Section 1: The Good Bookkeeping Guide

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Disclaimer

This guide is designed to alert you to some of the major issues you should be considering. It is not a replacement for professional advice tailored to your precise needs and circumstances.

You should always seek the advice of a suitably qualified professional before acting on any of the advice.

And if you would like to speak to us about any of the issues covered in this guide, please feel free to give us a call or drop us an email.

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1 Introduction

The key to running a business is good bookkeeping. Unless you understand your accounts you will never be able to make good business decisions.

Better bookkeeping = better business = better life!!

Do you know what the numbers in your business are really telling you about your life and your plans for retirement? If you really knew, would you be happy or terrified?

Most people bury their head in the sand and never look up to see what the numbers are telling them – it would be too frightening! Make sure you're not one of them!

Because we know how important it is for a business to keep on top of its books, we not only provide you with access to the 'The Friendly Accountants Small Business Bookkeeping Guide', we also provide you free of charge with bookkeeping software specifically to help you keep on top of the paperwork.

But you have a responsibility in return to keep your books up to date and to follow certain rules. Which rules you follow depends on whether you record just your money in and money out or if you also record any sales invoices raised for customers and purchase invoices received from suppliers and also whether you are VAT registered.

Make sure you review these sections and get to grips with their contents.

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1.1 Bank Reconciliation

The key to good bookkeeping is making sure that your bank account is reconciled. HMRC consider your business bank statements as your 'primary' records – so this is what they will look at first. If you have recorded all your money in and money out transactions then you can't have gone far wrong!!

You should therefore reconcile your bank **every** month.

In fact, if you're using an online bookkeeping system with bank feeds then we suggest you reconcile on at least a weekly basis.

And whatever system you're using, you should make sure that at the end of the month, the balance in your bookkeeping system is the same as the balance on your bank statement.

If you're not able to use direct bank feeds (either because your bank doesn't support them or because or you're using an offline system) you may be able to import your bank statements into your bookkeeping system. This may be easier and quicker than entering all the entries manually. If you need to do this, we can help and make lifer easier for you.

You should also make sure each month that there are no long outstanding items in your bookkeeping system which haven't cleared on your bank statement – if there are then the chances are that these are either duplicates or have been entered in error. They'll need to be deleted out of your bookkeeping.

By the way, this also includes reconciling your cash if you have any in the business.

PLEASE NOTE: If you set up any new bank accounts or credit cards in the business name then these will need to be set up in your bookkeeping system. If you need help doing this, just give us a call.

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1.2 Credit cards

If you have a **business** credit card, this needs to be set up in your bookkeeping system and will normally be set up as a 'bank account'.

If you're using an online bookkeeping system then, as with your bank account, you may be able to use bank feeds to pull transactions in automatically.

Otherwise, as with your bank account, you may find it easier to import your credit card statement.

When you pay your credit card from your main business bank account, this will usually be entered as a transfer in whatever system you are using.

You will also need to reconcile your credit card each month – the balance will be how much you have outstanding on your credit card. And, as with your business bank account, you should make sure you don't have any old outstanding reconciling items – these will probably be duplicates or errors and need amending.

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1.3 Analysing your expenditure

Strictly speaking, from a tax perspective, as long as an expense is allowable for tax it doesn't really matter where you code it eg you could post an invoice for stationery to telephone costs.

However, the problem with inaccurate coding is three-fold:

- It makes it difficult for you to review your profit and loss account from one year to the next
- HMRC use software which analyses and compares accounts from one year to the next and also has certain industry standards that it compares your accounts to. Therefore the more inaccurate coding there is, the more likely your business is to be subject to an enquiry
- If you had an aspect enquiry and HMRC found that you were miscoding items on a regular basis, this may lead them to question what else might be wrong in the accounts.

We therefore strongly recommend that you are consistent in the codes you use for your expenses and are consistent from one year to the next.

Also you can usually enter new analysis codes in any system which you use. However, the more codes you have the more difficult it becomes to make any sense of the numbers – as you'll quite often end up with analysis codes which only have one item in them!

For a normal business, somewhere between 10 and 30 analysis codes is sufficient. And as a general rule of thumb – the smaller the business, the less analysis codes you need.

Also it's important that you understand that when we prepare your year end accounts we won't be carrying out an audit on your bookkeeping (that's a whole different ball game!).

So we'll assume that you have analysed your expenditure correctly and we will only carry out our standard checking procedure.

And, whilst mis-analysing isn't so critical if your expenditure is allowable for tax, analysing correctly where it isn't is very important.

So for instance, if you attend a networking meeting and analyse it one month as 'Networking' and the next month as 'Marketing', then this isn't a problem – both analysis categories are allowable expenses for tax and so it doesn't matter if you use a different analysis.

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However, if you take a client out to lunch and analyse it as 'Marketing' rather than 'Client entertaining', this does create a problem. Whilst marketing is allowable for tax, generally speaking client entertaining isn't.

When we prepare your accounts and tax return we won't know that you have mis-analysed some client entertaining expenditure and so we won't necessarily pick this up when we prepare your tax return.

If you are later the subject of a tax investigation, then this may be spotted by the taxman and you may incur fines and penalties. This is because you have claimed a tax deduction for costs which are not allowable.

The main categories of expenditure which are not allowable are as follows:

1) Non-staff entertaining (including client entertaining)
2) Personal clothing (there are of course some exceptions).
3) Parking and speeding fines
4) HMRC fines and penalties

There are specific rules covering each of these areas which are covered in section 4 of this guide - '**The difference between your bookkeeping profit and your tax profit**'. Please refer to this section if you have any expenditure which you think may fall into these categories.

This may be different from what your mate down the pub told you. And if you analyse these expenses incorrectly and they are claimed against your business income as an allowable deduction, then this may be not be picked up by the taxman in the normal course of events.

However if you have a tax enquiry and it is noticed by HM Revenue, then this could open up a whole can of worms and end in a very expensive tax headache. We would suggest you think very carefully about the risk of not treating these types of expenditures correctly – especially as HMRC are now quite aggressive in pursuing tax which they believe is payable.

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1.4 Expense vs Fixed Asset

A lot of people get confused as to when to post something to expenses (which goes into your profit and loss) and when to post it to fixed assets (which sit in your balance sheet).

Well an asset is something tangible which is going to last in your business a number of years, eg a computer or a desk. Whereas most expenses you incur are set against your income for the year, for accounting purposes assets are written off over a number of years.

So, for example, if you spend £1,000 on stationery in the year ended 30 September 2014, this £1,000 will be set against your income for that year.

However, if you buy a computer in that same year for £1,000, for accounting purposes only a proportion of this £1,000 will be written off against your income for that year – in the case of a computer this is normally one third.

The amount written off represents the deterioration in the value of the asset to you and is called depreciation.

Your bookkeeping software will not show the amount of the assets purchased against the profit and loss account – they will be included in the balance sheet.

The adjustment to write these assets off will generally be done when your accounts are produced and will form one of the differences between your bookkeeping profit and accounting profit (although some online packages such as Xero can post your depreciation for you on a monthly basis).

(The differences between your bookkeeping profit and accounting profit are covered in greater details in section 4 – '**The difference between your bookkeeping profit and your tax profit**')

The tax treatment of any assets purchased will be different from the accounting treatment.

If you wish to account for the depreciation charge each month through your bookkeeping software, you will probably need to develop a system to reflect this. Let us know if you need help and we will set this up for you.

Whenever you post an asset in your bookkeeping software, please put a note in the system if possible so we know what it is you have purchased. This will make it easier for us to do your accounts at the year end.

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1.5 Direct Debits/Recurring expenditure

There will be some suppliers that you pay on a monthly basis eg council tax, insurance.

If you are using a system which allows you to post supplier invoices, then you will need to decide whether to post the invoice in the system or whether to post the individual payments.

Be aware that in most systems when you enter a purchase invoice this will appear in total in the month in which it is entered.

If you would like to see a more accurate reflection of your costs in your profit and loss account then we would suggest posting these types of expenses as you pay them - even though you may only receive one set of documentation during the year (such as insurance, rent or subscriptions).

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1.6 VAT

The VAT treatment on supplier invoices/payments should be correct ie you claim the right amount of VAT depending on the invoice you receive. This sounds straight-forward but it's something many people get wrong.

This isn't so much of an issue if you're flat rate VAT accounting. However you do need to remember **not** to claim VAT on any supplier invoices or payments – unless it's a single fixed asset purchase of £2,000 (including VAT) or more. A single fixed asset purchase means one invoice – so you could buy a printer and laptop totalling more than £2,000 and claim the VAT as long as this is all on one invoice.

However if you're accounting for VAT normally - ie you're claiming VAT on your supplier invoices/payments - then it's very important that you get the VAT treatment correct.

First of all, if you have a VATable supply, it's important to get the VAT rate right.

An invoice with standard VAT will be coded with 20% VAT (correct as at September 2014).

Any expense which doesn't have VAT should be coded with zero VAT. You need to work out how to do this in your bookkeeping system so that VATable and exempt supplies show in your VAT return but transactions outside the scope of VAT (eg insurance, bank charges) do not.

(By the way, whilst it's good practice to treat VATable, exempt and out of scope transactions correctly for VAT purposes, it's more important that you only claim VAT when you're entitled to do so and that you claim the correct amount of VAT.)

And it's also important to make sure that if you are claiming VAT on a transaction that you have a VAT invoice to back this up or, if you don't have a VAT invoice, that you are confident that the expense is VATable and that you will be able to obtain a VAT invoice from the supplier if you ever have a VAT inspection.

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We're often asked if there's a de minimis where the taxman won't be bothered if you have a VAT receipt or not. There's no straight answer to this but in our experience VAT inspectors seem to take a pragmatic view when it comes to smaller receipts. However if they find other errors they may well include any smaller amounts as well. And of course you may get the VAT inspector who does everything 'by the book' - reviewing everything to the nth degree – if you do, you need to be prepared to pay the VAT back plus a little interest. You might also be liable to penalties which start at 30% for taking unreasonable care with your bookkeeping – although you should be able to reduce this if you've co-operated with the VAT man and have voluntarily disclosed any errors without any prompting from HMRC.

However, please note the following:

- VAT on non-staff entertaining is not allowable –non-staff includes clients, potential clients, networking contacts or even the spouses of your staff.

If you are claiming VAT on fuel using HMRC's approved rates (AMAPs) then you can claim the VAT on the fuel element – this is covered in our separate guide entitled '**Travel Expenses'** which can be found on our client training portal - **www.tfatraining.co.uk**.

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1.7 Personal payments

Sometimes you'll pay a supplier using your own money rather than the business money.

Where you do this, it's important to post the payment to the right place.

If you're running a limited company this is likely to be an account called 'Director's account', for a sole trader it's likely to be 'Proprietor's account' and for a partnership it's likely to be 'Partner account'.

In some bookkeeping systems you may have postings to these accounts broken down even further to show drawings and personal payments separately – just use whatever appears to be the most appropriate. It's more important that it goes to the right place in the accounts.

Please note that just because the business owner pays for something with cash, unless it is cash which belongs to the business (and not the business owners own cash), you should still consider this to be a personal payment.

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1.8 Travel Expenses/Fuel

Travel expenses are a topic on their own – which is why we have a separate guide entitled 'Travel Expenses' – please download a copy from the client training portal **www.tfatraining.co.uk**.

However, one of the main travel expenses you will incur is fuel.

And if you use your own car for business trips, you can charge the mileage expense to your business.

1.8.1 Limited companies

If you are a director of a limited company you should normally charge business mileage at the HMRC agreed mileage rates (as at the 2014/15 tax year these are 45p per mile up to 10,000 miles and 25p per mile for any mileage over 10,000 miles).

> For the most up to date rates go to '**https://www.gov.uk/simpler-income-tax-simplified-expenses/vehicles-**'.

1.8.2 Sole traders & partnerships

If you are a sole trader or partnership you can charge business mileage at the either the HMRC agreed mileage rates (as noted above) or you can charge a proportion of your car costs based on the percentage business to private mileage you do.

Your car costs can include the following:

- Petrol
- Car tax
- Repairs
- A proportion of the cost of your car
- Insurance
- Servicing

If you decide to use this second method you will need to continue with this method until you change your car.

Under either method you may claim VAT on the fuel element of your petrol costs. See our separate travel guide for more information about this - please download a copy from the client training portal **www.tfatraining.co.uk**.

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1.9 Customers and Suppliers

1.9.1 Recording invoices within your bookkeeping system

If you are recording your debtors (invoices not paid by your customers) and creditors (invoices from suppliers not yet paid) in your bookkeeping system, it's very important that these are correct – it's amazing how many times we see errors in these accounts!

So we suggest that once a month you review your outstanding debtors and creditors and make sure that these are accurate.

With debtors you need to make sure that you have allocated any money received to the correct invoices and that the outstanding invoices are as you would expect. It's also useful to review your actual debtor accounts and make sure you don't have more than one account for the same customer – if you do it can be very confusing and we would suggest merging these within your software.

If you have any old, outstanding invoices from customers then you need to consider whether these are bad debts and, if so, they need to be dealt with in your bookkeeping system. How you do that will be different for every system however it may be as straight forward as raising a credit note which is posted to a bad debts account. If you have any questions about this, please ask.

With creditors, you need again to make sure that you don't have duplicate supplier accounts and, if you do, you will be well advised to merge these within your software.

And, again, if you have any old, outstanding invoices these will need investigating as to whether these are duplicates or errors. If they are correct and have not yet been paid they should be left as outstanding invoices – your supplier has up to six years to claim this money from you!

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1.9.2 Recording invoices outside of your bookkeeping system

If you're not recording supplier and customer invoices in your bookkeeping system, you need to keep a good tab on these outside of the system.

We would suggest that you have a file for sales invoices and a file for purchase invoices.

In each file we would suggest three sections – one for fully paid invoices (at the back as you'll access this least frequently), one for partly paid invoices and one for unpaid invoices.

How you file your invoices within these sections is up to you and may differ for customers and suppliers. The most important point is that you can find an invoice at any point in time should you need to.

For supplier invoices we've found some business owners find it very effective to log invoices on a piece of paper at the front of their files (or even in an excel spreadsheet). You can then allocate a number to each invoice received and then file these invoices in numerical order in each section.

If you use excel to record these invoices then you will have the advantage that you will be able to do further analysis on your suppliers eg how much you have spent with an individual supplier.

For customer invoices we would recommend that you have a log of all invoices sent and that these are numbered sequentially – both on your log and on the invoice you send. This is particularly important if you are VAT registered as numerical sequencing is one of the requirements.

If you need help setting up your filing, or would like us to provide you with a template for recording supplier and customer invoices, please let us know.

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