

What are Accounts?

Accounts are a **summary** of the business financial activities for a period of time, commonly 12 months. They can also be referred to as financial statements.

Why does a business need accounts?

- **To know how the business is doing...**

Why not just look at how much money you have in the bank?

The bank balance does not show you who owes you and who you owe.

For example, say you have a warehouse selling clothes to shops and other retailers and you sell £58,000 worth of clothes, on credit (i.e. customers do not pay for them when they take them but agree to pay later), so your Sales are £58,000.

You owe your suppliers, who you bought the clothes from, £16,000, so purchases are £16,000.

You have made a profit of £42,000 (Goods sold £58,000 less goods purchased £16,000):

		£
Clothes sold on credit	(Sales)	58000
Clothes bought on credit	(Purchases)	16000
	Profit	42000

but you have no money in your bank account:

	£
Money received for Sales and paid into the bank	0
Money paid out of the bank for Purchases	0
Bank transactions	None
Money in bank	0

The bank account does not show any of these transactions because they are not yet paid for, so relying on your bank account and the bank balance alone would not help you see how the business was doing **at all**.

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- **To raise money for the business e.g. bank loan/overdraft**

The bank will ask you for your latest accounts to see if you can afford to pay the loan/overdraft back as well as the interest on the loan. People often complain that banks offer loans to people who already have money e.g. savings, but are not so keen to lend businesses money when they first start out or want to expand. In other words the bank wants a safe bet that it's loan will be repaid.

The bank almost always is only interested in a business which has been trading successfully for a while and has a good track record, and it wants to see the business accounts before it will consider lending. Often the bank will want a lot more e.g. cashflow forecasts and possibly management accounts.

- **To raise money for the owner(s) e.g. a mortgage to buy a home**

Again the bank or building society will want to know the businessman or woman can afford the mortgage repayments on their earnings and their accounts will be an indication of this.

- **For an insurance claim**

It may be that the business is insured for loss of sales or profits in the event of a fire or flood, for example. In the event of a claim, the Insurance Company might want to see the accounts to see what the Sales and Profits have been in previous years to check that the insurance claim is reasonable (they may also wish to check the records to see what the sales were in the same months in previous years).

- **For making a business tax return**

A Sole Trader or Partnership pays tax AND national insurance on the business profits. The accounts show the Profit, which often has to be adjusted to arrive at the Profit for tax purposes.

- **For partners in a partnership to see their share of the business**

Partners may lend money to the partnership, will take money out of the business to live on, and may be entitled to different

Hot tip



Get your accounts done as soon as possible so they are available when you need them and so the figures are as up-to-date as they can be and therefore most useful.

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shares of the profits each year depending on what has been agreed. The accounts will keep track of each partner's share of the business.

- **For a business which is a company, for filing with Companies House**

Companies have to file accounts with Companies House every year. Sometimes the accounts for Companies House are for a different period than the accounts for tax for HM Revenue & Customs and so it is important to align them early or the business is faced with paying for two different sets of accounts each year!

- **To sell the business**

The purchaser's accountant will want to see how the business has been doing to see if it is worth the price that is being asked for it. He will ask for copies of accounts for the last few years.

