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1 Introduction

You will be surprised how often you might need your business accounts

Business Accounts

Businesses can be sole traders, partnerships, companies or limited liability partnerships.

- **A SOLE TRADER** is a self-employed individual who is personally financially responsible if things go wrong, e.g. if the business cannot pay its debts and taxes, the individual's home or other assets may be at risk.
- **A PARTNERSHIP** is more than one self-employed person working together to make a profit and sharing everything on an agreed split. Each partner is personally responsible for all debts run up by the partnership as a whole, except for tax debts (individuals are responsible for their own tax debts). Again, their homes or other assets may be at risk.
- **A LIMITED COMPANY** is a separate legal structure where the liability of owners of the business is limited to the amount of their shares. Any legal action has to be against the Company, not the shareholders, and the shareholders' personal assets are often safe.
- **A LIMITED LIABILITY PARTNERSHIP (LLP)** has many of the features of a normal partnership – but it is also like a limited company in that members in an LLP cannot usually lose more than they invest.

Hot tip

What a limited company can or cannot do is set out in the Articles of Association which are produced when a company is registered. The Articles are commonly very wide ranging and it is unlikely that the activities of the company will be restricted by them. However, all company directors should know what they say.

Beware

Shareholder Directors of limited companies and members of LLPs can be held responsible for the debts of limited companies/LLPs if they are guilty of fraud or wrongful trading (knowing they traded while unable to pay the debts of the business as they become due).

"Business" is the same as "trade". Being "self-employed" means you are your own boss and answer only to yourself. The word "firm" is often used to describe a partnership. The expression "my company" is commonly used to mean any business whether a company or a sole trader or partnership.

You may hear the expression "profession" which describes people who do jobs which need special training and skill and often involve a high level of education, such as doctors or lawyers. Professional people may be self-employed as sole traders (for example as Consultants) or be Limited Companies or Limited Liability Partnerships, although sometimes the rules of their governing organisation prevent them being anything other than sole traders.

However you run your business, you need to prepare accounts.

Running your business as a Limited Company is the most common way of protecting your personal assets.

Banks and other lenders may insist that directors of limited companies provide personal guarantees for loans to the company so that if the company goes bust, the directors still have to pay the loans back.

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**.

- **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 its 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

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.

...cont'd

out of the business to live on, and may be entitled to different 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**

  Limited companies and LLPs 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.

Does a Business Need an Accountant?

A bank or building society lending money will always want the accounts to have been prepared by a qualified, independent accountant who does not work for the business.

Many lenders may ask for copies of tax returns if the businessman is a sole trader or partnership, as their tax returns show the accounts figures, provided the tax returns have been prepared by qualified accountants.

HM Revenue & Customs expect profits of a business to be calculated using current accepted accountancy principles. If a business can familiarise itself with all of these and all the tax rules, then in theory a business does not need an accountant. However, HMRC are more likely to challenge a tax return received from a business without an accountant because it is more likely to be wrong.

Tax rules are complicated and a business may be able to reduce its tax bill by being advised by a suitably qualified accountant. Equally, a business may be paying too little tax because of ignorance, and should HMRC discover this, they will raise extra tax bills going back up to 6 years AND charge interest and penalties. In some cases they will go back 20 years!

HMRC can charge penalties even though errors may be innocent because they expect businesses to take reasonable care in completing their tax returns. They may not regard the business as having taken reasonable care if it did not use the services of a suitably qualified accountant.

If the business did not use an accountant, HMRC would expect it to seek professional advice on any potential tax issues. It would not be enough for the business to say that it was not aware that it had any!

Very large businesses need to have their accounts audited. Their business records and accounts have to be checked by an independent accountant qualified to carry out audits. The auditor will say whether he feels that the accounts and other financial statements accurately and fairly represent the business's financial position. Accounts for small and medium businesses do not need to be audited.

Beware

HMRC do not accept ignorance as an excuse.

Summary

- Accounts or financial statements are a summary of the business finances, usually for 12 months.
- They are used:
  - to see how the business is doing
  - where more than one person is running the business, to show their stake in the business
  - to raise money
  - for insurance
  - for tax returns
  - for Companies House if the business is a company
  - for selling the business

  So, Accounts are useful for a variety of purposes and are not just for tax.
- A business may need to prepare **different types of financial statements**, e.g. annual accounts, management accounts, and cashflow statements and forecasts.
- Using a qualified accountant should give you accurate accounts, help you raise money, reduce your tax bill and stay out of trouble with HMRC.