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# Book- Keeping MADE EASY

- ✓ Fundamentals explained
- ✓ Learn how to read accounts
- ✓ Set up your own accounts

This is an excerpt from Lawpack's guide *Book-Keeping Made Easy*.

To find out the secrets of good book-keeping/accounting and a lower tax bill, [click here](#).

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by Roy Hedges

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For convenience (and for no other reason) 'him', 'he' and 'his' have been used throughout and should be read to include 'her', 'she' and 'her'.

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# Introduction

Most people who are in business for the first time wrongly believe that keeping a set of books is an unnecessary and unpleasant chore that they have to do just for the benefit of the taxman. It's true that HM Revenue & Customs will use the accounts produced from your business records to extract as much tax as they can. On the other hand, a skilled accountant will be able to use them to minimise your tax liability.

Keeping an accurate detail of all your business transactions should never be classed as a job to be done only when you can fit it into your busy schedule. Your business paperwork needs to be updated daily because it's the gauge of the financial health of your business. It's no good moaning that time could be more profitably spent making sales, because if you sell goods or services at a loss due to poor accounting procedures, what is the point of being in business? Did you know that more businesses fail in their first year or two because of insufficient financial control than for any other reason?

What makes this book different from the many others published over the years on book-keeping? It's because it's written primarily for the entrepreneur. Whilst students and those entering book-keeping and accountancy careers for the first time may find it of interest, it's not a textbook. It's really aimed at small business owners. Apart from showing how to set up accounting records and explaining the jargon used by those in the profession, it also demonstrates the practical uses to which a go-ahead businessperson can put the information stored within the accounts of a business.

Since the financial records of an owner-managed enterprise can differ greatly from those of medium-sized and larger businesses, Chapters 2 and

3 relate to the book-keeping requirements of a sole proprietor, for example, a self-employed tradesman or small shopkeeper, in fact anyone mainly trading in cash and not credit transactions. If you fall into this category, you will have little use for double entry book-keeping, and piles of ledgers. What you really need is an easy-to-operate, no-frills system and that's exactly what you get in these chapters. Nevertheless, it's important not to neglect some of the later chapters, as these will be invaluable to you as a source of reference; I refer to the sections on Balance Sheets, Profit and Loss Accounts, computerised accounting and payroll (even if you are only employing one member of staff).

At the end of each fiscal year, putting the final accounts together will be a lot easier for your accountant if he is presented with a full set of well-kept books, instead of just being given piles of invoices and receipts to sort out. Apart from ensuring you are not paying too much tax, his fees will be much lower.

Those of you who are on the threshold of an exciting new business adventure may be interested in reading my other books in Lawpack's Made Easy series: *Running Your Own Business Made Easy*, *Debt Collection Made Easy* and *Earning and Keeping Customer Loyalty Made Easy*. Each draws on personal experience to help you avoid the pitfalls I encountered when embarking on the same path you are now taking.

Finally, I would like to thank the many firms and individuals without whose help I would have been unable to write this book.

Roy Hedges

## CHAPTER 2

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# Keeping records for the small business

**What you'll find in this chapter**

- ✓ The cash book
- ✓ The sales book
- ✓ The purchase book
- ✓ Dealing with petty cash
- ✓ The petty cash book
- ✓ Using credit cards for business payments

Cash is king – we all know that – so it's vital that you monitor your cash flow accurately. The main advantage of having knowledge of book-keeping is that not only will it save you the expense of an accountant, but it can help you keep track of how your business is doing as you go along.

The last thing sole proprietors need is a complicated accounting system. What they really want is a simple, easy-to-operate method to keep track of:

1. cash;
2. income; and
3. expenditure.

Income is the receipts you get from selling your goods and/or services and this is classed as revenue income. On the other hand, not all money you

receive is necessary income; for example, you may invest some of your own money in the business or get a loan from a bank. These types of receipts are classified as capital receipts.

Expenditure will be divided into revenue expenditure, which is money you spend on purchasing your goods for resale, advertising, utilities, etc. This type of expenditure can be either fixed or variable; for example, an expense is variable if it changes depending on the number of customers purchasing from you. Fixed covers items such as rent and insurance.

Capital expenditure is the money you spend on items you plan to use for the longer term, say one year or more. These include plant and machinery, office furniture and equipment.

In order to provide more detail, I am going to describe keeping these records in three books, but you can do it in one.

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## The cash book

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This book monitors the movement of your money in and out of your bank account. From the first moment you begin trading, you will need to know how much cash is coming into your firm and how much is flowing out. Without this basic knowledge, you will never know whether you have enough cash to pay your staff or suppliers.



TOP TIP

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All money taken out of your business account for personal use must be classified as drawings.

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The cash book monitoring your money should look like your bank statement; it will show you what cash is coming in and going out of your business, and what happens to it. Also, each month you must check that the bank doesn't make any errors, and with this method you can, simply by reconciling your cash book with your bank statement each month.

I recommend using a three-column cash book with one column for receipts, one for payments and one for the accumulated balance. This allows you to keep a running balance of the cash you have available in the bank at any given moment in time. Without having to keep adding and subtracting figures, your actual balance can be seen at a glance. The reason

for this is because invariably the balance at the bank or on your statement doesn't take into account cash or cheques in transit.

An example of the type of cash book recommended is shown on the following page. All entries should show the date you actually sent a cheque to your supplier and details of the payee, including the cheque number. The type of payment should be stated if you are not paying by cheque, for example, either by standing order (s/o) or direct debit (d/d).

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Your cash book should be your best friend. Make sure that you know everything about it and look at it regularly.

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TOP TIP

In this sample, I have assumed our retailer is a newsagent. In the course of business, the newsagent supplies a local company with trade magazines and newspapers for their reception area. As they prefer to pay monthly, he invoices them; hence in the last row reference is made to its number. This item would be recorded in the sales book as soon as it has been sent to the customer, but obviously the cash can only be entered into the cash book once it has been received.

In this illustration a 'contra' item is shown; this is because not all the money received was banked. In this case, £20 was kept back to increase the daily float of loose change retained in the cash register, the petty cash. Had the item shown only reflected the actual amount banked; there would have been a discrepancy between the cash received and cash at the bank. Contra entries save you having to bank the entire sales receipts and then write a cheque to withdraw the sum needed, requiring you to make additional entries in your books and pay extra bank charges into the bargain.

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Some items, such as bank charges and interest payments, will only come to light when your bank statement is received. These should be entered as soon as possible, after reconciling your statement with your cash book.

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TOP TIP

The date the payment is entered in your cash book and the date it actually leaves your account could vary considerably, depending on how long the payee takes to pay in your cheque.

Your cash book should reflect all transactions as and when they happen. If you only rely on your bank statement, it will not show those credits and

debits that are in transit. The dates entered in your book should be the dates the cheque was made out or a deposit made. In the case of standing orders and direct debits, the date they are due to be paid should be used.

Date	Description	Money In	Money Out	Balance
5 Jan	Balance b/fwd			3,535.50
	Banked – Till Roll No 1 (less Contra £20)	352.28		3,887.78
	B. Smith C/Htg. Chq. No: 123		45.60	3,842.18
6 Jan	T. Knavish Gar. Chq. No: 124		53.84	3,788.34
	HH Finance d/d		250.00	3,538.34
	Banked – Till Roll No 2	529.85		4,068.19
7 Jan	Pensions R Us s/o – Drawings		125.00	3,943.19
	Banked – Till Roll No 3	414.37		4,357.56
8 Jan	MC Ltd (Invoice 323)	28.40		4,385.96

*A retailer's banking cash book*

## The sales book

I have found it easier to write up the books on a daily basis. If you do these things while they are fresh in your mind, there is less chance of errors occurring, and it only takes a couple of minutes a day.

This book will be used for recording your daily sales, or takings. For a shopkeeper, each day's takings will be entered in total. No one, not even the taxman, expects you to list individual sales. On the other hand, a decorator, for example, would only have one or two entries per week or month to record so more detail may be preferred.



For ease of reference, VAT has not been included in any illustration.

Week No: 1		Commencing: 5 January 2009		
Date	Till Roll No.	Takings/Sales Cash	Takings/Sales Chq/Cr. Card	Totals
Mon 5/1	1	372.28		372.28
Tue 6/1	2	494.75	35.10	529.85
Wed 7/1	3	398.00	16.37	414.37
Thu 8/1	4	254.86		254.86
Fri 9/1	5	529.44		529.44
Sat 10/1	6	783.56	103.40	886.96
<b>Totals:</b>		2,832.89	154.87	2,987.76

*An average shopkeeper's sales book*

As you can see, the totals of the cash and cheque columns across equal the total of the third column down. This method not only allows you to confirm your sums are right but it also ensures all amounts have been entered correctly and figures have not been transposed. Numbering every till roll will make it easy for your accountant to verify the amount of sales at the year-end. The till rolls can be filed in a folder or box file once the entry has been made.

The book-keeping system described in this and the next chapter is not suitable for limited companies or partnerships.



Date	Detail	Amount
Mon 5/1	Mr Jones, Any Rd, Newtown (Chq. No: 21)	952.18
Thu 29/1	Smith's Stores, High St (Chq. No: 65)	421.50
Sat 31/1	Monthly total	1,373.68

*An example of a decorator's sales record*

An extraordinary item, such as an overdraft, loan or additional capital, would simply be entered under the weekly totals as: 'January 5 £5,000 Loan from Anytown Bank PLC', or capital introduced.

Date	Item	Stationery	Drawings	Vehicles	Stock	Heating	HP/Loans	Rent	Total
4 Feb	G Smith Garage Chq No: 84		20.00	53.84					73.84
	R & S Stationery Chq No: 85	189.15							189.15
5 Feb	M White C/H Ltd					45.60			45.60
	Roberts Finance (D/Debit)						250.00		250.00
	WA Estates Chq No: 86							1,200.00	1,200.00
18 Feb	R & S Stationery Chq No: 87	16.20							16.20
	<b>Totals</b>	205.35	20.00	53.84		45.60	250.00	1,200.00	1,774.79

## The purchase book

This book analyses the purchases in order to save paying an accountant to do the work. However, should you use a professional book-keeper, this book will be unnecessary.

If it's not your intention to use an accountant, HM Revenue & Customs (HMRC) provides a large range of booklets to help you.



TOP TIP

When analysing payments, the first two columns will show the date and description as shown before in the cash book and sales book examples. To the right of these two columns will be a series of other columns, each one with a heading denoting the type of expense to which the payment relates. The number of columns you use will depend on the type of business you are in. Also there is no set rule on how you classify your expenses. Some people prefer to keep utilities separate and have one column for electricity, and another for gas. Others may prefer to put these two items into a single column.

In the example of a purchase book above, you will note that apart from the name of the supplier in the item column, the method of payment is also shown. This helps you to reconcile your bank account and cash book.

To ensure that you are using the correct headings in your expense columns, copy those listed in HMRC's Self-Assessment Form supplied by your Tax Office.



It should also be noted that the payment to G. Smith's Garage shows payments in two columns: this is because one cheque was used to pay for two expenses, one for private petrol purchased and the other for business. The two items are added together in the total column.

At the end of each page, and month, each column is totalled, and the sum of the totals along the bottom line must tally with the total at the bottom of the total column; thereby confirming every entry is correct.

The analysis of the expenses in the purchase book enables you to see at a glance what costs you are incurring and makes the accountant's job at the year-end easier – and cheaper.

There are a number of classifications that can be used to analyse expenditure; some of the most common are listed here, together with a general explanation of the differing items that can fall into each category.

- 1. Costs of sales (stock):** Those goods you buy for resale to your customers. Or in a manufacturing business raw materials used in production of finished articles.
- 2. Employee costs:** These include salaries and commissions, and subcontractors expenses. Money paid to you is drawings and must not be included in this column, but wages paid to your spouse or partner would.
- 3. Premises:** In this column you would include such things as insurance, rent and rates. If you are a small user, you could include heat and light. It's possible for those working from home to make an adjustment to offset part of your home expenses against business costs. An accountant will advise you on the proportion you are allowed to claim.
- 4. Repairs** include machinery used in your business, but not cars. Repairs to business property are an allowable expense, but not improvements. There can be a fine line between repairs and improvements; either read HMRC's guidelines or see your accountant.
- 5. Administrative expenses** cover a wide range. More items will end up in this column than anywhere else. Things such as telephone, postage, tea and coffee are just a few possibilities. Subscriptions to trade associations also fall into this category.
- 6. Travel** and overnight accommodation fit into this classification, for business trips away from your area. Meals are also permissible if staying away overnight.
- 7. Vehicle expenses** such as car repair, servicing and petrol costs fit into this sector. Also, a road fund licence can be included, but not fines for speeding or other motoring offences.
- 8. Advertising** includes all promotional material, for example, for direct mail or newspaper advertising. Taking clients or suppliers to lunch is not a claimable business expense for taxation purposes.

Notes of the cost of this type of entertainment should be included in your budgeting, which is discussed in chapter 6.

9. **Professional fees** for accountants and solicitors are another item of expense to be recorded and deserve a column of their own.
10. **Financial charges** such as interest on overdrafts and loans go in this column; also in this category would be leased equipment.

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Some of the expense headings used here may not be applicable to your business, so just leave them out. However, there may be some headings not included, so simply add them to the list. The suggestions mentioned are not set in stone.

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Columns for drawings should encompass anything of a personal nature, rather than a business expense.

You should have a column for each category of genuine business expenses. Nevertheless, there are some expenses, which in practice are borderline cases inasmuch as they are part private and part business, petrol for example. As a general rule, your accountant should be able to negotiate with the HMRC to apportion these types of costs.

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Don't forget to claim for membership of trade and professional organisations.

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What are allowable or disallowable business expenses is a minefield, and before setting out your columns you should read HMRC's form mentioned on page 17 and discuss it with your accountant. A few more allowable expenses are mentioned in the last chapter. Remember that if you run your business from home, a proportion of certain household expenses can be claimed – full details are available from HMRC.

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Throughout this book there are references to taxation. These are purely layman's observations. Advice should be sought on this subject from HMRC and your accountant.

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## Dealing with petty cash

Inevitably there are times for every business, irrespective of its size, to make a cash purchase. In some firms, a simple metal cash box is used to keep the money safe, or in retail business the purchase may be made straight from the till. In either case, a record of the transaction must be kept.

<b>Petty cash voucher</b>		<b>no 54</b>	
		Date ___ February 7 ___	
		<b>£</b>	<b>p</b>
25 envelopes		2	50
2 pens			90
12 first class stamps		3	96
		7	36
Signature _____		Authorised by _____	

*A typical petty cash voucher*

Using a cash box normally requires a fixed sum of money being withdrawn from the bank and topped-up at regular intervals. The method of entry in the cash book and cheque stub will be no different from any other transaction.

There is no reason to purchase pads of petty cash vouchers; an odd scrap of paper will do. The important thing to remember is to complete a petty cash record as soon as the purchase is made or when you return to your shop or home. Otherwise, it could be forgotten, and you'll end up not claiming for it.

If you are using cash direct from the till, when it comes to banking the daily takings, a contra entry will be necessary. In both cases, a note or petty cash voucher is required to replace the money used. You will attach the receipt given at the time of purchase to the voucher.

One of the best systems for dealing with petty cash is the imprest method. This works as follows. Say you start off your petty cash with £50. During

the course of a week you take from the cash box enough money to pay for fares, cleaning materials, tea and coffee.

Each time you spend a sum of money, a petty cash voucher replaces the cash spent. At the end of the week, every voucher is added together with the remaining cash and the total should be £50. Now if your purchases came to £40, for example, your petty cash is reimbursed by this sum to start you off on the following week with £50 again, thus restoring the imprest position. In larger organisations the petty cash voucher would be signed by a manager; in a small business it may be initialled by the owner – this would vouch for the authenticity of the expense. Numbering the vouchers allows them to be filed in numerical order, making it easier for your accountant when auditing the books at year-end. It also helps to identify the payment when your firm's expenses are being analysed at the end of the week or month. The imprest system can be, and is, used by all businesses irrespective of their size.

The advantage of this method is that petty cash can be checked for accuracy at short notice and at regular intervals.



## The petty cash book

The petty cash book analyses expenses in the same way as the purchase book. All you need is a simple analysis sheet and at the end of each month put the petty cash vouchers in order, all travel dockets in one pile, and stationery items in another and so forth. Total each pile and record the totals on an analysis sheet.

Date	Cash From Bank/ Contra	Cheque Nos.	Total Expenses	Travel	Stationery	Cash Balance
Jan	Petty cash	128	40.00	25.00	12.50	2.50

*A simple petty cash analysis sheet*

Your petty cash book should be set up in the same manner as your cash and purchase books and should include the following:

- Date of petty cash payment
- Details and amount of payment
- Petty cash voucher numbers

Always ensure that the entries are made in this book on a daily basis to avoid errors occurring.

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## **Using credit cards for business payments**

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Credit cards are increasingly being used to pay for business expenses. Some credit card companies will issue a second card, or set up another account solely for business purposes. You are advised, for the same reason as having separate bank accounts, to have two credit card accounts, one for business and the other for private use.

Always remember to include the charges card processors make, and the interest element if not paying the account in full each month, with other financial costs as an expense. Credit card statements should be filed as any other receipt or invoice.

Because of the steep interest charges, it's always advisable to pay the credit card bill in full each month and not take advantage of the credit facility. Not only are there cheaper finance deals available but it can also cause complications when recording transactions. Paying for an item by credit card is no different from paying by cheque – you have incurred the expense on the day you sign the voucher. If you do make numerous credit card transactions, I recommend that you create a credit card book to analyse this expenditure.