

Fearless accounting with Wave

Master your accounting
and steer your business to
success with the world's
most popular free
accounting software.



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We're glad you're here!

Welcome to Wave's **Fearless Accounting** guide, and congratulations on opening a document that says "Accounting" on the front!

We know that accounting – like math – is a topic that most people were turned off from before they even left school, but hopefully this guide will show you not just how easy it is to look after your own accounting in Wave, but also how having a good grasp of your numbers helps you understand and improve your business.

Of course, you can have someone else do your bookkeeping, but we firmly believe that – at least until your business grows so successful you have no time for it – the benefits that flow from looking after your own books more than justify the effort of learning how!

The Wave Customer Success Team

About this guide

This guide is designed to be read once, and referred to often.

Seriously, you'll get the most benefit if you read it all the way through, starting at the beginning, and continuing to the very end!

Here's the good news, though: you don't need to read it all in one go!

Good accounting and bookkeeping practices have a natural rhythm.

You need to set up your accounts before you can use them. Once that's done, there are some routine tasks you'll probably want to perform daily; others weekly; and others monthly, or even quarterly.

Finally, once a year, you'll need to complete year-end tasks to be ready for tax time.

We've designed this **Fearless Accounting guide** to follow a similar cycle. Start by reading just what you need to get set up correctly; then learn the simple tasks you'll perform daily or weekly in Wave. Later, you'll discover best practices to follow monthly and quarterly. Save learning about year-end tasks for, well, the end of the year!

If you jump to the end of this guide, you'll find a comprehensive checklist of every task covered here. Print it out and keep it somewhere handy. It's your to-do list for staying in control of your accounting, and your business.

"But I don't know anything about accounting!"

If that's you, don't be concerned. We'll quickly cover the basic accounting concepts that will help you use Wave successfully.

But goal is not just to show you how to use Wave; we want to make you comfortable *using* financial information to understand your business, make better decisions, and become more successful.

So when you get to the **Accounting coffee break** sections – grab a coffee! Give yourself a few minutes to gain true understanding of accounting concepts and tools that help ensure your success in Wave, and in your business!

Ready to do this? Let's go!

Table of contents

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ACCOUNTING COFFEE BREAK #1

The 10,000 foot view



Three reasons to keep accounts



Compliance

If you run a business, you need to report your income and pay taxes. Depending upon where you operate your business, and what business structure you adopt, you may also need to file accounts that are available for official or even public inspection. The law requires you to keep appropriate accounts of your business transactions, so that *the man* can get his piece of the action.



Account to owners

You're probably reading this guide to tackle the accounting for your own business, but another important reason many businesses need proper accounts is to *account to owners*. In any incorporated business with investors, in any partnership, and any private business where managers are employed to look after day-to-day operations, the owners need to know what is being done with their money, and how it is generating profits.



Understand & grow your business

This is the main focus of our guide, and we believe it is the best and most compelling reason to gain a solid understanding of fundamental accounting concepts, and to handle your own management accounting.

Being in charge of your numbers means being in charge of your business, and that gives you the power to plan a path to success.



Management accounting, not financial accounting



Let's repeat that.

The main focus of this guide is to provide you the accounting knowledge you need to *understand and grow your business*, and the practical steps and skills in Wave to handle your own *management accounting*.

This is super important. **Management accounting** is mostly intuitive, easy to learn, and the same wherever in the world you run your business.

Management accounting is about documenting how your business works, so you see early warning signs of problems, and clear insight into opportunities.

Every business owner can and should master the basics of management accounting – it won't be hard to learn, and it *will* make you more successful.

Financial accounting takes your management accounting records and re-purposes them to report your tax liabilities, and to file information and make reports to owners in compliance with applicable laws and standards. It is about complying with local regulations where you operate your business.

Financial accounting is *not* easy to learn, which is why your CPA spent so long in school, and charges you so much!

Here's the good news: just about everything you need in order to understand your business and be more successful falls under management accounting. And not only is it fine to leave your business' financial reporting to your accountant (seriously – do this!), his or her services will be much less expensive if you have your core management accounting records in good order.

The balance sheet and income statement (aka "P&L")



If you were exposed to any accounting classes at school or college, or have dipped into other accounting books, you may have painful memories of T accounts, journal transactions, and debit-credit theory.

Well, we may meet some of that along the way, but let's start in a more sensible place: at the end!

At the risk of repeating ourselves, as a small business owner you keep accounts to better understand your business, and the two most important financial statements that you'll rely on - the 'end', or output of your work - are your balance sheet and your income statement (also known as your profit and loss report).

So let's dive straight in and take a look at how these actually work, using just one sheet of paper...



<u>What I have</u>		<u>What I earn</u>	
<u>What my business has</u>		<u>What my business makes</u>	
<i>less</i> <u>What my business owes</u>		<i>less</i> <u>What my business spends</u>	
<i>equals</i> <u>What' s left for me</u>		<i>equals</i> <u>What' s left for me</u>	

Imagine for a moment there are no easy, free accounting systems like Wave. Instead, we're going to give you one sheet of paper to track your business.

To help you get started, though, we'll add a few headings:

On the left, we've made space to list out "What I have." That's made up of three sections:

1. What my business has
2. (take away) What my business owes
3. (equals) What's left for me

On the right, we've made space to list out "What I earn". That's also made up of three sections:

1. What my business makes
2. (take away) What my business spends
3. (equals) What's left for me

Read on, and let's see how these six simple headings give us space to record everything we need to keep track of our business.



1. Initial investment

Let's say we're starting a web design business. We have \$5,000 of personal start-up capital to get us going.

Whatever business you're running, it's a *really* good idea to set up a dedicated bank account for everything to do with your business, separate from your personal spending. So let's go ahead and deposit our \$5,000 start-up capital into our shiny new business bank account.

How would we record this on our one-sheet accounting system?

Well, the business now has \$5,000 in the bank, so we can write that in under *What my business has*.

Bank: \$5,000

And we don't owe anyone else any money, so that means *What's left for me* must also be \$5,000. And we know that \$5,000 was our original investment.

Owner's Investment: \$5,000

Here it is, written up in our notebook:

<u>What I have</u>		<u>What I earn</u>
<u>What my business has</u>		<u>What my business makes</u>
Bank: \$5,000		
<i>less</i> <u>What my business owes</u>		<i>less</i> <u>What my business spends</u>
<i>equals</i> <u>What's left for me</u>		<i>equals</i> <u>What's left for me</u>
Owner's Investment: \$5,000		



2. Rent payment

Next order of business – somewhere to work and meet clients. We're budget minded, so we set up shop in a co-working space that charges \$800 a month in rent.

Look at the right side of the page. Rent is an expense, so we'll record it under 'What my business spends':

Rent: \$800

We haven't made any money yet, so our business is showing a loss. We'll write that down at the bottom on the right, under 'What's left for me':

Profit (Loss): (\$800)

Note: Parentheses (like this) are one way of showing a negative number.

On the left side, we've paid the rent out of our business bank account, so we'll need to go ahead and deduct \$800 from there, bringing the balance down to \$4,200.

We still don't owe any money, so 'What's left for me' should also total up to \$4,200 – and it does, so long as we remember that our profit (or loss) on the right hand side also belongs to us. So let's finish up and record:

What I've earned: (\$800)

Here's how our page looks now:

<u>What I have</u>	<u>What I earn</u>
<u>What my business has</u>	<u>What my business makes</u>
Bank: -\$5,000	
- \$800 = \$4,200	
<i>less</i> <u>What my business owes</u>	<i>less</i> <u>What my business spends</u>
	Rent: \$ 800
<i>equals</i> <u>What' s left for me</u>	<i>equals</i> <u>What' s left for me</u>
Owner' s Investment: \$5,000	Profit (Loss): (\$ 800)
What I' ve earned: (\$ 800)	
\$4,200	



3. First sale

We've invested some cash into the business; we have office space; and now we have our first sale! Our first customer has signed on the dotted line, and handed over a check for \$3,500.

It's tempting to pin that first ever check to the wall as a memento, but let's be smart and stick it in the bank!

We'll add it to bank, bringing our running balance up to \$7,700.

We also now have some income to add under the 'What my business makes' section.

Sales: \$3,500

As we saw when we paid Rent in Step 2, this will also affect our profit/loss, and in turn feed into 'What's left for me' on the left.

As you can see, our accounts are still looking nice and logical:

- *What my business has, less what it owes, is what's left for me*

which is

- *My Owner's Investment, plus what my business has made, less what it has spent.*

<u>What I have</u>		<u>What I earn</u>	
<u>What my business has</u>		<u>What my business makes</u>	
Bank:	\$5,000	Sales:	\$3,500
	- \$ 800 = \$4,200		
	+ \$3,500 = \$7,700		
<i>less</i> <u>What my business owes</u>		<i>less</i> <u>What my business spends</u>	
		Rent:	\$ 800
<i>equals</i> <u>What' s left for me</u>		<i>equals</i> <u>What' s left for me</u>	
Owner' s Investment:	\$5,000	Profit (Loss):	(\$ 800)
What I' ve earned:	(\$ 800)		+ \$3,500 = \$2,700
	+ \$3,500 = \$2,700		
	\$7,700		



4. Purchase on credit

We've worked with five of the six headings. Let's do one more transaction that will use the sixth.

Let's say we decide to commission a logo for our new business. A local graphic designer does this work, and invoices us \$500, due in 30 days.

This is also an expense, so on the right hand side of our notebook we'll add it under 'What my business spends':

Design Services: \$500

As usual, when we make or spend money, our Profit changes, and that flows through into the bottom of 'What's left for me' on the left side.

We also need to note how we've paid for the logo design – except we haven't paid! Unlike when we paid for Rent from the bank, we've been given 30 days to pay our designer. This means our business currently owes \$500. This is a vendor 'account' that we'll pay in the future, so we can enter:

Accounts Payable: \$500

Now the left side adds up again. *What the business has* (\$7,700 in the bank), less *what it owes* (\$500 'Accounts Payable') equals *what's left for us*: \$7,200, made up of our original \$5,000 investment, and \$2,200 profit.

	<u>What I have</u>	<u>What I earn</u>
	<u>What my business has</u>	<u>What my business makes</u>
	Bank: \$5,000	Sales: \$3,500
	- \$ 800 = \$4,200	
	+ \$3,500 = \$7,700	
	<i>less</i> <u>What my business owes</u>	<i>less</i> <u>What my business spends</u>
	Accounts Payable \$ 500	Rent: \$ 800
		Design Services \$ 500
		<u>\$1,300</u>
	<i>equals</i> <u>What' s left for me</u>	<i>equals</i> <u>What' s left for me</u>
	Owner' s Investment: \$5,000	Profit (Loss): (\$ 800)
	What I' ve earned: (\$ 800)	+ \$3,500 = \$2,700
	+ \$3,500 = \$2,700	- \$ 500 = \$2,200
	- \$ 500 = <u>\$2,200</u>	
	<u>\$7,200</u>	



Financial Statements: My Web Design Co.

<u>Balance Sheet</u>		<u>Income Statement ("P&L")</u>	
<u>Assets</u>		<u>Income</u>	
Bank:	-\$5,000	Sales:	\$3,500
	- \$ 800 = \$4,200		
	+ \$3,500 = \$7,700		
<u>Liabilities</u>		<u>Expenses</u>	
Accounts Payable	\$ 500	Rent:	\$ 800
		Design Services	\$ 500
			<u>\$1,300</u>
<u>Owner' s Equity</u>		<u>Profit (Loss)</u>	
Owner' s Investment:	\$5,000	Profit (Loss):	(\$ 800)
Retained Earnings:	(\$ 800)		+ \$3,500 = \$2,700
	+ \$3,500 = \$2,700		- \$ 500 = \$2,200
	- \$ 500 = \$2,200		
	<u>\$7,200</u>		

Up till now, we've recorded transactions under six headings on just one sheet of paper.

We've been calling the two sides "What I have" and "What I earn", but as you may have guessed, these two sides are exactly what go into creating the Balance Sheet and the Income Statement.

Here's where we ended up a page ago, but replacing our 'business owner' words with 'accountant' words:

On the left, our 'Balance Sheet' comprises:

- Assets (what our business has)
- Liabilities (what it owes to other people)
- Owner's equity (what's left for us)*

On the right, our 'Income Statement' shows:

- Income (what our business makes)
- Expenses (what it spends)
- Profit or Loss (what's left for us)

Modern accounting software, such as Wave, will usually create a Balance Sheet and Income Statement with a bit more detail than this, but fundamentally this is all there is. If you've followed along this far, you should now have the understanding to read your financial statements with confidence!

* Note that under Owner's Equity, we've also changed 'What I've earned' to 'Retained Earnings', because that's what accountants call it!

No, you can't really keep your accounts on one page!



As you've seen, there's no magic about the Balance Sheet or Income Statement.

The Balance Sheet details what the business has, what it owes, and what's left for you and any other owners.

The Income Statement records income, expenses incurred to generate that income, and the profit available to the owners of the business.

They're connected because profit available to the owners of the business will end up in the Owners' Equity section of the Balance Sheet.

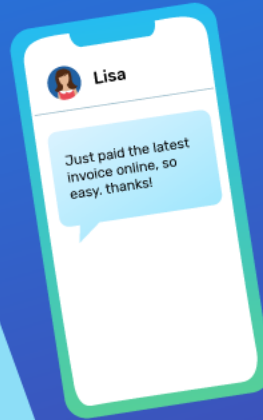
But seriously – with all those notes and crossings-out, who could make sense of either report?

That's why, ever since modern accounting practices developed at least 600 years ago, people have written the details of transactions as they've taken place into stand-alone date-ordered lists, called *Journals*; cross-posted them into separate lists that are organized by account, called *Ledgers*; and then copied summarized totals from the Ledgers into the *Income Statement* and *Balance Sheet*.

Today, of course, accounting software like Wave handles nearly all of this automatically, but the fundamental principles and methods remain the same. The huge benefit that accounting software offers (other than saving an enormous amount of time recording and copying-out transactions), is that everything is instant.

Whereas all the copying and summarizing meant that in the world of paper accounts, you could only reasonably produce financial statements once in a while, with Wave the Balance Sheet and Income Statement update *every time you record a transaction*.

If you are interested in really understanding how your accounting works, this is a neat thing to do: generate your Balance Sheet and Income Statement in Wave; add one transaction; and generate them again. You'll see movements exactly like we have illustrated in our one-page examples above.

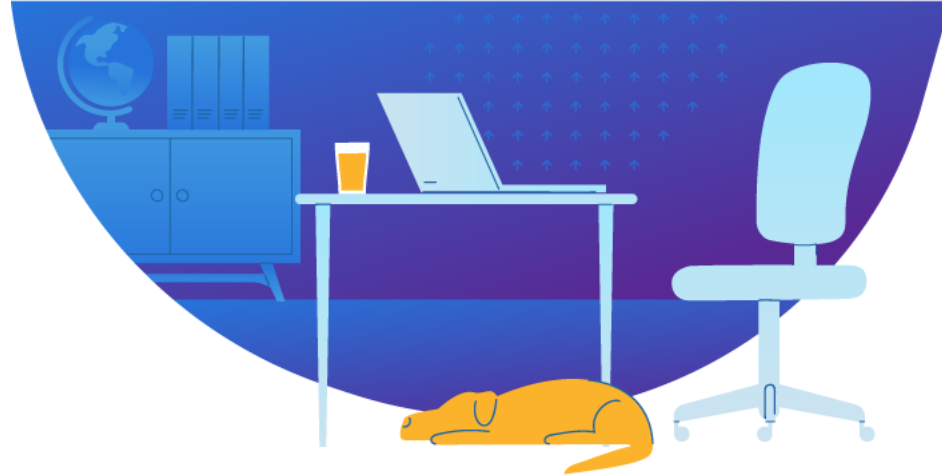


PUTTING IT INTO ACTION

Getting set up



Putting it into action



We've got our first Accounting coffee break under our belt, but as with learning anything, all the theory and coffee in the world isn't going to do us any good until we put it into practice. From here on in, we're going to be splitting our time between learning a few key accounting principles, and seeing how they all shake out in Wave.

The next few sections lay out all the tasks you'll ever have to perform in Wave, some financial metrics to help you better analyze your business, and a few more "accounting coffee breaks" sprinkled throughout. You'll be able to breeze through some of these coffee breaks in a single cup, while others might require a full pot. The bookkeeping tasks themselves are designed to be cyclical; once you've set yourself up for success, you can continue to use what you've learned on a day-to-day, week-to-week, quarter-to-quarter, and year-to-year basis.

You should find that, by the end of our time together, you perform the tasks we've laid out not because we've explicitly said that they should be performed, but because each task is a natural extension of your understanding of accounting, and of your business. Every step we'll take is one step closer to a set of meaningful books that will help you better understand your business, and drive its growth!

Let's get started...

Getting started



Wave's signup process is designed to be as quick and easy as possible. In fact, you've likely signed up before even reading this – so welcome!

In this section, we're going to go beyond the initial signup, and help you get set up the right way, with the bookkeeping processes that we'll cover later in mind.

Signing up for Wave is easy! If you haven't already, simply visit www.waveapps.com, and click **Create your Free Account**.

Sign up using your main business email address, or you can sign up with your Google account if you have one.

Next, tell Wave your Business Name, and choose the Business Type that looks most like what you do. This will help Wave start you off with income and expense categories that should cover most of your needs.

Because we want to focus on organizing our finances, let's start there!

Congratulations! You now have a new Wave business. Let's start filling it with useful information!

Tip: Have a dedicated business bank account! Your accounting is **so much easier** if you have a separate business bank account. If your business is incorporated, or you need to write or receive checks in your business name, this will need to be an account that your bank explicitly offers as a "Business bank account." But if you're a sole proprietor and don't need to send or receive check payments in your business' name, then you can use a separate personal bank account. Follow this golden rule: **do not mix personal and business transactions in the same account.**

Note: If you have more than one credit card, keep one just for business purchases, too.

Nine simple setup steps



If you're the kind of person who likes to set up your workspace before beginning, we'll have you up and running in no time.

If you're not, don't worry. You can skip these steps for now and complete them as you continue using Wave.

1. Enter your bank accounts

Head over to the **Chart of Accounts** page, which is under **Accounting** on the left menu in Wave, and add your bank account(s) in the **Assets** tab.

You'll also want to add accounts for any Credit Cards you'll be using for your business, which you'll do on the **Liabilities & Credit Cards** tab.

Chart of Accounts ?

Assets 3

Liabilities & Credit Cards 3

Credit Card ?

Business Credit Card

Last transaction on July 31, 2018

+ Add a new account

Connect your bank account

Select your bank from the choices below, or search for your financial institution to get started.



Can't find your bank above? Wave supports over 10,000 different financial institutions. Search for yours here:

Q Type the name or website of your bank or financial institution

2. Get transaction data into Wave

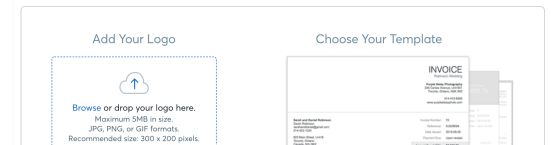
If you bank with one of the 10,000+ banks Wave connects to, go to **Banking > Bank Connections** to import up to 3 months' historic transactions. (This will also keep your transactions up-to-date going forward!)

If your bank is not supported with a direct connection, or you also need to import older data, you can export transactions from your online banking website and upload the into Wave from the **Transactions** page.

3. Set Wave to suit your brand

Click on **Sales > Invoices**. If this is your first time on the Invoice page, you can upload your logo and pick an invoice layout and color that suits your brand. You can update this any time under **Settings > Invoice Customization**.

Create the perfect invoice to match your brand.





4. Add sales taxes

If your business will charge or recover Sales Taxes, go to **Settings > Sales Taxes** to define any taxes you will use.

Important: Sales Taxes cannot be changed after you've started to use them, so double-check to be sure you've entered them right!

Sales taxes

[Create a sales tax](#)

Name	Actions
HST (13.0000%) - Harmonized Sales Tax	Edit Delete

Products & Services (Sales)

[Add a product or service](#)

Name	Price	Actions
Advanced widget widget with advanced features	\$200.00	Edit Delete
Basic widget widget with basic features	\$100.00	Edit Delete

5. Add products & services

Go to **Sales > Products & Services** to create a list of the Products / Services that you will be supplying to customers. (You'll use these to create invoices.)

You'll see that you can associate an Income account (category) to each Product / Service, and also set the default Sales Tax.

6. Add customers

Go to **Sales > Customers** to start entering details of your customers.

Note that you can also bulk import customers to save time.

Tip: If you decide to use Wave Payments, you or your customers can also record payment card information for repeat billing.


Customers

[Import from...](#)[Add a customer](#)

Name	Email	Phone	Payment methods	Actions
Daring Design Dan Sidhu	dan@daringdesign.com	416-123-4567		Edit Delete
International Widgets Inc. Monica Hui	accountsreceivable@widgetsint.com	647-554-7777		Edit Delete







Your new Wave business will automatically provide your customers the ability to pay you online for any invoices that you send. Once you've received your first payment, you'll be asked to fill out a brief application so that Wave knows a bit more about you, your business, and – of course – where the money should be deposited! You can fill this out before sending your first invoice: head over to **Sales > Payments** and click **Finish Payments Setup**.



PAYMENTS BY WAVE



Accept all major forms of payment.

Turn on Payments

- ✓ **No surprise fees, ever.** No setup, monthly, or hidden fees.
- ✓ **You're in control.** Customize payment methods on any invoice, and cancel anytime.
- ✓ **Flexible for your needs.** Receive individual or recurring automatic payments.

Two ways to get your invoices paid:

 <p>Credit Cards 2.9% + 30¢ per transaction 2 business days to get paid out</p>	OR	 <p>Bank Payments (EFT) 1% per transaction 7 business days to get paid out How does it work?</p>
---	----	---

[illegible]

Tip: Make sure you have all tax information for your business on hand, as well as any information for payrolls you've run earlier in the year. This will streamline the setup process. You'll be paying your employees right alongside handling your invoicing and bookkeeping in no time!



9. Enter starting balances

If you're moving over to Wave from another accounting system, you'll want to enter your account balances from the previous system:

1. Giving yourself a pat on the back for choosing Wave
2. Entering a **starting balance transaction**

Get the starting balances from your previous system in the form of a **Trial Balances** report.

Before adding your starting balances, go to **Accounting > Chart of Accounts**, and add any accounts from your previous system that don't yet exist in Wave.

Once this is done, all of your starting balances can be added to the biggest journal transaction that you'll ever create in Wave. Just recreate each line of the Trial Balances report by clicking **Add Debit** or **Add Credit** and selecting the appropriate account and amount. After this monster journal transaction has been saved, you're good to go!

Edit transaction details	
Description Starting balances	
Date 2018-08-01	Total 8000.00
Debits	Credits
Accounts Receivable 5200	
Accounts Payable 2400	
Depreciation and Amortization 2300	
Payroll Liabilities 5600	
Undeposited funds 500	
Add Debit	Add Credit
Total Debit is 8000.00	Total Credit is 8000.00

Tip: If you have any outstanding bills or invoices in the accounting system that you're coming from, recreate them in Wave and then delete them from the old system before generating a Trial Balances report.

Setup checklist

	<input checked="" type="checkbox"/>
<i>Sign up with Wave!</i>	<input type="checkbox"/>
<i>Set up a separate, business bank account with your bank</i>	<input type="checkbox"/>
<i>Enter your bank accounts</i>	<input type="checkbox"/>
<i>Get transaction data into Wave</i>	<input type="checkbox"/>
<i>Set Wave to suit your brand</i>	<input type="checkbox"/>
<i>Add sales taxes</i>	<input type="checkbox"/>
<i>Add products & services</i>	<input type="checkbox"/>
<i>Add customers</i>	<input type="checkbox"/>
<i>Sign up for online payments</i>	<input type="checkbox"/>
<i>Sign up for payroll</i>	<input type="checkbox"/>
<i>Enter starting balances</i>	<input type="checkbox"/>



ACCOUNTING COFFEE BREAK #2

Why the balance sheet balances





The accounting equation

Most accounting guides focus on helping you learn accounting rules. The problem with learning rules is that they are just as easy to forget.

That's why our goal here is to help you understand at a fundamental level how - and why - accounting "works." Understanding is both more useful, and harder to forget!



Rather than just telling you what 'The Accounting Equation' is all about, let's dig into *Why the Balance Sheet Balances*.

If you think about all the money and other assets in your business at any point in time, they must have come from somewhere. But where?

The money in your business can have come from only three places:

1. Investment that you, the owner (and any other co-owners/investors), put into the business.
2. Income that the business has earned, right back from when it started.
3. Money or things that we've borrowed from other people - i.e. what the business owes to others, which we call Liabilities.

(Sometimes your business may receive gifts, in the form of government grants; let's keep it simple and just include these as 'income!')

Now, if you had a 'magic' business that had no operating costs, all the money that flowed in from these three sources would be sitting in your bank account (an Asset on your Balance Sheet), or perhaps turned into other assets - things you had purchased and retained in the business. In the real world, however, at least some of that money is going to have to flow back out of the business.

That outflow can only have gone to two places:

1. It has been spent on goods and services to operate the business* ("Expenses").
2. It has been withdrawn by you, the owner.

So if we know the only three places money can have come from into your business, and the only two places it can have gone, what can we do with that information? Let's take a look...

** Note: Tax is also an Expense, even though it might not feel like it directly helps you operate your business!*



Let's stop the clock and think about the source of the Assets in your business *right now*. Can we agree that all the money that has ever come into the business is still in the business *right now* as Assets in one form or another, or it has gone out of the business to pay for expenses, or been withdrawn by the owners?

Awesome! Let's start turning this into some 'math'...

Assets	=	Owner's Investment	+	Lifetime Income	+	Liabilities	-	Lifetime Expense	-	Owner's Withdrawals
All the money and value of 'things' in the business today		What owners have put into the business since it started		All the income the business has ever earned		What other people have provided to the business, and are owed right now		All the expenses the business has ever incurred		What the owners have taken out of the business since it started

Still with us? OK. Let's reorganize this a bit:

Assets	=	Liabilities	+	{	Owner's Investment	-	Owner's Withdrawals	}	+	{	Lifetime Income	-	Lifetime Expense	}
All the money and value of 'things' in the business today		What other people have put into the business, and are owed right now			What owners have put into the business since it started, less what they've taken out						All the income the business has ever earned, less all its expenses			

Nearly there! Let's simplify this some more...



Let's just call all the Owner's Investment less all the Owner's Withdrawals "**Owner's Net Investment**".

And, of course, all the Income the business has earned less all its Expenses is, simply, the business's total **Lifetime Profit** up to today.

So here's the equation once again, with these changes:

Assets	=	Liabilities	+	Owner's Net Investment	+	Lifetime Profit
All the money and value of 'things' in the business today		What other people have put into the business, and are owed right now		What owners have put into the business since it started, less what they've taken out.		All the income the business has ever earned, less all its expenses

Take a look back, now, at the simple 'one page' financial statements starting on page 9. Do you see how each time we recorded a Profit in the Profit & Loss Report, we added it to 'Retained Earnings' over at the bottom of the Balance Sheet? "Retained Earnings" is simply accountant-speak for *Lifetime Profit, from when the business started right up to the date of the Balance Sheet*. So we can rewrite our equation again:

Assets	=	Liabilities	+	Owner's Net Investment	+	Retained Earnings
All the money and value of 'things' in the business today		What other people have put into the business, and are owed right now		What owners have put into the business since it started, less what they've taken out.		Accountant-speak for lifetime profit*

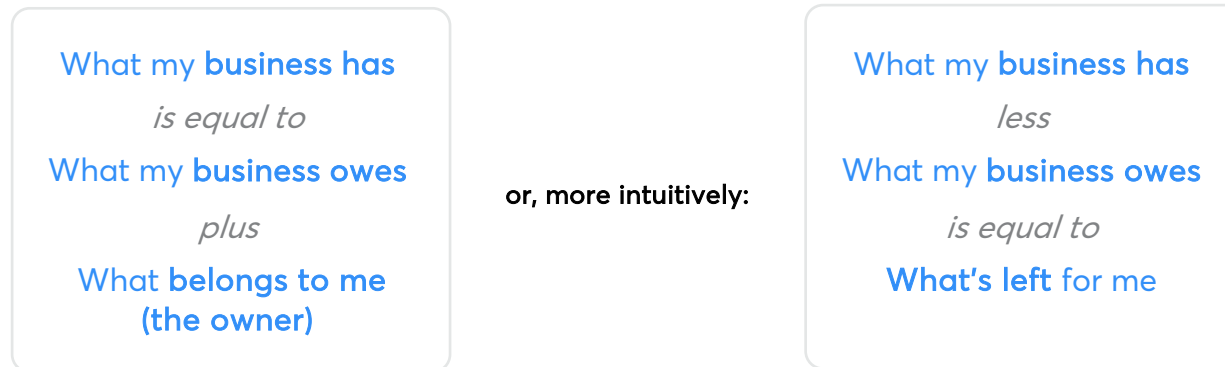
* Technically, in an incorporated business, Owners' withdrawals normally are made from Retained Earnings, rather than reduction of Owner's Investment. That's what the 'Retained' in "Retained Earnings" means: "Retained" as opposed to "Paid Out". Mathematically, however, this distinction is unimportant, so let's not get hung up on it for now.



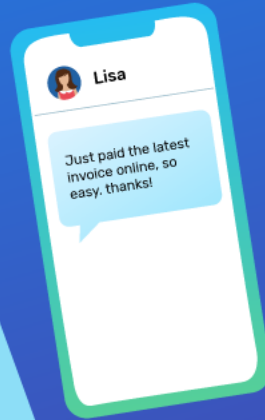
In formal accounting terms, *Owner's Investment* and *Retained Earnings* are both components of **Owner's Equity ("OE")**. This is an unfortunate choice of words, and confuses many business owners because of its similarity to "Equity", which is a class of capital within the funding structure of an incorporated business. However, we are stuck with it, so let's make a final simplification to our formula:

Assets	=	Liabilities	+	Owner's Equity
All the money and value of 'things' in the business today		What other people have put into the business, and are owed right now		Owner's Investment, together with Retained Profits

Accountants call this "**The Accounting Equation**", and as you can see it exactly maps on to the Balance Sheets that we have been working with so far:



Remember, we haven't learned the Accounting Equation as a 'law' here. We've worked it out together from first principles, by thinking about all the places money can come from in a business, and all the places it can go. There's nowhere else money can come from or go to, so the Accounting Equation *has to be* correct, and Balance Sheets *must always* balance!



PUTTING IT INTO ACTION

Daily to weekly tasks



By the end of this section you'll know how to...

<i>Capture receipts</i>	Upload photos of your receipts and store them in Wave.
<i>Invoice clients</i>	Use Wave's Invoicing feature to send invoices to your clients and get paid.
<i>Record and categorize transactions</i>	Track your transactions and categorize them appropriately.
<i>Record business mileage</i>	Log business use of your vehicle outside of Wave.
<i>Record invoice payments</i>	Record payments received for your invoices.
<i>Record bills</i>	Record any owing bills.
<i>Record non-income and non-expense transactions</i>	Account for any deposit and withdrawal transactions that aren't strictly income and expenses.

Capture receipts

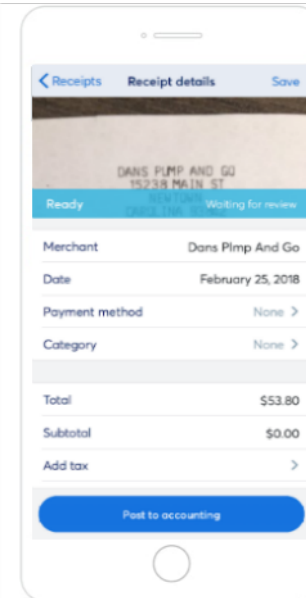
Whenever you incur a business expense and receive a receipt, it's a great habit to snap a picture of it immediately and upload it to Wave so that it can be accounted for properly.

*Wave provides **free** mobile Receipts apps for Android and iOS devices, which you can download from the relevant app store.*



Keeping digital copies of your receipts goes beyond simply accounting for the expenses that they represent. Receipts provide a real-world document of your purchases. If you want to claim something as a business expense, it's good practice to have the related receipt on hand.

In the interest of planning for the worst (the worst being an audit come tax time), receipts act as a control to keep your accounts as air-tight as possible. Once a receipt is uploaded and verified, Wave will automatically bookkeep the purchase for you.



Wave provides three options for uploading your receipts: direct upload, email, and mobile upload. As long as the receipt is in a supported image file format, Wave will attempt to read the receipt and pre-fill as many of its fields as possible.

Once the receipt is verified, a transaction recording the associated expense will be posted to your Transactions page.

Tip: Use the **Notes** field to record any details about the receipt. If you took a client to dinner and uploaded the receipt, be sure to make a note of the business purpose of the meeting, as well as who was there.



Invoice clients

Now to the bread and butter of your business: getting paid for your work!

To bill a customer for a service or product, you'll need to create an invoice. Creating and sending an invoice in Wave takes just a few clicks, either online or in the Invoicing mobile app.

*As long as you have **Payments by Wave** enabled, credit card payments can be in your bank account within just a couple of business days.*

Everything integrates with your Wave accounting, and designed to be as effortless as possible.

Once you've pre-filled your account with your **Customers**, **Sales Taxes**, and **Products and Services**, you'll find the process of creating and sending invoices just about as straightforward as it gets. Go to **Sales > Invoices** and click on **Create an Invoice**.

Select **Add a Customer** at the top of the page to choose from one of your saved customer profiles. You can also add a new one if needed directly from the page.

The same goes for your products and services; just click on **Add an Item** to choose from one of your saved products and services or create a new one.

Apply sales taxes to any items that need them; set the payment terms for your invoice at the top of the page; and click **Save**.

Now all you have left to do is **Approve** and **Send** the invoice to your customer.

Remember to enable online payments so your customers can pay you directly from the emailed invoice that they receive!

Tip: When you first **Save** an invoice, Wave will create it as a Draft. This means it is not yet recorded as part of your income.

The moment you click **Approve** on a draft invoice, Wave will take care of the necessary bookkeeping automatically: **Accounts Receivable** will be debited by the full invoice amount, and **Sales** will be credited. If there is any Sales Tax on the invoice, Wave will credit your Sales Tax account the correct portion of the Invoice.



Categorize transactions

<input type="checkbox"/>	Aug 1, 2018	Client dinner Business Credit Card	\$150.00	Meals and Entertainment	✓
<input type="checkbox"/>	Jul 31, 2018	Printer paper - OfficeStore Business Credit Card	\$33.65 Harmonized...	Office Supplies	✓
<input type="checkbox"/>	Jul 27, 2018	Created Transfer Business Credit Card	\$2,000.00	Transfer to Business checking ▼	✓

*Spend some time every time you log in to Wave to make sure that each and every transaction in the **Transactions** page is categorized.*

When you categorize a transaction, you're telling Wave how to bookkeep your income and expenses, so that you get useful reports to understand your business.

An uncategorized transaction should be seen as incomplete; it needs to be categorized and reviewed if it is going to accurately contribute to your reporting.

The categorization process consists of these steps:

- 1. Categorize:** Apply a category to the transaction that most appropriately describes the real-world transaction that took place. If you spent \$200 on a meal with a client, then when the transaction for that meal is imported into Wave, it should be categorized under **Meals & Entertainment**.
- 2. Apply a Sales Tax:** After a transaction has been categorized, it may then be necessary to add a sales tax. If your business is registered to charge and recover sales taxes, make sure that the correct sales tax is applied to each transaction.

- 3. Review:** Once a transaction has been categorized and tax has applied, review it to make sure everything checks out before marking it as **reviewed**. (You can un-mark or edit your reviewed transactions at any point.)

Adding Categories:

The 'Categories' you're offered when categorizing transactions are simply accounts that Wave has created for your use, based upon the business type you chose when getting started.

If you want to add more Categories, go to **Accounting > Chart of Accounts**, and create your own in the relevant sections.



Log business mileage

Logging mileage is not a feature of Wave, but it's an important daily task to keep your business records in good order, so we're calling it out here.

If you own a vehicle and use it in both your business and your personal life (whether you or the business technically owns the vehicle), then while some of its costs should be recorded as a business expense, it's unrealistic to consider the whole cost a business operating expense.

The most logical way to decide how much cost relates to the business and how much to you personally is usually on the basis of business vs personal mileage.

	<u>Date</u>	<u>Trip</u>	<u>Start</u>	<u>End</u>	<u>Business</u>	<u>Personal</u>
	1 Feb	Visited Acme Corp. Tulsa	15,100	15,160	60	
	1 Feb	Grocery run	15,160	15,171		11
	2 Feb	School run	15,171	15,185		14
	3 Feb	Site visit @ 131 West St.	15,185	15,230	45	
					105	25
					130	

While logging business mileage is not *essential* for your management accounting (you could simply estimate your business vs personal mileage, and apply whatever split you feel is right in your management accounts), when it comes to tax time, having good records of business and personal mileage *is* essential.

Different countries and regions have different rules for how you calculate and deduct driving expenses for tax purposes, but just about everywhere, if a vehicle is used for Business *and* Personal purposes, you'll need to be able to evidence the two categories of mileage.

It's a great idea to check with your accountant, or Google for local rules, what the minimum required information is to keep, but you can't be wrong for keeping *too detailed* records, so if in doubt, keep a notebook in your car and record the following for every trip:

- Date
- Trip details (from/to)
- Starting mileage
- Miles driven (or Kilometers!)
- Ending Mileage
- Purpose of trip
- Business or Personal
- Customer (if applicable)



Record invoice payments

<input type="checkbox"/>	Aug 1, 2018	Invoice payment Business checking	\$500.00	Choose a category ▼	✓
<input type="checkbox"/>	Aug 1, 2018	Client dinner Business Credit Card	\$150.00	Q search	
<input type="checkbox"/>	Jul 31, 2018	Printer paper - OfficeStore Business Credit Card	\$33.65 Harmonized...	Payment Received for an Invoice in Wave	>
		Created Transfer			

*If you receive payment for your invoice by check, or a payments processor other than **Payments by Wave**, you'll need to record the payment manually in your bookkeeping.*

*When a payment has been recorded correctly, you will be left with a **Deposit** transaction in the **Transactions** page that is linked to the invoice itself, marking it as paid.*

To record payment directly to an invoice:

1. Go to **Sales > Invoices**. You'll be greeted by a list of your unpaid or partially paid invoices.
2. Locate the invoice that you are recording payment for; click the arrow to its right, and select **Record a Payment**.
3. Enter the **Payment date, Amount, Method, and Account**. Click **Save**.

These steps will create a new Deposit transaction linked to the invoice, so if you have connected a bank account, or have uploaded transactions, you could find yourself with duplicate payments in your Transactions.

Simply go to **Accounting > Transactions** and delete the duplicate transaction. (Note: be careful to delete the 'unconnected' duplicate transaction; not the transaction linked to the Invoice that you have just added!).

To record an invoice payment using an already-imported income transaction:

1. Locate the uncategorized payment transaction in the **Transactions** page.
2. Open the **Category** dropdown menu and select **Payment Received for an Invoice in Wave**. This will bring up a list of any outstanding invoice amounts.
3. Select the related invoice from the dropdown menu. This will link the transaction to the invoice, and mark the invoice as paid.

Tip: What happens if you get paid by check on a Friday, but the check doesn't clear until Monday? You can prevent this delay from throwing your books off by using a Money in Transit Account. You can check out the process here: <http://bit.ly/transitpayment>



Receive invoice payments automatically

*When your customers pay invoices via **Payments by Wave**, you receive payment quickly straight into your bank, and all the bookkeeping is taken care of automatically!*

Here are some of the things that Wave takes care of, so you don't have to:

- The invoice is marked 'paid'.
- The payment transaction is recorded, and booked to a dedicated **Payments by Wave** holding account.
- The Accounts Receivable balance is reduced.
- Card processing fees are accurately accounted for.
- When funds are deposited into your bank and appear in your automated transaction import (for connected bank accounts) or upload, they're matched with a transfer from the holding account.

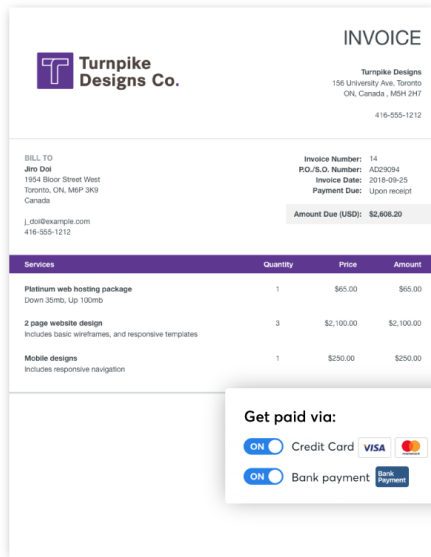
This process was designed to keep your bookkeeping as accurate as possible, while taking the work out of recording invoice payments via **Payments by Wave**.

Automatic bookkeeping with Payments by Wave:

Remember – this process is automatic; you don't have to do anything. But if you'd like to keep an eye on things, here's what you'll see on your Transactions page as Wave "does its thing":

1. When your customer pays an invoice online, you'll receive a notification email, and see a deposit transaction on your **Transactions** page. The **account** will be set to **Payments by Wave**.
2. If you have a bank account connected or are uploading transactions, a deposit transaction will be imported once the payment hits your bank account.
3. Wave will automatically detect the deposit transaction and create a transfer from **Payments by Wave** to your bank account. This will appear on the **Transactions** page as a transfer transaction.

You might receive several invoice payments in a single funds transfer from Wave. No problem – Wave knows how to match the deposit against multiple individual payments.





Record bills

*Record any expenditures that you've been billed for, but have not yet paid, as **Bills** in Wave.*

*Short term liabilities related to your Bills will be reflected on your reports in your **Accounts Payable**.*

*Adding a bill will increase the balance of your **Accounts Payable**, and paying it off will clear it.*



Creating a **Bill** in Wave will correctly account for any expense that does not have to be paid right away.

Is rent coming due? Have you been billed for internet? Has a contractor sent you an invoice? It's probably time to create a Bill!

The benefit of properly recording Bills is that you will have a better idea of how much money your business *really* has at any time: you're accounting for a payment out of your business that you *know* has to happen, so you're prepared when it comes time to pay.

Keeping this in mind will help when trying to figure out when to add a Bill, and when to simply record an Expense transaction.

It's not as simple as just recording anything with the word "bill" in its name - for example, if your business owns a vehicle and you take it in for service, the garage will likely write you a service bill... but you'll need to pay it before picking the vehicle up! You wouldn't need to bookkeep this in Wave as a bill.

Here's a simple rule of thumb:

- If you pay for a service at the time you consume it, you might as well record it then and there as an expense transaction in Wave (or, of course, just wait for it to import, assuming you have your bank connected to import transactions).
- If you are consuming a service now, but won't pay until later, it's good practice to create a bill - even if your supplier doesn't actually give you a physical 'bill' until later.

By recording the bill, you recognize the expense as it is incurred, which gives you a truer understanding of your business' financial position, and how expenses match against the income that they contribute to earning.

Tip: All of your overdue Bills will appear on your **Dashboard** when you log in to Wave.



Recording transactions that aren't income or expenses

Most of the transactions you categorize will be Income or Expenses. And you know that your income, less your expenses, is equal to your profit.

Every once in a while, though, you'll find that you have money flowing into or out of your account that doesn't really feel right categorized as a normal income or expense transaction. These require a little extra thought when categorizing. We'll go into detail on how to handle these later, but we'll touch on them here in case they come up for you.

Purchasing assets

Things you buy that help your business operate 'right now' are Expenses. Things you'll use in your business for many months, or even years, are 'Assets'.

When you purchase an Asset – for example a new truck for your business – you'll usually want to add a new account in the 'Assets' section of your Chart of Accounts for the asset (Go to **Accounting** > **Chart of Accounts** to create it.), and categorize the purchase transaction to the asset account.

<input type="checkbox"/>	Asset purchase (truck)	Aug 1, 2018	Choose a category ▼
<input type="checkbox"/>	Invoice paym	Aug 1, 2018	Search
<input type="checkbox"/>	Client dinner	Aug 1, 2018	Truck
<input type="checkbox"/>	Printer paper		Undeposited funds

Purchasing inventory

Depending upon the business you're in, you may purchase items for resale, or to use in delivering services over time. It may make sense to treat these as purchases of Inventory rather than directly as Expenses. Jump ahead to Page 74 to learn more.

Tip: If you get stuck categorizing something that doesn't *feel* right as Income or Expense, don't get hung up on it. Write yourself a note and come back to it when you sit down to tackle your Monthly to Quarterly bookkeeping.

Vendor prepayments

Sometimes, vendors may require you to pay for products or services in advance. In this case, the pre-payment is an Asset: you have not received the service, but you have acquired *the right* to receive it in the future. Jump ahead to Page 106 if you have a vendor pre-payment to categorize right now.

Customer prepayments

Customer pre-payments are the opposite of vendor pre-payments. A customer pays you for a product or service you haven't delivered yet – and may not deliver for some time.

This isn't 'Income', yet: you've got the money in the bank, but your business hasn't earned it. It actually creates a **Liability** – an obligation to your customer that you'll satisfy in the future. See Page 104 to learn more.

'Income' that reverses an expense

If you purchased an item and categorized it as an Expense, but later returned it for a refund, it's not income! Simply categorize the deposit as a **Refund for Expense** and select the same expense category as the original purchase.



Automations that save you time

Connect your bank to automatically import transactions



Once you have connected a bank account to Wave, your transactions will continue to pour into your account for as long as the connection is active. As much as bank connections are completely automated, changes to your online banking information or your bank's webpage can result in an interrupted connection. Whenever you're checking in on Wave to categorize transactions or create an invoice, it's a good idea to make a note of whether or not the connection is importing properly (bank reconciliation is another surefire way to check in on your connection!).

If you have changed your online banking information, or the bank connection does not appear to be importing, try refreshing the account by clicking on **Banking**, selecting **Bank Connections** and entering your online banking credentials in the **Edit your Credentials** page.

Should you find that your bank is not supported, you can still quickly and easily upload transactions by downloading them from your bank in Microsoft Money, Quicken, Quickbooks or Simply Accounting format and heading over to the **Transactions** page, clicking **More**, and clicking **Upload a bank statement**.

Tip: Wave works with a third-party data integration partner to provide secure bank connections for transaction imports. Wave does not access your bank directly. Instead, when you connect your bank account to import transactions into Wave, our data integration partner makes the connection to your bank.

Set up recurring invoices



*If you bill for anything on a recurring basis, you can save yourself a lot of manual entry by scheduling a recurring invoice. To add a recurring invoice, click on **Sales** and select **Recurring Invoices**. Create an invoice as you normally would, and set a schedule.*

That's it! A recurring invoice will be automatically generated and sent with each scheduled date.

To save time – and make your business' income more stable and predictable – try to find ways to make the goods and services that you sell repeat at regular intervals.

If you sell a subscription-based service, recurring invoices are by default your best option for billing customers, but there are a number of other services that can be billed on a recurring cycle.

Monthly payments on contracts, web-hosting fees, and most other services over a consistent basis with the same customer can be handled through recurring invoices, saving you valuable time that can be spent elsewhere.

Look around, and you'll find people selling products as diverse as groceries, office supplies, and razors on a recurring basis!

Tip: If you want to send an invoice just once on a specific date in the future, Recurring Invoices can help with that too! Click on **Sales > Recurring Invoices**; create your invoice; then schedule it to **repeat Daily**; Create the first invoice **on your chosen date**; and choose **end After 1 invoice**. Wave will send your invoice on the date you have selected – and no more, as you have selected to send 1 invoice only.

Credit card, bank, & recurring payments



Any time you can accept payment for your invoices online, you save yourself the trouble of chasing payments in the real world.

If you have credit card and bank payments enabled in Wave, then every time a customer receives an invoice, they will have the option to pay directly from the invoice.

Even better, when your customers pay online, some will choose to save their credit card details, and give you permission to charge their account directly for future invoices!

Wave provides your customers with the option to do this every time they make a card payment.

Credit card payments work together with recurring invoices in Wave. Any recurring invoices that you create can be paid through recurring billing, a feature that automatically bills a customer from their saved credit card information each time an invoice is generated. Once this feature is enabled (either by you or your customer), neither of you will have to do anything to record a payment. With each invoice that goes out, your customer will receive a receipt, and you will collect payment immediately.



ACCOUNTING COFFEE BREAK #3

Journals & ledgers





What you really need to know about journals, ledgers, and double-entry (and what you don't!)



If you glance back at the one-page financial statements from Accounting Coffee Break #1, you may notice that every transaction we recorded directly affected two accounts. For example when we paid rent, we used (reduced) money from our bank account (an asset account) and recorded the payment to Rent (an expense account).

In every business, money - or value, more generally - doesn't just appear or disappear. It must come from somewhere (you, the owner; loans; or revenue), and be used or invested somewhere (in bank accounts and other assets; back to you, the owner; to settle liabilities; or to pay expenses). This leads very naturally to the practice of recording every transaction as an exchange between two accounts - just as we did in our simple examples.

As early as the mid-15th Century, merchants had evolved methods of accounting built on this fundamental double-entry concept, listing each transaction in a day-book, or 'journal', and cross-posting the same transactions into two separate Accounts within a Ledger. Given how well this method stood the test of time, when accounting began to move from paper to computers, software makers adopted exactly the same principles and methods.

With easy-to-use and free modern financial accounting systems like Wave available, there's no reason you'll ever need to be able to perform double-entry bookkeeping by hand, on paper; but it's good to know the ingredients of a traditional bookkeeping system, so you can understand what Wave is doing behind the scenes.

So, to that purpose, let's take a look at the traditional accounting process...



Source records

Invoices, Purchase Orders, Bills, Receipts, Petty Cash Slips, Bank Transaction histories, and other possible data provide the original source records of the financial activities of the business.

Journalize transactions

Each transaction of the business is listed in chronological order in the Journals

Journals

Books of daily record (just like a personal journal that you write in every day), where each transaction is recorded in chronological order, with a note of which account received value in the transaction, and which provided value.

Post transactions to the ledgers (double entry)

Transactions in the Journals are 'posted' (copied out) into the relevant Ledger Accounts. Note that every Journal entry records an Account that receives value, and an Account that provides value, so every Journal entry contributes to two postings, to the two affected Ledger Accounts: a "double entry".

Ledgers

Books of summary record, usually with a page for each Account. Transactions first entered in the Journals are re-listed in the Ledgers, where they are organized and summarized by Account, rather than by Date.

Prepare financial reports

As at the reporting date, a Trial Balance is conducted to ensure there have been no errors in postings to the Ledger. Ledger balances are extracted and re-presented in the Financial Statements.

Financial statements

The Balance Sheet shows totals at the Balance Date from the Asset, Liability, and Owner's Equity-type Ledger Accounts.

The P&L comprises totals for the reporting period from the Income and Expense-type accounts.



Wave looks after (almost) all of this for you!

In traditional paper-based accounting, the first step was always to take the Source Documents, and list transactions into the day-book, or Journal.

With Wave, however, you mostly either create the Source Documents directly in Wave, or easily capture their details from elsewhere.

For example, when you send an invoice in Wave, the system automatically:

- Creates a transaction in the Sales Journal, recording the transfer of value between Sales and Accounts Receivable.
- Posts two copies of the transaction: one to the correct Income Account and one to the Accounts Receivable account in your General Ledger.

In the same way, whenever you categorize a transaction in your bank Account, Wave is actually journalizing a transfer of value between bank, and the Account into which you chose to categorize it.

While Wave can handle (almost) all your accounting by simply working from the 'Source Documents' such as Invoices, Bills, Receipts and categorized bank Transactions, there are other exchanges of value for which there may be no source document – or not one that you can create in Wave. An example of this would be applying a depreciation or amortization expense, which we shall meet on page 65.

For these transactions that Wave cannot create automatically, you will directly create a Journal Transaction, much as accountants have done for centuries. Of course, unlike in the paper-based past, your Journal Transaction will automatically be posted to the correct Ledgers, and immediately be reflected in updated Financial Statements.



So, what's relevant to you?

Know how to record a Journal Transaction in Wave

Most individual transactions in Wave are recorded automatically. For example, when you send an invoice, record a bill, or categorize an expense transaction from your bank account, Wave uses these source records and does all the bookkeeping for you.

But sometimes you'll want to directly record a transaction between two Accounts, and you'll do that using a Journal Transaction (we'll encounter journal transactions for the first time on page 65).

Know a little about the General Ledger

Although it's no longer pages in a big, leather-bound book, there's still the General Ledger – which is simply a listing of all the transactions you've ever made, organized by Account – right at the heart of Wave.

The list of all the accounts in your General Ledger is referred to as your **Chart of Accounts**, and you'll want to know how to add new Accounts to your Chart of Accounts, so you can use them in your bookkeeping.

Know that you'll never in your life have to Post a Journal Transaction to a Ledger

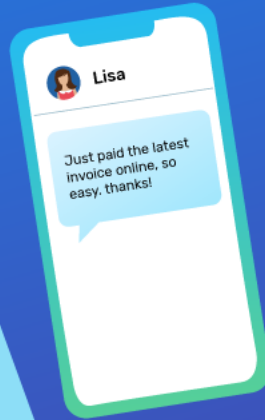
Unlike the old days of paper-based, manual accounting – when transactions were literally written in to Journals, then copied into Ledgers, then checked and aggregated into financial statements that you could use – everything now sits in a big database, ready for you to look at it from whichever angle you need.

Unless you're a member of a Period Accounting Re-enactment Society, you'll never need to manually post a Journal Transaction to a Ledger in your life!

Know that there were other Journals and Ledgers, but that you don't care!

Way back in the day, big businesses with tons of sales and purchases would use journals like the Sales Journal to record Sales, and then post them to special Ledgers, like the Sales Ledger. Periodically, the transactions in these ledgers would be totaled and posted to the General Ledger as a single amount for the period.

You don't need to bother with any of this, but if your accountant is talking to you about your Sales Ledger or Purchases Ledger, now you'll know what they're talking about!



PUTTING IT INTO ACTION

Weekly to monthly tasks



By the end of this section you'll know how to...

Pay and record payment of bills

Record payments for any bills that were recorded earlier in the period.

Run payroll

Review payroll and pay your employees.

Review aged receivables

Manage your overdue invoices to turn Accounts Receivable into cash

Reconcile bank account(s)

Reconcile your Wave transactions against those in your bank statement.



Record bill payments

The screenshot shows the Wave interface with a list of transactions. A dropdown menu is open for the 'Bill payment' transaction, showing options to categorize it. The transactions listed are:

Transaction	Date	Amount	Status
Bill payment	Jul 26, 2018	\$35.00	✓
Owner's draw	Jul 23, 2018	\$200.00	✓
Printer purch	Jul 23, 2018	\$300.00	✓
Transfer from	Jul 19, 2018	\$5,000.00	✓
Starting bal			

The dropdown menu for 'Bill payment' shows the following options:

- Choose a category ▼
- Search
- Transfer to Bank, Credit Card, or Loan >
- Payment Sent for a Bill in Wave >
- Refund Sent for an Invoice in Wave >

As you sit down each week or month to tackle paying bills, make sure that the same bills that you created earlier in the month are marked as 'paid' in Wave.

*Your **Dashboard** page will remind you of any overdue bills that still have to be paid.*

*Recording bill payments as soon as they occur will keep your **Accounts Payable** correct and up-to-date, and ensure you know what's available in your bank.*

There are two ways to record a bill payment in Wave:

1. Locate the imported payment transaction that your bank connection or transaction upload creates, and categorize it: **Payment Sent for a Bill in Wave**. This will bring up a list of any outstanding bills in Wave, from which you can select the appropriate one.
2. Record payment for the bill directly. Go to **Purchases > Bills**; identify the Bill you want to pay; and use the drop-down to the right of the Bill to select 'Add a payment'. (Tip: Remember to delete any duplicate transaction that your bank connection or imports may add later.)

Why not use 'Money in Transit'?

If you checked out the Help Center article linked on page 35 (how to use a **Money in Transit** account to track checks), you may be wondering why not do the same when you pay a bill? The answer is simply to be conservative:

When you receive a payment that will take time to reach your bank account, record it via Money in Transit so you don't temporarily over-state your bank balance.

When you send payment, it's best to assume it's gone from your bank right away, so you don't forget about it if your vendor sits on your check for a few days or weeks.



Run payroll

START Mon Aug 6 2018	>	END Sun Aug 19 2018 Edit	•	PAYDAY Sun Aug 19 2018 Edit
Your total payroll cost is \$2,602.52				
Everything looks good! This payroll is ready for approval.				
Review this payroll				

*Depending on the frequency with which you run payroll, find time a few days before your scheduled pay day to make any changes to your employees' hours, add to or deduct from pay, and review the payroll details before clicking **Approve this payroll**.*

Once a payroll is approved, a journal transaction will automatically be created to bookkeep the expense of the wages paid, as well as any employee reimbursements and payroll liabilities.

If you are using Wave's **Payroll Direct Deposit** service to pay your employees, set aside time to review and approve payroll several days before your actual scheduled pay day. This will give you sufficient time to make any changes and approve the payroll while leaving time for the Direct Deposit process to withdraw from your account and deposit into your employees' on the scheduled pay day.

When you approve a payroll with Direct Deposit in Wave, the system will automatically withhold local, state, and federal taxes from your employees' pay, record employer remittance amounts, and calculate any remittance amounts owed to the government.

Wave will also automatically bookkeep the expenses and liabilities from the payrolls that you run, so that they can contribute towards meaningful reports.

Payroll to-do list:

1. Complete timesheets for any hourly employees.
2. Add to or deduct from pay if you need to add any bonuses, commissions, benefits, or deductions.
3. Review each line of the period's **Payroll Details** and **Pay Stubs**.
4. Click **Approve this Payroll**.
5. Provide employees with pay stubs if they have not been invited to Wave.
6. When the payroll withdrawal transaction is imported, categorize it to **Payroll Liabilities** to show that the funds successfully went to your employees.

Tip: Go paperless by inviting your Employees to access their pay stubs and year-end paperwork directly in Wave. Just add their email address to their employee profile and click **Invite to Wave**.



Review aged receivables, and chase payments early

*Set up your invoices so there's less chance of them becoming overdue, and make reviewing your **Aged Receivables Report** a part of your weekly routine.*

Reaching out to important clients for money can feel awkward, but your business's success and survival relies on cash coming in. Chasing payments the moment they become due trains your customers to pay on time, and keeps your cash flowing!

*Regularly reviewing your **Aged Receivables Report** is key to ensuring that you're on top of your due and overdue payments.*

BILLS YOU OWE	
INVOICES PAYABLE TO YOU	
Coming Due	\$738.50
1-30 days overdue	\$347.45
31-60 days overdue	\$186.23
61-90 days overdue	\$53.68
> 90 days overdue	\$0

Nobody wants to feel like they're hassling clients. Wave provides two convenient tools to help you face this challenge less often:

Invoice reminders

When you send an invoice in Wave, click the **Payment Due** field to set the due date.

After clicking **Save and Continue**, you'll see a menu with options to send reminders before, on, and after the invoice due date. Set reminders now, so you don't forget later.

You can also send a reminder at any time after an invoice has been sent by navigating to your **Invoices** page, and clicking the **Send Reminder** link next to any overdue invoices.

Saved cards and recurring payments

When your customer pays an invoice online via **Payments by Wave**, they're invited to save their payment card and authorize you to charge it for future invoices.

If a customer is overdue, check if they've saved a card – and don't be afraid to use it. It's there because they gave you permission!

If your business provides a repeating service, you can set up automated recurring invoices and ask customers to save their cards to enable automated recurring billing.

Go to **Sales > Recurring Invoices** to get started.



If you do let a couple of invoices get away from you and they become overdue. As soon as you sign in to Wave, a list of all of your overdue invoices will appear in the **Dashboard** page. The option to send a reminder will appear right next to any overdue amounts.

You can also get a better idea of how much money is expected to come in by generating an **Aged Receivables** report in the **Reports** page.

Your **Aged Receivables** report will give you a breakdown of the payments that are expected to come in per customer, as well as the overdue amounts for each customer, organized by the number of days by which they are overdue.

Tip: Before getting a hold of any customers with outstanding payments, be sure to check the customer's profile to see if you have their saved credit card information. If so, go ahead and apply a payment!

	Not Yet Overdue	Number of Days Overdue				Total Unpaid
		30 or Less	31 to 60	61 to 90	91 or More	
Dan Sidhu		\$900.00 2 invoices				\$900.00 900.00 overdue
D'arcy Hamilton			\$340.00 1 invoice			\$340.00 340.00 overdue
Larry Knowles			\$3,500.00 1 invoice			\$3,500.00 3,500.00 overdue
Total Unpaid	\$0.00 0 invoice	\$900.00 2 invoices	\$3,840.00 2 invoices	\$0.00 0 invoice	\$0.00 0 invoice	\$4,740.00 4,740.00 overdue

How to chase payments like a pro

Many business owners struggle with chasing payments. Here are some tips to help you chase payments like a pro:

- Use Wave automated reminders for a first reminder, but as soon as a payment is overdue, use the phone.
- Call earlier in the week; it's easy for customers to 'forget' a promised check as they head off for the weekend!
- You are calling for a specific commitment to pay on a particular date – ideally today!

- Whatever date your customer promises to make payment, confirm your discussion by email, and re-send your invoice from Wave.
- If a customer tells you a check's in the mail, ask for the check number as well as when it was sent so you can look out for it.
- Enable Payments by Wave, and ask your customer to pay online – right now. Try saying:

"You can pay this invoice online with a credit card. In fact, why don't I stay on the line now to make sure it goes through and you don't have any problems?"



Reconcile your bank account(s)

Account Reconciliation					What's new	Business checking
AUG 2018	Unreconciled	6,541.00 Statement Balance Ending August 31, 2018	VS.	5,665.00 Wave Balance Ending August 31, 2018	876.00 Difference	Reconcile
JUL 2018	Reconciled	5,165.00 Statement Balance Ending July 31, 2018	VS.	5,165.00 Wave Balance Ending July 31, 2018	0.00 Difference	View

On a monthly basis, reconcile your bank account against the transactions that have been recorded in Wave. Reconciling your bank accounts regularly is the single best way to ensure that what's happening in Wave matches what's happening in the real world.

It's also a key control that will quickly alert you if there are any unapproved charges being taken from your accounts!

Reconciliation comes down to checking the numbers in your accounting against your bank statement to make sure they match. If a transaction was recorded incorrectly, if you have a duplicate payment for an invoice, or if any other number of inconsistencies has occurred in your books, bank reconciliation is how you'll find out.

To reconcile a bank account in Wave, click **Accounting**, select the **Reconciliation** feature, and select an account at the top of the page. This will reveal a list of every month for which you have transactions with a status of either **Reconciled** or **Unreconciled**. Log in to your online banking page in a separate tab, and generate a statement for the month that you want to reconcile. Click **Start** and enter in the closing balance for the month. If the closing balance matches Wave's then you're all good!

If not, well, we've got some reconciling to do. Click **Reconcile** to reveal a list of the month's transactions. You're going to want to take a closer look at your bank statement for the month, checking each transaction that appears there against the transactions that appear in Wave, and making edits as needed. By the end of the reconciliation process, the closing balances of your bank statement should match with Wave's exactly.

Tip: When you upload a receipt or apply a payment to an invoice or bill, Wave will create an associated transaction on the **Transactions** page.

If you're importing transactions, you'll likely wind up with duplicate transactions. Go ahead and delete the bank-imported transaction, as the one created by Wave will contain more detail!



ACCOUNTING COFFEE BREAK #4

Your business over time





Profit & loss: Understanding your business over time



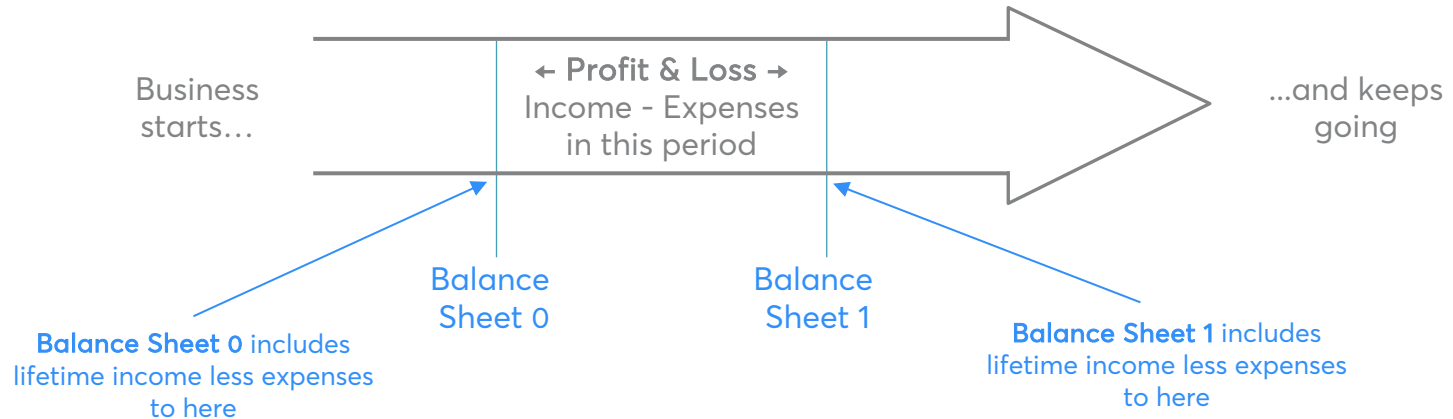
*As we explored the Accounting Equation, we saw that the Balance Sheet **always balances**, because it captures all the assets, all the liabilities, all the funding from owners and all the income and expenses from when the business started until right now.*

If we turn our focus to the Income Statement (aka the Profit & Loss Report), we aren't interested in just the total of our income and expenses from when the our business started. We want to see profit for a specific period: last month; last year; the first quarter.

Perhaps we also want to compare our profit this month to our profit last month.

Whereas the Balance Sheet reports what the business has, what it owes, and what's left over for owners **at a specific date**, the P&L reports the income earned **during a chosen period**, and the expenses incurred during that same period.

Let's see how these two views connect.



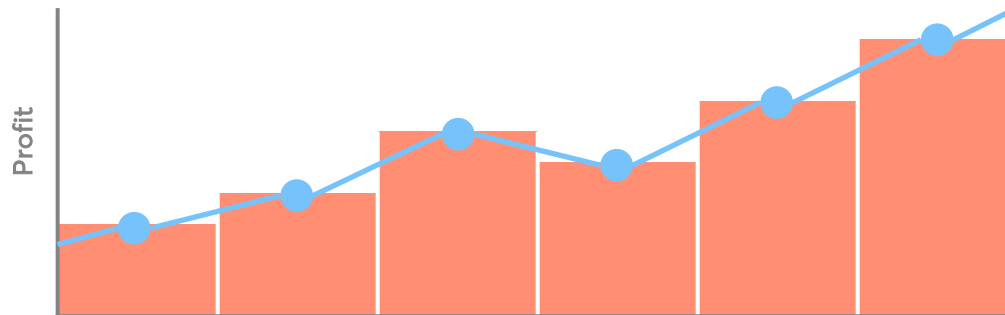
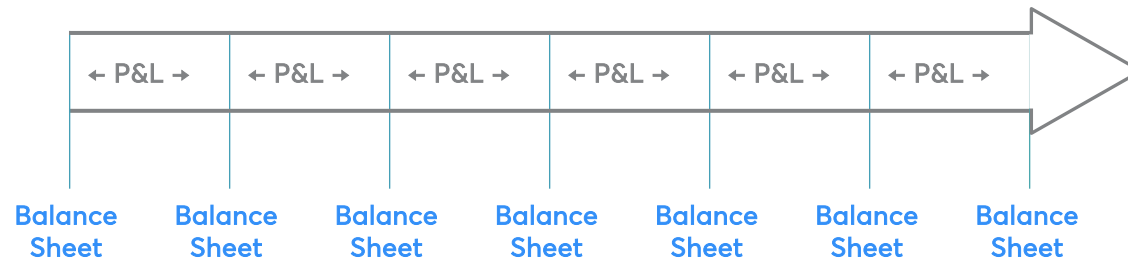
As you can see, the P&L for any period reflects all the income less all the expenses for that period, and 'bridges the gap' between a Balance Sheet at the start of the period, and a Balance Sheet as at the end.

This is of course what we should expect: the profit in the business belongs to the owners, so it adds to Retained Earnings within the Owners Equity section, i.e. the part of the Balance Sheet that belongs to the owners.

Assuming the owners didn't make any withdrawals, then this increase in Retained Earnings will have funded either an increase in Assets or reduction in Liabilities, or both.

Obviously, it is good to know that we are making profits, but often what you *really* want to know is how your profits are changing over time. This is why - although your tax authority only requires you to calculate and tell them your profit once each fiscal year - most business owners like to look at their P&L report on a regular monthly basis (or even more often) to see if things are getting better or worse.

This means running regular P&L reports, and comparing them over time.



Tip: Tracking profit month-to-month is a great thing to do (and who doesn't like a profit line that goes up and to the right?), but you can get much more out of regularly comparing your P&L reports than this.

In the section on Interpreting your Financial Statements (which starts on page 87), we'll go through some really helpful techniques that you can use with your P&L reports from Wave.



Accounting basis: Accrual for understanding; cash for taxes

If you only look at your Income Statement once a year, it is pretty clear which financial transactions relate to that year. But as you narrow the time period of your accounting down to monthly - and as you hope to gain useful under-standing of how your business is changing month-to-month, determining

which month any transaction relates to may require a bit more care.

There are two main, accepted methods of assigning transactions to periods: the **Accrual** method, and the **Cash** method.

Let's look at the differences, using a simple example:

Jenny is a successful marketing consultant. In March, she completed a major project for a long-standing client. The project started and completed during March, and all the work was done in that period.

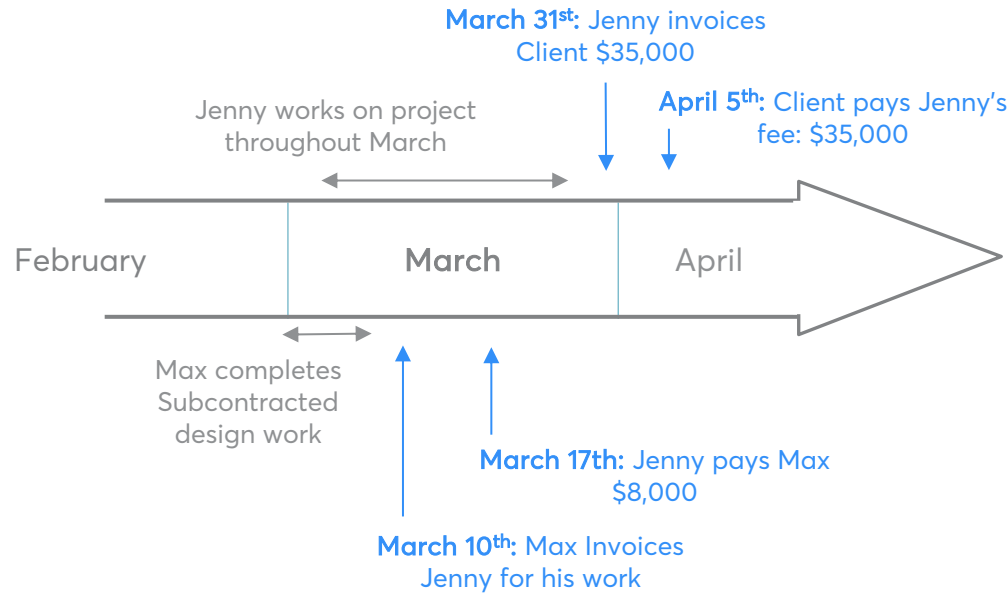
On March 31st, she invoiced her client her \$35,000 fee.

The opening stages of the project had required some graphic design work that Jenny didn't have time to do herself, so she had contracted Max to handle that part of the project. Max completed the work really quickly, and invoiced Jenny his \$8,000 fee on March 10th. Jenny paid it one week later - on March 17th.

Jenny's client was delighted with the project, and paid her promptly within 1 week, on April 5th.



*Let's look at this on a timeline,
and explore the accounting...*



On a **Cash** basis, Jenny would recognize the revenue from the project in April, when her client paid. She would recognize the cost of Max's sub-contracted design in March, however, because that's when she paid him. If this were her only project, the top of her P&L would look like this:

ACCOUNTS	MARCH	APRIL
Income		
Project Sales		\$35,000
Cost of Goods Sold		
Subcontracted Design	\$8,000	
Gross Profit (Loss)	(\$8,000)	\$35,000
Gross Profit Margin	N/A	N/A



Clearly, something's not quite right. Jenny's business hasn't swung from tragic loss to glorious profit in the space of a month: there's just a confusion created by splitting the income and expense into separate months.

By comparison, on an **Accrual** basis, Jenny would recognize the revenue from the project in March, when it was done and invoiced; and the expense to Max in March as well, when she incurred that expense. If this were her only project, the top of her P&L would look like this:

ACCOUNTS	MARCH	APRIL
Income		
Project Sales	\$35,000	
Cost of Goods Sold		
Subcontracted Design	\$8,000	
Gross Profit (Loss)	\$27,000	
Gross Profit Margin*	77%	

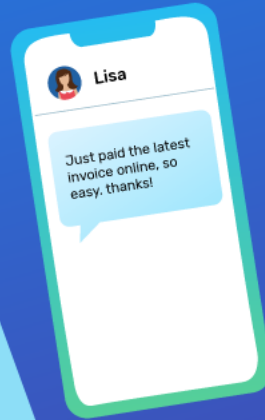
*** Gross Profit Margin**
measures the proportion of Sales that remain after paying for Cost of Goods Sold to cover general business expenses and provide profit to owners.

As this demonstrates, the Accrual basis better shows what *really* happened in Jenny's business: she completed a \$35,000 project in March with \$8,000 of costs, resulting in a \$27,000 profit. Her Gross Profit Margin was 77%. Pretty good!

In general, accounting on an **Accrual Basis** provides a much better platform to understand, and better manage your business. The vast majority of business owners in North America, however, are required to report and pay taxes on the **Cash Basis**, which has the advantage that the government isn't asking you to pay tax on work you have not yet been paid for.

This leads many small businesses owners to believe they should run their accounting on a Cash basis, but this is not the case. Accounting on an Accrual basis gives a much clearer and more actionable understanding of your business throughout the whole year, and adjusting your Year-end numbers to Cash basis to file taxes is quick and easy. The reverse is not the case.

The primary purpose of accounting is to understand your business and be more successful every day, not to file taxes once a year!



PUTTING IT INTO ACTION

Monthly to quarterly tasks



By the end of this section you'll know how to...

<i>Report & remit sales tax</i>	Identify any taxes owed and correctly account for their payment.
<i>Record depreciation/amortization</i>	Accurately recognize how your assets contribute to your business over time.
<i>Expense business use of home</i>	Record and account for office space and services that you provide within your home.
<i>Re-phase income</i>	Match income made over time with the work and materials that went into it.
<i>Write off bad debt</i>	Record bad debt when customers don't pay.
<i>Track inventory</i>	Record the value of your inventory as it's purchased and sold.



Report & remit sales tax

<input type="checkbox"/>	Aug 15, 2018	Client dinner Business Credit Card	\$150.00	Meals and Entertainment	✓
<input type="checkbox"/>	Aug 1, 2018	HST payment Business checking	\$0.00	Choose a category ▼	✓
<input type="checkbox"/>	Jul 31, 2018	Printer paper - OfficeStore Business Credit Card	\$33.65 Harmonized...		
<input type="checkbox"/>	Jul 27, 2018	Created Transfer Business Credit Card	\$2,000.00		
<input type="checkbox"/>	Jul 27, 2018	Owner investment Business checking	\$5,000.00		
		Bill payment			

[More options](#)
Sales Tax Accounts
HST

If your business collects sales tax, one regular task you'll need to perform is calculating the net amount of sales tax you have collected on behalf of the government, and paying it.

Wave's Sales Tax Report will give you a breakdown of the tax you have collected, the tax you have paid on purchases, and the balance that you owe (or are owed).

Depending on where you're doing business, the size of your business, and other considerations, you may report and remit sales taxes on an accrual or a cash-basis.

The Sales Tax Report can be adjusted to display your taxes owed on an accrual or cash basis by setting the **Report Type** at the top of the page, so either way, Wave's got you covered!

Once the payment has been made outside of Wave, it can be accounted for through a simple transaction in the **Transactions** page.

Categorize the tax payment transaction under the name of the sales tax. The system will take into account if the transaction is a withdrawal or deposit in order to determine whether sales tax account's balance should be credited or debited.

Important: Sales Tax rules and reporting processes vary widely from country to country, and even within countries. Check with your tax authority, or consult an accountant where you do business, to make sure you understand your local requirements correctly.



Apply depreciation or amortization

To get the best picture of the true profitability of your business, you'll want to spread out the cost of high-value fixed assets such as vehicles or equipment over their useful life, so that you recognize a part of their cost against each month's income and see what it really costs to operate your business.

*The technical term for this is applying **depreciation**, or **amortization**. (Strictly, depreciation applies to tangible assets, and amortization to intangible, but you'll see the terms used interchangeably.)*

In the last Accounting Coffee Break, we saw how taking care that expenses and the related income that they contribute to earning were grouped together in the correct time period ensured Jenny's Income Statement (P&L) made sense and properly showed how her business was performing.

When a business acquires high-value assets that will contribute to help the business earn revenues over a long period, it wouldn't make sense to take all the cost as an expense when the asset is acquired. Instead, the purchase is originally accounted as buying an asset, and a portion of its value is charged as being 'used up' each month.

Think of it like this: if your business rented a delivery vehicle, you'd obviously record the

rental expense every month. If, instead, you are able to buy a vehicle for cash and "rent it from yourself", the profitability of your business isn't fundamentally different: you're still using a delivery vehicle every month, and should still charge the expense.

Here's an example: Let's say you bought a truck for \$34,000. You plan to keep it for 2 years, and estimate you'll be able to sell it for \$10,000 at the end of that time. That means that over 24 months, the business will 'use up' \$24,000 of value in the truck. If you're 'using up' \$24,000 in value over 24 months, it seems to make sense that you'd recognize \$1,000 in expense each month.

Let's take a look at how this can be accomplished in Wave...



How to record depreciation or amortization in Wave:

1. If you haven't done so already, record the purchase of the asset. (Follow the instructions on page 38 for how to categorize an asset purchase.)
2. Next, we'll want to add a Depreciation *Contra Asset* account.

Go to **Accounting > Chart of Accounts**. On the **Assets** tab, scroll down to **Depreciation and Amortization**, and click the **Add a New Depreciation and Amortization Account** link.

Sticking with our \$34,000 truck example, we might call this new account **Depreciation - Truck**.

Tip: In general, if you only have a few assets to depreciate, it can be easiest to have an account for each; if you have a great many, you'll probably be better off tracking their depreciation on a spreadsheet, and just recording a total for depreciation across all assets in one account.

3. Each month, create a Journal Transaction to **Debit** an account called **Depreciation Expense** and **Credit** the appropriate **Depreciation and Amortization** account.

Here it is for our Truck example:

Note: to create a Journal Transaction, go to **Accounting > Transactions**, and click the 'More' button at the top-right of the page.

Important: Depreciation is a **management accounting** concept, designed to fairly spread the cost of an asset across its useful life. Your depreciation calculations are 'correct' when they faithfully reflect what *really* happens in your business.

This depreciation is *not* what you use to claim deductions for your tax.

Governments also understand that assets should be expensed over their useful life, but rather than leaving it to you to calculate what's realistic, they create long and complex lists of rules. In the US, tax depreciation rules are defined under the **Modified Accelerated Cost Recovery System (MACRS)**. In Canada, businesses claim **Capital Cost Allowances**.

Deciphering all the rules and calculating your deductions under MACRS / CCA is one area where it is wise to consult a CPA in the tax jurisdiction where your business operates.



Expense business use of home

*If you've run your own business for some time, you may be accustomed to claiming a deduction for **Business Use of Home** in your tax returns. But have you considered that this is about more than just tax?*

In Management Accounting, the goal is to document and understand the true performance of your business. If your business relies on office space or other services that you provide within your home, then that resource is part of how your business operates, whether you document the cost or not. We suggest you document it.

Imagine your business operates from a rented office, costing \$1,000 per month. That feels like a pretty obvious business expense.

Imagine now that you had signed the lease personally, and that you pay the rent out of your own pocket. Is it still an expense of the business? Surely, yes. You would record this as an expense of the business, and either be reimbursed, or add the cost to your Owner's Investment balance to take out later, when your business can afford it.

When your business occupies space in your home, the situation is really not much different: you are paying personally for a resource that your business consumes to operate; you should record the expense, and be reimbursed, or credited for your Owner's Investment.

The screenshot shows a software interface with a list of transactions on the left and a dropdown menu on the right. The transactions list includes:

- ☐ Reimbursement for use of home Apr 18, 2018
- ☐ Invoice paym Apr 5, 2018
- ☐ Subcontracte Mar 17, 2018

The dropdown menu is open, showing a search bar with the text "offi" and a list of expense accounts:

- Office Expense (highlighted in blue)
- Office Supplies

There are two methods to recognize use of your home for business in your bookkeeping:

- If you actually reimburse yourself each month from your business account, simply categorize the expense as Office Expense; or
- If you don't reimburse yourself, post a monthly Journal Transaction to **debit** Office Expense; **credit** Owner's Investment / Drawings.

How much should you charge?

In your management accounts, you can charge whatever feels right. Using the same calculation that you apply for tax, however, will save time later.

Talk to your accountant, or research your local rules, to figure out what is allowed for tax where you are.

Expense business mileage



When you use your personal vehicle for business travel (just like when you use your home for business purposes, as we've just explored), it's a good idea to recognize this expense in your bookkeeping – whether or not you actually get reimbursed by your business at the time.

Of course, it could also be that your business directly owns or leases a vehicle, and you make some use of it in your personal life. In this case, you should again be bookkeeping in such a way that you and your business properly share the cost.

For *management accounting* purposes, there are three commonly used approaches to calculating and sharing vehicle expenses:

1. *For a vehicle that your business owns or leases:* directly record as expense all lease or depreciation costs, together with insurance; fuel; servicing; etc. Reimburse your business for personal use of the vehicle, based upon your share of mileage;
2. *For a vehicle that you own or lease:* record all your expenses of operating the vehicle, and assign a proportionate cost to your business based on mileage share; or
3. *Alternatively, for a vehicle that you own or lease:* charge your business a flat rate per mile, consistent with tax allowances where you are.

Pick one – don't mix methods!

There are two ways to bookkeep shared vehicle expenses:

- *If you/your business are directly reimbursing the other,* categorize the transaction in your bank account as Vehicle Expense (which should be categorized as a refund if you are reimbursing your business.)
- *If there is no reimbursement,* post a monthly Journal Transaction between Vehicle Expense; and Owner's Investment / Drawings.

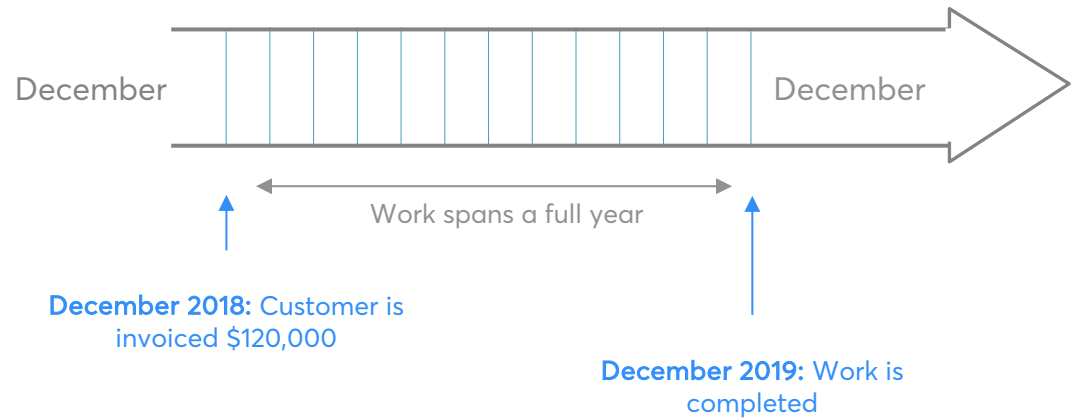
How much should you charge?

For a vehicle you own, the simplest way is to charge a cost-per-mile that matches the tax deduction for business use of your vehicle.

For a vehicle your business owns, go with the actual expenses and pro-rate according to mileage. Just know that come tax time, different rules may apply.



Re-phase “lumpy” income



When you create an invoice for work that will take place (or has taken place) over an extended period, it's good practice to spread the income out over the months in which the work is done.

This will allow you to match the income with the work and materials that go into it.

Heads up: the word “lumpy” isn’t accountant-speak for anything! We’re using it here to describe income that is invoiced all at once but earned across several periods.

Let’s say you invoice a customer \$120,000 for a project in December, that will take a full year to complete. In this scenario, your profit and loss statement for December is going to look pretty darn impressive, but really, the work will be ongoing until the following December.

Common sense tells us that, if we want our accounting to show us what’s *really* happening with our businesses, we need to take this ‘December-this-year’ income and spread it out over the period we’ll actually be delivering the project.

This can also work the other way around. Suppose you have a good customer whose credit-worthiness you trust, and you deliver a project for them over two months, invoicing at the end.

Suppose also this project is a large chunk of your total work in those two months.

In this case, taking all the income into Month 2, when you write the invoice, would distort your accounting: much lower income in Month 1 than you *really* earned; much higher in Month 2.

So, just as we might re-phase income *forward* when it is billed all at the beginning of a long project, we might re-phase *back* when it is billed at the end.



Re-phase income *forward* in Wave

Let's get the scenario clear: you have invoiced your customer \$120,000 in December. Wave has recorded \$120,000 of Sales, and balanced this with \$120,000 of Accounts Receivable – an Asset in your balance sheet.

(Perhaps your customer has actually *paid* for a year's work in advance, which would be awesome. From an accounting perspective, however, that just means you'd have the \$120,000 in the bank asset on your Balance Sheet, instead of Accounts Receivable.)

Now, you haven't actually *earned* the Income yet, so how can you reasonably have this Asset? The answer is that it is offset by an *obligation* – to deliver \$120,000 worth of service or products. And we record *obligations* as Liabilities. Let's go ahead and do this...

1. We'll need a liability account to track the obligation arising from the unearned income. Go to **Accounting > Chart of Accounts** and switch to the **Liabilities & Credit Cards** tab. Scroll down to **Customer Prepayments and Customer Credits** and click the 'add' link. Name the account "**Unearned Income**".

2. Right now, your December income includes \$120,000 for this project. You know that only \$10,000 *really* relates to work that you will complete in December – the rest is going to spread out over the next 11 months. More formally, \$110,000 is *unearned* as at the end of December, so that's what we'll record.

Go to **Accounting > Transactions** and click the **More** button on the top-right to add a journal transaction (dated in December):

Debit Sales \$110,000
Credit Unearned Income the same amount.

Edit transaction details

Description: Initial income adjustment

Date: 2017-12-31

Total: 110000.00

Debits	Credits
Sales	
110000	
	Unearned income
	110000

3. We've successfully removed the \$110,000 income that didn't 'belong' in December. Now we need to put it back in the next January through November. Add another journal transaction, this time for January:

Debit Unearned Income \$10,000
Credit Sales the same amount.

Repeat this step for each month of the year.

You're done! You've spread the December income to reflect when it is *actually* earned. On your Income Statements, you'll see a true picture of how your business is performing!

Edit transaction details

Description: Periodic income adjustment

Date: 2018-01-31

Total: 10000.00

Debits	Credits
Unearned income	
10000	
	Sales
	10000



Re-phase income *backwards* in Wave

Let's work this through, using the example of a \$20,000 project, with the work done equally in March and April, and invoiced on April 30th.

When you create the invoice, Wave records \$20,000 to April **Sales**, balanced by \$20,000 of **Accounts Receivable**. But we know that \$10,000 of the income 'belongs to' March.

Re-phasing income 'backwards' is – no surprise – the opposite process of re-phasing 'forwards'. But what accounts should we use?

When we recorded income that wasn't yet earned, we used a *liability* account that we called 'Unearned Income'. In this case, we are dealing with income that has been *earned* in an earlier period, but *invoiced* in this period.

So if it is income that was *earned* but not *invoiced*, why not call it '**Un-invoiced Income**'? And because this is something that will ultimately turn into cash in the bank, it must be an *Asset*.

1. Go to **Accounting > Chart of Accounts**. Scroll down to **Expected Payments from Customers** and click the 'add' link. Name the account "**Un-invoiced Income**".

2. The easiest way to think about this is probably to imagine our way back into March (the prior month – before the project was completed and invoiced).

As at the end of March, you had delivered \$10,000 of services and/or products; you had *earned* this income. But because you hadn't yet asked the customer for the money, it wasn't an Account Receivable, it was simply Un-invoiced Income.

Let's record that now; go to **Accounting > Transactions** and click the '**More**' button to add a Journal transaction dated March:

Debit Un-invoiced Income \$10,000
Credit Sales the same amount.

Edit transaction details

Description: March income adjustment

Date: 2018-03-31

Total: 10000.00

Debits	Credits
Un-invoiced income 10000	Sales 10000

3. We've successfully recorded that \$10,000 was earned in March, but Wave recorded \$20,000 Sales when you invoiced your client. **We're double-counting \$10,000!**

Let's fix this. Add another Journal transaction, dated April:

Debit Sales \$10,000
Credit Un-invoiced Income the same amount.

You're done! You have carried \$10,000 income from April back into March when it was *actually* earned. Your March and April Income Statements should now be much more realistic.

Edit transaction details

Description: Income adjustment reversal

Date: 2018-04-30

Total: 10000.00

Debits	Credits
Sales 10000	Un-invoiced income 10000



Write off bad debt

Add an Account

Account Type * Cash and Bank

Account Name * Undeposited funds

Even if you've been keeping on top of your sent invoices, inevitably there will come a time when it's necessary to write off bad debt.

Go through your overdue invoices on a monthly or quarterly basis and be honest with yourself about which payments you can reasonably expect to receive.

If you realize a customer is never going to pay, bite the bullet and write off the invoice.

You might guess that writing off a bad debt is as simple as posting a Journal Transaction to reduce **Accounts Receivable** and record a **Bad Debt** expense.

In a sense, that's perfectly correct, but we also want to make sure that the written-off invoice doesn't keep showing up in **unpaid invoices**.

In Wave, the only way to remove an invoice from the **unpaid invoices** listing is to record a payment, so that's what we're going to need to do.

OK – perhaps you're thinking:

"So... the way to handle an invoice that I know is never going to be paid, is to mark it 'paid'?"

Yes it is.

But bear with us, and in a moment this will all make a lot more sense...



Write off bad debt in Wave:

1. Because we're going to 'pretend' that the invoice we're writing off is paid, you'll need a 'pretend' bank account to deposit the payment.

Accountants often use an '**Undeposited Funds**' account as an intermediate step in recording transactions. We'll do the same.

Navigate to **Accounting > Chart of Accounts**. Click the **Add a New Cash and Bank Account** link, and call your new Account '**Undeposited Funds**' (or any other name that you'll recognize as just a 'pretend' bank account for special transactions).

2. Let's also create an expense account for your bad debt. Go back to the **Chart of Accounts** page and switch to the Expenses tab. Scroll to the bottom of the Operating Expense section, and click the 'Add' link to create a new expense account named **Bad Debt**.

3. When you know that you will not receive payment for a particular invoice, navigate to your Invoices page and apply a full payment to the unpaid invoice. Use **Undeposited Funds** as the payment account. Now the invoice is removed from your Overdue Invoices list, and its value is deducted from Accounts Receivable.

Record a Payment for this Invoice

Record a payment you've already received, such as cash, cheque, or bank payment.

Payment date: 2018-08-01

Amount: \$ 100.00

Payment method: Other

Payment account: Undeposited funds (CAD)

Memo / notes: Written off

Buttons: Cancel, Submit

4. Now, head over to the **Transactions** page and add a new expense transaction equal to value of the invoice that you are writing off. Set the account to **Undeposited Funds** and the category to **Bad Debt Expense**. You've now balanced out your **Undeposited Funds** account from the earlier invoice payment, and successfully recorded the bad debt expense!

Edit transaction details

Description: Bad debt write-off

Account: Undeposited funds

Date: 2018-08-01

Deposit or withdrawal: Withdrawal

Total amount: 100

Category: Bad debt

Buttons: Add vendor, Add customer, Include sales tax, Split this withdrawal

Tip: You can also apply this method to write off small differences – for example if a good customer paid the dollar amount of a large invoice, but missed the cents off their check. You're probably not going to chase the customer for the odd few cents, but you also don't want the invoice appearing forever on your Dashboard and in your Aged Receivables Report.



Track inventory

Add an Account

Account Type *	<div>Select one...</div>
Account Name *	<div><div>Q Search</div></div>
Account ID	<div>Inventory</div>

If you're running a service-based business, then you may not need to worry about tracking your inventory. For product-based businesses, however, it's important to consider whether purchases of raw materials and goods for resale are direct costs of sales in the same period, or whether they represent building up Inventory – an Asset on your Balance Sheet.

It is common practice, when creating an Income Statement, to report direct **Cost of Goods Sold (CoGS)** right underneath your Sales. Wave does this automatically.

CoGS is a special category of Expenses. It includes only **direct** costs, which go up and down with the level of your sales – things like the buy-in cost of an item you resell, or charges from sub-contractors that work on 'piece-rate'.

Sales less CoGS equals your Gross Profit, which is available to pay general business overheads, and you!

Sometimes, you'll incur direct Cost of Goods Sold expenses just as you need them. If you are drop-shipping, for example, every time you sell one item, you buy one item. The expenses and income match in the same period, and everything is clear and simple.

Other times, you may make a purchase that will enable many sales over months to come, and it no longer makes sense to record the whole purchase as a CoGS expense right at the time. In these cases you'll need to record the purchase as creating Inventory (an Asset on your Balance Sheet) and then cycle the Inventory asset into CoGS expense as it is used up.

Let's see how to deal with this in Wave.



Track inventory in Wave

Method 1 – “Perpetual”:

There are two common methods to account for Inventory: ‘Perpetual’ and ‘Periodic’. The Perpetual method is most suitable if your business makes relatively few, larger sales, where the inputs used up to deliver a sale are clearly identifiable.

The Periodic basis is more suitable when your business makes many individual sales, and it is not practicable to track the inputs used for each individual sale.

Let’s look at the Perpetual method – but if ‘Periodic’ sounds more like your business, feel free to skip to the next page!

1. We’re going to need at least one Inventory account. Go to **Accounting > Chart of Accounts**; scroll down to the **Inventory** section, and click the ‘Add’ link to add an account. For this discussion, we’ll name it **‘Inventory’**, but you may create specific accounts for different types of inventory.
2. Switch to the Expenses tab in your Chart of Accounts; scroll down to **Cost of Goods Sold**; and click the ‘Add’ link. We’ll just call this **‘Cost of Goods Sold’**, but again you may want to use a more meaningful name in your business.

3. Each time you purchase any inventory, such as finished goods for re-sale, or materials that you will use to deliver your service, categorize the transaction that appears in your **Transactions** page under the **Inventory** category that you just created. *You are categorizing the purchase as an Asset; not an expense!*

The screenshot shows the 'Edit transaction details' window for an 'Inventory purchase'. The description is 'Inventory purchase'. The account is 'Business checking' and the date is '2018-08-29'. The deposit or withdrawal is 'Withdrawal' and the total amount is '4500'. There is an 'Add vendor' link. The category is 'Inventory'. There is an 'Include sales tax' link. At the bottom, there is a 'Split this withdrawal' button.

4. Every time you make a sale, create a Journal Transaction that *debits* your **Cost of Goods Sold** account, and *credits* your **Inventory** account by the value* of the inventory you have sold or used up in delivering your service. Your Balance Sheet will reflect the decrease in your Inventory asset, and the Gross Profit on your Profit & Loss Statement will reflect the cost applied to the sale.

The screenshot shows the 'Edit transaction details' window for an 'Inventory sale'. The description is 'Inventory sale'. The date is '2018-08-31' and the total is '250.00'. The window is divided into 'Debits' and 'Credits' sections. Under 'Debits', 'Cost of Goods Sold' is selected with a value of '250'. Under 'Credits', 'Inventory' is selected with a value of '250'.

* Always record the **value** of Inventory at the purchase cost to your business; not the price you will sell it. If you purchase many different items, you will probably want to have multiple Inventory accounts, and/or keep a record of your purchases, the cost per unit purchased, and the inventory used for each sale, in a spreadsheet.



Track inventory in Wave Method 2 – “Periodic”:

Imagine you jumped on the Fidget Spinner bandwagon. You got a great deal on 5,000 fidget spinners for \$10,000 (\$2 each) – enough for 6 months’ sales. Under the Perpetual method, we’d be recording this purchase to Inventory, then posting a Journal Transaction to record CoGS on every sale – *all 5,000 of them!* That would be a ridiculous amount of bookkeeping, so instead let’s use the Periodic method.

1. Just like before, we’re going to need at least one **Inventory** account, and at least one **Cost of Goods Sold** account. Refer back to Steps 1 and 2 on the previous page for a reminder how to create these.
2. To apply the Periodic method, we’re going to want one more account: another Asset account, which we’ll call **‘Purchases’**. This account is most like Inventory, so go to **Accounting > Chart of Accounts**; scroll down to the Inventory section; and click the ‘Add’ link to add this new **Purchases** account.

3. Each time you purchase any inventory, categorize the transaction that appears in your **Transactions** page under the **Purchases** category. *Again, you are categorizing the purchase as an Asset!*

4. At the end of each month, it’s time to count what inventory you physically have left. You need to know what you have, and what it cost you to buy.
5. Now it’s calculator time:

	Closing inventory from last month
+	Purchases made during this month
-	Closing inventory from this month
=	CoGS during this month

6. Now we can post a month-end Journal. Let’s say we calculated that our CoGS for Fidget Spinner Sales in January was \$1,602; here’s our Journal entry:

This is the first Journal Transaction we’ve seen with three entries. What’s happening here?

- i. We record \$1,602 of CoGS
- ii. We reduce the value of Purchases to zero – do this every month
- iii. The difference represents an increase in Inventory since last month.



A third way to track inventory in Wave...

Don't bother!



Seriously. Before you spend a lot of time tracking and making adjustments for Inventory, consider *how much* this will impact your accounting.

We haven't talked about "materiality" yet, but we have stressed the idea that you keep accounts primarily to understand your business. So if the costs of things you sell or combine into your services are small, or even if the costs are large, but you buy and sell a consistent amount each month so that your inventory levels don't change much, then ask yourself: *"Does tracking inventory every month really help me better understand my business?"*

And if you answer "No", then simply categorize your purchases of items for resale and other direct costs straight to Cost of Goods Sold.

Does this mean we're saying don't bother with Inventory at all? Not quite – but if the fluctuations month-to-month aren't at all significant, then you'll probably be just as well off adjusting your inventory once each year – i.e. make sure your Inventory account is correct for your year-end Balance Sheet (reduce CoGS for any increase in Inventory, and vice versa), but otherwise save yourself the work.

Remember – you're accounting for *your* benefit, and time spent on accounting precision that is not material to your business is time wasted!



ACCOUNTING COFFEE BREAK #5

Understanding debits and credits





Understanding debits & credits



When you run your business with Wave, most basic bookkeeping is handled for you. For example, when you send an Invoice, Wave automatically updates your Income and Accounts Receivable accounts.

*In the previous section, we looked at special cases where you need to record an exchange between two accounts yourself, using a **Journal Transaction** to debit one account and credit another.*

This brings us to the nemesis of so many fledgling bookkeepers:

Debit/Credit theory!

Don't be afraid... Stick with us. We'll get through this together!

Debit/Credit theory is not a theory!

Right off the bat, let's get one thing out of the way: *Debit/Credit theory* is not a 'theory'. It is simply a naming convention.

As we discussed in Accounting Coffee Break #2, every transaction with or inside your business is an exchange between two accounts: one account gives value; one receives value.

In recording the transaction, we **credit** the account that gives value, and **debit** the account that receives value!

By convention, 'Credit' is abbreviated to 'Cr'; 'Debit' is abbreviated to 'Dr'.

Your bank Isn't trying to confuse you!

OK. We **credit** the account that gives value, and **debit** the account that receives value. So when a customer pays us \$1,000 and we deposit the money into the bank, we **debit** bank.

But when we see our bank statement, it shows a **Credit**. What's going on?

This is actually key to a really important understanding: all your bookkeeping is performed *from the perspective of your business*. So, when your business deposits money into the bank - i.e. 'bank' receives value - you **debit** bank.

But how does this transaction look from the bank's perspective?



If we flip things around and look at the same transaction from the bank's perspective, everything is reversed. When your business deposits funds, the bank sees your business as *giving* value (literally, you are lending the bank money!).

In any transaction, we credit the account that gives value, so the bank - in **its** bookkeeping - **credits** your business. And that's what shows on your statement.

This is the source of much confusion for business owners as they try to get their heads around bookkeeping for the first time, but hopefully once you understand the difference in perspective between your business and

your bank, it will not only cease to be confusing - it will actually help understand and remember the difference between debits and credits.

Let's summarize it this way:

When the bank receives value from your business (a deposit into *your account with the bank*), they **credit** your business' account. In your bookkeeping, you **debit** the bank's account with your business.

When the bank returns value to your business (a withdrawal from *your account with the bank*, or issuing your business a loan), they **debit** your business' account. In your bookkeeping, you **credit** the bank's account with your business.





Why some accounts get bigger with debits, and others With credits



At this point in explaining Debits and Credits, most accounting texts will present you with a table listing a set of account types that you *debit* to increase their value in a journal transaction, and a set that you *credit* to increase their value. They may offer a handy mnemonic that you are supposed to remember so that you will be able to recall these rules and get your journal transactions the right way around.

Let's skip that, and continue the work of *actually understanding* the core concepts, so that you'll never need to go look up a table, or remember what each letter in your 'easy-to-remember' mnemonic stood for!

Let's talk, instead, about **normal direction**, which reveals the underlying common sense (Can we say 'beauty'? No? OK, let's stick to 'common sense!') of the double entry method of capturing the exchange of value between two accounts in every transaction.

Most of the time – i.e. “normally” – in a well-functioning business, we'd expect to make **Sales**, which ultimately flow into **Bank**. Each time we make a sale, bank receives value (so we *debit* it); our Sales account gives value (we *credit* it).

So, the *normal direction* of bank is *debit*; the *normal direction* of Sales is *credit*. (Think back to the difference between your business' perspective of your bank account, and the bank's. The normal direction of your account *from the bank's perspective, which shows up on your bank statement* is hopefully *credit*!)

Let's generalize this:

Bank is an **Asset** account:

The *normal direction* of all **Asset** accounts is **Debit**.

Sales is an **Income** account:

The *normal direction* of all **Income** accounts is **Credit**.



Another source of funds into your business' bank – or other Asset accounts – will very likely be your original investment of **Owner's Equity**.

We already know that the normal direction of Asset accounts is *debit*, and indeed bank receives value in this original investment.

The account that gives value – *from your business' perspective: you are not your business!* – is you, i.e. Owner's Equity. So we *credit* Owner's Equity.

The *normal direction* of **Owner's Equity** is **Credit**

OK. That's Assets, Income and Owner's Equity. What types of account are we left with? Expense and Liability. Let's think about Expense.

In the normal course of things, we buy goods and services to consume in our business, and pay for them ultimately with money from our business' bank account. So, bank *gives value* (we *credit* bank); the relevant Expense account *receives value*, and we *debit* it.

The longer we are in business, the more in total we will have spent on each type of expense, so the more we will debit it.

The *normal direction* of an **Expense** is **Debit**.

Lastly, Liability. Let's say our business purchases a vehicle on finance. Our Motor Vehicles (asset) account receives value, so we debit Motor Vehicles (which is the normal balance direction for all asset accounts). The account that gives value in this transaction is the Detroit Motor Vehicle Finance Corp (DMVFC), which is a Liability account in our business' accounts. So we *credit* DMVFC.

Any time we create or increase a liability in our accounts, we credit it.

The *normal direction* of a **Liability** is **Credit**.

Whenever we record a transaction that increases the numeric value of any Account in our bookkeeping, we are increasing the value of that account further in its *normal direction*. Here's why:

- when we increase the value of an **Asset** or **Expense** account – that account *receives value* – so we **Debit** it.
- when we increase the value of an **Income**, **Liability** or **Owner's Equity** account – that account *gives value* – so we **Credit** it.

This explains why some accounts get bigger with debits, and others with credits. This is not an accounting 'rule' that you need to learn; it simply emerges from following the logic of tracking how accounts give and receive value *always from the perspective of your business*.

Accountants also refer to **Normal Balance**. If you perform a series of transactions in an account's *normal direction*, then it's balance will – naturally enough – lie in that direction. So, we can also say that the *Normal Balance* of Asset and Expense Accounts is **Debit**; the *Normal Balance* of Income, Liability and Owner's Equity accounts is **Credit**.



Why total debits must equal total credits

Hopefully we've already cemented in your mind the idea that none of this debit / credit business is anything more than applying labels to the very obvious and logical process of recording which account gives value in each transaction (credit it!), and which account receives value (debit it!).

But we're just geeky enough at Wave to think the way accounting works is actually kind of cool, so if you have a spare few minutes, stay with us to explore - at a deeper level - why this works, and why the accounting 'rule' that total debits must equal total credits in every transaction has to be true.

If you remember back to Coffee Break #2, we spent some time thinking about all the places money could come from in your business, and all the places it could go to. We started with this...

Assets	=	Owner's Investment	+	Lifetime Income	+	Liabilities	-	Lifetime Expense	-	Owner's Withdrawals
All the money and value of 'things' in the business today		What owners have put into the business since it started		All the income the business has ever earned		What other people have provided to the business, and are owed right now		All the expenses the business has ever incurred		What the owners have taken out of the business since it started

...and worked our way through to discovering for ourselves the simple principle that accountants call the **Accounting Equation**:

Assets	=	Liabilities	+	Owner's Equity
All the money and value of 'things' in the business today		What other people have put into the business, and are owed right now		Owner's Investment, together with Retained Profits



Let's go back to that simple first observation, and rearrange the formula in a slightly different way by adding Lifetime Expense to both sides, and grouping Owner's Investment less Owner's Withdrawals together as we did before:

Assets	+	Lifetime Expense	=	Liabilities	+	{	Owner's Investment	-	Owner's Withdrawal	}	+	Lifetime Income
All the money and value of 'things' in the business today		All the expenses the business has ever incurred		What other people have put into the business, and are owed right now			What owners have put into the business since it started, less what they've taken out					All the income the business has ever earned, less all its expenses

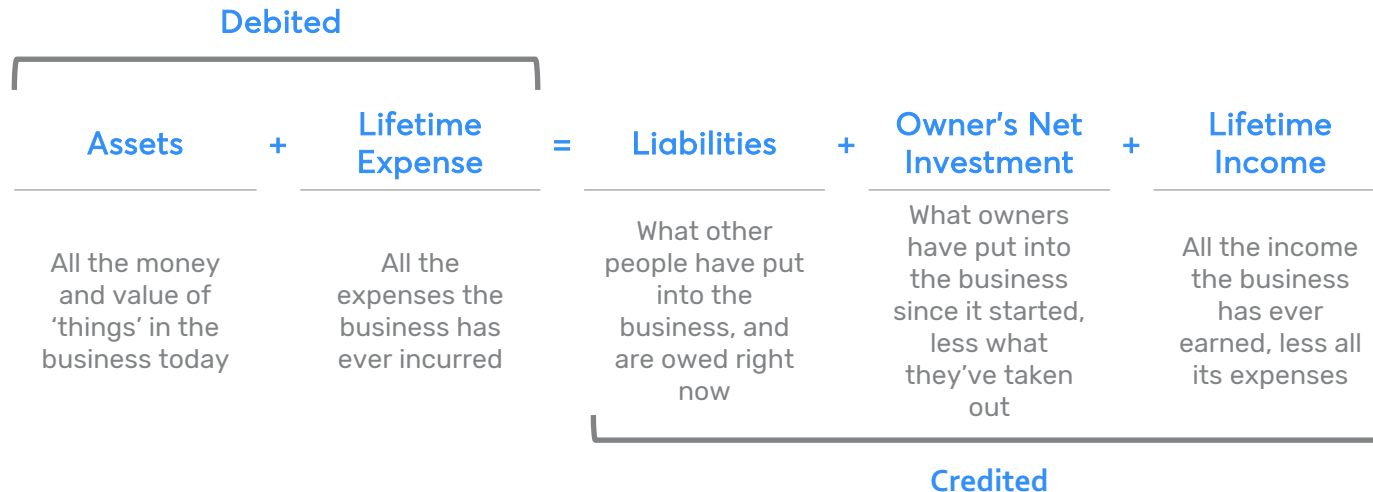
As we did last time, let's simplify Owner's Investment less Owner's Withdrawals simply to Owner's Net Investment, so we have this - let's call it the **Accounting Flows Equation**:

Assets	+	Lifetime Expense	=	Liabilities	+	Owner's Net Investment	+	Lifetime Income
All the money and value of 'things' in the business today		All the expenses the business has ever incurred		What other people have put into the business, and are owed right now		What owners have put into the business since it started, less what they've taken out		All the income the business has ever earned, less all its expenses



Cool. But what does it all mean?

Let's look at that again:



As you can see, we have **Asset** and **Expense** terms on the left; **Liability**, **Owner's Equity** and **Income** terms on the right.

Now, this equation is like any equation: to keep it in balance, changes on the left of the equal sign must be matched with changes on the right.

So, if a transaction increases an Asset account by, say, \$100 (the Asset account *receives value* and is therefore debited) this *must* be matched either by a reduction on the left - reducing (crediting) another Asset account, or reversing a charge to an Expense account - or more commonly by a matching \$100 increase on the right, crediting the 'giving' account(s), which will be a Liability, Owner's Equity, or Income account.

Conversely, a transaction that reduces the value of an Asset or Expense (credit), must be matched by an equal increase (debit) to another Asset or Expense account, or by reducing (debit) a Liability, Owner's Equity or Income account.

We know that every accounting transaction involves an exchange of value, expressed as a Debit and a Credit. Having worked through the logic of where money can possibly flow into, through or out of a business, it hopefully becomes clear that to keep our formula in balance, **total Debits must equal total Credits** in every transaction. This is not an arbitrary accounting 'rule'; just the natural consequence of a realization that money, like energy, is neither created nor destroyed - only transformed.



The least important thing to know about debits and credits

Now that you know everything you need to know about Debits and Credits, let's take a look at something you don't!

When accounting journals were updated by hand, accountants developed a convention to always write the two sides of the transaction in a particular order.

Looking at the equation on the previous page, perhaps you might guess they would always write the side of the transaction that deals with Assets or Expenses on the left, and the side that deals with Liabilities, Owner's Equity or Income on the right.

That would work for many, or even most, transactions, but what about a transaction that transfers value between two accounts on the same 'side' – for example receiving a customer payment that reduces (credits) the Accounts Receivable asset account and increases (debits) the bank asset account?

Which would go first?

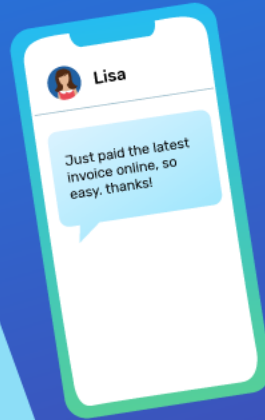
Well, accountants are a fairly logical bunch, so adding in our understanding of *Normal Direction / Normal Balance*, you might guess the solution they arrived at: place the account that is Debited on the left, and the account that is Credited on the right. In other words, for a 'normal' transaction, involving one account from either side of the "Accounting Flows Equation", where each is increased, the Debited account *will* be from the left side of the equation, and the Credited account from the right.

This gives rise to...

The least important thing to know about debits and credits

... but something that many accounting texts stress as the key take-away: in a Journal Transaction, Debit written is on the left; Credit on the right.

Of course, using an accounting software such as Wave, you can enter your debits and credits in whatever order you please: Wave will sort out displaying these in your reports in a way that makes your Accountant happy!



ANALYZING YOUR BUSINESS

Interpret your financial statements



By the end of this section you'll know how to...

Analyze your financial statements

Read and interpret your Balance Sheet and Income Statement (Profit & Loss Report) to get meaningful insights for your business.

Calculate the quick ratio

Can your business pay off its current liabilities with its current liquid assets?

Calculate break even sales

Determine the exact point at which your business will make neither a profit nor a loss.

Explore trends in your numbers

Note trends month-over-month to give you the information you need to continue driving your business forward.

Make forecasts

Use previous periods' numbers to forecast your business' cash flow and help anticipate its financial needs.

Analyzing your financial statements



Right from the beginning of this guide, we have stressed that the primary purpose of keeping accounts is to understand your business and be more successful.

So now let's dive in and look at some of the insights you can gain from analyzing the financial statements for your business.

***Tip:** You can do this work as often as you choose, but we'd suggest setting aside some time each month for analysis, which also allows you to look at trends in your business over time.*

Over the next few pages, we're going to dig into the Financial Statements – your Balance Sheet and Income Statement (P&L) – and see how with a few simple calculations, they can yield useful information about how your business is performing.

Just so that we don't have to keep saying "now open up your Balance Sheet" or "run your P&L", let's go ahead and grab both those reports now.

Run both reports for the month just ended (or other period you're analyzing), and print them off so they are handy.

Balance Sheet

Go to **Reports > Balance Sheet** and set the date picker to the last day of the period you are analyzing. Click **Update Report**, and switch the 'toggle' from Summary to **Details**. Print the report.

Profit & Loss (Income Statement)

Go to **Reports > Profit & Loss** and set the two date pickers to the first and last days of the period you are analyzing. Again, click **Update Report**; switch the 'toggle' to **Details**; and print.

Tip: As well as printing your Financial Statements, click the 'Export' button and save each as a .CSV file, which will allow you to use the numbers in a spreadsheet.

Review the balance sheet



We've seen before that the **Balance Sheet** reports **Assets**, **Liabilities** and **Owners Equity**, but if you look at your Balance Sheet now, you'll notice it has a little more structure than that.

Your Wave Balance Sheet separates **Assets** into **Cash and Bank**; **Other Current Assets**; and **Long-term Assets**.

Current Assets (which include Cash and Bank), are resources that you expect to turn into cash in the relatively short term - certainly under a year. So in addition to physical cash, your business' Current Assets include bank accounts, money owed to you by customers, and products available for resale (and potentially many other things).

Long-term Assets are things that you use in the business, and wouldn't normally expect to turn into cash in less than a year: office equipment; vehicles; tools; etc. You *could* sell them for cash in an emergency, but then your business would be missing things it needs to operate.

Liabilities are also broken out, into **Current Liabilities** and **Long-term Liabilities**.

Current Liabilities are pretty much the reverse of Current Assets: obligations that your business is going to need to settle in under a year (usually much less than that!). Examples include short term debt such as credit card balances; money owed to suppliers; and payroll and tax liabilities.

Long Term Liabilities are (no surprise here!) obligations that you will pay back in the long term, which is considered to be beyond 12 months. A 5-year fixed term loan from the bank, or credit finance on a vehicle, would be examples of Long Term Liabilities.

Current and Long-term Assets and Liabilities are separated out for a simple reason: it allows you to see at a glance what you have in ready cash, and assets that turn into cash in the short term, to pay obligations that are also due in the short term.

What does your Balance Sheet show?

Review the income statement (P&L)



If you remember back to the first Accounting Coffee Break, the basic function of the **Income Statement** should be familiar to you.

It simply shows the income that your business has earned during a particular period, less the expenses incurred in the course of generating that income.

If the amount of income was greater than the amount of expense, your business made a profit; if expenses were more than income, your business turned a loss!

Just as the Balance Sheet is normally presented with a little more structure, it's normal to see the Income Statement broken up as follows:

PROFIT & LOSS
Income (Revenue)
- Cost of Goods Sold
= Gross Profit
(Gross Profit %)
- Operating Expenses
= Net Profit
(Net Profit %)

The Income Statement separates out Costs of Good Sold (CoGS) from other expenses, so that you can clearly see the Gross Profit that your business generates from operations.

Gross Profit is the amount available to fund your business' regular overhead expenses, and provide a profit for you, the business owner.

Calculate the quick ratio

$$\frac{\text{current assets} - \text{inventory}}{\text{current liabilities}}$$

When we looked at the structure of the Balance Sheet just now, we mentioned that both Assets and Liabilities are separated into Current and Long-term, allowing you to see at a glance how well your Current Assets cover your Current Liabilities.

*The quick ratio (also commonly referred to as the **acid test ratio**), provides another lens to look at this question.*

Calculate the quick ratio for your business on a weekly or monthly basis to get a snapshot of your business' health that can be tracked over time.

"Quick" in this case doesn't refer to the speed at which the ratio can be calculated (although this will be a pretty simple ratio to calculate). Instead, we're using the archaic meaning of "quick" which is "alive."

This gives us a framework to use when thinking about the quick ratio: it is a pulse check for your business.

Subtract any Inventory (a relatively difficult asset to convert to cash) from your Current Assets, and divide the resulting number by your current liabilities. "Current" here excludes any long-term liabilities or long-term assets that appear in your balance sheet.

The quick ratio gives you a number that indicates whether or not your business can pay off its current liabilities using its current liquid assets (cash, and any asset that can be easily converted into cash).

In general, most businesses should **aim to have a Quick Ratio of 1 or above** – meaning all Current Liabilities can be paid from Cash and near-cash assets.

If your Quick Ratio is significantly below 1, look deeper at the composition of your Current Liabilities: 'Current' is a fairly broad definition, so thinking through which liabilities could actually need paying in the short term – and perhaps unexpectedly, for example if your bank calls a loan – will help you better decide if your business is facing some liquidity risks.



Calculate your break-even sales

operating expenses (overhead) gross profit margin

New businesses often require a few months to generate enough sales to begin to turn a profit every month. If you're in this situation, knowing what level of sales you need to break even gives to a target to aim at, and to beat.

If you're past this stage and making profits on a regular basis, it's still useful to know how far past break-even you are. This tells you how secure your profitability is, and also helps if you're thinking about taking on more regular expenses to grow your business.

As noted before, your Income Statement (P&L) shows your Sales, and your Gross Profit after deducting Cost of Goods Sold. Gross Profit is the amount available to pay the fixed, general overheads of your business, and hopefully deliver a profit. (In fact, Gross Profit is sometimes called "Contribution to Overhead".)

Dividing your Operating Expenses by your Gross Profit Margin (both shown on your Income Statement) gives you a quick idea of how much your business needs to sell to exactly break even, i.e. make neither a profit nor a loss. For example, if your business has general expenses of \$10,000 per month, and your Gross Profit Margin is 40%, your break-even point in Sales is:

$$\$10,000 \div \frac{40}{100} = \$25,000$$

If your business isn't making \$25,000 a month in sales, can you get there soon enough, or should you be reviewing your expenses?

Let's say your business is already profitable, with \$30,000 in Sales. How secure are you? Well, if your Sales next month come in \$5,000 lower, with the same Gross Profit Margin and same Operating Expenses, you'd be back to break-even, so the amount of sales you can stand to lose before making a loss is:

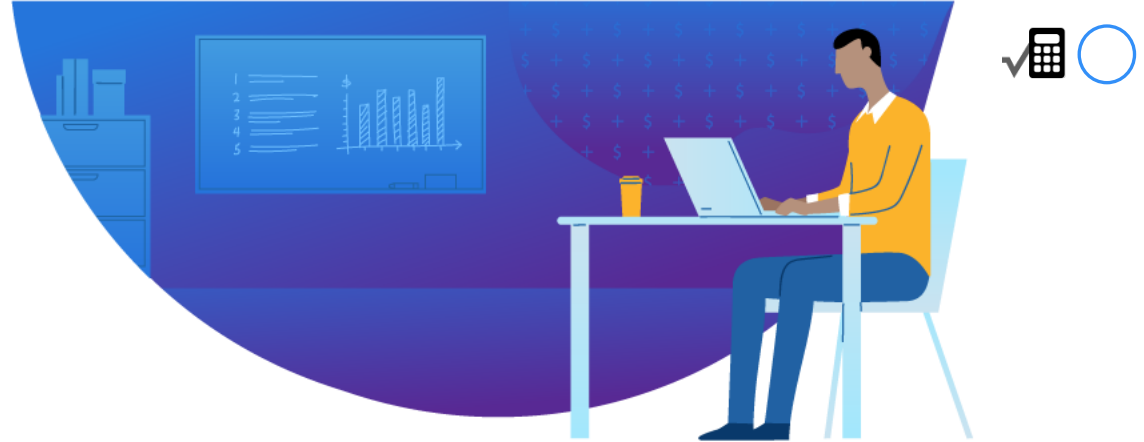
$$\frac{\$5,000}{\$30,000} \times 100 = 16.7\%$$

This gives you an idea of the 'safety margin' in your business' current performance.

Break-even analysis relies on some important assumptions: including that your Operating Expenses and Gross Profit Margin remain consistent as you move from current sales to break-even sales.

Take some time to think about your business. Are your Operating expenses fixed, or do they actually vary with Sales. Can you improve your Gross Profit Margin? What else can you change?

Explore trends in your numbers



So far, we've looked at reviewing financial statements for a single period. To get the most from your reporting, however, it's important to track trends in your business month-over-month.

When you're busy, it's easy for change to creep up unnoticed. This is a particular risk when things seem to be going well: If you're having your busiest ever month ever, it's easy to miss that gross profit margin is slipping, customers are paying more slowly, or costs are rising unchecked! Reviewing your financial statements every month and tracking trends will ensure you are not blind-sided, and that you have the information you need to drive your business forward.

As you print out your financial statements each month, look back at previous months to see what's changing.

Grab a pen and make notes of any significant increases or decreases from previous months. Think about what you're seeing, and make notes of your conclusions, or special factors that explain the numbers.

For example, you might note: "Offered 10% discount to win big Acme Widgets sale. Hit Gross Profit Margin. ☹"

Tracking **percentage** changes is also helpful. Pick the largest components of your Balance Sheet and Income Statement, and calculate the percentage change from last month to this month. Are your numbers moving together, or diverging? For example, if your Sales are growing 10% month-over-month, but Accounts Receivable are growing 30%, that is something to check out!

Of course, paper and pencil records have their limitations, and this is the 21st century! The best way to track trends is to take your monthly exports of your Balance Sheet and Income Statement and build a spreadsheet of month-by-month numbers.

Add your % change analysis, and use your spreadsheet's charting capabilities to build trend graphs of significant numbers so that you can visually track how your key metrics are moving over time, and in relation to each other.

You've maybe heard the saying: What gets measured, gets managed. Over the page, we suggest a few metrics that many businesses track month-to-month, but the key is to figure out what's important to manage in your business, and measure that!



Income (Revenue)

Total Income, straight off your Income Statement. Is it growing month-over-month? Are there seasonal peaks and lows?

Quotations / Estimates Issued

Think about your Sales cycle. What predicts income 1 – 3 months down the road? For some businesses it will be Quotations / Estimates issued. For others it may be inquiries from their website. Figure out what predicts future income in your business, and measure it!

Pending Orders / Bookings / Utilization

If your business has fixed costs and capacity, such as a permanent team of technicians, or property to rent out, how many days' full utilization will current orders fill? Do you need more Sales?

Customer Concentration

How much of your Income came from which customers? How much would losing your top customer hurt your business? Are your Sales becoming more concentrated on your top customers, or less? (Check the **Income by Customer** report.

Gross Profit Margin

Are you giving up margin to grow total Income? Would you be better off growing more slowly with better-paying customers?

Net Profit

After covering Operating Expenses, is your Net Profit increasing or decreasing?

Is it increasing faster or slower than the rate your top-line Income is increasing? If slower, where is your rising income being consumed? What can you change?

Quick Ratio

Is your business able to cover its short-term liabilities from cash and assets that turn into cash in the short term? Is this stable over time, or moving up / down?

Accounts Receivable (AR)

AR is cash in your customers' bank accounts, that could be cash in yours! If AR is growing faster than income, are you spending enough time on collections?

Overdue Portion of AR

Check your **Aged Receivables** report, and note what proportion of total AR is outstanding longer than your terms permit. Act fast to chase overdue balances.

Bad Debt % of Previous Month's AR

Track how much of the *previous* month's AR you must write off each month to get a basis for estimating future bad debt losses. Can you improve it?

Inventory

If you are tracking Inventory, how is the total value changing over time? If Inventory is increasing faster than Income, do you need to check you are holding the correct items that current sales require, or could you adjust your average order size to keep inventory levels under control?

Forecast your cash flow



Tracking trends in your business gives you priceless insight to how your business has been performing over time.

But trying to manage your business by looking at your accounting history can be a bit like trying to drive by looking in the rear-view mirror. We need to look forward, too!

The single most important way to "look forward" is to forecast your cash. Every day, businesses that are making sales, serving happy customers, and even operating profitably, go out of business – simply because they run out of cash.

Don't be one of them!

Like all accounting software, Wave is a tool for tracking what *has* happened. Now, we want to think about what's *going to* happen. It's time to step out of Wave, and fire up a spreadsheet.

To help you build a good forecast for your business, we've put together a [Cash Flow Forecast Template spreadsheet](#) that you can download and complete.

This spreadsheet has been built using Microsoft Excel, but if you don't have access to Excel, you will also be able to open it using Google Sheets, which is available for free, or for a small fee as part of Google's G Suite.

We'd recommend creating a new forecast each month (or even weekly, if cash is tight), and checking regularly to see how accurate your forecasts are, so you keep getting better at predicting your cash flow.

As you build your Cash Flow forecast, you'll need to refer to data from Wave for your starting balances, and also to guide you on suitable amounts to estimate for your various expenditures. So get ready by creating and printing or exporting the following reports:

1. Income Statements for several recent periods.
2. Cash Flow Report for several recent periods.
3. Aged Receivables Report.
4. Aged Payables Report.
5. Balance Sheet.

Download the template from
<http://bit.ly/wave-cash-flow-forecast>

Year-end accounting



By the end of this section you'll know how to...

<i>Bring your record keeping up to date</i>	Check all the boxes to make sure that your financial year's books are complete.
<i>Review personal/business transactions</i>	Ensure that any instances where a personal account was used to pay for a business expense (or vice versa) are recorded properly.
<i>Correct loan balances and interest expenses</i>	Adjust loan and interest expense balances to match your lender's Year-end statement.
<i>Recognize un-invoiced income</i>	Account for work that you've performed that hasn't been invoiced.
<i>Record unearned income and customer prepayments</i>	Match payments that you've received with the work you'll be doing in the next financial year.
<i>Recognize unbilled expenses</i>	Record expenses that your business has incurred, but have not yet been paid for.
<i>Record prepaid expenses/vendor prepayments</i>	Account for products & services that you've paid for, but haven't received yet.
<i>Check and adjust inventory</i>	Take stock of, and record any loss of valuation in your inventory.

Finalize your year-end



Year-end marks the point where having kept on top of your Management Accounting throughout the year pays dividends in streamlining and simplifying the financial accounting processes needed to report and calculate taxes.

If you've been following the Weekly to Monthly and Monthly to Quarterly bookkeeping steps set out in this guide, completing your Year-end financial statements is going to be pretty straightforward. If you haven't... don't worry – we'll take you through everything you need to do!

Year-end is a significant landmark in the accounting lifecycle of your business.

Significant because – in most of the world – it is when you need to gather and report information in specified formats for tax purposes, but also because the end of a full year is when we naturally want to pause to compare performance with the year before, and plan the year ahead.

Importantly, for businesses that are at all seasonal, comparing performance on a year-to-year basis averages out seasonal impacts and lets us see the underlying growth trends. So, even if you are already tracking your business performance on a monthly basis, Year-end is a great time to make comparisons on an annual basis too.

Completing Year-end accounting essentially involves two steps:

1. Bring your management accounting record-keeping 100% up to date, and
2. Provide the necessary reports and transaction-level data to your Accountant that he or she will need to calculate and report your tax liability, along with any other prescribed reporting.

Wave creates all the report formats that you will need to give to your Accountant (CPA), so let's get on now with completing your Management Accounts for the year.

There are 8 steps...



Step 1: Bring your record keeping 100% up-to-date



You've been tracking income and expenses all year in Wave, so this really shouldn't be hard.

A final check will make sure you haven't missed anything, and that you have the complete baseline information for your year-end.

Issue remaining invoices

Any completed sales or work that you can invoice with a date before the Year-end: get those invoices out! Not only will you be getting your bookkeeping straight, customers might even pay you!

Record incidental income

Some bank interest? Affiliate Referral fees? A forgotten royalty check? If there's income you've missed, record that too!

Gather and record remaining bills and receipts

In the glove box of your car? In your wallet? Pockets of the outfit you wore to that trade conference? Check if you have any remaining bills or receipts that you have forgotten to record, and enter them now.

Finalize your last payroll of the year

Whether you use Wave Payroll or another service, now's the time to run your last payroll of the year. Be sure, too, to include any Year-end bonuses you may want to pay to yourself, or any team members.

Balance your business bank account(s)

With everything recorded, now's the time to balance your bank accounts for the final time in the year.

A properly balanced bank account is your reassurance that all your major transactions are recorded correctly.



Step 2: Review personal and business transactions



Even though you've hopefully kept business transactions separate from your personal money in a dedicated business bank account, there will still be a number of areas where your business and personal finances intersect.

Review all the areas where you have paid expenses on behalf of the business, or the business has paid for items for your personal benefit, and ensure you have recorded and documented these fully.

Business use of home

We discussed on Page 67 why you might want to record Business Use of Home on a regular, monthly basis – to get a clear view of your business' operating costs.

If you have chosen not to record it monthly, decide if you want to add it now as part of your Management Accounting (**debit** Office Expense; **credit** Owner's Investment / Drawings), or simply handle it as part of your personal tax filing.

Business mileage

If you use your personal vehicle for business purposes, you should be logging personal and business miles, and ideally recording the expense at least monthly.

Go back to check your motor expenses are correct. (See page 68 for more).

Personal expenses paid by business

It's easy to mix up credit cards, and pay for a personal item on your business card (or vice versa). Check your business card charges to make sure everything is right.

Personal element of business expenses

Just as you can identify a business element in personal expenditures, such as for your home or vehicle, there can be a personal element in business expenses.

A cellphone plan paid for from your business is likely to have a personal element, for example. Looking at your itemized bill, if you see that 30% of your usage is personal, you should adjust for this portion in your bookkeeping by means of a Journal Transaction (credit Cellphone Expense; debit Owner Investment / Drawings)



Step 3: Correct loan balances & interest expenses



If your business has a bank loan or other commercial loan, your lender will have assigned part of each payment that you have made to Interest, and part to reducing the outstanding loan balance ("principal"). The split between interest and principal repayment changes with every payment.

It's rarely easy or convenient to record the split every time we make a loan payment, so at Year-end you will want to make an adjustment so that the total interest you have recorded for year is correct, and the amount showing outstanding on your Balance Sheet reflects the actual amount your business still owes.

In most countries where Wave is used, your lender will automatically send you a Year-end statement of payments made, showing how much of each payment was Interest, and how much went to repay the Principal. Of course their Year-end may be different to yours, or the statement may never appear, so if you don't already have the statement handy, ask your bank to provide one.

Business owners usually record monthly loan payments in one of three ways. Here they are, and how to adjust for each:

1. All payments have been recorded as Principal, reducing the Loan liability account.

*Your Loan liability has not actually reduced this much. Create a Journal Transaction to **debit** Interest Expense by the amount of Interest on your lender's statement; **credit** Loan liability account.*

2. All payments have been recorded as Interest, leaving Loan liability untouched.

*You have recorded too much Interest. Create a Journal Transaction to **debit** Loan liability account by the amount of principal repayment during the year; **credit** Interest Expense.*

3. Each payment has been split using estimated amounts for Interest and repayment of Principal.

You're hopefully pretty close to the correct split between Interest expense and Principal repayment. Refer to your lender's Year-end statement to calculate the appropriate adjustment between these two accounts, and create a Journal Transaction to make the necessary change.



Step 4: Recognize un-invoiced income



*Back in the section on Monthly to Quarterly tasks, we looked at re-phasing “lumpy” income. We saw that a long project delivered over more than one month could distort our monthly accounts if we treat the income it creates as all being earned at the end of the project, when an invoice is issued. Instead, we showed you how recognize part of the income each month, growing the value of an **Un-invoiced Income** asset.*

If you reach your Year-end in the middle of just such a project, you’ll want to recognize your un-invoiced income, to be sure your total for the year is accurate.

Here’s how to handle un-invoiced income in Wave:

1. First, review partially-completed orders and customer projects. Determine the proportion of each that has been completed, and the value. For example, if you had completed 30% of a \$10,000 project at the Year-end date, you would value this at \$3,000 complete.
2. If you haven’t previously done so in following the steps to manage “lumpy” income (refer back to Page 69), go to **Accounting > Chart of Accounts**; scroll down to **Expected Payments from Customers** and add a new account. Call it **Un-invoiced Income**.
3. Create a Journal Transaction to Debit Un-invoiced Income and credit your appropriate Sales (Income) account for the total calculated in Step 1.
4. Remember (in the next fiscal year) to post additional Journal Transactions in the opposite direction as you complete each order / project and invoice the full sale value.

Tip: Don’t record ‘speculative’ work – without a firm and reliable customer agreement – as Income. Un-invoiced income should only be recorded for confirmed customer orders / projects where you know the sale will be completed.



Step 5: Record unearned income and customer prepayments



Just as you'll sometimes reach Year-end with income that has been earned but not Invoiced, you could also find you have income that is invoiced but not earned.

You could even have invoices that have been paid by your customers, but the actual products and services on them won't be delivered until some time in the next financial year.

These should be recorded as customer prepayments.

We looked at re-phasing Income in *Monthly to Quarterly Tasks* (see Page 70.) The process at Year-end is identical:

1. Wave records the value of each Invoice as Income at the Invoice Date, balanced by AR. We need to reduce that Income, and replace it at a later date, when we believe the Income will actually be earned.
2. If you haven't already, add a new Liability account under **Customer Prepayments and Customer Credits**. Call it **Unearned Income**.
3. Figure out what proportion of the value of your incomplete orders / projects remains to be delivered as at the Year-end date, and create a Journal Transaction to **debit** Income; **credit** Unearned Income (Liability) this amount.
4. Moving into the next fiscal year, as the affected orders / projects are fully delivered, post new Journal Transactions to reinstate the Income: **debit** Unearned Income (Liability); **credit** Income.

We have suggested using a Customer Prepayments-type Account called **Unearned Income**. If you are recording actual Customer Prepayments or Deposits – i.e. deliberately and consciously paid by your customer for future work – you may prefer to add another Account explicitly called **Customer Prepayments** or **Customer Deposits**. The accounting will be identical, by you may find these names make clearer what's happening in your business.



Step 6: Recognize unbilled expenses



As at the Year-end date, had your business incurred expenses that you had not yet paid for, or even received a bill for?

Perhaps you hosted a small holiday party for customers; you had a caterer take care of the food, but they hadn't yet invoiced you when you hit your Year-end on December 31st.

*Your business has incurred and benefitted from the expense, but right now it's nowhere in your numbers. Record this **Unbilled Expense** to make your accounting more accurate.*

There are two ways to record an Unbilled Expense.

Method 1 (The easy way!):

1. Add a Bill dated whenever your business actually incurred the expense. Wave will handle this like any other Bill, meaning the expense is recognized at the Bill Date; not when you pay it.
2. When the 'real' Bill arrives, check the bill details are correct, but don't enter it again! Simply pay it like any other Bill.

(Note that this method will throw your Aged Payables reporting off a little, because we are recording a bill before it actually arrives.)

Method 2 (Keeps Accounts Payable 'clean'):

1. Go to **Accounting > Chart of Accounts** and create a new **Short Term Liability** Account called something like **Unbilled Expense Liability**.
2. Create a Journal Transaction as at the date the expense was incurred to **debit** the relevant Expense categories; **credit** Unbilled Expense Liability.
3. When the vendor's Bill arrives, enter it normally, and also create a Journal Transaction as at the Bill date to reverse the previous one; i.e. **debit** Unbilled Expense Liability; **credit** the relevant Expense categories.



Step 7: Record prepaid expenses and vendor prepayments



Just like you can arrive at Year-end with invoiced Income you haven't fully earned, you might also have recorded Expenses your business hasn't yet consumed.

If you pay rent quarterly, and your Year-end falls 1 month into a rental quarter, if you've recorded the full quarter's rent, you're applying too much to the current financial year: 2 months' of the quarter's rent belong in the next year.

*As with Unearned Income and Customer Prepayments in Step 5, resolve this by adjusting for **Prepaid Expenses / Vendor Prepayments**.*

Adjusting for Prepaid Expense / Vendor Prepayments is very like the way we handle Unearned Income / Customer Prepayments:

1. Wave records the value of each **Bill** as Expense at the Bill Date, balanced by AP, together with directly-entered **Expenses** paid from Cash / Bank / Credit accounts. We need to reduce that Expense, and replace it at a later date, when we the Expense will be consumed.
2. Add a new Asset account under **Vendor Prepayments and Vendor Credits**. Call it **Prepaid Expense**.
3. Figure out what proportion of any products or services you have purchased remains undelivered or unused as at the Year-end date, and create a Journal Transaction to **debit** Prepaid Expense; **credit** the relevant Expense accounts.
4. Moving into the next fiscal year, as your business receives or makes use of these products and services, post new Journal Transactions to reinstate the Expense: **debit** the correct Expense accounts; **credit** Income.

Note that there is no accounting difference between **Prepaid Expenses** that exist because your business has not fully received or consumed purchased products or services, and a deliberate prepayment to a vendor for services that will be delivered wholly in the next financial year. For clarity, however, you might wish to distinguish these as **Vendor Prepayments**.



Step 8: Check and adjust inventory



*If you're a service-based business with no inventory, feel free to skip along to the next section. If you've been tracking Inventory as described in the Monthly to Quarterly Tasks section, you'll be familiar with the inventory tracking processes. (If not, refer back to Page 76 to read about the **Periodic Method** of accounting for Inventory.)*

However you've been approaching Inventory, get ready to do some counting. At Year-end you want to take particular care that the Inventory value reported on your Balance Sheet matches what you actually have available to your business.

Goods that you purchase for re-sale, or materials and resources that you use to create your product or service, are either used straight away and accounted as Cost of Goods Sold (CoGS) expenses, or are kept within your business as Inventory to be used over the weeks and months to come. If your business accumulates inventory, you should have been tracking this in one of three ways:

- 1. Perpetual method:** recording all purchases into your Inventory asset, and using Journal Transactions to record inventory being consumed in CoGS on a sale-by-sale basis.
- 2. Periodic method:** recording all purchases into a dedicated 'Purchases' asset account, and updating Inventory and CoGS maybe monthly, based on a physical count.

- 3. Straight to CoGS:** if your inventory levels don't fluctuate much, you may have chosen to simply record all your purchases as CoGS, and not track Inventory at all. This could be accurate enough for your day-to-day needs, but still needs adjustment at Year -end.

Whichever approach you've taken, your Year-end Inventory adjustment essentially applies a Periodic approach: you're going to check what inventory you have on hand, and adjust your accounts so that they match this reality.

Turn over the page for a summary of the different adjustments you might make...



How to adjust Inventory if...

*The physical Inventory you have is **more** than your Balance Sheet shows*

*The physical Inventory you have is **less** than your Balance Sheet shows*

You use the Perpetual method

You have likely under-recorded purchases of inventory, or over-recorded use of inventory as CoGS expenses for sales.

Check your expense transaction records to see if you have mis-categorized any inventory purchases as expenses. Review your Journal Transactions to see if you have duplicated transactions, or applied too much CoGS expense against Sales, and correct your bookkeeping as required.

... because you used more inventory than you realized in delivering your product / service

You have likely over-recorded purchases of inventory, or under-recorded use of inventory as CoGS expenses for sales.

Check your inventory purchase transaction records to see if any should have been categorized as simple expense transactions. Review your Sales history to ensure there is a Journal Transaction that applies appropriate CoGS against each sale. Correct your bookkeeping as required.

... or because some of your Inventory has been lost, stolen, or destroyed

Using the perpetual method, the inventory you have available should match what your Balance Sheet says at all times if your bookkeeping has been accurate. If it doesn't, common reasons are theft, breakage, fire or flood damage, etc. These are collectively referred to as 'Shrinkage', which is a general Expense.

To account for 'Shrinkage', add this as a new Expense account, and create a Journal Transaction to **debit** Shrinkage and **credit** Inventory as required.

You use the Periodic method

You have previously under-recorded Purchases, or applied too much CoGS expense.

Check your expense transaction records to see if you have mis-categorized any Purchases as expenses; make corrections. If a difference remains, create a Journal Transaction to **debit** Inventory for the difference; **credit** CoGS.

You have previously over-recorded Purchases, or applied too little CoGS expense.

Check your expense transaction records to see if you have mis-categorized any expenses as Purchases; make corrections. If a difference remains, create a Journal Transaction to **debit** CoGS and **credit** Inventory for the difference.

The Periodic method relies on counting physical inventory, and assumes that all the difference between your last inventory count (plus purchases since then) and your present inventory account is attributable to CoGS. This makes it hard to identify Shrinkage.

If your inventory count reveals a pile of broken, unsaleable items, however, you could certainly categorize these as 'Shrinkage'.

You record purchases straight to CoGS

For convenience, you are treating all purchases as CoGS, but in fact the unused purchases you have on hand have increased since last year.

Create a Journal Transaction to **debit** Inventory so it matches your physical inventory on hand; **credit** CoGS.

For convenience, you are treating all purchases as CoGS, but it looks like you actually started the year with some inventory on hand, and you've used some of that up along with whatever you've purchased in the year.

Post a Journal Transaction to **debit** CoGS and **credit** Inventory so it matches your physical inventory on hand.

Recording purchases straight to CoGS makes sense when either the amount that you are purchasing to support your sales, or the change in inventories month-to-month, is small.

If you are accounting this way, there is likely to be little benefit in attempting to track and report 'Shrinkage'.



Congratulations!

Your year-end management accounting is complete!



With all your adjustments completed, you now have a full picture of the income earned during your financial year, and the expenses incurred to support that income. You also know – as of the end of the year – what your business has, what it owes, and... yes... what's left for you, as the owner!

Take a moment to review your Year-end Financial Statements, just as you have been every month. If this isn't your first year in business, compare your business' performance this year to last, and think about goals for the year ahead.

This is also a great time to export information to share with your accountant, so they can complete your tax filings for the year.

Your Management Accounting records also include all the transaction data that your CPA requires to calculate and report your taxes.

Here's what you should plan to share (export all Reports on a Detailed basis – as opposed to Summary):

- Your Income Statement (P&L) for the year.
- Your closing Balance Sheet at the end of the current year.
- Your closing Balance Sheet at the end of the prior year.
- Your Cash Flow Report for the year (select 'Cash and Cash Equivalents').
- Your Account Transactions (General Ledger) Report on an Accruals basis.*
- Your Account Transactions (General Ledger) Report on a 'Cash and Cash Equivalents' Basis*.

With these reports, your CPA now has all the information they need to finalize any public reporting that may be required on an Accruals basis, as well as any tax calculations that may be required on a Cash basis.

They can also see all your investments in fixed assets through the year, so they can calculate the correct capital allowances/depreciation allowances, as well as any other charges you've applied to understand and reflect the realities of your business, that may need to be adjusted and replaced with 'official' tax calculations.

Depending on your business structure, it may be liable to tax, independent of any personal taxes you pay. In this case, your Accountant will let you know the Tax Expense to add as a final Journal Transaction in your bookkeeping.

*And now you're really done!
Congratulations!*



Bonus tip:

What to do if you don't have an accountant and are filing your own taxes

There are many advantages to working with an accountant (CPA) as you complete your Year-end. A good CPA may find tax allowances and deductions that you would not know about yourself, saving you money – and they may prevent you making mistakes that could come back to bite you in an audit. Also, a good accountant can be a valued advisor to your business all year round.

If your business is still at its early growth stage, however, the cost of using a CPA may seem out of balance with the kind of income you are making, so you may be thinking of “going it alone” at Tax Time.

Taxes are different from country to country, and even at more local levels, so we can't give you specific tax advice. We can set you on the right track, however.

To file your own taxes, you're going to be using some of the same six reports we identified on the previous page, so go ahead and print / export them now. You're also going to need a set of tax forms from your local tax authority, or some software to prepare and submit your tax return online.

Good online tax preparation software will guide you and provide you lots of information about what numbers to include in every part of your tax return, so using tax preparation software is a great choice.

Let your tax preparation software guide you, and refer to your Wave reports for each of the numbers you are asked for. Here's where you'll find the main numbers:

Total Income comes from your Income Statement if you file on an Accruals basis, or your Cash Flow Report on a Cash basis.

Expenses come from your Income Statement (Accruals basis) or Cash Flow Report (Cash).

Fixed Asset purchases are found on the Account Transactions (General Ledger) report. Your tax preparation software should use this information to calculate Capital / Depreciation allowances. (If you file taxes on an an Accruals basis – be sure to deduct Depreciation from your expenses, so you're not claiming twice!)

You may need to also add back **Business Use of Home** and **Business Motoring** expenses if you are claiming these as personal deductions: you can't deduct them twice! Note that if you recorded these expenses via Journal Transactions, they won't appear on any of your Cash-based Reports; Journal Transactions only appear on Accruals-based Reports.

Continue through your tax preparation software, locating all the numbers you need on your Wave reports until you're done.

Double-check everything, and submit when you're ready. Well done on reporting your own taxes!



Comprehensive checklist

The bookkeeping cycle



Daily/Weekly	Capture receipts	Upload photos of your receipts and store them in Wave.	<input type="radio"/>
	Invoice Clients	Use Wave's Invoicing feature to send invoices to your clients and get paid.	<input type="radio"/>
	Record and categorize transactions	Track your transactions and categorize them appropriately.	<input type="radio"/>
	Record business mileage	Log business use of your vehicle outside of Wave.	<input type="radio"/>
	Record invoice payments	Record payments received for your invoices.	<input type="radio"/>
	Record bills	Record any owing bills.	<input type="radio"/>
	Record non-income and non-expense transactions	Account for any deposit and withdrawal transactions that aren't income and expenses.	<input type="radio"/>
Weekly/Monthly	Pay and record payment of bills	Record payments for any bills that were recorded earlier in the period.	<input type="radio"/>
	Run Payroll	Review payroll and pay your employees.	<input type="radio"/>
	Review Aged Receivables	Manage your overdue invoices to bring down your bad debt.	<input type="radio"/>
	Reconcile bank accounts	Reconcile your Wave transactions against those in your bank statement.	<input type="radio"/>
Monthly/Quarterly	Report & remit sales tax	Identify any sales taxes owed and correctly account for their payment.	<input type="radio"/>
	Record Amortization/Depreciation	Accurately record the value of your assets over time.	<input type="radio"/>
	Expense business use of home	Record and account for office space and services that you provide within your home.	<input type="radio"/>
	Re-phase income	Match income made over time with the work and materials that went into it.	<input type="radio"/>
	Write off bad debt	Record bad debt when customers don't pay.	<input type="radio"/>
	Track inventory	Record the value of your inventory as it's purchased and sold.	<input type="radio"/>

The analysis cycle



Monthly	Analyze your financial statements	Read and interpret your Balance Sheet and Profit & Loss Statement to get meaningful insights for your business.	<input type="radio"/>
	Calculate and track the Quick Ratio	Determine whether or not your business can pay off its current liabilities with its current liquid assets.	<input type="radio"/>
	Calculate Break Even Sales	Determine the exact point at which your business will make neither a profit nor a loss.	<input type="radio"/>
	Explore trends in your numbers	Note trends month-over-month to give you the information you need to continue driving your business forward.	<input type="radio"/>
	Forecast cash flow	Use previous periods' numbers to forecast your business' cash flow and help anticipate its financial needs.	<input type="radio"/>
Year-End Accounting			
Yearly	Bring your record keeping up to date	Check all the boxes to make sure that your financial year's records are complete.	<input type="radio"/>
	Review personal/business transactions	Ensure that any instances where a personal account was used to pay for a business expense (or vice versa) are recorded properly.	<input type="radio"/>
	Correct loan balances and Interest Expense	Adjust Loan and Interest Expense balances to match your lender's Year-end statement.	<input type="radio"/>
	Recognize un-invoiced income	Account for work that you've performed that hasn't been invoiced.	<input type="radio"/>
	Record unearned income and customer prepayments	Match payments that you've received with the work you'll be doing in the next financial year.	<input type="radio"/>
	Recognize unbilled expenses	Record expenses that your business has incurred, but have not yet been paid for.	<input type="radio"/>
	Record prepaid expenses/vendor prepayments	Account for products & services that you've paid for, but haven't received yet.	<input type="radio"/>
	Check and adjust inventory	Take stock of, and record any loss of valuation in your inventory.	<input type="radio"/>