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Basic Financial Literacy and Bookkeeping

What is Financial Literacy?

Financial literacy is the knowledge and understanding of financial skills that allow people to make informed decisions with money. Financial literacy is the understanding of financial concepts that lead to informed money decisions. These concepts include saving, investing, and budgeting for short- and long-term goals. Financial literacy not only helps people manage their money better, but keeps them prepared for the unexpected ups and downs of life.

5 Components of Financial Literacy

1. **Earn**

   This is more than just the cash coming into your bank account. Earnings include your investment income, which can include, for example, money in a brokerage account or a retirement account. If it is invested, you may earn interest or dividends that you can include in your total earnings amount.

   Earnings can be variable. While salary is usually consistent throughout each paycheck, many people also experience variable income either in addition to salary or as their primary source. Working on commission can be less predictable than salary but may have the potential for higher earnings overall. All commission should be included in earnings.

2. **Spend**

   The second component of financial literacy is spending, meaning the money that leaves your bank account. If you don't have a handle on how much money you spend, this may be the most intimidating part of your financial life. Knowing what you pay is not the same thing as living frugally. This is a common misconception. And just because you know your spending habits doesn't necessarily mean you need to change them.

The best place to start is to categorize your expenses between fixed and variable. Fixed expenses are the things that stay the same month to month (mortgage, debt payments, cell phone bill, etc.), while variable expenses will vary month to month (food, entertainment, travel, etc.).

3. **Save**

   We all know that saving money is essential. But saving money without a goal becomes futile. As a reminder, saving is the excess earnings you put into an account for a future purpose.There is an element of deferred gratification tied to the concept. Saving income for the bill due next week is not savings. The most common event that people save for is retirement. While this is a very long-term goal, you can also create smaller, shorter-term goals along the way as well.

4. **Invest**

   Invest comes fourth in financial literacy for a reason. It’s crucial to understand your earnings, spending, and savings before moving on to investing. While this is the sexy part of personal finance, it can’t be done in isolation. Investing is a way to help your savings grow and compound over the long term. The concept of investing may be easily understandable, but the actual implementation and monitoring are more daunting.

5. **Protect**

   It’s simple to protect your wealth from foreseeable threats, like locking valuables in a safe or not leaving your cash in the seat of your car. However, it’s the unforeseen threats that add complexity to wealth protection. Protection can involve risk management from creditors, volatile markets, and lawsuits. It can also include insurance, like life insurance, to protect against the potential loss of income if you were to die prematurely.

What is bookkeeping?

Bookkeeping is the process of tracking and recording a business's financial transactions. These business activities are recorded based on the company's accounting principles and supporting documentation.

Examples of these documents include:

1. Bills
2. Receipts
3. Invoices
4. Purchase orders

Business transactions can be recorded by hand in a journal or an Excel spreadsheet. To make things easier, many companies opt to use bookkeeping software to keep track of their financial history.

Bookkeeping is just one facet of doing business and keeping accurate financial records. With well-managed bookkeeping, your business can closely monitor its financial capabilities and journey toward heightened profits, breakthrough growth, and deserved success.

3 key benefits of bookkeeping

1. **Access to detailed records of all transactions**

   By logging and keeping track of all financial transactions, you will have easy access to any financial information you might need. To make it even easier, bookkeepers often group transactions into categories. Common transaction categories include:

   - Goods
   - Services
   - Wages
   - Taxes

2. **Ability to make informed decisions**

   Because bookkeeping involves the creation of financial reports, you will have access to information that provides accurate indicators of measurable success. By having access to this data, businesses of all sizes and ages can make strategic plans and develop realistic objectives.

   Examples of financial statements that can help with decision-making include:

   - Balance sheets
   - Income statements
   - Cash flow statements

3. **Better tax preparation**

   When it's time to file your taxes, you'll need to comply with the Internal Revenue Service's (IRS) legal regulations and systems that govern their finances. Some of the most common documentation businesses must provide to the federal government include:

   - Financial transactions
   - Financial statements
   - Tax compliance
   - Cash flow reports

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2 types of bookkeeping for small businesses

1. **Single-entry bookkeeping**

The single-entry bookkeeping method is often preferred for sole proprietors, small startups, and companies with unfussy or minimal transaction activity. The single-entry system tracks cash sales and expenditures over a period of time. With this bookkeeping process, you must maintain three pieces of documentation:

- **Cash sales journal**: This is where the business records all revenue.
- **Cash disbursements journal:** This is where the business records all expenses.
- **Bank statements:** All journal entries should align with the business's bank statements.

In these documents, transactions are recorded as a single entry rather than two separate entries.

2. **Double-entry bookkeeping**

   Double-entry bookkeeping is the practice of recording transactions in at least two accounts, as a debit or credit. When following this method of bookkeeping, the amounts of debits recorded must match the amounts of credits recorded. This more advanced process is ideal for enterprises with accrued expenses.The following documents are required for double-entry bookkeeping:

   - Journal entries
   - General ledgers
   - Inventory
   - Cashbooks
   - Accounts payable
   - Accounts receivable
   - Loans
   - Payroll

What is credit?

Credit is basically when we receive a good or service at the moment and make a promise to pay for it

Later. Debt essentially means that you owe someone or you owe a company. When you buy lots of things on credit, you run the risk of accumulating a lot of debt. One way to avoid this is to understand credit and to monitor your borrowing. It is important to have good credit which means you are trusted by banks and lenders to repay them what you borrow. This means that you can set up contracts for things such as a phone and also will allow you to borrow large sums of money for buying a house (mortgage).

Credit

How do you get good credit? How you borrow money, and the type of borrowing (and whether you can pay it back) will impact your credit. If you borrow more than you can afford to repay on time your credit score will go down.

- Credit card - borrowing money off a lender
- Secured loan - the loan is “secured” with an item like the car or home you are going to use the loan to buy
- Payday loan - often a loan with high interest rates with the intention of repaying quickly
- Personal loan - You usually do what you like with the money
- Overdraft - Overdrafts are a way of borrowing money but through your bank account

Debt

What is debt and how can you get into debt? A reminder of the types of debt:

- Credit card - borrowing money off a lender
- Secured loan - the loan is “secured” with an item like the car or home you are going to use the loan to buy
- Payday loan - often a loan with high interest rates with the intention of repaying quickly
- Personal loan - You usually do what you like with the money
- Overdraft - Overdrafts are a way of borrowing money but through your bank account

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