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Want more? Advanced embedding details, examples, and help! Even at the best of times, knowing how to keep books for a small business can be challenging. But in 2021 things can seem confusing than ever. Small and medium-sized enterprises (SMEs) are facing a highly unusual set of challenges – including Brexit, coronavirus (COVID-19) and business rate changes. Staying on top of all these developments is tough. While bookkeeping responsibilities can feel overwhelming, you might find they're more manageable than they first seem. By breaking your bookkeeping responsibilities down into smaller chunks and creating a calendar of tasks to do, you should be able to get on top of your bookkeeping responsibilities. In this guide, you'll learn everything you need to know about how to start keeping books for a small business. Here's what we cover: Small business bookkeeping vs accounting The basics remain the same for SME bookkeeping in 2021 7 tips on how to keep books for a small business Final thoughts on how to keep books for a small business in 2021 Dreaming of bossing your own business? Take our quiz to see how ready you are to take the plunge Accounting and bookkeeping are two terms that are sometimes used interchangeably. But they don't mean the same thing. So what's the difference between bookkeeping and accounting? Bookkeeping is simply the process of recording all the money that goes in and out of a business. It used to involve entering information into ledger books – hence the name – but most businesses now do it using cloud accounting software. Besides recording all income and outgoings, bookkeeping tasks also involve collecting and storing financial information such as receipts, invoices and bank statements. It involves paying bills and staff, reconciling bank statements, data entry and paying taxes. Every business, from self-employed freelancers to major global corporations, must perform bookkeeping tasks. Bookkeeping sits within the world of accounting and it's often seen as the first step of a bigger process. Business accounting is about interpreting complex financial data and using it to create reports and forecasts, generally in order to understand the financial health and performance of a business. While your business is still fairly small, it's worth focusing on getting the basics of bookkeeping right since you have a legal obligation to record financial data. Business accounting will certainly help in time but your priority should be to get on top of your books first. While the past year has seen many unprecedented changes in the way businesses work, the essentials of how to do the books for a small business haven't changed. That said, there are certain developments affecting bookkeeping that you should be aware of this year. SME bookkeeping changes to remember in 2021 Certain changes have come in (be it in the past year or in just before that), which may affect how you keep financial records. These include: Making Tax Digital: If your business has a taxable turnover above the £85,000 VAT threshold, you'll have to use digital software to feed data about your revenue to HMRC (the UK's tax authority). IR35: The government's IR35 changes came into effect in April 2021. While the main focus is on medium and larger businesses, if you work as a contractor, you may be affected by IR35. So you'll need to plan and account for it. Brexit and customs duties: Rules around taxes for imports and exports to the European Union (EU) have changed since the end of the Brexit transition period. If you sell or buy goods from the EU, you will need to check how this affects the records you keep and the taxes you pay. Increase in minimum wages: You'll need to increase hourly pay for any staff on minimum wage in line with the new rates (for example, people aged 23 or over receive the National Living Wage – £8.91 per hour for the 2021/22 tax year). Keep records in these unusual times: You may well be eligible for a variety of coronavirus grants, loans and tax deductions. This is all good, but you will need to keep extensive records that provide evidence of why you claimed the relief. If you are affected by these changes, it might be worth speaking to an accountant for professional advice. That said, these developments don't change the fundamentals of how to keep books for a small business in the UK. Thinking about starting a business or already putting your ideas into action? We've got the resources, expertise and software to help you achieve your goals. Find out more Bookkeeping might at first seem like a confusing world of tax codes, VAT returns and accounting jargon. In reality, it's fairly straightforward. Essentially, it's all about recording how much money entered the business and how much money left it. By keeping track of this information, HMRC can then calculate what tax you owe. Here's everything you need to know about how to do bookkeeping for small businesses. Keeping an accurate record of all your transactions is a vital small business bookkeeping task. Each time you make a purchase or receive a payment, you need to record this information. Traditionally this would have been done in a ledger book or a spreadsheet, but it's a lot faster to record this information using cloud accounting software. Each time a customer makes a purchase, you need to note down how much they spent (if you sell products, it's useful to note what they bought too). Each time you buy something for the business, pay a supplier or pay your staff, you should record this too. Write down how much left the business bank account and what type of purchase it was. You should keep a copy of all your receipts for at least six years. Recording transactions is a legal obligation for businesses. But there are other reasons to do it too: Keep on top of spending and see how much is coming in and out of the business. Monitor your income and gain a clear view of what you're actually earning. Makes your tax return less painful by keeping receipts and a record of all spending in an organised way. By law, sole traders must maintain accurate financial records (bookkeeping), and you must retain records for six years if you are running a limited company. Many business owners start off with a simple process using spreadsheets, while a growing number opt to use accounting software. Here's how to keep track of finances in a small business. Manual bookkeeping You can manage your cash flow on spreadsheets, like the kind you can create in Excel. While manual bookkeeping might seem fine, it can become very time-consuming, and you'll need to watch out for errors and duplications. Bookkeeping using software Using cloud accounting software to manage your bookkeeping saves time, money and human error. Inexpensive software that's easy to use is available to automate your record-keeping. For example, you can use it to automatically pull transaction records from your bank account, so you don't have to manually enter each transaction. A good accounting solution can take care of all your vital business information and present it in an at-a-glance view to help you make the right decisions. You can customise your reporting depending on your priorities at any given time. You may want a quick daily overview, drilling down to whatever is appropriate that day. Tracking your income and expenses in real-time is a big time-saver. Your accounting software may include an app that can be used to easily recording income and expenses while on the go. The best accounting apps have features that make keeping up with the details easy, such as saving photos of receipts, so you don't have to keep paper copies. Reconciling your transactions is the second major bookkeeping task for small business owners and is usually done at the end of the month. Bank reconciliation is about looking at your monthly business bank statement and checking whether your financial records match up with the credits and debits shown on the bank statement. The aim of reconciliation is to give you an accurate view of your business's financial health. It can help you spot things such as unexplained spending or double payments, for instance. If there are any unexplained purchases or charges, bank reconciliation should help you figure out why. Doing reconciliation can be complicated if done manually. But by using accounting software, bank reconciliation tasks can be a lot easier – and less time consuming too. The software can automatically match up income and outgoing on the bank statement with invoices you've sent and things you've paid for. Knowing how to manage cash in a small business is a key skill for any founder. The good news is there are solutions to make life easier, such as outsourcing some of the burden to an accountant or using cloud accounting software. It's also worth noting that you could work alongside an accountant while using your accounting software, meaning they can see your numbers in real time and offer insights and advice that move your business in the right direction. What is cash flow? Cash flow simply refers to the amount of money that enters and exits your company. The cash coming in refers to all bills that your customers pay you (plus government grants). The cash going out refers to the likes of supplier invoices, staff salaries, utility bills and rent. If you have steady cash coming into the business, you can keep paying your expenses. If the money coming in dries up, you won't be able to pay money out. And that means your business would soon stop being able to function. The principles of good cash flow management are straightforward, but it's also where many businesses struggle. First, you need to make sure you have more money coming in than going out. Money also needs to come in on time, so you can pay suppliers and invest in stock and supplies. Having access to cash also gives you better buying and negotiating power, which could save you money in the long-term. Anticipating any shortfalls in funds is important, too. This allows you to make cash contingency cash flow plans such as extending credit. Here's our 10 top tips on how to maintain cash flow in a small business Tip 1: Have a good credit control system Setting up a good credit control system doesn't need to be complicated. The basics include setting clear credit limits and payment terms for your customers, sending out invoices promptly and firmly chasing all debts as they are due. Tip 2: Use sales forecasting Sales forecasting is all about predicting what's ahead to prepare for cash flow peaks and troughs. You can start forecasting cash flow once you have a month's sales behind you. Using your market knowledge, think about your pricing, your competitors' pricing, the state of the economy and so on to figure out demand. Remember, it's better to be overly cautious than optimistic. This is the best way to avoid nasty surprises. Tip 3: Cut unnecessary costs and spending When it comes to preserving cash flow, think lean and mean. Scrutinise every item you buy. Know exactly where your cash is going, and always get the best value for your money. Only make purchases that are essential to grow or maintain your business. Some costs will be tax-deductible. The UK government website has a detailed explanation of qualifying purchases and how to document them. There are different rules for limited companies, so be sure to do your due diligence. Tip 4: Negotiate good terms with suppliers It's always worth investigating your payment terms with suppliers. After all, if you can settle your bill in 60 or 90 days rather than 30, you get to keep your cash a while longer and regulate cash flow. If you're considering making a large order, always negotiate. Also, try to find ways to set up a regular payment plan rather than paying off outstanding amounts in one go. Tip 5: Manage your stock Monitoring stock closely and only ordering what you need means that you avoid tying up cash unnecessarily. Work out what sells quickly and profitably to keep income steady. Don't tie up funds in slow-moving items that are hard to sell. If you need a quick cash injection, try selling off old or outdated stock at a lower price. Tip 6: Apply for government grants and low-cost loans There's an enormous amount of help available that you should try to access if possible. This includes low-cost government grants, loans, tax breaks and support for investments. Keep an eye out and apply for any government support you might be eligible for. Tip 7: Keep on good terms with lenders Times may get tight, so it's worth staying on good terms with your bank or other lenders. Always keep your books up to date so you can show your figures in case you ever need to borrow a loan. If you're struggling with repayments, talk to the bank – and don't bury your head in the sand. Tip 8: Consider alternative finance Alternative finance providers create a platform for independent investors and small businesses to connect. Small business owners who can't get funding through high-street banks, or want fast, flexible access to capital can quickly connect with lenders and investors to create their own funding terms. Tip 9: Spot the warning signs A slump in turnover, late customer payments, and settling supplier invoices late are tell-tale signs that your cash flow is suffering. Don't ignore the warnings. It's generally easier to work out ways to increase working capital before you incur more debt. Tip 10: Step back and review your business' financial position Sometimes it's better to take a step back to see things clearly. If you are always struggling with money and your cash flow statement is poor, ask yourself why. Are your sales too low? Is your pricing off? Could you chase payments more aggressively? Be level-headed about your venture and its future. If you're not making a profit, you may need to rethink things. Late payments are one of the top reasons that businesses struggle. Common reasons for late payments include: Suppliers changing terms and conditions Customers withholding funds to check quality of work Customers demanding a payment discount not agreed at the outset Suppliers withdrawing credit without notice Customers withholding payment to question quality of work or delivery times Wondering how best to approach a late-paying client? Mike Cuttridge, business psychologist and member of the British Psychological Society, gives his best tips on getting paid: When you're chasing an unpaid bill, you must clearly state what you want to happen. Make sure the client understands your point of view. Explain that you invoiced 30 days ago (or whatever your payment terms are), the amount is now overdue, and you expect to get paid by the end of the week (or by whatever timeline you define). Be nice. Stay calm, but don't be a pushover. Certain clients will push you to the back of the queue if they think you'll accept it. Be clear on your goal. Keep reiterating the facts. State when you invoiced the customer and your payment terms. Always get the facts right. If you sketch over the details – or worse, get them wrong – you'll lose credibility and make yourself easier to ignore. Make personal contact with the person who hired you. It's much harder to brush off someone you've worked with or built a rapport with in the past. Ask if they can pull strings with the finance department or have a word with the boss. Be persistent. Make regular phone calls. Suggest a meeting. Get in touch often. If you have to deal with the accounts department, be personable. Find out the person's name and try to understand their point of view. Do they pay only on certain days? Is the company struggling? Treat everyone with respect, including the most junior assistant. It helps. At a high level, your financials are the reports or statements that offer you insights into the fiscal health of your business. It's important to know what these are and how they are generated so that you're aware of how your business is performing at any given time. The three most important financial statements you should think about are the balance sheet, the income statement and the cash flow statement. Balance sheet The balance sheet of a business essentially identifies its net worth. This gives a snapshot of your company's health by indicating how much your company owns (its assets) and how much it owes (its liabilities). Examples of assets are cash, accounts receivable, inventory, prepaid insurance, investments, land, buildings and equipment. Examples of liabilities include notes or loans payable, accounts payable, salaries and wages payable, and interest payable. Income statement A business's performance or results are reflected in the income statement (also known as a profit and loss statement). Use this report to monitor when your business makes a profit or a loss at any time. This statement is generally divided into two parts: the operating items section and the non-operating items section. The operating items section reflects the revenues and expenses involved with the production, importing and selling. The non-operating items section discloses revenue and expense information about activities that are not tied directly to your company's regular operations. Cash flow statement For small business owners, managing money is especially important because your start-up capital may not be enough to cover your daily expenses. You would therefore need to forecast and plan for cash coming in and going out as accurately as possible. Knowing and understanding what your business's income is and where it comes from allows you to determine what you have in the bank to spend. That's where your cash flow statement (also known as the statement of cash flows) comes in. Using it can help ensure that you can pay your suppliers and staff on time. In addition to managing your income and outgoings, you need to make sure you're on top of your taxes. Here's what you need to be aware of: Self Assessment Self Assessment is a system that HMRC uses to collect income tax. If you're a sole trader, you'll need to register with HMRC to file your taxes. You should register as soon as possible (or by the 5 October deadline) once you've started your business to avoid fines. Corporation tax Corporation tax applies to: Limited companies Any foreign company with a UK branch or office Clubs, co-operatives or other unincorporated association (such as a community group or sports club). As an owner of any of these business types, you are responsible for calculating and reporting your corporation tax. If you run a limited company, you will need to pay corporation tax on your profits. This is currently set at 19% for profits up to £300,000 (and also profits over £300,000). You'll need to file your company tax return by the end of your accounting period. If you need help with corporation tax, you can: Appoint an accountant or tax adviser to help you Call the HMRC helpline VAT Value Added Tax, or VAT, is a tax that's charged on most goods and services sold by VAT registered UK businesses. Unlike other taxes, VAT is collected on behalf of HMRC by registered businesses. Once you're registered for VAT, you must charge the applicable tax rate on any products or services you sell. If your business has a taxable turnover of more than £85,000 over a 12-month period, or if you expect to make more than that over the next 30 days, you will need to register for VAT. And under the Making Tax Digital (MTD) for VAT rules, you'll have to submit your tax returns using software. Note: MTD for VAT will apply to all VAT registered businesses, regardless of what their taxable turnover is, from April 2022. If you fall below the £85,000 threshold, it may be beneficial for you to voluntarily register. Being VAT registered may add to your business's professionalism. Also, if you make a lot of purchases, you may be able to reclaim the value of VAT on those items. There are several different VAT schemes that could help you save time and money. It's worth speaking to an accountant if you need more support here. Staying VAT compliant To be compliant with VAT legislation, there are two key things to bear in mind: You must keep your VAT records for at least six years. Records must be accurate, complete, and accessible – storing them digitally using software will help you to achieve this. You need to make sure you create official VAT invoices. The following 13 elements must be included on an invoice for it to comply with VAT regulations: Unique invoice number that is a continuation from your last invoice Your business name and address Your VAT number Date The tax point (or 'time of supply') if it is different from the invoice date Customers' names or trading names and addresses Description of the goods or services Total amount excluding VAT Total amount of VAT Price per item, excluding VAT Quantity of each type of item Rate of VAT charged per item. If an item is exempt or zero-rate, make it clear that there is no VAT on that item The total of these values separately Using accounting software that creates invoices is the best way to make sure your invoices are always compliant. It's important to stay on top of this – HMRC can contact or visit your business to inspect your VAT records for accuracy. Hiring or outsourcing these tasks to a professional bookkeeper means you won't have to spend so much time thinking about the books yourself. Ultimately, it's up to you and how comfortable you are with taking responsibility for these processes. While it may seem like a lot to think about, completing all these bookkeeping tasks need not take more than a few hours per month – especially if you use accounting software. For new business owners and sole traders, you might find you can do almost all of these small business bookkeeping tasks yourself. You'll also save on the bookkeeper's fee. However, as you grow, there will be more things to think about and doing your books will take more time. If you're new to business bookkeeping, it's helpful to write down a to-do list, so you ensure all your tasks are completed correctly and on time. You can then set yourself reminders for things such as paying suppliers, chasing invoices or applying for government funding. By taking the time to think about how to start accounting and bookkeeping for a small business, you can be confident that you'll be prepared for all tax requirements and ensure your business stays healthy. While the list of tasks might seem long, you'll be surprised by how quickly it becomes second nature. Editor's note: This article was first published in September 2017 and has been updated for relevance. Dreaming of bossing your own business? Take our quiz to see how ready you are to take the plunge. Take the quiz



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