The IRIS essential guide to bookkeeping



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Bookkeeping is the beating heart of business.

It's how you keep everything on track, visible and compliant.

Because of this, all UK limited companies must have accurate records of transactions. These records need to include income, expenses, liabilities, and more.

However, bookkeeping is also good financial practice for everyone else. Even the smallest sole trader needs pristine records in case HMRC knocks on the door.



About this guide

There's something for everyone in this guide to bookkeeping.

For those new to bookkeeping, we set out all the foundations you'll need to get started.

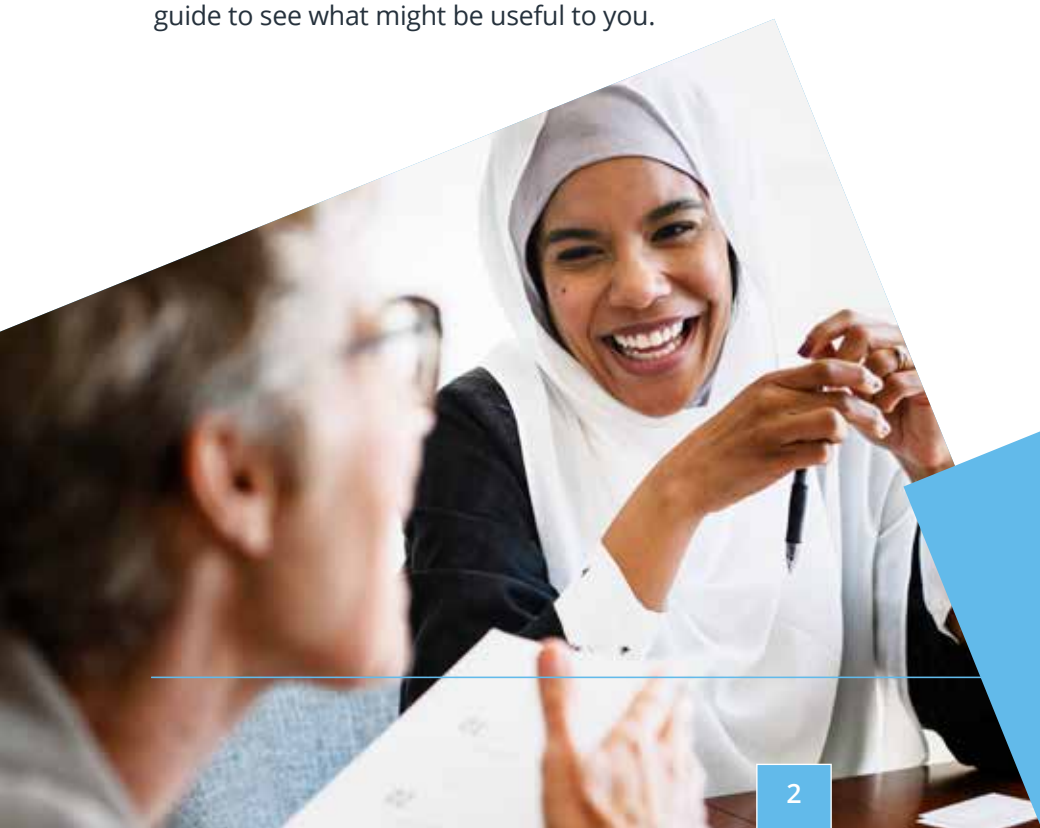
But it's always helpful to refresh what we know and seek out new approaches in this field. That's why the latter sections have something to offer those who are more experienced.

So, whether you're doing bookkeeping in-house or providing accounting and bookkeeping services for businesses, we suggest you look through our guide to see what might be useful to you.

Here's what's included:

- The basics of bookkeeping
- Setting up your bookkeeping system
- Recording transactions
- Managing financial documents
- Financial reporting and analysis
- End of Year procedures
- Common bookkeeping challenges

... and more.



The importance of bookkeeping

"How healthy is your business?"

Some people might answer this question using their instincts. Others might glance at their bank account to give you an answer.

But good bookkeeping is the only way to get a complete overview of your company's current situation.

Without keeping the right records, you can't plan; you need to be able to track cash flow, manage expenses, and identify growth opportunities.

Without this essential step, you'll struggle. You'll have problems when you want help from advisors (including accountants) or are trying to win funding.

Understanding bookkeeping basics

Bookkeeping is the process of recording all financial transactions made by a business. A bookkeeper keeps track of where money comes from, where it goes, and ensures that the books are 'balanced'.

> What does 'balancing the books' actually mean? In short, it's making sure the outgoings (also known as debits) don't exceed the money received (also known as credits).

What you'll be keeping an eye on in bookkeeping

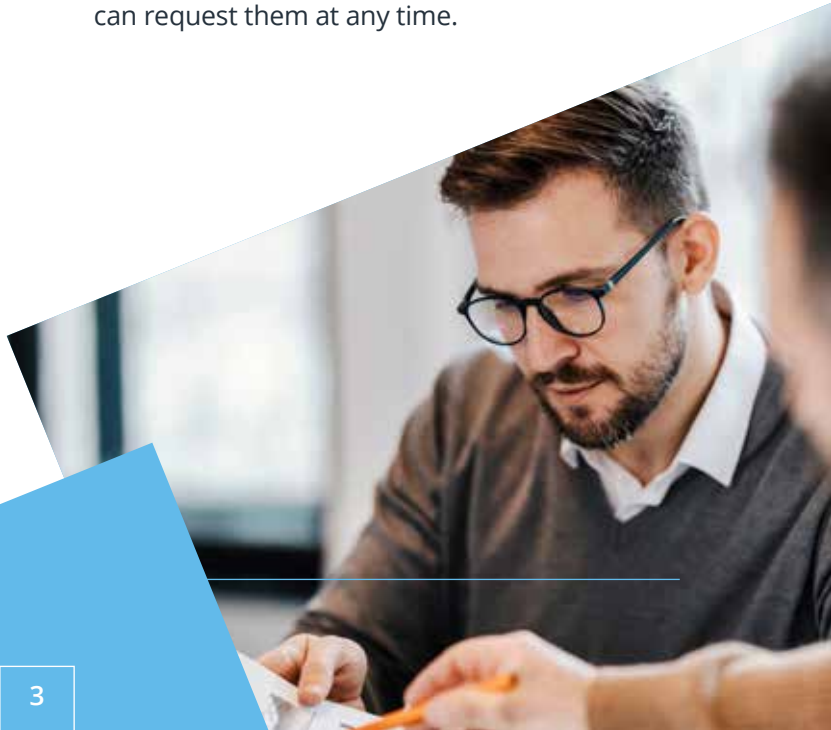
- **Your income:** Also known as revenue, this is the money earned from selling goods or services.
- **Your expenses:** These are the costs incurred in the process of earning income, such as rent, utilities, and salaries.
- **Your assets:** These are resources owned by the business that have economic value. Examples include cash in your bank, inventory, and property.
- **Your liabilities:** These are obligations or debts that the business needs to pay in the future, including loans, HP agreements.
- **Your equity:** This represents the owner's interest in the business after all liabilities have been deducted from assets. It's essentially what the business owes to its owners.

The outputs include an income statement (or profit and loss statement), a balance sheet (your current financial position), and a cash flow statement. A cash flow statement demonstrates how money is being managed over time.

Legal requirements

In the UK, keeping accurate financial records isn't only good practice - it's the law. Here's what you need to know:

- **Record-keeping mandates:** UK businesses must maintain detailed records of all financial transactions. This includes income, expenses, and any assets or liabilities your business holds. Limited companies must produce detailed financial statements. Sole traders and partnerships don't need as much detail, but it's important to keep high standards in case of an audit.
- **HMRC guidelines:** HMRC has specific guidelines on what records you need to keep and for how long. Generally, you should keep records for at least six years. These records are crucial examining of business records, HMRC can request them at any time.



Your bookkeeping system

At the core of bookkeeping is the system you use.

Some bookkeepers try to make do with spreadsheets, but they have several disadvantages. First, it doesn't take much for spreadsheets to become disorganised. When this happens, keeping things in order becomes an additional, arduous task.

Choosing the right bookkeeping software

You need a bookkeeping application that includes:

1. **An easy-to-use interface:** The software needs to be intuitive and user-friendly. It should take you through the process. Remember: small annoyances on day one become much worse over time.
2. **Financial reporting:** It's important to create comprehensible reports on profit & loss, stock control, and self-assessment.
3. **Bank integration:** Life is much easier when you can link your bank accounts and match bank statements with your business accounts.
4. **Digital Tax compliance:** The world is becoming increasingly digital, and that includes your tax affairs. Your software should support Making Tax Digital (MTD) for Income Tax Self Assessment, allowing for direct submissions to HMRC. Whether you submit the tax return or someone else carries out this task, it's always good to have your accounts prepared.
5. **Cloud functionality:** Cloud bookkeeping software is a powerful solution. It backs everything up and generally means you'll get seamless updates.
6. **Mobile access:** It's best to deal with things as they occur, and being able to work on the go will make all the difference if you want to work flexibly. Cloud bookkeeping solutions mean you can access everything from a browser, making all this possible.
7. **Expense and purchase management:** It's important to track and manage purchases, expenses, and mileage as efficiently as you can.

> Do bookkeepers need to register for anti-money laundering (AML) supervision? In part, yes. Self-employed bookkeepers in the UK must register with HMRC or relevant professional bodies like the Association of Accounting Technicians (AAT) or the Institute of Certified Bookkeepers (ICB).

In-house bookkeepers, however, do not need to register individually. Instead, their employers are responsible for ensuring compliance with AML regulations through risk assessments, training, internal controls, and reporting suspicious activities as regulated by their industry bodies.

Recording transactions

There are two main ways to do your bookkeeping. These are referred to as single- and double-entry bookkeeping systems.

Single-entry bookkeeping

Single-entry bookkeeping is a straightforward accounting method.

Here, you record each financial transaction as a single entry in a ledger. If all you need is a basic overview of cash flow, this is the method for you. Unsurprisingly, many small businesses with uncomplicated financial activities choose to work this way.

But do you want the best possible overview of your financial situation? In that case, it's time to consider the double-entry bookkeeping system.

Double-entry bookkeeping

With double-entry bookkeeping, every transaction has two entries: a debit and a credit. For example, if you buy office supplies, you might record a debit in an 'office supplies' account and a credit in a 'cash' account. This credit, or payment, reduces the available balance of the cash account.

Keeping an eye on the detail

Let's look at the different types of transactions you'll come across in bookkeeping:

- **Sales:** This is the money your business makes from selling products or services. Here, you record each sale with details like the date, amount, and the customer.
- **Purchases:** These are expenses for buying goods or services needed to run your business. This is where you keep track of what you bought, from whom, and how much it cost.
- **Receipts:** This includes any money your business receives that isn't from sales, such as loans or investments.
- **Payments:** Record all outgoing payments. This includes those to suppliers, utilities, employee wages, and other business-related costs.

You can organise accounts in a manner that suits your business. A **Chart Of Accounts (COA)** is a document that provides stakeholders with an overview of how you separate your expenditures, revenues, assets, and liabilities into different codes, referred to as 'Nominal Codes'. Like any good summary, make sure people know what information is available for them to read; as a minimum, include identifying names, descriptions and codes for each account.

Common mistakes

Even the best can slip up sometimes. Here are some common bookkeeping mistakes and how you can avoid them:

x **You omit a transaction:** It's easy to overlook small transactions. To avoid this, make a habit of keeping all receipts and enter transactions regularly.

x **You don't categorise properly:** Misclassifying expenses or income can mess up your financial statements. Make sure you understand your chart of accounts and stick to consistent categories.

x **You don't reconcile your accounts:** Reconciling is when you compare your bookkeeping accounts with real money entering and leaving your business bank account. Doing this helps you spot problems - when the two don't match, it often means an error. It can also point to illegal activity, such as theft or fraud.

x **You don't back things up:** Losing financial data can be a nightmare for your business. Always back up your records. If your software works in the cloud, then that's a good way of protecting precious information.

x **Overlooking VAT:** Not recording VAT can cause serious compliance issues. Be familiar with how VAT applies to your transactions and be diligent in your recording.



Managing financial documents

Keeping track of invoices and receipts is a fundamental part of managing your business finances.

What do invoices need?

When creating an invoice, include essential details you can refer to later, such as:

- ☑ **Business information:** Your business name, address, and contact details.
- ☑ **Customer information:** The customer's name and contact details.
- ☑ **Invoice number:** A unique identifier for each invoice.
- ☑ **Date:** The date the invoice is issued.
- ☑ **Description of goods/services:** Clear and concise details of what was sold.
- ☑ **Amounts:** The cost of each item or service and the total amount due.
- ☑ **Payment terms:** Specify when payment is due and the acceptable payment methods.

How to track invoices

Because bookkeeping is a regular task, you need to keep an eye on where invoices are in the payment cycle. To manage invoices effectively, you should:

- **Track due dates:** Monitor when payments are due. Your business needs to follow up on overdue invoices. Keeping on top of your credit control is vital for your cash flow.
- **Record payments:** When the invoice is paid, ensure that it is recorded properly.

Although we have examined this from the perspective of your business and your invoices, you must also exercise the same diligence when suppliers issue invoices to you.

Good software will help you issue an invoice and track its status.

Storing invoices and receipts

Use digital storage: Scan paper documents and store them electronically. Cloud storage services can be particularly helpful here.

Organise your files: Categorise and label files clearly, such as by date or customer name.

Know your retention policies: Follow legal guidelines on how long to keep financial documents. Typically, this may range from three to seven years.

Petty cash management

Managing petty cash is crucial for smoothly handling small, everyday expenses.

Begin by deciding on an initial amount that covers daily, minor expenses. Assign a responsible person to manage the fund and use a voucher system. A voucher system means every reason for using petty cash is recorded, as well as the date and amount.

Review the petty cash on a regular basis and use a simple approval process to maintain control. When funds run low, replenish them by writing a check for the exact amount spent and record it in your accounts.



Financial reporting and analysis

Financial reporting and analysis is when you take your financial data and turn it into actionable insights for your business.

Good software lets you generate balance sheets, income statements, and cash flow statements. From there, you have a comprehensive overview of your business's financial health.

And reports are not only useful to the business leadership; they can be referred to by investors. As such, they play a central role in attracting funding for your business.

Key financial reports in more detail

- **Income statement (profit and loss statement):** This shows your revenues, costs, and expenses over a specific period. It helps you understand how profitable your business is.
- **Balance sheet:** This provides a snapshot of your assets, liabilities, and equity at a specific time - in other words, what you own and owe.
- **Cash flow statement:** A cash flow statement tracks the movement of cash in and out of your business. It highlights if you have enough cash to meet your obligations.
- **Accounts receivable and payable aging reports:** These reports help you track outstanding invoices and bills.

How to prepare and interpret P&L statements

As a bookkeeper, you will often refer to the profit and loss (P&L) statement. As such, it's worth looking in more detail at how you might prepare one for your business.

What follows are some of the main steps for creating and interpreting them.

Preparing a P&L statement

1. **Calculate revenue:** Begin by listing all sources of revenue during the period in question from your sales and services.
2. **Apply the cost of sales:** Calculate direct costs associated with producing goods or delivering services. Deduct this from the total revenue, providing you with the gross profit.
3. **Apply operating expenses:** List all operating expenses. This includes things like rent, utilities, salaries, and marketing costs. Subtracting these from the gross profit gives you your earnings before interest and taxes (EBIT).
4. **Consider other income and expenses:** Include any income or expenses not related to core operations. This can include interest and tax expenses. Subtracting these from the operating profit gives you the net profit. This is also called your 'actual profit' or your 'bottom line'.

Interpreting revenue trends

Are your sales growing, declining, or stagnant? Here's how to find out.

To spot revenue trends, start by comparing revenue figures over several periods. Explore your numbers on a monthly, quarterly, or annual basis. This helps identify patterns or changes and provides a view of financial performance over time.

Generating line graphs or bar charts can make these trends more obvious.

Next, analyse variances by comparing actual revenue to budgeted or forecasted figures. This will help you identify any significant deviations from your initial plan. From there, you can begin to understand the reasons why things could have changed.

You can also conduct a segment analysis. You do this by breaking down revenue by product lines, services, or regions to pinpoint areas of growth or decline. Additionally, calculating the percentage change in revenue between periods reveals the business growth rates. That way, you get a precise measure of the business's financial trajectory.

Expense management: Look at where your money is going. Are there areas where you can cut costs?

Understanding balance sheets

A balance sheet provides a snapshot of your business's financial position at a specific point in time. Here's a breakdown of its components and how to understand them:

1 **Assets:** These are things your business owns.

- **Current assets:** Cash, accounts receivable, inventory - these are assets that can be converted into cash within a year.
- **Non-current assets:** Long-term investments, property, equipment - these are assets held for more than a year.

2 **Liabilities:** These are what your business owes.

- **Current liabilities:** Accounts payable, short-term loans - in other words, debts due within a year.
- **Non-current liabilities:** Long-term loans, mortgages - these are debts payable over a longer term.

3 **Equity:** This represents the owner's interest in the business.

- **Owner's equity:** This refers to capital invested by the owners plus retained earnings (i.e. money left over that owners can put back into the business).

How to examine business performance in a balance sheet

- **Liquidity:** Check the current ratio (current assets divided by current liabilities). A ratio above 1 indicates good liquidity.
- **Financial health:** Compare total assets to total liabilities. Ideally, assets should exceed liabilities, indicating a healthy financial state.
- **Growth potential:** Look at changes in equity over time. Increasing equity suggests the business is growing.



Closing your books

Closing your books at the end of the financial year is important. It's a final check of your financial records to ensure they're accurate and ready for reporting. It's also a way of making sure everything is set up in your accounts for the next financial year.

But how do you 'close your books'? Here's a simple guide:

1. **Review transactions:** Go through all transactions for the year. Ensure they are recorded correctly and classified in the right accounts. Look out for any discrepancies or errors.
2. **Reconcile all control account:** Reconcile your bank statements with your accounting records. Make sure all amounts match up and resolve any differences.
3. **Adjust entries:** Make necessary adjustments for things like depreciation, accruals, and prepayments. This ensures your financial statements reflect the true state of your finances.
4. **Close temporary accounts:** Transfer balances from temporary accounts (like 'revenue' and 'expenses') to permanent accounts (such as 'retained earnings'). This resets the temporary accounts for the new financial year.
5. **Generate financial statements:** Use your software to produce your Profit and Loss Statement, Balance Sheet, and Cash Flow Statement. These documents summarise your business's financial performance over the year.



Annual accounts: preparing annual accounts for submission to Companies House

If your business is VAT registered, you have to prepare annual accounts for Companies House.

Steps to prepare annual accounts

1. **Compile financial data:** Gather all the financial information from your year-end close.
2. **Format documents:** Ensure your financial statements are formatted according to Companies House requirements.
3. **Review for accuracy:** Double-check all figures and notes to ensure accuracy and completeness.
4. **Submit on time:** File your accounts with Companies House by the deadline, typically nine months after your company's financial year-end.

What to include in your Annual Accounts

- **Balance sheet**
- **Profit and loss account**
- **Cash flow statement**

Notes to the accounts: These provide additional context and explanations for figures in the financial statements.

Directors' report: This is an overview of the company's performance, significant events, and future outlook.

Many bookkeepers in the UK (in-house or external) handle tax returns as part of what they do. While their primary role is to manage financial records and transactions, many also assist with tax preparation and submission. However they might work with an accountant at this stage.

How to prepare for an HMRC audit

It can be anxiety-inducing to get a letter saying HMRC wants to inspect your business affairs.

That said, it is common: you should expect an audit to happen once every five years. Businesses will get picked up by spot checks and singled out if they've made a mistake in their tax return.

If HMRC wants to inspect your books, they might conduct a full enquiry, which reviews the business's full tax affairs. Alternatively, they might carry out an 'aspect enquiry', which looks at a selected area of a tax return or the business's financial records.

Regardless of which type of inspection they are going for, preparing for such an audit can be a daunting task.

However, with the right steps, you can make the process much smoother.



Getting ready for HMRC

- Ensure you organise all your financial records and make them accessible.
- Review your financial statements and ensure they reflect your business's financial position.
- Prepare all supporting documents for transactions and balances shown in your financial statements. This includes contracts, bills, and payroll records.
- Conduct an internal review or mock audit. This can identify and address potential issues before the actual audit.
- Be open in your communications with auditors. Give them the information they need and be ready to answer their questions.

Seek professional help if you need it in the lead-up to an audit. Consider hiring an accountant to assist with audit preparation and ensure everything is in order.

How KashFlow can help you

IRIS KashFlow is easy to use and automates routine tasks - saving you time and making your bookkeeping life simpler.

Many of the steps we've outlined above can be done within a few clicks, such as invoicing and producing financial reports.

And the great news is you can work from anywhere because it's based in the cloud.

Enjoy:

- A full view of finances
- Intuitive invoicing
- Solutions that help you get paid faster
- Easy-to-understand reports

Click here to find out more