer

Electricity expense is an example of an expense that should have been accrued. The reason is that the company received the electricity from the utility prior to being billed. Hence the company records the estimated expense and liability. For example, if the company estimates it used and owes approximately \$1,000 for the electricity it used during December (but had not yet received a bill when preparing its December financial statements) it should make the following accrual *adjusting entry*:

Date	Account Name	Debit	Credit
Dec. 31	Electricity Expense	1,000	
	Accrued Electricity Payable		1,000

In early January, the company will receive the actual bill for the electricity it used in December. Certainly, the company should not record the December electricity expense twice. In order to avoid double-counting, many companies will reverse out the December accrual. However, the amount cannot be reversed until January.

The **reversing entry** to remove the accrual adjusting entry of December 31 will be:

Date	Account Name	Debit	Credit
Jan. 2	Accrued Electricity Payable	1,000	
	Electricity Expense		1,000

Since the accounts for expenses begin each accounting year with zero balances, this reversing entry will cause Electricity Expense to have a credit balance of \$1,000 on January 2. However, when the actual electric bill for December's usage is processed in January, the Electricity Expense will bring the account balance close to \$0. (There is no problem with a small difference/balance in January because the estimated amount was not precise.)

At the end of January, another accrual-type adjusting entry will be needed since the electric bill for January's electricity will not be received until February.

Accounting principles

In the U.S. the accounting standards and rules are established by the Financial Accounting Standards Board. Many of the accounting rules are complex because many financial transactions are complex. However, you should be aware of accounting's basic underlying guidelines or concepts such as the cost principle, matching principle, full disclosure principle, revenue recognition principle, conservatism, materiality, going concern, and more. (You can learn more about these under the AccountingCoach topic [Accounting Principles](#).)

Balance sheet (or statement of financial position)

The balance sheet is also known as the statement of financial position. It reports an organization's assets, liabilities and equity as of an instant, moment, or point in time. The instant is usually the final moment of the accounting period such as midnight of December 31, June 30, etc. and is indicated in the heading.

Here is an example of the heading in the balance sheet:

**ABC Corp.
Balance Sheet
March 31, 2016**

The format of the balance sheet reflects the accounting equation:

Assets = Liabilities + Stockholders' Equity

Typically the balance sheet has the following sections:

- Assets
 - Current assets
 - Long-term investments
 - Property, plant and equipment
 - Other assets
- Liabilities
 - Current liabilities
 - Noncurrent liabilities
 - Deferred credits
- Stockholders' equity
 - Paid-in capital (or contributed capital)
 - Retained earnings
 - Treasury stock (if any)

Usually two columns of amounts will be presented on the balance sheet. The first column will report the most recent amounts and the second column will report the comparable amounts from one year earlier. Having more than one column of amounts is referred to as a **comparative balance sheet**.

Generally, the noncurrent assets are reported on the balance sheet at the cost when they were acquired minus accumulated depreciation. As a result, some valuable assets such as trademarks and patents that were developed by the company (as opposed to recently purchased from another company) will not be listed as assets. For instance, the value of Coca-Cola's logo will not be included in the total amount of its assets or stockholders' equity.

Learn more about the [Balance Sheet](#).

Income statement

The income statement is also referred to as the statement of earnings, statement of operations, statement of income, and profit and loss statement (or P&L). The income statement reports the revenues and expenses occurring during the accounting period such as the year 2016, the month of January, the nine months ended September 30, etc. The period covered by the income statement is shown in its heading:

ABC Corp.
Income Statement
For the Year Ended December 31, 2015

The income statement will report a company's operating revenues, other revenues (non-operating and gains), operating expenses, other expenses (non-operating and losses). The income statements of corporations with stock that is publicly traded must also include the earnings per share of common stock.

Corporations with stock that is publicly traded will issue comparative income statements which include three columns of amounts. The first column could be the amounts for the most recent accounting year. The second column will be the amounts for the year prior, and the third column will be the amounts for two years prior.

Private companies often issue multiple-step income statements which have the following format:

- Sales
- Cost of goods sold
- Gross profit
- Selling, general & admin expenses
- Operating profit
- Other income
- Earnings before tax
- Income tax expense
- Net earnings

Under the accrual method, the revenues reported on the income statement will be different from the amount of cash received, and the expenses will be different from the amount of cash paid. As a result, a company could report positive net income and yet experience a decrease in cash. It is also possible that the income statement will report a net loss but the company's cash actually increased. This is why the statement of cash flows should be presented whenever a company's income statement and balance sheet are issued.

Learn more about the [Income Statement](#).

Statement of cash flows

The statement of cash flows (or cash flow statement) summarizes how a company's cash and cash equivalents have changed during the same period of time as the company's income statement. The statement has three sections in which to report the change in cash:

1. Cash flows from **operating activities**
2. Cash flows from **investing activities**
3. Cash flows from **financing activities**

Some of the details for the three sections of the statement of cash flows include:

1. **Cash flows from operating activities.** Using the *indirect method* this section begins with the net income reported on the income statement and then adds back the amount of depreciation expense. The reason is that depreciation expense had reduced the net income but the depreciation entry did not reduce the company's cash. There are also adjustments for losses and gains as well as the changes in accounts receivable, inventory, accounts payable and other current assets and current liabilities.
2. **Cash flows from investing activities.** This section lists the amounts spent on capital expenditures (property, plant and equipment), long-term investments, and other noncurrent assets. It also lists the cash received from the sale of long-term investments, property, plant and equipment, and other noncurrent assets.
3. **Cash flows from financing activities.** This section lists the amounts received from issuing debt and stock as well as the amounts spent to retire debt, buy back shares of the company's stock and the amount paid in dividends.

The amounts from the three sections are added and the total must reconcile with the change in the company's cash and cash equivalents.

The *inflows* of cash are presented on the statement of cash flows as *positive* amounts while the *outflows* of cash are presented as *negative* amounts.

In addition to the amounts reported in the three sections, the statement of cash flows must include supplemental disclosures including the income taxes paid, interest paid, significant noncash exchanges, and stock dividends issued.

The statement of cash flows is one of the required financial statements because users need information on a company's cash. Recall that the income statement prepared under the accrual method does not report cash amounts.

Learn more about the [Statement of Cash Flows](#).

Statement of stockholders' equity

The statement of stockholders' equity lists the changes in stockholders' equity that occurred from the beginning of the accounting year until the end of the accounting year. The changes will include the corporation's net earnings, sale of stock, repurchase of stock, cash dividends declared, exercise of stock options, stock-based compensation expense, and other comprehensive income.

Common financial ratios

Some of the more common **financial ratios** (and how they are calculated) include:

- **Current ratio** (current assets divided by current liabilities)
- **Working capital** (current assets minus current liabilities)
- **Accounts receivable turnover** (sales divided by average accounts receivable)
- **Inventory turnover** (cost of goods sold divided by average inventory)
- **Debt to equity** (total liabilities divided by total stockholders' equity)

Learn more about [Financial Ratios](#).

Bank reconciliation

The bank reconciliation is also known as the *bank statement reconciliation* or *bank rec*. Its purpose is to determine an organization's true amount of cash. (Cash includes bank accounts.) For instance, the amount of cash shown in a company's general ledger account (or in an individual's check register) may not be the true amount if the bank had recently charged the bank account for a service charge, loan payment, a deposited check that was returned because of insufficient funds, etc.

For a business, it is possible that neither 1) the bank statement balance, nor 2) the company's general ledger account balance is the true balance. The bank reconciliation process that we prefer adjusts both the balance per the bank statement and the balance per the general ledger to the one true amount.

Any adjustments to the *balance per the general ledger* will need a journal entry in order to get the correct amounts into the general ledger. (Since every journal entry will affect two or more accounts, the bank rec is important for accurate financial statements.)

For good internal control of an organization's assets, the bank reconciliation should be prepared by someone who does not write checks, process deposits, make entries in the cash account, etc. The idea is to separate duties so that one person cannot easily misuse or embezzle the organization's money.

Learn more about [Bank Reconciliation](#).

Petty cash

Petty cash or petty cash fund refers to a relatively small amount of currency and coins on hand in order to pay small amounts such as postage, cost of emergency supplies, parking, etc. The petty cash fund is established by writing a company check (say \$200) which will be coded to credit Cash and debit a new general ledger account Petty Cash. Next, one person should be designated as the petty cash custodian. The petty cash custodian is responsible for the \$200 and is required to document any payments. Therefore, at all times the petty cash custodian should have cash and receipts that will total \$200. (When the Petty Cash account is a constant \$200 balance, it is said to be *imprest*.)

When the currency and coin is low and also at the end of each accounting period the petty cash fund needs to be *replenished*. This means getting the cash back to the general ledger amount of \$200. This is achieved by submitting a check request for the difference between the \$200 needed and the actual cash on hand. Hopefully, the documentation equals that difference and should be attached to the check request. If the documentation does not equal the amount of cash needed, the difference is debited or credited to an account such as Cash Short or Over (a miscellaneous income statement account).

Accounts payable

Accounts payable could refer to:

- the general ledger liability account
- the bill paying department in a large company, or
- the process of reviewing vendor invoices and other bills to be certain they are legitimate

Often the **three-way match** is used as part of the accounts payable process. This technique requires that the following information be compared and reconciled:

1. the vendor invoice
2. the company's purchase order, and
3. the company's receiving report

Only after the three-way match is completed and any differences reconciled is a vendor invoice approved for payment.

Vendor invoices and receiving reports that are not fully matched as of the last day of the accounting period also need to be reviewed as this information may require that an accrual-type adjusting entry be recorded. Accrued expenses are usually reported in a liability account that is separate from Accounts Payable.

The account Accounts Payable is usually reported as the first or second item in the current liability section of the company's balance sheet.

Learn more about [Accounts Payable](#).

Accounts receivable

Accounts receivable result when a company has sold goods or has provided services on credit. This means that the customer or client is allowed to pay 10 days, 30 days, 60 days, etc. after the goods or services have been delivered.

Delivering goods or services on credit could lead to Bad Debts Expense if the customer or client cannot pay the total amount owed. Therefore, a company needs to review the credit worthiness of its customers and potential customers before transferring goods or providing services on credit.

An **aging of accounts receivable** is a report that sorts the company's existing accounts receivable according to their invoice dates. The aging shows the amount of each receivable that is current (not past due), 1-30 days past due, 31-60 days past due, 61-90 days past due, and so on.

Learn more about [Accounts Receivable](#).

Internal control

Internal control refers to the safeguards that a company has established in order to minimize the loss of its assets. For instance, good internal control requires that the cash receipts be handled by someone other than the person who records the transactions in the company's accounting records. Likewise the bank statement should be reconciled by someone who does not write the checks. Customer credits should be authorized only by a designated manager or company officer instead of a member of the sales staff or the accounts receivable clerk. The idea is to separate a company's tasks so that one person alone cannot cause the company to lose any of its assets.

In addition to the separation of tasks and duties, internal control also involves clear, documented procedures for handling transactions.

Small business owners should discuss internal controls with their accountant in order to protect their company's assets from dishonest acts.