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Chapter **1**

Recording the Financial Facts

If profit is one of the more exciting and interesting aspects of running your own business, keeping track of exactly how that profit is made is almost universally seen as one of the duller tasks. The work involved in this area is often either left to the last minute, delegated in its entirety to an accountant or bookkeeper, or outsourced.

Nevertheless, as the boss you have to know everything about everything, and accounting and finance is no exception to that rule. In fact, it is one area where there are some hard and fast rules imposed and checked up on by regulatory bodies: the people who make and oversee rules for governments. You can decide whether or not to advertise your wares, where to advertise and to a large extent the format of your adverts. When it comes to recording financial information, however, there are set procedures and formats.

If you aren't going to keep the financial records yourself, you'll have to trust someone else to do it for you. That poses a potential problem. How will you find someone to do your books, and is that person honest? Accountants and bookkeepers are no more likely to be honest than anyone else in business, and they certainly have more opportunity than most to be dishonest.

No matter who keeps your financial records, the buck stops with you. You're required to be financially literate enough to put your signature on the accounts you file, and any mistakes, penalties and fines will end up at your door.

Keeping the Books

To survive and prosper in business, you need to know how much cash you have, what your profit or loss on sales is, who owes you money and who you owe money to. You need these facts on at least a monthly, weekly or occasionally even a daily basis to survive, let alone grow.

Recording financial information

Although bad luck plays a part in a very small number of business failures, a lack of reliable financial information and bad business judgement play a part in most. However, businesses have all the information they need close at hand to manage and make better business decisions. Among the bills you have to pay, invoices to raise, petty cash slips to file and bank statements to diagnose, you've enough to give you a true picture of your business's performance. All you need to do is record and organise that information so that the financial picture becomes clear. The way you record financial information is called *bookkeeping*.



REMEMBER

It's not just the business owner who needs these financial facts. Bankers, shareholders and tax inspectors are unsympathetic audiences to anyone without well-documented facts to back up the numbers. If, for example, HM Revenue and Customs (HMRC) presents a business with a tax demand, the onus then lies with the businessperson, using their records, to agree or dispute the sum claimed.

In any event, if you plan to trade as a limited company (refer to Chapter 2 in Book 1), the Companies Act 2006 requires you to 'keep adequate records sufficient to show and explain the company's transactions'.



REMEMBER

Keeping proper records enables you to

- » Know the cash position of your business precisely and accurately.
- » Discover how profitable your business really is.
- » See which of your activities are profitable and which aren't.
- » Give bankers and other sources of finance confidence that your business is being well managed and that their money is in good hands.

- » Calculate your tax bill accurately.
- » Prepare timely financial forecasts and projections.
- » Collect and pay money due correctly.
- » Keep accountancy and audit costs to a minimum.
- » Meet HMRC's requirement to keep proper records.

Starting simple with single entry

If you're doing books by hand and don't have a lot of transactions, the single-entry method is the easiest acceptable way to go. *Single entry* means that you write down each transaction in your records once, preferably on a ledger sheet. You record the flow of income and expenses through your business by making a running total of money taken in (gross receipts) and money paid out (payments, or as they're sometimes called, *disbursements*). You should keep receipts and payments and summarise them daily, weekly or monthly, as the business needs require. At the end of the year, you total up the 12 monthly summaries. You're ready for tax time.



TIP

You may benefit from separating different types of income and expense into categories – for example, stock, vehicles, telephone – as shown in Figure 1-1. This separation lets you see how much you're spending or receiving in each area.

<i>Payments</i>				<i>Analysis</i>			
<i>Date</i>	<i>Name</i>	<i>Details</i>	<i>Amount £</i>	<i>Stocks</i>	<i>Vehicles</i>	<i>Telephone</i>	<i>Other</i>
4 June	Gibbs	Stock purchase	310	310			
8 June	Gibbs	Stock purchase	130	130			
12 June	ABC Telecoms	Telephone charges	55.23			55.23	
18 June	Colt Rentals	Vehicle hire	87.26		87.26		
22 June	VV Mobiles	Mobile phone	53.24			53.24	
27 June	Gibbs	Stock purchase	36.28	36.28			
Totals			672.01	476.28	87.26	108.47	

FIGURE 1-1:
An example
of an analysed
cash book.

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You need to keep copies of paid and unpaid sales invoices and the same for purchases, as well as your bank statements. You then reconcile (match) bank statements to your cash book to tie everything together.

Dealing with double entry

If you operate a partnership or trade as a company, you may need a double-entry bookkeeping system from the start. A *double-entry bookkeeping system* requires two entries for each transaction – hence the name – and every transaction has two effects on the accounts. For example, when you buy an item of stock for sale and pay for it in cash, your cash balance goes down and your amount of stock goes up by the same amount, keeping everything in balance.

Choosing the right accounting program

With the cost of a basic computerised accounting system starting at barely £12, and a reasonable package costing around £20, planning to use such a system from the outset is sensible. If you're concerned as to whether such software represents value, try out QuickBooks Online Simple Start on a low-price trial basis, which will set you back as little as £5 a month plus VAT (value-added tax); go to www.quickbooks.intuit.co.uk. Thereafter, it costs around £12 a month. Or, if you can face having adverts pop up from time to time, Wave, which makes cloud-based, integrated software and tools for small businesses, offers a free-forever accounting package at www.waveapps.com/accounting.

Using a computerised accounting system means no more arithmetical errors. As long as you enter the information correctly, the computer adds it up correctly. With a computer, the £53.24 mobile phone expenditure shown in Figure 1-1 is input as an expense (a debit), and then the computer automatically posts it to the mobile phone account as a credit. In effect, the computer eliminates the extra step or the need to differentiate between debit and credit.



REMEMBER

A computerised accounting program is only as good as the data you enter into it. Introduce strict end-of-month controls to make sure that you've counted and valued all stock, dealt with all the month's invoices and so on. Without this, your computer program reflects inaccurate data.

Routine tasks, such as filling in tax and VAT returns, take minutes rather than days with a computer. The system can ensure that your returns are accurate and fully reconciled. With a computerised system, invoices are always accurate. You can see at a glance which customers regularly take too long to pay. You've two main options in your choice of your first accounting system:

- » **Manual:** If you think that a manual system is best for your purposes, you can get sheets of analysis paper with printed columns for accounting entries, and put in your own headings as appropriate. Or you can buy off-the-shelf sets of books from any office stationer's outlet. These cost anything from £10 to



TIP

£20 for a full set of ledgers. Hingston Publishing (hingston-publishing.co.uk/accounts-books) produces small business accounts systems for both VAT and non-VAT registered businesses for about £15.

- » **Accounting software:** If you decide to take the plunge and go straight for accounting software, you have myriad software providers to choose from that serve the small business market with bookkeeping software.
- » TechRadar reviews some of the top free and paid accounting software packages in 2023 at www.techradar.com/uk/best/best-accounting-software. They repeat this review periodically. You can enter some basic details on your accounting needs and TechRadar matches your requirements with the services and prices of the software reviewed.

THE MAKING TAX DIGITAL INITIATIVE

In 2019, HMRC started the initiative to get VAT-registered businesses to submit their VAT returns via an online portal. This initiative is called Making Tax Digital (MTD), and in time means that all businesses (sole trader or limited company) will be required to have a digital record of all its transactions required for its VAT return. This means that businesses will have to ditch their paper-based accounting systems and adopt a commercially available software package.

However, HMRC will accept spreadsheet input via an approved interface. This option means that small businesses can use a simplified homemade solution. MTD for VAT started in April 2019, but was extended to all VAT-registered businesses in April 2022. MTD for income tax (for the self-employed and those with income from property) is to be mandated from April 2026.

Soon, all but the very smallest businesses will have to file their accounts online, so you need an accounting system that meets the requirements of Her Majesty's Revenue and Customs (HMRC). A range of Internet-filing-enabled software and forms is available from HMRC and commercial software and service suppliers. You can use this software to file company tax returns online, including accounts and computations. HMRC provides a list of software suppliers at www.gov.uk/government/publications/self-assessment-commercial-software-suppliers, but doesn't take responsibility for loss, damage or costs incurred by using the software.

You can keep up to date on Making Tax Digital at <https://www.gov.uk/guidance/sign-up-your-business-for-making-tax-digital-for-income-tax>.

Outsourcing your bookkeeping

Accountants and freelance bookkeepers can do all your bookkeeping work – at a price. The rate is anything from £20 per hour upwards. Bookkeeping services range from a basic write-up of the entries and leave-the-rest-to-you approach, to providing weekly or monthly accounts, perhaps with pointers as to what may be going wrong. Services even exist that act as a virtual finance director, giving you access to a senior accountant who may sit on your board.



REMEMBER

Most bookkeeping services have a computer system into which you have to plug your records, so if you're thinking of going down this route, check out which software you require first.

The bookkeeper's most routine but vital task may be doing the payroll. If you don't get this done on time and correctly, both staff and HMRC, for which you have to collect Pay As You Earn (PAYE), become restless. A weekly payroll service for up to ten employees costs upwards of £85 per month. If you pay everyone monthly, the cost drops to about a third of that figure.

If you choose to outsource your bookkeeping, you'll probably need someone local, so ask around to find someone who uses a bookkeeper and is satisfied. Alternatively, turn to the phone book, or use Service Start (<http://uk.servicestart.com>), which gets up to five price quotes from rated bookkeeping service providers all over the UK.

As with an accountant, make sure that a prospective bookkeeper is adequately qualified. The Institute of Accountants & Bookkeepers (IAB; www.iab.org.uk) and the Institute of Certified Bookkeepers (www.bookkeepers.org.uk) are the two professional associations that are good starting points.



TIP

You can check out the letters that anyone in the accounting profession uses after their name or the bodies they claim to be a member of at the Directory of Essential Accountancy Abbreviations, maintained by the Library and Information Service at the Institute of Chartered Accountants in England and Wales (www.icaew.com/en/library/subject-gateways/accounting/abbreviations).

Maintaining the Right Paperwork

When handling cash, you can see that a lot of paper changes hands, whether from the cash register, deposits into your current accounts or petty cash withdrawals. Therefore, careful documentation is paramount to control the movement of cash into and out of your business properly. And don't forget about organisation; you need to be able to find that documentation if questions about cash flow arise later.

Monitoring cash flow isn't the only reason why you need to keep loads of paperwork. In order to do your taxes and write off business expenses, you need receipts for those expenses. You also need details about the money you pay to employees, and tax and National Insurance contributions collected for your employees, in order to file the proper reports with HMRC. Setting up a good filing system and knowing what to keep and for how long are very important for any small-business person.

Creating a filing system

To get started setting up your filing system, you need the following supplies:

- » **Filing cabinets:** This is pretty self-explanatory – you can't have a filing system with nothing to keep the files in.
- » **File folders:** Set up separate files for each of your suppliers, employees and customers who buy on credit, as well as files for backup information on each of your transactions. Many bookkeepers file transaction information using the date the transaction was added to their journal. If the transaction relates to a customer, supplier or employee, they add a duplicate copy of the transaction to the individual files as well.



REMEMBER

Even if you have a computerised accounting system, you need to file paperwork related to the transactions you enter into your computer system. You still need to maintain employee, supplier and customer files in hard copy just in case something goes wrong – for example, if your computer system crashes, you need the originals to restore the data. Back up your computerised accounting system's data regularly to minimise the effects of such a crisis. Daily backups are best; one week is the longest you should ever go without a backup.

- » **Ring binders:** These binders are great for things you add to regularly, and the binders make adding pages easy. Make sure that you number the pages as you add them to the binder, so that you can quickly spot a missing page. How many binders you need depends on how many financial transactions you have for each accounting period. You can keep everything in one binder, or you may want to set up a binder for the Chart of Accounts and Nominal Ledger and a separate binder for each of your active journals. The decision is based on what makes your job easier.
- » **Expandable files:** These files are the best way to keep track of current supplier activity and any bills that may be due. Make sure that you have:
 - **An alphabetical file:** Use this file to track all your outstanding purchase orders by supplier. After you fill the order, you can file all details about that order in the supplier's individual file in case questions about the order arise later.



TIP

- **A 12-month file:** Use this file to keep track of bills that you need to pay. Simply place the bill in the slot for the month payment is due. Many businesses also use a 30-day expandable file. At the beginning of the month, the bills are placed in the 30-day expandable file based on the dates that they need to be paid. This approach provides a quick and organised visual reminder for bills that are due.

If you're using a computerised accounting system, you don't need the expandable files because your accounting system can remind you when bills are due. You can also print an Aged Debtor report, which shows you who owes you money, and an Aged Creditor report, which shows you how much money you owe your suppliers and how many days overdue your invoices are.

- **Backup portable hard drives:** These hard drives can be used to back up your computerised system on a daily basis. Keep the backup hard drive in a fire safe or somewhere that will remain unaffected if a fire destroys the business. (A fire safe is the best way to keep critical financial data safe, and is therefore a must for any business.) If you don't have a fire safe, take the backup off-site each night. You can get a 1TB hard drive for as little as £32.
- **Backup to the cloud:** As well as backing up data to a hard drive, you can back it up away from any of your premises to the cloud. If you're using a cloud-based accounting package, this backup happens automatically. Just Google 'cloud storage' to see myriad inexpensive storage providers. Just think: If you had a fire at home or in the office where you had stored your backup, you could lose everything, but a commercial backup provider would keep multiple copies of your backup all over the cloud.

Working out what to keep and for how long

As you can probably imagine, the pile of paperwork you need to hold on to can get very large very quickly. As they see their files getting thicker and thicker, most businesspeople wonder what they can toss, what they really need to keep and how long they need to keep it.

Generally, keep most transaction-related paperwork for as long as HMRC can come and audit your books. For most types of audits, that means six years. But if you fail to file your tax return or file it fraudulently (and hopefully this doesn't apply to you), HMRC may question you about it any time, because no time limitations exist in these cases.

HMRC isn't the only reason to keep records around for longer than one year. You may need proof-of-purchase information for your insurance company if an asset is lost, stolen or destroyed by fire or other accident. Also, you need to hang on to

information regarding any business loan until it's paid off, just in case the bank questions how much you paid. After the loan's paid off, ensure that you keep proof of payment indefinitely in case a question about the loan ever arises. Information about property and other asset holdings needs to be kept around for as long as you hold the asset and for at least six years after the asset is sold. You're legally required to keep information about employees for at least three years after the employee leaves.

Keep the current year's files easily accessible in a designated filing area and keep the most recent past year's files in accessible filing cabinets if you have room. Box up records when they hit the two-year-old mark and put them in storage. Make sure that you date your boxed records with information about what they are, when they were put into storage and when you can destroy them. Many people forget that last detail, and boxes pile up until total desperation sets in and no more room is left. Then someone must take the time to sort through the boxes and figure out what needs to be kept and what can be destroyed – not a fun job!



TIP

It's a legal requirement to keep information about all transactions for six years. After that, make a list of things you want to hold on to longer for other reasons, such as asset holdings and loan information. Check with your solicitor and accountant to get their recommendations on what to keep and for how long.

Filing Your Accounts

If you're trading as a company, you have to file your accounts with Companies House (<https://www.gov.uk/file-your-company-annual-accounts>) each year.



REMEMBER

Unless you're filing your company's first accounts, the time normally allowed for delivering accounts to Companies House is nine months from the end of the relevant accounting period for private companies. If you're filing your company's first accounts and they cover a period of more than 12 months, you must deliver them to the registrar within 21 months of the date of incorporation for private companies. Late filing attracts financial penalties, details of which you can find on the Companies House website.

All companies must prepare full accounts for presentation to their shareholders, but small and medium-sized companies can send abbreviated accounts to the registrar of companies. Abbreviated accounts contain little information that can be of use to a competitor. Nothing is given away on turnover or margins, for example, a luxury denied to larger companies. Small companies' accounts (those with less than £6.5 million turnover, a balance sheet total of less than £3.26 million, and

fewer than 50 employees on average, to be precise) delivered to the registrar must contain:

- » An abbreviated balance sheet
- » Selected notes to the accounts, including accounting policies, share capital, particulars of creditors payable in more than five years and the basis of any foreign currency transactions
- » A special auditor's report (unless exempt from audit)



REMEMBER

The rules of disclosure are complex and the preceding is only an overview of the requirements. If you're unsure about the information that you have to provide, seek professional advice.

Managing Your Accountant



REMEMBER

Accountancy is just another business discipline, like selling, research, administration or production. So you need to manage, motivate, reward and appraise your accountant, like any other member of staff. Whoever acts as your company accountant, be that person a part-timer from outside or a fellow director, you as the owner must take the lead.

Make sure that your accountant is ahead of the curve on the following key points:

- » **Your monthly management accounts should be available within a week to ten days of the end of each month.** You have the wrong accountant or the wrong accounting system if you can't achieve this standard. If you don't yet have monthly management accounts, make that your accountant's next measurable goal.
- » **Accounting systems and reports should be simple, free of jargon and supported by clear written explanations of the key issues to consider.** For example, in a situation where profits are down by 10 percent, in addition to reporting this fact, you need to clarify the underlying cause in order to get the business back on track. Explaining that this reduction was caused by a 5 percent drop in sales of product X and a 5 percent increase in raw material costs gives a clear indication of responsibilities and possible remedies.
- » **Your accountant should ensure that your books and records are kept to the standard required by company law.** They must also see that your accounting policies meet the required standards and that accounts, VAT returns, and PAYE and tax demands are dealt with in a timely manner.

Protecting Your Business Against Internal Fraud

Many businesspeople start their operations by carefully hiring people they can trust, thinking: 'We're a family – they'd never steal from me.' But often a business owner finds out too late that even the most loyal employee may steal from the business if the opportunity arises and the temptation becomes too great – or if the employee gets caught up in a serious personal financial dilemma and needs fast cash. In this section, you find out about the steps you can take to prevent people stealing from your business.

Facing the reality of financial fraud

There are four basic types of financial fraud:

- » **Embezzlement** is the illegal use of funds by a person who controls those funds. For example, a bookkeeper may use business money for their own personal needs. Many times, embezzlement stories don't appear in the newspapers because businesspeople are so embarrassed that they choose to keep the affair quiet. They usually settle privately with the embezzler rather than face public scrutiny.
- » **Internal theft** is the stealing of business assets by employees, such as taking office supplies or products the business sells without paying for them. Internal theft is often the culprit behind stock shrinkage.
- » **Payoffs and kickbacks** are situations in which employees accept cash or other benefits in exchange for access to the business, often creating a scenario where the business that the employee works for pays more for the goods or products than necessary. That extra money finds its way into the pocket of the employee who helped facilitate the access. For example, say Business A wants to sell its products to Business B. An employee in Business B helps Business A get in the door. Business A prices its product a bit higher and gives the employee of Business B the extra profit in the form of a kickback for helping it out. A payoff is paid before the sale is made, essentially saying 'please'. A kickback is paid after the sale is made, essentially saying 'thank you'. In reality, payoffs and kickbacks are a form of bribery, but few businesses report or litigate this problem (although employees are fired when deals are uncovered).
- » **Skimming** occurs when employees take money from receipts and don't record the revenue in the books.

Although any of these financial crimes can happen in a small business, the one that hits small businesses the hardest is embezzlement. This crime happens most frequently when one person has access or control over most of the business's financial activities. For example, a single bookkeeper may write cheques, make deposits and balance the monthly bank statement – talk about having your fingers in a very big till.



WARNING

In their Fraud Barometer report for 2022, major accounting firm KPMG reported that embezzlement was the most prevalent type of fraud case. They also reported that employees, members of the management team or a family member accounted for the majority of this type of fraud. See the report at <https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2023/02/fraud-barometer-2023.pdf>.

Dividing staff responsibilities

Your primary protection against financial crime is properly separating staff responsibilities when the flow of business cash is involved. Basically, never have one person handling more than one of the following tasks:

- » **Bookkeeping:** Involves reviewing and entering all transactions into the business's books. The bookkeeper makes sure that transactions are accurate, valid, appropriate and have the proper authorisation. For example, if a transaction requires paying a supplier, the bookkeeper makes sure that the charges are accurate and someone with proper authority has approved the payment. The bookkeeper can review documentation of cash receipts and the overnight deposits taken to the bank, but shouldn't actually make the deposit. Also, if the bookkeeper is responsible for handling payments from external parties, such as customers or suppliers, they shouldn't enter those transactions in the books.
- » **Authorisation:** Involves being the manager or managers delegated to authorise expenditures for their departments. You may decide that transactions over a certain amount must have two or more authorisations before cheques can be sent to pay a bill. Spell out authorisation levels clearly and make sure that everyone follows them, even the owner or managing director of the business. (Remember, as owner, you set the tone for how the rest of the office operates; when you take shortcuts, you set a bad example and undermine the system you put in place.)
- » **Dealing with suppliers:** Involves making sure that you're only paying for goods and services that you actually received. You can do this by checking invoices against delivery notes/goods received notes to make sure you got the goods you're being charged for. Also, check off supplier invoices against their statements to make sure that you aren't missing any invoices.



TIP

- » **Money-handling:** Involves direct contact with incoming cash or revenue, whether cheque, credit card or credit transactions, as well as outgoing cash flow. People who handle money directly, such as cashiers, shouldn't also prepare and make bank deposits. Likewise, the person writing cheques to pay business bills shouldn't be authorised to sign those cheques; to be safe, have one person prepare the cheques based on authorised documentation and a second person sign those cheques after reviewing the authorised documentation.

When setting up your cash-handling systems, try to think like an embezzler to figure out how someone can take advantage of a system.

- » **Financial report preparation and analysis:** Involves the actual preparation of the financial reports and any analysis of those reports. Someone who's not involved in the day-to-day entering of transactions in the books needs to prepare the financial reports. For most small businesses, the bookkeeper turns over the raw reports from the computerised accounting system to an outside accountant, who reviews the materials and prepares the financial reports. In addition, the accountant does a financial analysis of the business activity results for the previous accounting period.



TIP

You may be just starting up a small business and therefore not have enough staff to separate all these duties. Until you do have that capability, make sure that you stay heavily involved in the inflow and outflow of cash in your business. The following tips tell you how:

- » **Periodically (once a month) open your business's bank statements and review the transactions.** Someone else can be given the responsibility of reconciling the statement, but you still need to keep an eye on the transactions listed.
- » **Periodically look at your business cheque book counterfoils to ensure that no cheques are missing.** A bookkeeper who knows that you periodically check the books is less likely to find an opportunity for theft or embezzlement. If you find that a cheque or page of cheques is missing, act quickly to find out if the cheques were used legitimately. If you can't find the answer, call your bank and put a stop on the missing cheque numbers.
- » **Periodically observe your cashiers and managers handling cash to make sure that they're following the rules you've established.** This practice is known as *management by walking around* – the more often you're out there, the less likely you are to be a victim of employee theft and fraud.

CAUGHT WITH THEIR FINGERS IN THE TILL

Alice is a bookkeeper who's been with Business A for a long time. She was promoted to office manager after being with the business for 20 years. She's like a family member to the business owner, who trusts her implicitly. Because the owner is so busy with other aspects of running the business, they give her control of the daily grind of cash flow. The beloved office manager handles or supervises all incoming and outgoing cash, reconciles the bank statements, handles payroll, signs all the cheques and files the business's tax returns.

All that control gives her the opportunity, credibility and access to embezzle a lot of money. At first, the trust in her is well founded, and Alice handles her new responsibilities very well. But after about three years in the role as office manager, she develops a gambling habit and those debts mount up.

Alice decides to pay herself more money. She adds her husband to the payroll and documents the cheques for him as consulting expenses. She draws large cash cheques to buy nonexistent office supplies and equipment, and then, worst of all, she files the business's tax returns and pockets the money that should go to paying the tax due. The business owner doesn't find out about the problem until HMRC comes calling, and by then, the office manager has retired and moved away.



TIP

Watch this video clip produced by the Institute of Chartered Accountants of England and Wales (ICAEW) showing how a financial controller stole £20,000 from their company and four actions you can take to make sure that doesn't happen to you: <https://www.icaew.com/insights/viewpoints-on-the-news/2021/mar-2021/the-financial-controller-who-stole-20k-from-her-company>.

Balancing control costs

As a small-business person, you're always trying to balance the cost of protecting your cash and assets with the cost of adequately separating those duties. But putting in place *too* many controls, which end up costing you money, can be a big mistake. For example, you may create stock controls that require salespeople to contact one particular person who has the key to your product warehouse. This kind of control may prevent employee theft, but can also result in lost sales, because salespeople can't find the key-holder while dealing with an interested customer. In the end, the customer gets mad, and you lose the sale.



TIP

When you put controls in place, talk to your staff both before and after instituting the controls to see how they're working and to check for any unforeseen problems. Be willing and able to adjust your controls to balance the business needs of selling your products, managing the cash flow and keeping your eye on making a profit. Talk to other businesspeople to see what they do and pick up tips from established best practice. Your external accountant can also be a good source of valuable information.



REMEMBER

Generally, as you make rules for your internal controls, make sure that the cost of protecting an asset is no more than the asset you're trying to protect. For example, don't go overboard to protect office supplies by forcing your staff to wait around for hours to access needed supplies while you and a manager are at a meeting away from the office.

Ask yourself these four questions as you design your internal controls:

- »» What exactly do I want to prevent or detect – errors, sloppiness, theft, fraud or embezzlement?
- »» Do I face the problem frequently?
- »» What do I estimate the loss to be?
- »» What is the cost to me of implementing the change in procedures to prevent or detect the problem?

You can't answer all these questions yourself, so consult with your managers and the staff the changes are likely to impact. Get their answers to these questions and listen to their feedback.



TIP

When you finish putting together the new internal control rule, ensure that you document why you decided to implement the rule and the information you collected in developing it. After the rule's been in place for a while, test your assumptions. Make sure that you are in fact detecting the errors, theft, fraud or embezzlement that you hoped and expected to detect. Check the costs of keeping the rule in place by looking at cash outlay, employee time and morale, and the impact on customer service. If you find any problems with your internal controls, take the time to fix them and change the rule, again documenting the process. Detailed documentation ensures that, if two or three years down the road someone questions why they are doing something, you have the answers and are able to determine whether the problem is still valid, as well as whether the rule is still necessary or needs to be changed.

Insuring Your Cash through Fidelity Bonds

Employers can insure themselves against the loss of money through embezzlement by employees. A *fidelity bond* is a form of specialised insurance that companies can take out to protect themselves against financial loss caused by employee theft or dishonesty. If an employee steals from you or one of your customers, the insurance covers the loss.

This type of insurance can be added to your normal business insurance. The cost varies greatly depending on the type of business you operate and the amount of cash or other assets that are handled by the employees you want to bond. Ask your insurance broker for an accurate quotation for your business.