

BOOK-KEEPING

**FIRST STEPS IN FINANCIAL RECORD
KEEPING FOR THE SMALLER BUSINESS**

Contents

SECTION		PAGE
1	Why keep books	1
2	Book-keeping methods available	3
3	Introduction to VAT	5
4	The Analysed Cash Book	15
5	Sales and Purchase Day Books	25
6	Filing your records	35
7	Reconciling the Bank Account	41
8	Double Entry Book-keeping	55
9	Single Entry Systems	63
 APPENDIX		
1	Cash Flow Forecast	68
2	Answers to Questions	70
3	Glossary of Accounting Terms	81

AIMS AND OBJECTIVES

The aims of this book are to:

- understand why book-keeping is important
- examine a wide variety of book-keeping options and select the one most appropriate for your business
- introduce Value Added Tax
- practice recording financial transactions

SECTION 1

WHY KEEP BOOKS?

Let's be honest, book-keeping isn't the fun part of any business. If it is, perhaps you're in the wrong business! However, it is an essential part of business success. There are five good reasons for keeping books. These are:

1 **Financial Control**

Good financial control is essential for the survival of any business. If you have prepared a realistic cash flow forecast (see pages 68 and 69), you will be able to monitor the performance of your business by using information provided by your book-keeping system. This way you are the first to know when things go wrong. Lack of financial information is a major reason for business failure.

2 **Taxation**

The government uses business to collect tax. Although the work is unpaid, there are severe penalties for failing to collect the right amount of tax. Most businesses are involved in the collection of:

PAYE
VAT
National Insurance
Schedule D or Corporation Tax.



Good records are needed for tax administration.

3 **Accounting Costs**

Most businesses use an accountant to calculate their profit and agree the tax with Revenue & Customs. If you have good records, the accountant should be able to produce accounts quickly and cheaply. If your records are a mess, the accountant will have to spend a great deal of time collecting basic data together - you will pay heavily for this privilege.

4 **Bank Borrowing**

At some point in time, most businesses need to borrow money from the bank. Banks like to see past accounts as a guide to business profitability. Banks also like to see some form of business controls in place. This gives them confidence that the debt will be repaid as agreed. An accurate, complete and up-to-date book-keeping system will give you the information you will need for you to control your business.

5 **Stakeholders**

The bank and government are stakeholders in your business as they have an interest in seeing it do well. However, many other groups will have an interest in seeing your business do well. For the small business the key ones are suppliers, who may use your posted accounts to check your credit worthiness. Your customers may also wish to check your financial strength to be assured that you will be able to supply them in the long term.

For larger businesses, other good examples of stakeholders are:

- Employees
- Local community
- Non-governmental organisations
- Shareholders
- Pressure groups

Therefore filing accurate accounts in a timely manner may improve your stakeholder relationships.

(note that stakeholders are different from shareholders as they don't necessarily own shares or have a direct financial interest).

SECTION 2

BOOK-KEEPING METHODS AVAILABLE

There is no single 'perfect' way of keeping books which suits everyone. Sole traders or partnerships have no legal constraints on the method they choose. If you trade as a Company, you will be controlled by Section 22 of the 1985 Companies Act. However, Section 22 only lays down simple commonsense rules which most businesses would adopt anyway.

A look in any good business stationers will reveal a host of book-keeping methods available to you. The methods generally fall into four basic types.

1 **Analysed Cash Book**

This is a very flexible book-keeping system. It is capable of meeting most business needs. As the name suggests, cash is analysed into different types of receipts and payments. This system is considered in Section 4 in more detail.

2 **Double Entry**

Double Entry is a traditional accounting system. For most small firms, *manual* double entry is simply too complicated for day to day use. Firms with accounts of sufficient complexity to warrant double entry should consider computerised accounting. This will increase productivity enormously. Section 8 gives more detail on double entry.

3 **Patent Systems**

Examples include Simplex, Everite, All-In-One etc. These are fine if your business fits the system. These systems tend to suit retailers, publicans or tradesmen. Ask your tutor to show you a couple of examples. More details are given in Section 9.



4 **Computerised Accounting**

The cost of computer hardware and software has fallen dramatically. Computerised book-keeping is now a real possibility for small businesses. However, even with today's costs, a firm will require an investment in hardware and software of around £800. This will provide a system which will keep books and also provide some word processing capability. For a firm with a lot of transactions, computerised accounting is definitely the answer.

Before you decide to take this significant step, remember you have to learn how to keep the books and how to use the computer. Neither task is easy and, if you undertake both at the same time, you could find yourself in real trouble. The installation of a computerised 'double entry' system should only be undertaken after discussion with your accountant or computer dealer. You must take advice unless you are sure you know what you are doing.

Computerised accounting takes a lot of effort to set up initially. Firms with simple accounting may not need this investment of time and effort. 'Accounting with Computers' is available as a Business Skills Seminar.

SECTION 3

INTRODUCTION TO VAT

INTRODUCTION

Before proceeding with book-keeping, we need to undertake a slight diversion and look at Value Added Tax. Sorry, but we do! This is because most book-keeping transactions include vat and we need to understand the effect of vat on the process.

VAT stands for 'Value Added Tax'. It is an indirect tax which enables the Government to tax consumer expenditure on a very wide scale. It covers most goods and services.

VAT's administration, collection and enforcement is the responsibility of HM Revenue & Customs. Local VAT offices administer the scheme around the country. The Central Unit at Southend-on-Sea maintains a central record of registered persons, issues periodical vat return forms and receives or makes tax payments.

Although not an official definition, VAT can be described as:

"A tax on final consumer spending, collected in stages, when goods change hands or services are performed".



Almost any commercial transaction can be a taxable supply for VAT purposes. For example:

- the sale of goods, or the performance of a service, which results in payment
- an exchange of goods or services, or
- a gift in kind.

Wages paid to employees are not included.

When sales turnover reaches a certain level, the business has to register with HM Revenue and Customs through their local VAT office. The registration threshold from April 2007 was £64,000.

It is possible for a business to register for VAT even if the turnover is below the registration limit. This is called 'voluntary registration'. Voluntary registration enables a business to reclaim VAT earlier than would normally be the case.

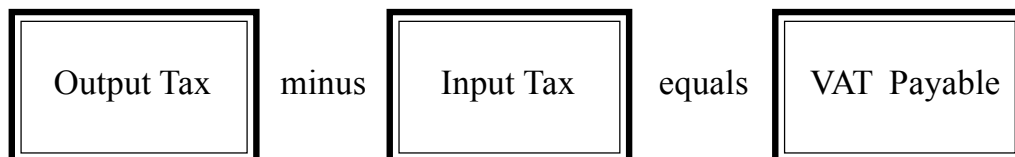
Once registered, the business has to charge its customers VAT. The business is, however, allowed to recover any vat paid to its suppliers.

There are two sides to VAT:

Output Tax - This is the tax collected from your customers

Input Tax - This is the tax charged by your suppliers.

Under normal circumstances, output tax will be greater than input tax. The tax payable to HM Customs and Excise is the difference between the two amounts.



Some businesses, however, pay more VAT than they collect. For example, a milkman collects no VAT from his customers but many of his supplies carry standard rate VAT. This type of trader is called a 'reclaimer'. HM Revenue & Customs refund the returned VAT, normally within 10 working days. The diagram on page 8 shows how VAT is collected at each stage in the manufacture and distribution of a product.

VAT CATEGORIES

In Britain, there are, currently, four broad categories of VAT. These are:

Standard Rate

Most goods or services fall into this category. The trader adds standard rate VAT to the price of every item sold. Standard rate VAT is currently 17½%.

Zero Rated

This category is similar to standard rate since tax is levied. However, the rate is zero percent! At first sight, it may seem rather pointless charging your customers a nil tax rate since you don't actually collect any money.

However, provided the traders charge VAT (even at zero percent), they are still entitled to reclaim VAT paid out by them. This means that businesses trading in zero rated supplies get a regular repayment from HM Revenue & Customs.

Examples of zero rated traders include foodshops and booksellers.

Exempt Supplies

Exempt supplies are supplies exempt from tax. This may sound rather attractive; however, if all your supplies are exempt, you will not be able to reclaim any input tax (ie tax paid by you). Examples of exempt supplies include insurance, most health care, some education and training.

Special Lower Rate Supplies

VAT is levied on domestic fuel and power, energy saving materials, pensioners' security and women's sanitary products at 5%.

