

Chapter 6 Finance

In the previous Chapter, I mentioned the Cash Flow Forecast (CFF). This is a vital part of your business financial planning - but you won't find it in any of the popular accounting systems like Xero, Sage or QuickBooks.

Why, because, like most accountants, they look **back** and not forwards. They are about *record keeping*, about what **has** happened and not about looking ahead.

The CFF is very simple and you can easily set it up using a simple spreadsheet. It's a rolling forecast set up starting with 'this month's' actual figures of income and expenditure.

Then you predict as accurately as you can how much is coming into and going out of the business each month for the next 12 months.

To do this you'll need to categorise each source of income and each type of expenditure and adjust accordingly as you get monthly 'actuals'

You should also create a longer term prediction which will be less accurate, covering up to 5 years.

Records & Accounts

To create and maintain this forecast and to understand and monitor how your business is performing you need to keep records. This is vital and an area where, by not doing so properly, you could lose a lot of money.

How so? Well it's all to do with tax, how much tax you pay either as a Sole Trader or a Limited Company because everything you spend in order to set up your business, operate your business, market your offering, deliver it, and comply with any regulations is chargeable against tax.

What this means is that all these ‘expenses’ are deducted from your income before the amount of tax you have to pay is calculated.

Rule No. 1 here is to keep **all** your receipts and **all** your invoices and print records of **all** your online purchases for anything that has anything to do with the business.

You have the paper records, and ‘back in the day’ all of that information would have been entered, by hand, into a ledger, added up, balanced out and the amount of profit - excess of income over expenditure - calculated for submission to the tax authorities.

Now of course it is simpler. We use computing power instead and there are three approaches to how you might do this.

Some people will collect and keep all the paperwork and then at the end of the year hand it all over to an accountant or bookkeeper to get it all into shape and prepare a tax return. This of course is a very expensive way of doing things and not recommended at all!

Second, you can subscribe to one of the popular on-line accounting systems that are regularly advertised. Some of these allow you just to scan in your paper receipts and so forth maybe using your phone and have other simple ways of entering the data.

There are some drawbacks to this, one being that there is a monthly subscription which according to the size of your business can be quite high and if you fail to pay for any reason you lose access to your data!

I’ve tried several of these systems and found them to be rather inflexible. First, if you make a mistake it’s very difficult to correct it - you usually have to ‘delete’ the transaction and do it again. (the ‘deleted’ entry doesn’t actually go away). And also because these systems seem to be designed for a ‘standard’ or ‘typical’ business but of course there is no such thing.

You will have to make compromises about how you classify your income and expenditure to conform with the ‘chart of accounts’ that they specify.

The third way is to ‘do it yourself’. Now this isn’t difficult, but it is more time consuming than using an automated system - but you can tailor it to exactly what you want.

The PBCS gives you all the necessary templates and shows you how to use them and these feed into an HMRC compliant spreadsheet suite that is updated each year in accordance with any tax changes

Whether you use an automated or a ‘diy’ system and do all the data entry in this way it can save you more than £1000 or more a year in accountancy fees and gives you a clear idea on a regular basis of how your business is doing.

It is possible to use the diy system without going to an accountant, but it is nevertheless **essential** for you to use a professionally qualified Chartered Accountant to review your figures before they are submitted to the taxman.

Your accountant’s job is not to ‘do your accounts’ (enter all the data and so on), but to **save you tax!** When you use an online system, it can be linked to your accountant, so they can see what is going on regularly and advise you on what you need to do or not do to become tax efficient.

This is a big subject and this Chapter can only cover key issues. All you need to know however is in the PBCS.

Banking

Whether you operate as a Sole Trader or Limited Company you need to set up a separate bank account for your business. I’ve seen many sole traders try to operate their business through their normal personal current account, or even worse, through a joint account, resulting in much unnecessary stress and confusion.

Set up a separate account, which can be a ‘personal’ account if you are a sole trader but must be a business account if you are a Company. Most banks will give you at least a year of ‘free banking’ for a business account and after that it’s not really expensive.

You may need to open your account before you start trading or before you have anything to pay into it so you will probably need to identify your account to people for other reasons, for example, if you want to set up an account with PayPal. In any case it is essential to get the account set up.

Cash

Using cash is an area where a lot of businesses and especially sole traders, tend to run into problems unless they are meticulous about keeping ‘business cash’ and ‘personal cash’ entirely separate and not ‘borrow’ from one or the other to make cash payments.

All cash payments and receipts must be recorded, and all cash movements accounted for. Doing anything else when you are running a business is technically illegal and you can incur big penalties, sometimes custodial, if you are discovered to be running an ‘under the counter’ business or getting involved (even unintentionally) in anything that might be considered to be ‘money laundering’.

Ideally, cash should be avoided wherever possible but procedures for dealing with cash on a regular basis are provided in the PBCS.

Payments

Which brings us to the question of how do you collect payment?

There are several ways, yes you can use cash but avoid if possible, keep it separate and pay it in to your business bank account as often as possible.

It then depends whether you take payment at ‘point of sale’ when you actually deliver products or services, or by invoice before or after delivery.

If you are trading on line it’s common practice to take payment prior to delivery although purchasers can use the online systems through which they are paying to defer payment until delivery has been made. They cannot then actually back out of payment unless they return the goods.

Depending on circumstances and the nature of the business relationship it is always recommended to take payment up front in full or by guaranteed stage payment. Only in certain circumstances and with highly trusted buyers would you take payment after delivery.

Unfortunately, if you are dealing with larger corporates or the public sector you'll find that you won't get paid for between 30 and 90 days after delivery so it has to be 'worth it' to operate in these sectors.

So how precisely do you collect your money from your buyer?

Common practice now is to use cards, credit or debit, and you can use this direct by purchasing or renting a card machine or an app on your phone. The card company will take a commission on the sale which can be up to 3.5%, sometimes more.

Note that it is no longer legal to add any sort of premium or 'administration fee' to your price for card purchases. But you can offer a discount for direct transfer to your bank or use of a standing order.

There is a company called Go Cardless who facilitate this, ensure that you do get paid, and they charge a much lower commission than the card companies.

If you issue an invoice in advance of, or after delivery, normal practice is for direct transfer but you **must** state the payment terms, such as 'payable immediately' on your invoice.

By the way, hardly anyone uses cheques much any more and the banks always charge a fee, sometimes even with 'free banking', to process them.

Expenses and Costs

One of the things you need to do with your business accounts is to separate out ‘expenses’ and ‘costs’ because these are not the same thing.

It’s quite simple though.

Costs are what you spend that is directly attributable to delivering a specific product or service. It may be the cost of the raw materials or other direct input to creating the products you offer, or they may be items like course materials if you are providing them as part of a training or coaching programme.

Costs also include any supplies that are ‘used up’ as you deliver a service and without which you could not deliver the service. Costs also include all products that you buy for direct resale and these are referred to in the accounts as ‘Stock’.

Expenses are everything else, including things like fees, training and education (or ‘CPD’), insurance, heating and lighting, telephony, IT, and anything that cannot be directly attributed to a specific sale.

This topic is covered in detail in the PBCS.

Tax

If you don’t get the accounting right yourself or you hire an accountant unfamiliar with small business operations then there is a high probability that you will pay *too much tax*, either as a Sole Trader or Limited Company.

The first thing to consider as a Sole Trader is whether your business income, when combined with any other personal income, will take you into the higher rate band - especially if you are carrying on your business alongside employment or receive pension income.

It’s all added together, and no distinction is made by the taxman between personal and business.

As a Limited Company however, things are different. First of all, for all small ‘personal’ businesses the rate of ‘corporation tax’ is around, sometimes lower than, the standard rate of personal tax. It’s not until your profit is into 7 figures that it really goes up.

A good accountant will find everything they possibly can to reduce your nominal profit and thereby your tax. So it’s actually a ‘good thing’ for your profit to be ‘low’ - unless of course you are looking for a loan or mortgage or have shareholders who expect a dividend payment. A good accountant will *advise* you on all this rather than just ‘doing the books’.

The secret to paying as little tax as possible is to keep meticulous records of everything!

VAT

What about VAT? To VAT or not to VAT, that is the question.

There are advantages and disadvantages to being ‘VAT Registered’ and any business can register for VAT at any time. It only becomes compulsory when your turnover reaches the current ‘threshold’.

So why should you register?

The advantage is that you can claim back the VAT on all your business costs and expenses - which can be significant during the pre-launch phase.

The downside is that you have to charge VAT on your products and services whenever they are subject to VAT - which will increase the price to the purchaser.

Often, depending on the price you are charging, you can factor in the VAT, but the higher the price, then the higher the VAT. It all depends on your business and the market you are serving.

If however your output products or services (or a good proportion of them) are **not** subject to VAT so that you don’t have to charge VAT, then registering for VAT is a good option as you can claim back a significant amount of the money invested in costs and expenses.

It's a myth that 'doing the VAT' every quarter is hard work and takes a lot of your time. It's not, and it doesn't, **provided** that you keep all your financial records on an ongoing basis.

One more thing on VAT. If you do charge VAT then it must be **included** in the price you quote to consumers or domestic customers, but it should be shown **separately** in the price you quote to business customers.

The Big Secret

Lastly in this Chapter I'm going to reveal one of the most powerful reasons for having a Limited Company. It's called the **Directors' Loan Account (DL)**.

During the pre-launch stage you will undoubtedly invest a chunk, often a large one, of your own money into developing your business and your offering.

For the majority of small personal businesses, it's unlikely that you'll get or even bother to apply for a business development loan. Most personal businesses are set up using personal money, such as a redundancy payment or some other 'windfall'.

If you form a Limited Company, ALL the money you have invested for a period of up to two years before registering the company and starting trading can be, on paper, put into the DL account. The effect of this is that the Company then owes you this money, along with any other personal money that you use to invest in or operate the business.

Now **this is your personal money**. *It's already been taxed*, so you don't have to pay tax on it again if you take it out of the DL account and you don't have to declare it as income when the Company is fully operational and generating enough income to pay you back, and, it's an expense against the Company and thus reduces the tax that the Company has to pay.