Guide

The Fundamentals of Accounting

How to simplify your finances and make your business flow.

Table of Contents

Page 3
Free hours to focus on what matters

Page 4
Bookkeeping vs accounting

Page 5
Level one: Keep clean books

Page 6
Level two: Go further with accounting

Page 9
Level three: Power up with software

Page 10
Ten tips to get the best start

Page 12
Summary

Page 13
Glossary

Sage

Free hours to focus on what matters

Keeping a business profitable is no easy feat. If you're managing to do this already, it's likely you're extremely driven, hardworking, and passionate about your chosen field. But to keep this success going, you also need to master managing money.

Go back a while and this included tedious manual tasks that would take up a good chunk of your time. Even if you had an accountant or in-house bookkeeper, you'd still need to do things like organise expense receipts and chase up unpaid invoices.

No matter how complex your finances have become, you can still manage them efficiently. All you need is quality software and to brush up on your knowledge of basic accounting concepts.

In this guide, we run through both. By the end, you'll be ready to keep your finances in shape, stay compliant with the latest legislation, and extract insights that help you make decisions. All while freeing more hours to focus on what really matters.

Bookkeeping vs accounting

Before we dive in, lets clear something up. And that's the difference between the words 'bookkeeping' and 'accounting'. If you've ever used these terms interchangeably, you're not alone. But they do have different meanings, and you'll need to understand both.

Bookkeeping
The process of recording all the money that goes in and out of your business. This involves collecting and storing financial information such as receipts, invoices and bank statements.

Accounting
The process of interpreting financial data and creating reports and forecasts. This helps you understand the financial health and performance of your business.

If you're looking to improve the way you manage money, getting bookkeeping right should be your first priority. This will ensure you're doing everything that's legally required at an absolute minimum. After that, you can start exploring the possibilities of accounting, where you'll surface the insight hidden within your numbers and feel more confident in your decisions.

To keep things simple, we've broken this into three levels. First, we'll look at how to keep your books properly, then some smart accounting practices, and finally the ways software brings it all together with a host of benefits.

Quick note: We'll be explaining some concepts as we go, but **we've included a glossary at the end of the guide, so that** you can quickly refer to any terms you're unsure of.

Level one: Keep clean books

Whether you're a freelancer, sole trader, or run a business, you are legally required to perform bookkeeping tasks.

Not only do you need to keep a clean record of all the money that enters and leaves your business, but there are other tasks too; like paying bills and staff, reconciling bank statements, entering data, and paying taxes.

Doing all of this keeps your business operating legally and ensures you're paying the right amount of tax. So, the more vigilant you are about bookkeeping, the better.

The whole process is much easier if you can build consistent habits that keep you on top of everything on a continuous basis. Here are five main bookkeeping tasks and how often (at least) you should be doing them:

1. Record all transactions (When: Every day)
Keeping an accurate record of all incoming and outgoing transactions is the primary task of bookkeeping and a legal obligation for your business. That means, each time you make a purchase or receive a payment, the information needs to be stored, along with the amount.

These financial records will be used later for your tax return, so accuracy is essential. Holding onto receipts for up to six years is also recommended.

2. Back up files and records (When: Every week)
Always back up your financial records so that you have at least once copy of them. If you keep paper files and records, you need to make sure they are well ordered and safe, but also consider scanning them so that you have digital versions.

If you record all transactions digitally already, you can use the cloud to store backups offsite, just in case you have a system failure or any IT issues.

3. Bank reconciliation (When: Every month)
This is where you look at your monthly business bank statement and check whether your financial records match up with the credits and debits shown.

Doing this gives you an accurate view of your business' financial health, and helps you spot things like unexplained spending or double payments. Without reconciling your accounts every month, you run the risk of unchecked errors building up and causing greater problems.

4. Do your tax return (When: Every year (but soon every quarter)
Each year, you need to report your revenue to HMRC so that they can calculate how much tax you owe. This is where all those financial records that you've kept are used. Once calculated, you'll then be sent a tax bill to pay.

Many businesses have an in-house finance team/person or work directly with an accountant to do this, as it can be a mighty task. However, if you stay consistent with your record keeping and accurately record all transactions and receipts digitally, it's much easier.

It's worth noting that the HMRC is implementing the Making Tax Digital (MTD) scheme. This requires the use of compatible software for submitting tax returns, as well as making digital accounting records compulsory.

So far, MTD for VAT-registered businesses has been launched, and MTD for those who use Self Assessment will be launched in April 2024. Another change is the frequency of tax returns, which will switch from annually to quarterly.

5. Send and chase invoices (When: Every day)
Getting paid is vital for a healthy cash flow. If you wait too long after a job is complete to send an invoice, or if a customer is delaying paying you, you're reducing the amount of available funds in your business. This impacts financial flexibility, so you need to make sure all invoices are being processed and paid as efficiently as they can be.

This is a preventative measure against having to delay essential purchases like stock. Each day, make sure your business is sending out fresh invoices for any work that was completed/products sold, and assess if any customers who still owe you money need reminders to pay.

Bookkeeping doesn't have to be complicated
Technology can significantly help you to ease the burden of bookkeeping. In fact, all five of these tasks can be partially (and, in some cases fully) automated, meaning you can stay consistent with little time and effort.

We'll explore this more when we look at software in level three. But just remember, there are ways to strip out manual bookkeeping work like entering data into spreadsheets, which takes a long time and has a higher chance of error.

Level two: Go further with accounting

Once you've tightened up your bookkeeping habits and established some consistency, you can start surfacing insights with accounting. This involves looking at your financial data, putting it into context, analysing patterns and trends, and making decisions to enhance financial performance.

To do that, you'll need to start running financial reports, which help you understand what's happening with your money at any given time. You'll be able to see how profitable the business is, which areas need improvement, or even when past performance was better or worse.

Knowing this stuff makes you feel in control and confident when making decisions and plans. So, master financial reports and you instantly boost your chances of keeping your business profitable.

Reports make it easier for you to spot problems, take immediate action, and give you more control over cash flow. They also reveal areas for improvement, show where you need to invest, and lead to smoother collaboration with your accountant or financial advisor.

There are dozens of financial reports you can run, but here are four that should be considered your essentials:

1. Profit and Loss report

The Profit and Loss report (also called the Income Statement, or Profit and Loss Statement) shows your business' sales and expense totals over a specific period. It subtracts associated costs from sales to reveal if the business is making or losing money. In other words, it shows if you can generate profit by increasing revenue, reducing costs, or both. It's mainly used:

- To share insights that help business owners, managers, or a board of directors to make decisions.
- In taxes and finance applications to provide a view of the business to banks, investors, customers, and suppliers.
- To show investors and lenders the profitability of your business over time, indicating whether you can repay loans and interest, and how much income your business generates.
- Internally, stakeholders can analyse details such as sales revenue sources and direct expenses to inform decisions.

2. Balance sheet

Usually running at the end of a quarter or year, the Balance Sheet is a list that compares everything your business owns (assets) and owes (liabilities), and the amount invested by shareholders (equity). It's called a balance sheet because each side should ideally match. It's mainly used:

- To show how much money is available to shareholders.
- For investors to gain insight into the business and its operations. They may also be looking to see if there is enough cash available to pay dividends or to invest more in the business.
- If your business is for sale, for potential buyers to assess the state of the business.
- To work out your 'liquidity ratio'. This tells you whether you have enough money in the bank or assets that can quickly be converted into cash to pay your bills.

The Balance Sheet also comes in handy when used for a few other calculations. For example, you can measure your liquidity ratio by dividing current assets by liabilities. This tells you if you'll be able to pay off your debts in the next 12 months.

3. Nominal Activity report

The Nominal Activity report is a summary of your ledger account balances for a specific period, including the opening and closing balance, and debit and credit balances. This makes it clear if there are any unusual spikes or dips where there shouldn't be. These are often the first sign that an error might have occurred, helping you to make corrections and gain confidence in the numbers you're working from. It's mainly used:

- For spotting balances that look wrong (such as being too high or low) so that you can find and fix any accounting errors.
- For forecasting and analysis, such as looking at this year's balances and one of last year's balances to compare costs, expenses, and income. This is critical for budgeting and making important financial decisions.

4. Trial Balance report

The Trial Balance report shows a snapshot of all ledger accounts at a specific point in time. This includes all Balance Sheet and Profit and Loss accounts together in one report, complete with cumulative totals of the debits and credits posted to each account, and a year-to-date column. It's mainly used:

- To check you've entered transactions correctly over time or at the end of a day.
- For forecasting and analysis, such as looking at this year's balances and one of last year's balances to compare costs, expenses, and income. This is critical for budgeting and making important financial decisions.

The Trial Balance report is a key tool in ensuring accurate recording of all transactions. This feeds directly into other reports that you'll use to make decisions and is also invaluable when used to compare financial performance between periods.

Get to know your cash flow

Knowing how much cash you have available at any time is vital for running a financially healthy business. So, as well as running financial reports, you also need to keep a continuous eye on cash flow.

This way, you'll always know if there is enough money for things like paying expenses, bank loans and taxes, as well as buying assets like stock and materials. Without this, planning becomes difficult, and you start to feel less in control.

To get full visibility of cash flow, you need fast access to up-to-date information, including what your current income and expenses are for the period.

This isn't as simple as how much cash is in the bank. It means considering things like how much you currently owe, how much customers owe you, when payments need to be made or are expected, and how much VAT you're liable for.

Knowing your true cash flow situation while considering these factors can get complicated and time consuming. But with the right tools, you can visualise key information, spot anomalies and missed payments, and discover insights—all using accurate real-time data.

Which brings us nicely to level three, and why software is so powerful.

Level three: Power up with software

As a business owner your time is extremely valuable. If you calculated how many hours you spend managing finances with basic admin tools, you'd also be able to see what they're really costing you financially. More value can be gained by focussing on what you do best.

This is where dedicated accounting software comes in. With the right solution, you're able to fully enable accurate bookkeeping and a make understanding your business finances much easier. You'll also feel empowered to take more control over your money, without having to become an account yourself, or dedicating such a huge chunk of your working week to finance.

If you have an accounting team, the same benefits mean you can boost their productivity, while making collaboration easier both inside and outside the business. By making your people's jobs easier, you may also see better retention. Solutions differ
in their capabilities, but any dedicated software will likely make your bookkeeping and accounting simpler, faster, more compliant, and more valuable to the business.

Here are the typical benefits delivered by a quality accounting solution:

Real-time insights–You can learn significantly more about your business with both top level and extremely detailed visualisations that present real-time data in different ways. This helps you make decisions based on an enhanced understanding of everything from cash flow to forecasting.

Efficient automation–Manual data entry is not only tedious, but also very prone to human error. A misplaced decimal or entry duplication can cause problems later down the line that take a long time to investigate and rectify. Automation not only significantly reduces these mistakes, it saves hours of work by doing many tasks for you.

Simpler compliance–Software that has integrated compliance delivers the ultimate peace of mind that you're doing everything correctly–from your tax return to payroll run. They also help you easily meet any legislation changes as they come in.

Manageable digital records–Keeping digital records means you no longer need physical storage for things like paper receipts. This saves space and is also more secure when backed up to the cloud. Finding, importing, and sending digital records is immeasurably easier when compared to physical files. Also, they are compliant with Making Tax Digital rules.

Intelligent invoicing–Manual creation of invoices is incredibly time consuming, difficult to personalise, and easy to get wrong. Intelligent invoicing features allow you to regularly produce and track customised invoices that get customers to pay you quicker.

Realtime clarity–When you need clarity of the performance of your business, nothing delivers faster than powerful software tools that let you run, manipulate, and interpret financial reports. From a better understanding of how much profit you're making to what your current asset and liabilities are, reporting tools get the up-to-date information you need to act with confidence.

Ten tips get the best start

So, you've got to grips with some key accounting concepts, are committed to keeping clean books, and have made the wise decision to use dedicated software.

You have everything you need to start creating maximum value in minimum time. Let's bring it all together, with 10 tips that will give you the best start with accounting for your business.

1. Keep personal and business accounts separate
This is really important, even if your business is already established. As a business owner, it can be difficult to separate your home life from your work life–and this includes managing your money.

To get tax right and be as efficient as possible, you need to draw a line between business and personal finances, which means having separate accounts. You'll also need to make sure any business expenses you claim are legitimate. Some after work beers with friends don't count and will only add confusion later down the line.

2. Use cash flow dashboards to stay agile
Cash flow insights like sales and purchase totals, trends, and anomalies can help you stay agile at times where you need to make decisions quickly. This is crucial during periods of economic uncertainty or sudden market shifts. Software that helps you visualise cash flow with dashboards gives you these insights instantly.

3. When you find an anomaly, see to it quickly
A huge benefit of accounting is being able to spot things that aren't quite right. Mistakes on your side, or unusual changes in customer behaviour are inevitable, but you don't want them to start stacking. For example, you might notice an unusual spike in unpaid sales invoices. While you may be inclined to be patient, leave this too long without chasing customers and you could run into difficulty in the following month when this is paired with missed supplier payments.

4. Schedule regular time for reporting
Make sure you proactively schedule reporting periods at least every month. You might not need to run every essential report each time, but get into the habit of digging into your data and using it to understand how to improve financial performance.

Frequent reporting will also help you feel less stressed at times where you urgently need to present financial data–like at the end of the financial year or for an investor meeting.

5. Use sales forecasting
Sales forecasting helps you predict what's ahead so that you can prepare for cash flow peaks and troughs. You can also use your market knowledge, both your own and competitor pricing, and the state of the economy to anticipate demand.

Just remember to be cautious rather than optimistic, as over estimating can land you in a tough situation if you achieve far fewer sales than you've banked on.

6. Don't avoid chasing payments
Part of accounting includes waiting for customers to pay you. It's understandable if you feel uncomfortable chasing them to settle invoices. After all, you've probably worked hard to build a great relationship and you don't want to jeopardise that.

But at the end of the day, you need to get paid to protect your cash flow. It's essential for the financial health of your business, and timing matters. So, be firm but polite with any customers who are well overdue and offer whatever support they might need to push things forward.

7. Be strict with costs and spending
To preserve cash flow, think lean and mean. From the items you buy, to the prices you negotiate with suppliers, you should always be aiming to get the best value for your money. This includes keeping a close eye on where your cash is going, and only make purchases that allow you to grow and maintain your business. Also, don't forget that some costs will be tax-deductible. There are different rules for limited companies, so be sure to do your due diligence.

8. Adjust your prices for 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, it's collected on behalf of HMRC by the businesses. Once you're registered, you must charge the applicable tax rate on any products or services you sell.

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, so it's worth asking your accountant about this.

9. Brush up on MTD for ITSA
Speaking of tax, you may have heard of this new legislation coming from HMRC. From April 2024, Making Tax Digital for Income Tax Self Assessment (MTD for ITSA) will require all sole traders, businesses, and landlords that do Self Assessment Tax returns within a certain income threshold to use compatible software to submit tax returns. They will also need to do this more frequently (once per quarter), and keep digital accounting records.

This legislation is its own subject, so check out our blog to learn more about what you need to do. Bring me up to speed

10. Don't feel like you have to do it alone
Accountants exist for a reason. Nowadays, they play a key role in the success of many small businesses by providing invaluable advice that goes beyond executing financial admin.

They can advise you on the best ways of doing things, help you simplify processes, show you how to get the most out of your software, and much more.

As you might expect, they will also provide you with guidance around key legislation periods, to help you make sure you're doing everything right from a legal point of view.

Summary

Running a business used to mean spending hours every week tracking down piles of receipts, typing up invoices, and manually entering data without much understanding of financial performance.

By keeping on top of bookkeeping tasks and using basic accounting practices, you can take control of the financial health of your business, meet compliance demands, and start making confident decisions.

Dedicated software powers up these efforts, while shrinking the time, energy, and headspace needed to make the most of your finances.

This allows you to free the passion that got you into business in the first place. You can focus what you love doing, whether that's getting hands on with running your business, coaching your people, or coming up with new ways to drive growth.

Keep on top of bookkeeping by consistently completing five main tasks:

- Record all transactions
- Back up files and records
- Bank reconciliation
- Do your tax return
- Send and chase invoices

Get used to frequently running four essential financial reports:

- Profit and loss report
- Balance sheet
- Nominal activity report
- Trial balance

Use dedicated software to power up accounting with key benefits:

- Efficient automation
- Simpler compliance
- Surface insight
- Manageable digital records
- Intelligent invoicing
- Realtime clarity

Bring it all together by following our top ten tips:

1. Keep personal and business accounts separate
2. Use cash flow dashboards to stay agile
3. When you find an anomaly, see to it quickly
4. Schedule regular time for reporting
5. Use sales forecasting
6. Don't avoid chasing payments
7. Be strict with costs and spending
8. Adjust your prices for VAT
9. Brush up on MTD for ITSA
10. Don't feel like you have to do it alone

See how Sage 50 Accounts makes life easier for small business owners, from capturing financial documents and bank reconciliation, to smart reporting and simple tax. **Let's go.**

Glossary

Accounting
The process of interpreting financial data and creating reports and forecasts. This helps you understand the financial health and performance of your business.

Asset
Any resource that produces positive economic value that is owned or controlled by your business.

Bookkeeping
The process of recording all the money that goes in and out of your business. This involves collecting and storing financial information such as receipts, invoices and bank statements.

Bank reconciliation
The process of comparing the balances of a bank statement with those recorded in your business ledger. This allows you to spot bookkeeping errors.

Cash flow
The revenue and expenses that are generated by your business during a specific period of time.

Credit
A transaction or accounting entry that either decreases assets or increases liabilities within the business.

Debit
A transaction or accounting entry that either increases assets or decreases liabilities within the business.

Dividends
The distribution of any of business earnings to its owners. This could be cash, assets, or stock.

Equity
A business' assets minus its liabilities. More specifically, 'owner's equity' is the percentage of the business' stock a person owns.

Expense
Any costs that a business incurs through its operations.

Financial report/statement
Documents that are generated to present financial data and communicate the business' financial position at a point in time.

Ledger
A complete record of all financial transactions over the life of your company.

Liability
Any resource, debt or financial obligation incurred by your business. These include both current liabilities, which are those that can be paid off within a year, and long-term liabilities with can be paid off over a longer stretch of time.

Liquidity
All available money your business has on hand or can access quickly. Having liquidity means you can pay any bills when they are due or take care of unexpected needs.

Making Tax Digital
A government scheme that is digitising the tax process for UK businesses. This includes VAT, Self Assessment, and will eventually extend to corporation tax in the future. Mandatory requirements include using compatible software to submit tax returns, keeping digital accounting records, and some changes to tax return frequency.

Revenue
The monetary value of sales, merchandise, services, interest, dividends, or rent. In other words, the money your business is making.

Self Assessment
A system used by HMRC to collect income tax from sole traders and business partners that earn over a certain threshold.

Sole trader
Someone that runs their own business as a self-employed individual. Sole traders keep all of their profits after tax and are personally responsible for any losses made by their business.

Tax return
The process of reporting income, expenses, and other financial information to HMRC. Depending on the type of business and how much it earns, taxpayers are liable for different types of tax.

Tax-deductible
Permitted expenses that can be subtracted from adjusted gross income to reduce the overall tax you pay.

Value Added Tax (VAT)
A tax added to most products and services sold by VAT - registered businesses.

sage.com