IRIS Success Kit

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for business growth

Financial Management

AN IRIS PUBLICATION

How to get financial management right!

Financial management - you either love or hate it; perhaps it's an opportunity to dig into those GCSE math skills, or it's simply a boring bit of admin you begrudgingly do.

Well, no matter your feelings towards managing your books, it's crucial for running any business.

Whether you want to update yourself on your responsibility or make financial management easier, we're here to help; in this guide, we've broken down all the relevant aspects to show you that it's not as daunting as it may initially seem.

PART 1

Bookkeeping

Let's start off with the elephant in the room - what is bookkeeping? What do you need to know? How does it work?

Stress over! Here we break everything you need to know into small, digestible bites.

What is bookkeeping?

In essence, bookkeeping encompasses all the activities around recording and managing the financial transactions in your business.

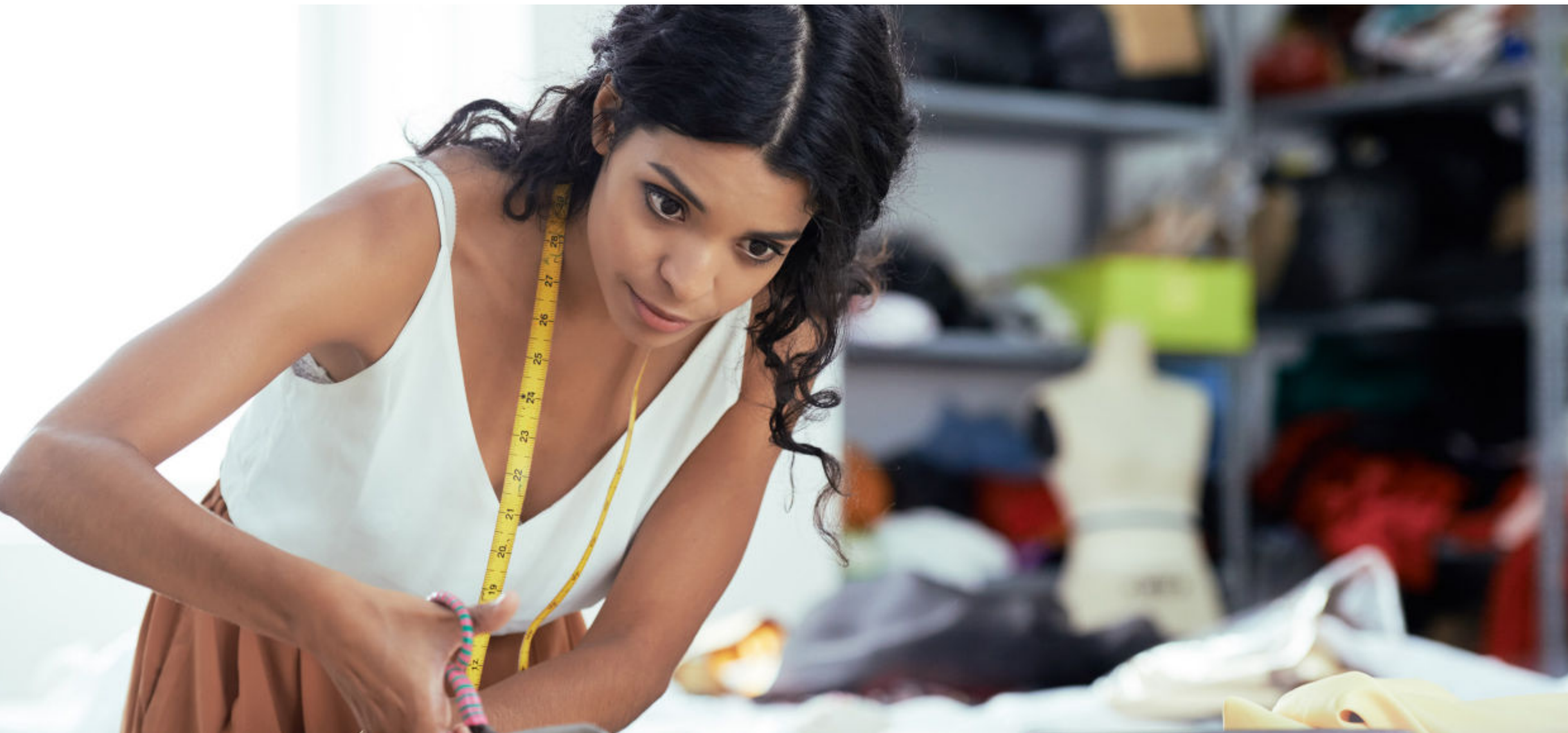
Why do small businesses need bookkeeping?

Let's face it - you probably didn't start a business with the sole goal of bookkeeping; however, having well-kept records of your finances can help you in many ways.
Where should we even start with the advantages? Consider the following:

- You can accurately check that you are making more than you are spending
- You can budget more adequately
- You are more likely to find incorrect payments and avoid fraud

Not convinced yet? There's more:

- You will be much more capable of filing accurate tax returns
- You will be able to forecast when cash might be running thin and take steps to avoid it
- You will have it much easier dealing with third parties like accountants or lenders



What does bookkeeping involve?

Managing your business' daily finances can look like a variety of different activities, including:

- Making payments (e.g. bills), also known as managing the accounts payable (the money you have to pay to suppliers or service providers)
- Chasing payments from clients and customers, also known as managing the accounts receivable (the money you're to receive from clients)
- Ensuring your business pays the right amount of tax
- Claiming back VAT for your business (e.g. on purchases and other expenses), if you're VAT registered
- Managing payroll to pay your staff and HMRC correctly

This may seem like loads of things to do, but once you've got the basics down, it's like riding a bike.

How to start bookkeeping

If bookkeeping is now something you want to take a crack at, there are three types of financial records you need to keep track of:

- Cash, recording everything going in or out of your bank account, i.e. your cashflow
- Sales, recording everything you have sold and every invoice sent, regardless of whether it's been paid yet or not
- Purchases, recording what you've bought, including services, and how you paid

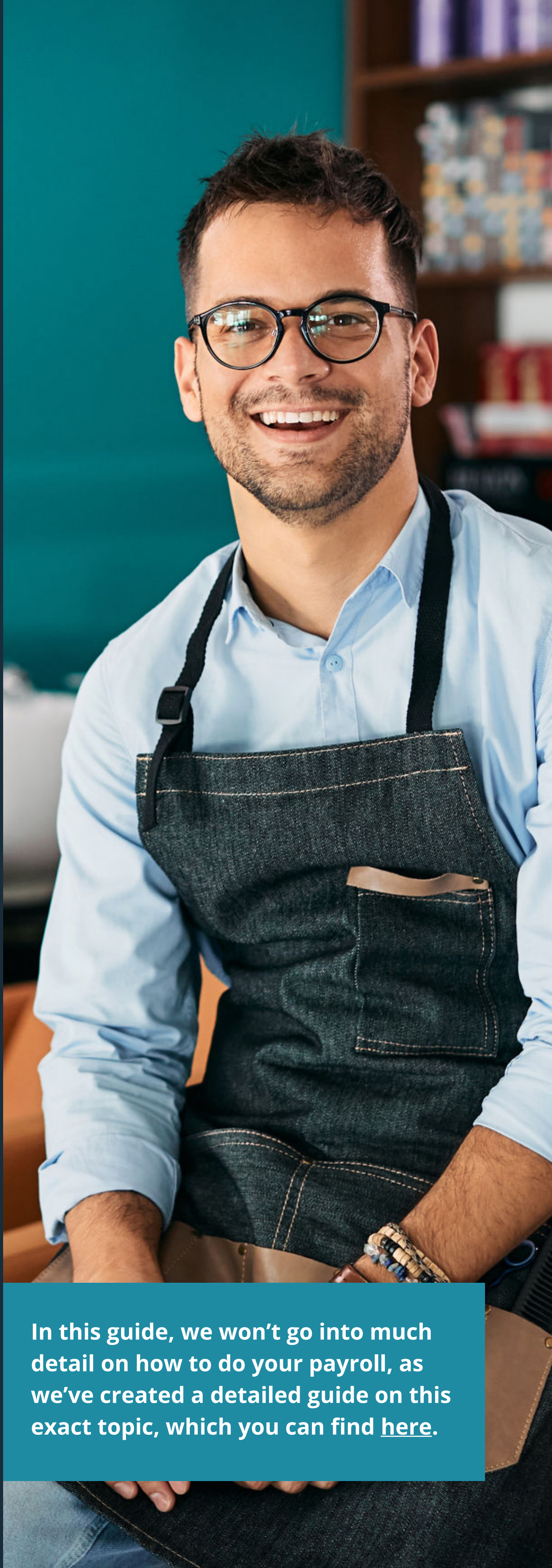
You can always track more financial records for even better financial management, but these three are the minimum to get started.

Once you have set up your record keeping, here are our top tips on how to not lose your head and manage everything effectively:

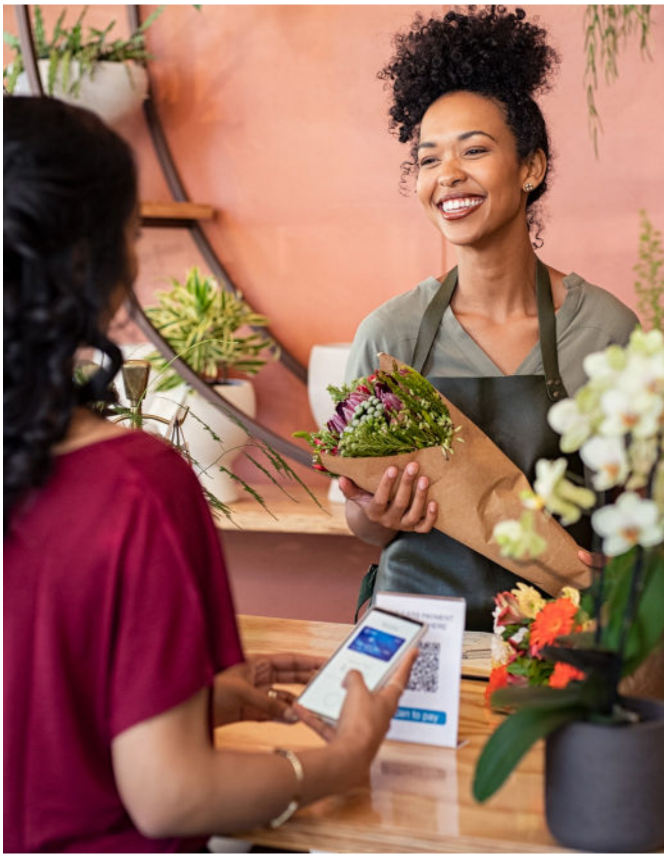
1) Track every payment

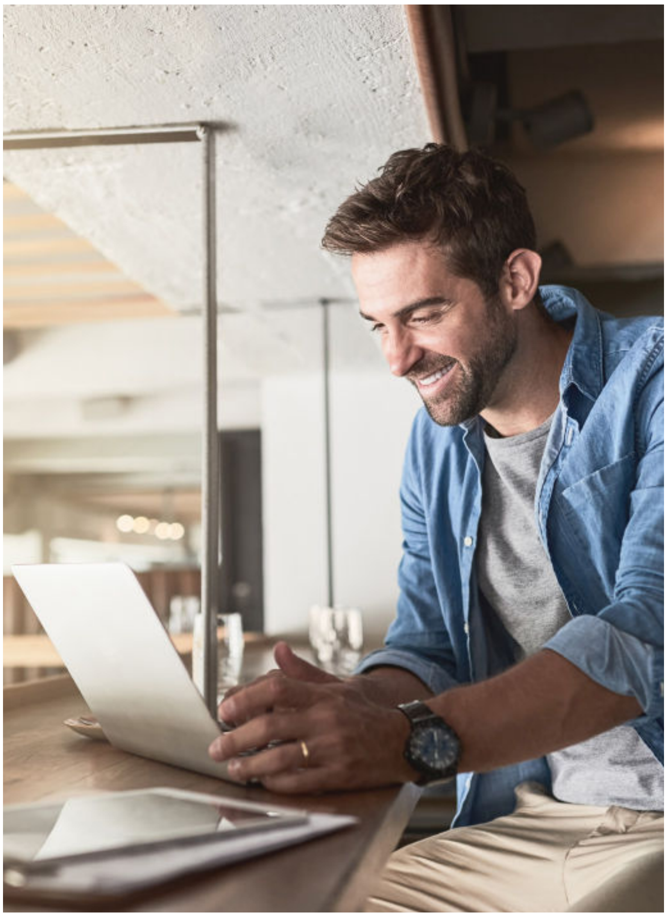
When we say every payment, we mean every single transaction happening in your business!

Frankly, your records won't be of much use if you only record finances sporadically - diligence is the keyword here.



In this guide, we won't go into much detail on how to do your payroll, as we've created a detailed guide on this exact topic, which you can find here.





Top tips:

- Store all invoices in a secure location and organise them by date and by unpaid/paid
- Alphabetise records by customer, helping you chase your payments if needed
- Keep personal and business expenses separate so you don't end up understating or overstating your profits and paying the wrong amount of tax

Question: how do I record my financial data?

Answer: you could use the old-fashioned way and record the transactions in a spreadsheet. However, this is very time-consuming. To make life a little easier, get yourself bookkeeping software. This will automatically group your cash, sales and purchase transactions for you and keep track of any VAT to be paid over to or reclaimed from HMRC.

2) Choose an accounting approach

To make the most of your bookkeeping data, consider the following two accounting approaches:

Traditional accounting records the transaction at the date of the invoice, no matter whether it's been paid yet or not.

Cash accounting records payments when they are actually made (the day the money leaves or enters your bank account). This approach is great for small businesses, as it avoids having to pay taxes on money you haven't received yet. Be cautious though, as only businesses with a turnover of £150,000 or less can use this method.

3) Regularly reconcile every transaction

To reconcile essentially means to cross-check all your transactions with your bank statements, ensuring you've accurately recorded all your sales and expenses.

Whether you reconcile weekly or monthly, that's up to you. However, the more regularly you do it, the easier it is to spot mistakes and correct them - stay on top of your game!

Top tip: *with bookkeeping, what may start simple at the beginning can quickly become a full-time job as your business grows. Make sure you know when it's time to outsource bookkeeping or to employ staff specifically for this task.*

PART 2

Cash flow

Cash flow - we bet you like the sound of that! But what actually is cash flow, and how can you keep on top of it?

We've already made you an expert in bookkeeping - now we'll do the same with all things cash flow.

What is cash flow?

No, it's not a river of money, but you can use that analogy to help visualise the concept!

Essentially, cash flow is all of the money flowing in and out of your bank accounts, such as sales or expenditures.

If your cash flow is negative, meaning you're spending more money than is coming in, you'll have to find an alternative source of income to pay off debts and invoices.

How do you find out your cash flow?

To determine your net cash flow, add up all of your cash payments over a set period (typically, a month is fine, but three months paints a more accurate picture) and take that away from your cash receipts.

Top tip: *you should have all the information you need to work out your net cash flow thanks to all that bookkeeping you just learnt about!*

What's the difference between cash flow and profit?

Imagine you sell an item for £500, and you spend £100 on equipment or labour. You record the £500 when it's invoiced, but there is no cash flow because your customer hasn't paid you yet.

Because you paid your expenses already, you have a net cash flow of -£100, whereas your recorded profit is £400.

How do you keep track of your cash flow?

The best way to gain a full understanding and overview of your cash flow is to create a cash flow forecast.

Start with the brought forward balance on your bank account at the first day of the month, then subtract all of the payments you expect to make that month.

That could be supplier payments, staff wages, or monies due to HMRC.

Then add all of the customer receipts you expect to get in.

The net result is the projected closing balance on your bank account at the end of the month.

Forecasting in this way helps you to plan for and manage your cash inflows and outflows.

What are the consequences of not keeping up with your cash flow?

Worryingly, 60% of small businesses regularly face cash flow issues; some of the most common cash flow problems are:

1. Too much stock
2. Long payment terms
3. Overspending
4. Overtrading

Top tips for improving your cash flow

Be strict with your clients

One of the leading cash flow issues is simply clients paying invoices late.

On average, 48% of invoices issued by small businesses are paid late - this will impact your cash flow and your ability to pay bills and cover expenses.

Ideally, you want the payment terms you offer your customers to be the same as or stricter than those offered to you by your suppliers, so the cash flows into your business faster than it flows out.

Make sure your sales invoices are accurate to avoid queries or disputes.

Be firm with your clients and chase them regularly if they haven't paid; for increased efficiency, use software to send automated reminders to anyone with an outstanding invoice - how practical!

Develop good supplier relationships and cut your costs

This is key.

Regularly review your expenses and renegotiate the terms with your suppliers where you can. Can you take advantage of quantity or settlement discounts? Can they offer you more favourable trade credit terms?

Increase your prices

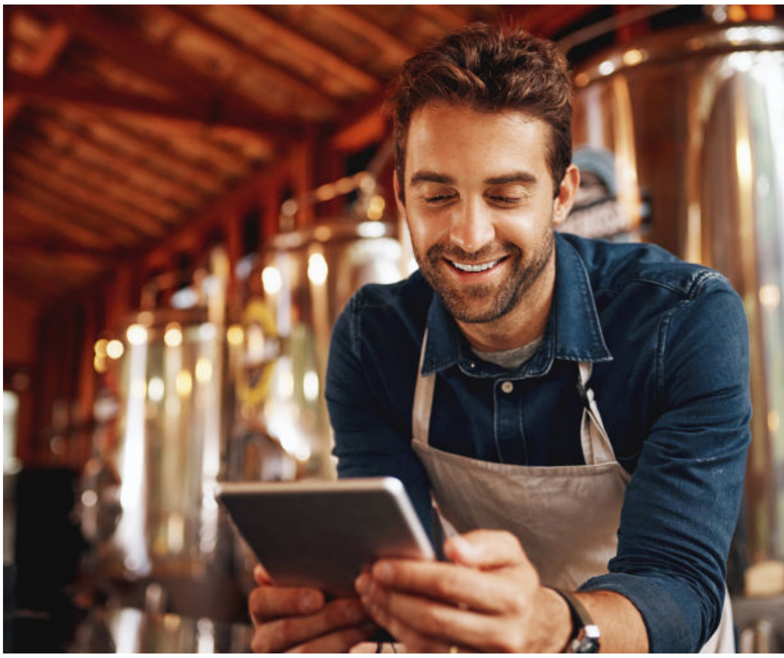
The opposite of reducing costs is increasing your prices - higher revenue, higher cash flow, in theory.

However, be careful when taking this step; as a new business with a new client base, you may want to ensure your customers' loyalties before increasing any prices. In addition to which, simply charging more on each invoice won't improve your cash flow if the invoice isn't paid.

Plan strategically

It's a good idea to plan for the next six to eighteen months, ensuring your business has the cash needed for any strategic decisions (for example, hiring new staff or moving to a bigger office space).

Organisation is key!



Optimise your stock control

This has two implications: firstly, the storage costs associated with holding large quantities of stock, and secondly, the risk of existing inventory becoming out of date or obsolete.

With an accurate cash flow plan on hand, accounting for seasonal changes in demand and accurate growth predictions can help ensure you don't overdo it on ordering stock.

Note: *this may take a while, as you need to experience different seasons and growth periods before you can make any predictions - patience is key.*

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PART 3

Making Tax Digital (MTD)

There's one more topic we'd like to bring to the table, which is relevant to all businesses: Making Tax Digital (MTD).

Every business has to pay taxes on their revenue to the HMRC - we know, it can be painstaking at times.

Well, these issues may be a thing of the past; Making Tax Digital is a Government initiative to make paying taxes easier!

What exactly is Making Tax Digital?

Making Tax Digital is a set of rules around paying taxes digitally, with the goal of making it easier for all involved.

With MTD, businesses will have to keep a digital record and submit online using industry-compliant software.

An overview of Making Tax Digital's rollout

We're currently well into a process of change that affects different types of taxes.

VAT

MTD for VAT-registered businesses is already in place. Any company earning more than £85,000 should be following MTD rules for reporting VAT since April 2019, with other complex organisations like local authorities moving across from October that year.

Income

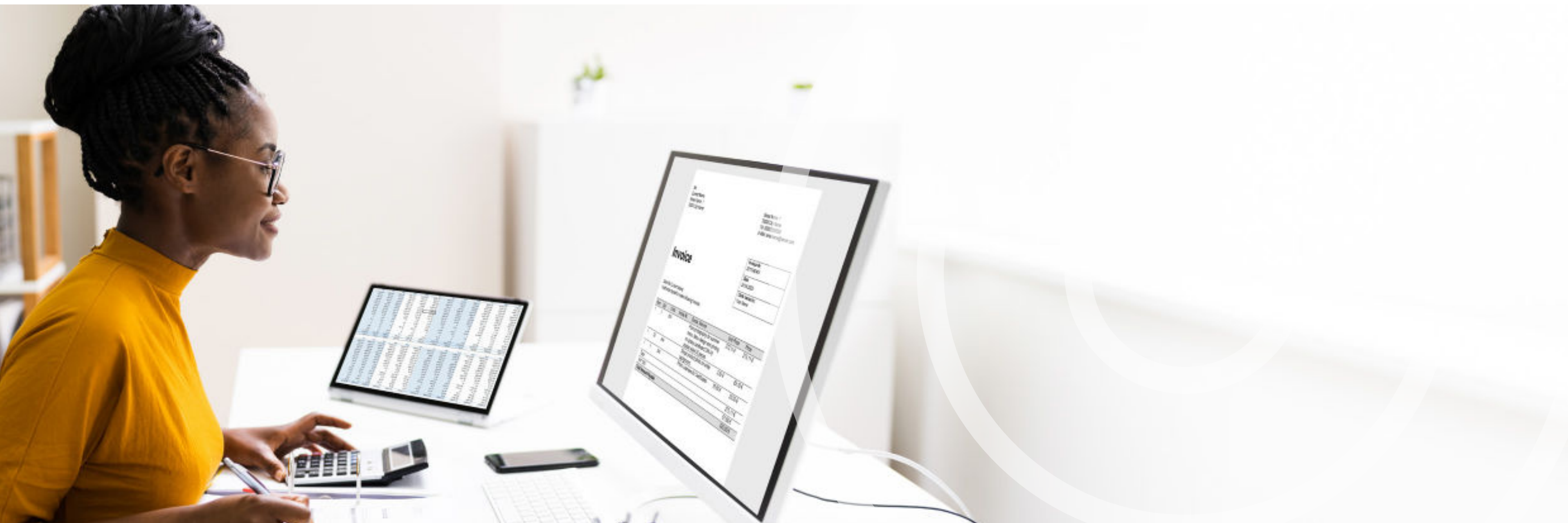
HMRC determined the next step in the rollout would concentrate on organisations going digital for income tax and National Insurance, initially due to start in April 2023.

However, this stage of MTD has just been delayed for the second time and is now expected to take place in April 2026. For many traders, this new system replaces the self-assessment tax return process.

It's worth bearing in mind that MTD for income tax has a specific scope: so far, self-employed businesses and landlords with annual income above £10,000 have been asked to register for Making Tax Digital... those below this threshold can carry on with their existing processes.

Partnerships

Making Tax Digital for general partnerships (i.e. not limited liability partnerships) has been delayed until April 2025, and there are no pilot plans.
Meanwhile, MTD for all other partnership types has been delayed until after April 2025.



Corporation Tax

The UK Government will allow companies to partake in a pilot that will test MTD for Corporation Tax. The changeover will happen for everyone after April 2026 but before 2030.

Why is the Government introducing MTD?

Well, if avoidable errors cost you £8.5 billion in one year, you'd probably be thinking about ways to cut down on the issues responsible for this eye-watering number.

Simply put, the Government wants to reduce the number of mistakes businesses make every year, which lead to that kind of cost to the Exchequer. It aims to make the process simpler and easier to follow.

With pre-MTD filing methods, business owners were often left racking their brains over transactions that happened up to nearly two years ago - and that's the kind of thing that can make costly mistakes happen.

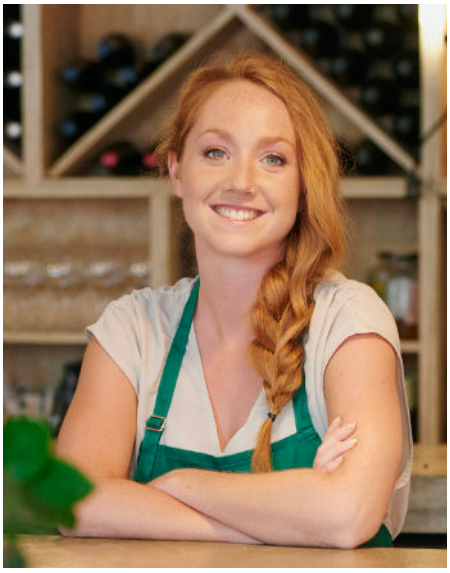
What happens if I don't comply with MTD?

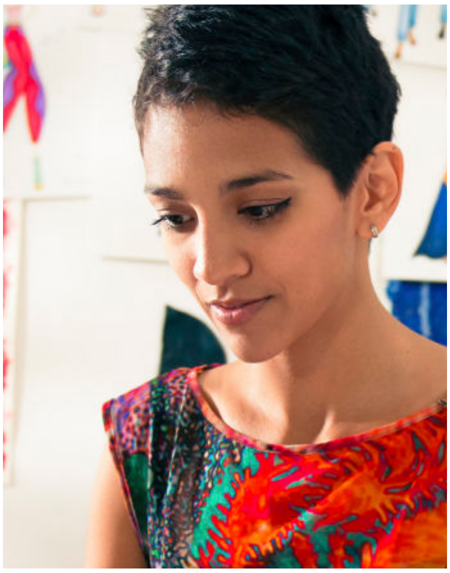
As with every set of legislative rules, if you don't stick to them, you'll be fined.

The Government has introduced a set of penalties for those who don't comply with MTD, which you can find here.

What do I need to do to comply with MTD?

If you are VAT registered, there's no way around MTD for you; here's what you need to do to stay compliant with this new initiative:





Get software in place: if you don't know where to start with your software search, visit the Government's webpage for recognised MTD-compatible software.

Register for MTD: once you have that software in place, you'll want to register for MTD VAT on the Government's website.

File your tax return: now that you're fully registered, you can file your tax return. Remember that software you got into place specifically for MTD?

All MTD-compatible software has a feature to file your VAT tax return in this way - easy-peasy!

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Conclusion

Numbers, numbers, numbers, whether you like them or not, they play a massive role in any successful business.

Hopefully now, the work associated with your finances is a little less daunting (perhaps it even seems manageable).

Well, financial management can be simplified even further with good software.

> “Well, no matter your feelings towards managing your books, it’s crucial for running any business.

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