Bookkeeping - The Essentials

4 Minute Read

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Keeping up-to-date and accurate accounting records is more than a legal requirement.

It's key to keeping track of your expenses and income, and understanding where your business stands financially.

What is bookkeeping and accounting and why is it important?

Bookkeeping simply means keeping a record of your company's financial transactions. This includes sales, expenses, salaries and other bank transactions. Your bookkeeping records form the basis of the statutory financial statements you submit to Companies House annually.

You can also use your records to produce management accounts focusing on specific areas. For example, you can prepare a breakdown of where your revenue is coming from or a comparison of budgeted expenses against actual expenses.

Should I do the bookkeeping myself?

Doing your own bookkeeping at the beginning can be a good idea. You'll learn a lot about your business and save money. The drawback is that it can take up a lot of time. You might also miss out on tax benefits or fail to meet all your legal requirements simply because you don't know about them.

As you grow, outsourcing your bookkeeping and accounting to an accountant is an option. With outsourcing, you can be confident of meeting all your compliance requirements and of taking full advantage of any potential tax incentives. You are also free to focus on developing your business.

Outsourcing doesn't always scale up well as your business grows, so this might be a temporary measure before you employ a finance team. In an established business, this would typically include a Finance Controller (FC), a Chief Financial Officer (CFO) and team of accountants with responsibility for different financial areas.

What does bookkeeping and accounting involve?

Here's a list of the tasks that you typically need to get done:

What needs to be done	Frequency
Bookkeeping / Posting transactions into accounting system / Paying bills / Chasing outstanding debtors / Payroll processing	Daily / Weekly
Prepare management accounts / Profit and loss / Balance sheet / Cash flow forecast	Monthly / Quarterly
Submitting VAT returns	Quarterly
Preparation of statutory financial statements	Annually
Corporation tax calculations	Annually
Claiming tax reliefs	One off

What sort of accounting software can I use to help?

You can choose between desktop accounting software such as Sage or cloud-based online software. Desktop-based software is generally more cost effective; there's just a one-off initial cost, while for cloud-based software you pay a monthly fee.

However, more businesses are switching to online solutions like Xero because they like the way these solutions can automate a lot of accounting tasks. For example, you can pull together a record of all your purchases into a VAT return. You can also sync your bank account with your accounting system so that your banking transactions are automatically posted to the right category in your accounts.

"Keeping accurate accounting records is key to understanding where your business stands financially."

What else should I know before I get started?

Accrual Accounting

There are two methods of accounting: cash accounting and accrual accounting. With cash accounting, you record transactions when cash is actually exchanged. With accrual accounting, you record transactions when they occur rather than when money changes hands. This gives you a much clearer picture of the financial health of your company.

In practice, most SMEs use cash accounting for internal use and switch to accrual accounting when they prepare their annual statutory financial statements. Accrual accounting must be used for statutory financial statements to adhere to accounting standards.

Here's an example of how accrual accounting works. You've hired a freelance developer in September and estimate she has worked 10 hours in the month for an hourly wage of £100. At the end of September, she hasn't submitted her timesheets so you don't pay her, but you should record what you estimate to be the right expense of £1,000.

What else should I know before I get started?

Matching Principle

So that your accounts give an accurate picture of how you are putting money to work in your business, you also have to match the cost of buying an asset with the period when you will use it to generate income. For example, when you buy a tablet, you expect it to help drive your revenue for as long as the tablet lasts. So, in your accounts, you spread the initial cost of the tablet over that period. This is where the concept of capitalisation and depreciation comes into play.

Let's look at the example in more detail. Say you have bought a tablet for £1,200. As you expect the tablet to also drive future revenue, you are allowed to capitalise it in your accounts and then depreciate it according to its useful life of say, two years. This is to say that you can include it as an asset in the balance sheet and then spread the costs over its useful life of two years. Instead of incurring a loss of £1,200 when you make the initial purchase, only £50 is charged to your monthly profit and loss until the tablet is fully depreciated.

This is also one of the reasons why your accounting profit can be very different from your cash position. When you buy the tablet you will have £1,200 less cash, but your accounts will only show £50 of loss in the month.

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