

Preparing for your annual accounts

This guide is aimed at smaller limited companies. Companies with an annual turnover of less than £6.5 million and total assets (fixed and current) under £3.26 million generally do not require an audit but they must prepare and send accounts to HM Revenue & Customs and Companies House.

This guide outlines:

- The basic information needed.
- The main problem areas, including stock and payroll.
- How to use the annual accounts process to improve your business.

1. Legal requirements

1.1 The accounts you submit to HM Revenue & Customs (HMRC) with your corporation tax return form the basis for the company's tax calculations each year.

- They are submitted with the company's tax return, within 12 months of your company's financial year end. The tax becomes payable at nine months so accounts are normally submitted around this date.

1.2 As a limited company, you must also make your accounts publicly available by filing them with Companies House.

- The accounts must be submitted within nine months of your company's year end.
- Most companies with a turnover below £25.9 million can, if they wish, file abbreviated accounts. These exclude the profit and loss account and most of the Notes (see 2.1).
- Company directors are legally responsible for ensuring the accuracy of the accounts. Using an accountant does not diminish this responsibility.
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2. Financial statements

To avoid confusion with everyday management accounts, the financial information in a company's annual accounts is generally referred to as financial statements.

2.1 There are usually four sections.

- A Report by the Directors, giving a business review and their view of the firm's performance and prospects.
- A balance sheet, outlining the company's financial position on the final day of the accounting period (the year end). Essentially, this shows what the company owns and what it owes.
- A profit and loss account, showing the trading performance over the accounting period (usually 12 months). It summarises sales, costs and expenses, profits (or losses), and any tax provisions.
- Notes, giving more details about the information in the balance sheet and the profit and loss account.

2.2 The Companies Act sets out how the accounts will be presented for a limited company, with headings and subheadings.

- The format should also comply with UK accounting standards, which dictate how certain transactions should be treated in the financial statements.

It is a director's duty that the financial statements must give a 'true and fair view' of the company's financial position.

3. Accounting records

There is a legal requirement to keep detailed accounting records for the company. The exact requirements will depend on the size and complexity of the business.

3.1 For the very smallest company, the absolute minimum accounting records would be:

- Bank statements, cheque books and paying-in books.
- Original invoices for all purchases and copy invoices for sales.
- PAYE records, even if the only employees are directors.
- VAT records if you are registered, including reconciliations of the amounts paid.
- Stock or uncompleted work at year end.
- A schedule of fixed assets.

You should also consider keeping a petty cash book and an analysed cash book splitting payments and receipts into separate columns for each type of expense or income.

- Businesses may wish to consider if they would benefit from using accounting software. The software systems can be used to replace your existing system or to improve the information available to you.

4. Planning

4.1 How much of the accounting work will you do yourself?

- If you use a manual accounting system, all the basic arithmetical work should be done by the book-keeper.
- If you wish to use accounting software, speak to your accountant to ensure you have the best software for your needs.

Every column of figures should add up correctly and tally with all the invoices, cheque books, bills, paying-in books and most importantly, with the bank statements.

- Depending on your company's accounting expertise, you may be able to produce a trial balance. This lists the totals of the credit entries and the debit entries in the accounts, and shows that they agree.

4.2 Ask whether there are any tax planning steps you should take before the year end.

- For example, you may be advised to bring forward certain purchases, so that they count in the current accounting period.

4.3 Ask what other information and explanations are needed. These are likely to fall into four key areas:

- Purchases and sales (see 5).
- Stock (see 6).
- Fixed assets (see 7).
- Employees (see 8).

5. Purchases and sales

Your accounting records should be clear and logical as this saves time for everyone involved. Also keep the recording simple and record in a way that is useful to your business.

5.1 Cross-referencing, for example recording an invoice number, means that any one transaction leaves a trail that can be traced right through the records.

5.2 List sales made before the year end, but not yet paid for, as outstanding debtors. Include the amount, invoice number and invoice date.

- Note any invoices that you suspect may not be paid, with a brief explanation.

A 'provision for bad debts' may be made in your accounts. This effectively cancels the sale in your accounts.

5.3 List purchases made before the year end, but not yet paid for, as outstanding creditors. Include the amount, the supplier's name and the payment due date.

- Note any invoices you dispute and do not expect to pay, with a brief explanation.

5.4 As general good practice, it is always best to list and analyse your debtors and creditors by date (an 'aged' list). It is then immediately apparent where problems may arise, such as bad debts. This is easier if you use accounting software rather than relying on manual records.

- How much of your overdraft is used to provide your customers with free credit?

Only include invoices for the financial year in question, and not the subsequent period.

6. Stock and uncompleted work

The value of stock is a key element in retail and manufacturing businesses. It includes work-in-progress. Service businesses have little physical stock, but may have considerable work-in-progress, such as half-finished projects.

6.1 The cut-off between stock, purchases and sales is one of the main areas for potential errors in the accounts.

- If a purchase has arrived in the warehouse, but an invoice has not been received, the cost is included in the accounts.
- If you have sold (and invoiced) but not yet delivered goods, exclude these goods from the valuation of your stock. The sale will already be in your accounts as a debtor.

6.2 Unless stocks are a minor item in your accounts, you will need to carry out a stocktake. This is a physical count-up of the goods on your premises. It is made easier and faster with careful planning.

- Set out stocktaking procedures in writing.
- Lay out stock in a logical way, so that all stock of the same type is in one place.
- Label the stock and print lists of the different types of stock on hand.
- Ensure no stock comes in on the day of the stocktake (usually a Saturday).

If this is unavoidable, stock movements must be tightly monitored and recorded.

Unless you have good stock records, you will probably need to carry out the stocktake close to the last day of the financial year.

6.3 Once the stock has been counted, it needs to be valued. This will be based on the lower of the cost to you or the amount for which you expect to sell the goods.

- Have the price lists from your suppliers available or a copy of the invoice for the goods from the supplier. Describe the items on your stock list in the same way as these items are described on the supplier's price lists, so everything can be matched.
- Make a note of any old, obsolete or damaged goods.
- Make a note of unfinished pieces of work and record what has to be done, giving it a value, for example of 25 per cent at the end of the year.

6.4 Service providers are required to include partly completed work at stage to completion method. For example, if a contract is 75 per cent complete at the year end, then 75 per cent of the contract value would be included in the year end accounts as uncompleted work. Keep a list of:

- Work you have started before the year end but haven't invoiced at the year end.
- Detail the estimated sales value when you have completed the work.
- Estimate and note as accurately as you can the percentage of the work you have done by the year end. You can use time records, job costing or diaries to help you work out the percentage.

7. Fixed assets

Fixed assets include buildings (if you own them), equipment, vehicles, and 'fixtures and fittings' (eg shelving).

7.1 Keep a fixed assets register, detailing all the assets that the company owns.

- Break it down into different types of asset.
- A purchase date, purchase price, description and location for each item.
- Note any items that have been purchased, sold or scrapped during the year.
- An asset register makes completing your annual insurance form easy, as you can attach the list of assets.
- You can also record details which would be useful if say equipment breaks down (eg supplier contact details, PIN numbers etc).

7.2 Keep the documents proving ownership.

7.3 The cost of fixed assets should be written off over time to the business, through a depreciation charge. These details can be recorded on the asset register.

- Generally depreciation cannot be offset against tax. Instead, you claim for some assets a capital allowance, using a rate of deduction which is fixed by HMRC.
- Small companies can get 100 per cent relief when purchasing certain fixed assets..

8. Employees

Payroll and expenses claims are of particular interest to HMRC.

8.1 The business is liable for incorrectly deducted tax and National Insurance, not the employee.

8.2 Keep records for all expense claims.

- Expenses claim forms make it easy to keep track of expenses. Employees attach the relevant receipts to the completed form, in order to receive reimbursement.

8.3 Completing P11D tax forms relating to benefits in kind can be very time consuming. Ask about getting a dispensation (P11D).

- This is a formal statement by HMRC, allowing your business to not record expense payments on the forms. HMRC must be satisfied that you reimburse nothing more than the legitimate costs incurred by your staff. But you will still need to keep records of any payments made.

9. Feedback meeting

Once the accounts are finished, a feedback meeting can produce good ideas and advice on how business practices can be improved.

9.1 What do you need?

- What information would help you run your business?

9.2 Can you improve your book-keeping system?

- Does it handle VAT quickly and easily, including VAT returns?
- Is there a better way to record income and expenditure

9.3 Should you introduce or upgrade accounting software?

9.4 Can you improve your credit control?

- What payment targets should you aim for?
- How can you cut exposure to bad debts?

9.5 Can you find ways of providing more timely and useful management information during the accounting year?

9.6 Can you reduce your tax bill?

Laying the trail

Simple, systematic book-keeping creates a trail that can be traced back to provide a full history of each transaction.

- A.** Every sale has an invoice number.
- When the invoice is paid, you write on it the date the cheque was received.
 - When you bank the cheque, the paying-in book records the invoice number and the paying-in date.
 - Later, when you check your bank statement, you can see whether or not the cheque has cleared.
- B.** Each purchase originates with a supplier's invoice and has a cheque number against it (if you use purchase orders, also a purchase order number).
- In the case of credit card purchases, there may be several invoices (or receipts), with one cheque number, against that month's credit card bill.

This information is provided for general guidance only. Please contact us if you require advice on any specific part thereon.