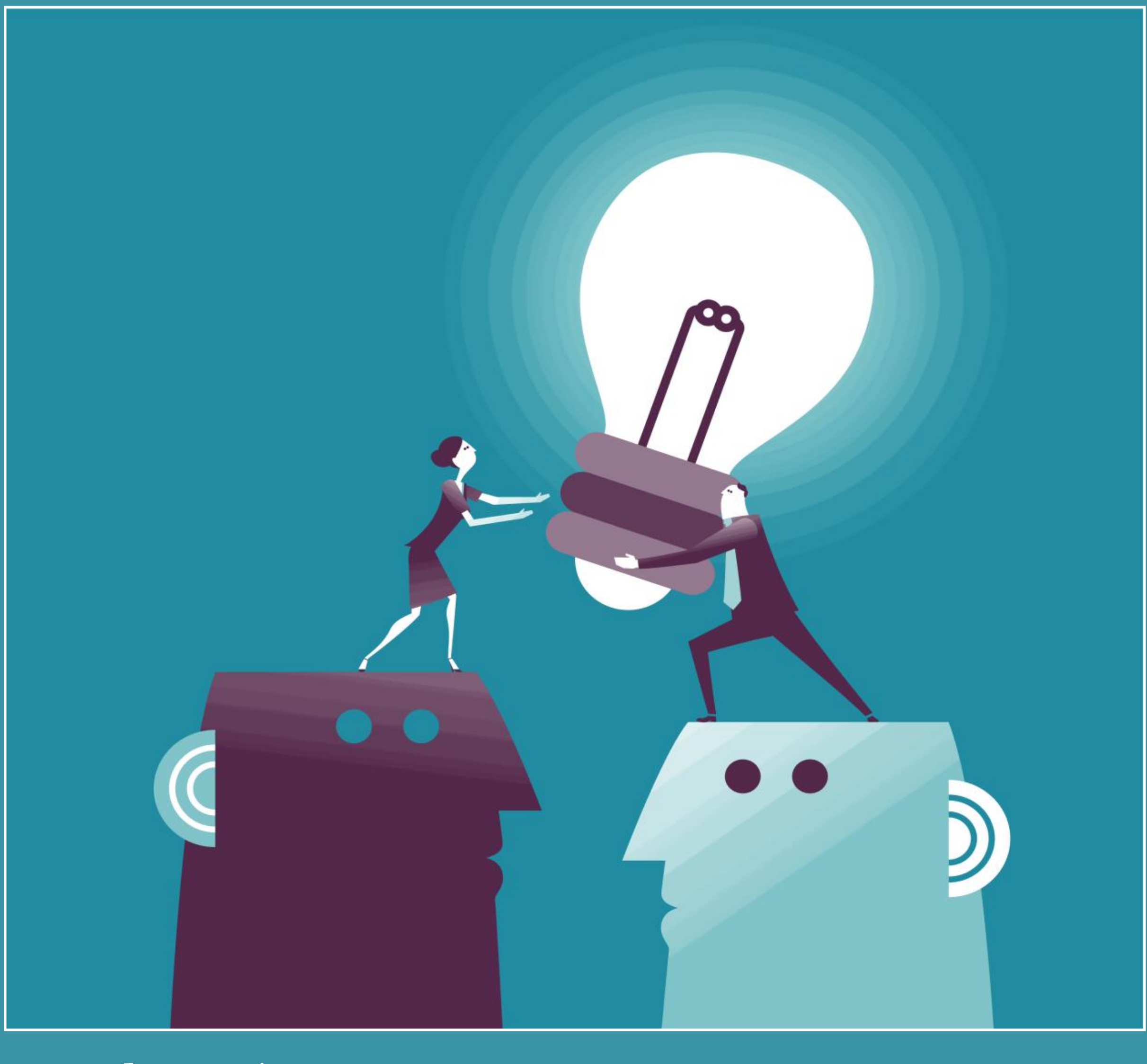
ApproachableAccountants

Chartered Accountants & Chartered Tax Advisers

Simple Financial Records for a Small Business



March 2015

A GUIDE TO SIMPLE FINANCIAL RECORDS FOR A SMALL BUSINESS

CAVEAT

This guide aims to help you set up simple financial records for your small business. It should help sole traders and those running smaller companies. It does not cover the detail of HMRC or Companies Act requirements. Most businesses should seek professional help in addition to following this guide. Please ask about our guides to cloud accounting and to company record keeping, both of which are available to clients.

Although we have taken every effort to ensure the content is relevant different businesses have different needs and options and accounting treatments can very over time.

You should consider the need to seek further/current professional advice before relying on this guide. Approachable Accountants takes no responsibility for any action taken or refrained from as a result of any of its content.

ABOUT APPROACHABLE ACCOUNTANTS

We are a firm of Chartered Accountants and Chartered Tax Advisers. We help our clients to achieve financial security and peace of mind while doing business in an ethical way. We specialise in helping owner managed businesses and personal tax clients.

For more information please see our website www.approachableaccountants.co.uk.

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1 INTRODUCTION

This guide covers setting up and maintaining basic financial records for a simple sole trade (self employed) business or a small limited company. Every business is different and it's important to find a system that works in practice for your circumstances. You should think through what will be easiest for you and adapt procedures so they will work for you.

New cloud-based accountancy software is making some processes much easier. For example, it is now possible to photograph or email receipts to get them into your business records, rather than keying data, and you can raise sales invoices on the go from your phone. These options are not expensive. For more detail, please ask us or see our guide to cloud accounting, which is available to clients.

2 YOUR OBLIGATIONS

HMRC requires you to:

- maintain business records that accurately record all business income and expenses; and
- take reasonable care over your own or your company's tax affairs.

Taking reasonable care over your tax affairs means understanding and meeting your tax obligations or seeking help if you are unsure. Company directors have additional responsibilities under the Companies Act.

If you update your records regularly it will be easier, they will be more accurate and you will be better able to control your business and make more profit. We suggest updating your records at least monthly as part of your usual business routine.

3 LIMITATIONS OF THIS GUIDE

This guide covers how to set up records to record income and expenses in a simple way. It does not cover all the HMRC or Companies Act requirements. If you are working with an accountant, they should review your accounts and advise on adjustments needed to bring them into the required format.

We suggest that all company directors use an accountant and that sole traders seek initial advice as an absolute minimum, to help you get started in the right direction.

4 GET THE BASICS RIGHT

Key points to help you stay in control as you set up your records and start running your business are as follows:

- Keep money for your business separate from your personal money
- Open a separate bank account for the business
- Pay all business income into the business bank account
- So far as possible pay all business expenses from the business bank account
- If you pay some expenses personally:
    - keep the receipts as part of your business records and
    - transfer funds from your business bank account to reimburse your personal account, or
    - for company directors, set up a loan account so that you know how much the company owes you at any time
- Include in your sales invoices, anything charged to the customer except for items you have specifically purchased as their agent. This means that you must record some items as both income and expenses – an example is travel costs that your customer reimburses to you
- Decide how you want to maintain your financial records. Options include;
    - Cloud-based accounting software – there are many options available. Most are easy to use and there are many advantages over other methods (for more detail, ask about our guide to cloud accounting)
    - Desk-based accounting software – most software is migrating to the cloud, so desk-based options probably have a limited life
    - A spreadsheet or paper cashbook – these can work well for smaller businesses with few transactions and which are not VAT registered
- Decide on your categories of expenses by type (purchases, IT, staff costs etc) and set your records up to record expenses by category. Accounting software allows for this automatically; you can use columns in a spreadsheet or paper cashbook (see Annex 1 for an example).

TIP: *We recommend VAT registered businesses use bespoke accounting software.*

Although smaller businesses can start with a spreadsheet or paper cashbook, finding the time to change system can be difficult once your business starts to grow.

5 ACCOUNTING FOR SALES TO CUSTOMERS

6.1 Sales invoices

You must supply each customer with a sales invoice or receipt. There are specific rules for what sales invoices must show, and exceptions such as for retailers, who can issue simplified invoices.

TIP: Your sales price must cover the cost of your purchases plus a share of other expenses plus a margin for profit.

6.2 Sales records

You must record all sales. If you have a high volume of sales such as through a till, you can record the daily till roll totals in your records. Showing cash, card and cheque sales separately should help you trace items through to the bank and ensure accuracy.

If you have a lower volume or allow credit, your records should list every invoice together with date and customer.

TIP: You can see the rules for what to include on a sales invoice at https://www.gov.uk/invoicing-and-taking-payment-from-customers/invoices-what-they-must-include.

You can see HMRC's requirements for VAT invoices at https://www.gov.uk/vat-record-keeping/vat-invoices

VAT-registered businesses must keep a record of net, VAT and total values. VAT invoiced to customers is paid over to HMRC after making a deduction for VAT paid to suppliers.

6.3 Collecting money from customers

Your records should distinguish sales invoices for which customers have paid from those for which payment is outstanding. This helps you identify customers who need chasing.

Set up a routine for identifying and managing late/non payers. Some accounting packages can send automatic email reminders.

TIP: Most businesses fail because they run out of cash. Invoice sales as quickly as possible and negotiate early payment terms. Consider asking for cash up front, (especially for new customers), and asking for regular stage payments for big jobs.

You have the right to charge interest for late payment, and the option of offering a discount for prompt payment. See HMRC's website or consult your accountant.

6 ACCOUNTING FOR PURCHASES AND EXPENSES

You need a system for accurately recording all purchases and other expenses.

TIP: Help is available with debt collection or recovery including online through the small claims court. You can get VAT and income / corporation tax relief on bad debts.

Depending on your business and record keeping system, you can enter purchases to your records as you make them, or keep the invoices and enter them regularly, say, at the end of each week or month. You may need to keep an order book to keep track of purchases and to help check that invoices you receive are valid.

6.1 Recording purchases and expenses

Record all purchases and expenses by category. Annex two shows a list of typical codes you may need.

TIP: You must keep a copy of all purchase invoices or receipts. These can be on paper or electronic.

TIP: The free "To pdf" app lets you convert photos of records into a pdf, for easy storage.

A simple way to ensure you capture all purchase invoices is to file them in a safe place on receipt, for later processing. You can file paper invoices in an in tray or folder or by scanning / photographing and uploading to a folder on your computer. Invoices received by email can be filed in an email folder.

Purchase invoices can be entered to your records weekly or monthly, if not more often. File invoices or copies in a safe place; you are required to keep them for six years.

Some cloud-based technology wil automatically enter receipts to your records, from a photograph or invoice. See our cloud accounting guide for more details.

6.2 Recording payments to suppliers

You will need a system to ensure that you pay all invoices on time and only once. It will often be sufficient to make payment when you enter an invoice to your records. Your records must identify whether an invoice has been paid.

Although payments should be made directly by the business so far as possible, sometimes it is practical for the business owner or another member of staff to pay expenses such as travel costs. In this case, receipts should be kept and totalled by expense category in an expense claim. When an expense claim is approved, the receipts should be filed and a bank transfer made to reimburse the director or staff member.

6.3 Motoring costs

Self-employed businesses below the VAT threshold have a choice, per car, of accounting for:

- the actual business cost of running a car, or
- mileage cost at HMRC approved rates.

The HMRC approved rates are 45p per mile or 25p over 10,000 miles pa. These also apply to employees. There are different rates for passengers, motorcycles, company cars and bicycles.

Businesses over the VAT threshold must use the actual business cost method, which involves apportioning the total cost of running a car between private and business use. The total costs includes fuel, road tax, service and insurance costs, etc. If you use the actual method, you must keep receipts for all expenses. You must be able to justify the business proportion charged, which could be:

- say, 5/7ths of total cost where a car is used for business Monday to Friday and personally at weekends, or
- according to detailed records of business and total mileage.

> TIP: Charging 45p per mile is simpler and generally leaves you no worse off

You can record mileage:

- on a spreadsheet (especially useful for regular journeys) or
- in a paper log book (especially useful for irregular journeys).

> TIP: You can keep a mileage logbook in your glove box, to record each business journey

7 ACCOUNTING FOR VAT

VAT registered business must record net, VAT and total invoice values. Each quarter you must calculate the difference between output VAT (on sales) and input VAT (on purchases) and pay it over to (or reclaim it from) HMRC. Sales and purchases are recorded net in your business accounts.

> TIP: VAT is a complicated tax, with many detailed rules. It is an expensive tax to get wrong. We suggest seeking professional help on becoming VAT registered.

It is important to record the invoice date in your records so that you account for VAT in the correct period. VAT returns must be filed online directly from your accounting system or by using the Government Gateway.

TIP: You must register for the government gateway in order to file tax returns including VAT returns.

Various schemes are available, which aim to simplify accounting for VAT. The Flat Rate Scheme can be particularly helpful.

Businesses below the VAT threshold do not have to register. In this case you must not charge VAT to customers and you must record the gross, rather than the net value of purchases as an expense.

8 ACCOUNTING FOR CAPITAL ITEMS

Capital items are purchases for continuing use (i.e. more than one year) in the business, such as a machine, desk or computer. Accounting and tax rules don't always allow these to be deducted from income in arriving at profit.

TIP: It can be particularly helpful to seek advice from an accountant or tax adviser on the capital allowances regime.

Most small businesses will be able to claim 100% deduction for tax in the year of purchase (often through claiming capital allowances). Companies and larger businesses should record capital items on the balance sheet, and claim capital allowances through the tax return. If recorded on the balance sheet, capital items must be depreciated over their useful life. This is an example of where the accounting and tax rules often diverge, as full tax relief is often allowed for tax in the year of purchase, leading to a timing difference in how profits are measured for the accounts and for tax.

9 OWNERS' EXPENSES AND DRAWINGS

The simplest way to account for owners' expenses is for the owner to make an expense claim each month and for the full value to be reimbursed from the business bank account.

It is not always necessary or desirable to reimburse an owner in cash for all expenses. As an alternative, the owner can maintain a loan with the business. Expense claims are still processed but the amounts

TIP: There are strict tax, accounting and disclosure rules about loans to a company director. Consult your accountant.

owing are recorded in a loan account instead of being repaid in cash. The owner can draw on the loan balance for repayment at a later date. Cash the owner puts into the business or salary that is not drawn in cash can be recorded through the same loan account.

As well as reclaiming expenses, business owners may draw profit ("drawings") from the business. Drawings must be entered in the records so you can reconcile to the bank. Company directors do not take drawings but may draw a loan from the company, within limits.

TIP: We recommend that drawings are taken in round sum amounts, on a regular basis, such as monthly. You should not use a business bank accounts to pay personal

10 BANK RECONCILIATION

The bank reconciliation is a key control to ensure that the business records accurately reflect all income and expenses. It checks that your business records match transactions through the bank account. A simple bank reconciliation is as follows:

Bank balance at start of month	£ X
Add: cash received for sales, per business records	£ X
Less: purchases and expenses, per business records	(£ X)
Less: owners' drawings	(£ X)
Equals: bank balance at end of month	£ X

The bank should balance to the penny and any differences should be investigated.

Common differences on a bank reconciliation are:

- Timing differences such as where a cheque has been paid or received and recorded in the records but not yet cashed in the bank
- Recurring expenses such as standing orders or direct debits
- Bank charges or interest.

If a difference remains after looking for these items, it could be due to an error in your records.

You should reconcile to the bank on a regular basis:

- Generally, at least monthly
- At least quarterly if you are VAT registered
- Always at the year end.

TIP: You should always give your accountant a year-end bank reconciliation. They will always need one and paying them to do it is an expensive option.

Performing a manual reconciliation can involve ticking items off from your bank statement to your records and vice versa. It can be time consuming. Accounting systems often allow you to download bank statements, and may perform some automatic matching.

Once you have updated your records and identified timing differences, your records and bank should balance.

11 MANAGEMENT INFORMATION

Management information ("MI") is key information on how your business is performing so that you can decide on action needed to meet your ambitions and plans. Timely MI helps you run the business and manage the finances.

MI can help you with:

- telling how profitable the business is
- showing the assets and liabilities at a particular point in time (usually at the end of each month, quarter or year)
- understanding where your profit is coming from e.g. from which customers or products, or where you are spending your money
- comparing income and expenditure between months/quarters so you can analyse the reasons for significant changes
- taking prompt action during the year, allowing you the opportunity to increase your income or reduce your cost base rather than waiting for your final accounts

It can be forward looking. If you want to grow your business timely MI is critical in understanding your business,

Forward-looking MI (forecasts and budgets) can be important in helping you achieve your business aims.

You can design your regular MI pack to your specific requirements. It could include:

- Income with monthly and year-to-date comparisons to the previous month / year
- Analysis of income by customers / products, allowing you to understand your customer base and what products are selling well
- Analysis by distribution channel e.g. comparing sales through a shop or on-line
- A list of all expenses by category with monthly and year-to-date comparisons to the previous month / year
- A list of all amounts owing to the business, highlighting any overdue items
- A list of amounts the business owes
- The value of stock held and statistics on stock turnover.

Simple statistics or ratios can be useful to compare performance e.g.:

- Gross and net profit margins (as a percentage of sales)
- Profit by product / customer
- Debtor / creditor days (day's worth of sales / purchases owing to or by the business)
- Days' worth of stock on hand.

Most businesses fail because they run out of cash rather than profit. You should consider the need to do a cash flow forecast each year or for any significant changes you plan to the business. A cash flow forecast should help you develop a contingency plan if you need one.

Many small businesses can be run effectively with the owner keeping a close eye on pricing, profitability and amounts owed to or by the business. Larger businesses are more likely to need more sophisticated MI.

Accounting software often provides basic MI as standard. You need to work out, for your business, what information you need to manage it effectively. An accountant can often be really valuable in helping to design and interpret management information.

12 PREPARING FOR THE YEAR END

It is important to bring your records right up to date at the year-end, and to make them as clean as possible. If you are using an accountant, this will help keep their fees down.

Your accountant should be able to help with a checklist of steps you should consider at year-end. At the least, we suggest the following:

Before the year end
- Invoice as much work as possible and chase payment from customers
- Consider the need for capital investment (with advice from your accountant)
- Pay outstanding purchase invoices so far as possible
- Ensure owner's expense claims are all accounted for, up to the year end.

At the year end
- Count stock on hand as close to the year end as possible, and note any damaged items together with the value you expect them to realise, if it is below cost
- If stock can't be counted at the year end, make a note of any movements such as purchases between the count date and the year end so the count figure can be adjusted
- Make a list of any significant work done that has not yet been invoiced, on an item-by-item basis.

After the year end

- Write up the books, including for purchases which were received before the year end but invoiced afterwards
- Reconcile the cash balance in your records to the bank
- List all sales and purchase invoices which were outstanding at the year end
- List any amounts paid in advance
- List any amounts due but not invoiced, such as for telephone bills or accountancy fees
- Make a note of how you will apportion expenses such as for motor, between business and private use
- Make a note of any queries to go over with your accountant.

13 WORKING WITH YOUR ACCOUNTANT

We recommend speaking to your accountant about how to account for:

- Money you borrow for the business
- Leases and HP or other finance agreements
- VAT
- Capital items (especially large ones).

Many small business owners can manage their own finances and accounts. Whether you intend to manage on your own or not, we suggest making an appointment with an accountant when you start out, to help you get going in the right direction. Many accountants will not charge for this but will be glad to help. They know that if they help you now, you may come back to them for help when your business is bigger and you can afford to pay for more help.

You should also seek help from an accountant if you are not confident in managing your business finances or if your business is big enough or busy enough that your time is best spent managing it. You should do your homework in choosing an accountant with suitable qualifications, who will be a good fit for your needs and who you feel you can work with for the long term.

For more information on choosing and an accountant and on getting the most out of your relationship with your accountant, see our guides on these topics.

14 FURTHER HELP

We would be interested to hear from businesses who would like our help. Please contact us if you would like further information.

CONTACT US

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Annex One – Example of a simple cash book

Money In

Date	Customer	Invoice number	NET	VAT	GROSS	Date received

Money out

									Accounts Information – enter net amount if VAT registered			
Date	Supplier	Invoice number	NET	VAT	GROSS	Date Paid	Paid by owner	Paid by business	Cost of Sales	Travel	Office costs	IT

Note: See Annex two for a list of key expense categories

Annex Two – A list of key expense categories

Cost of Sales - Materials
Cost of Sales – Shipping & distribution
Hire of equipment
Van fuel
Motor costs
Rent, rates
Utilities
Repairs of property and equipment
IT
Insurance
Training
Subscriptions
Wages
Employers NIC
VAT
Accountancy
Legal / professional fees
Marketing
Telephone
Office admin & stationery
Company assets
Interest
Bank charges
Other