

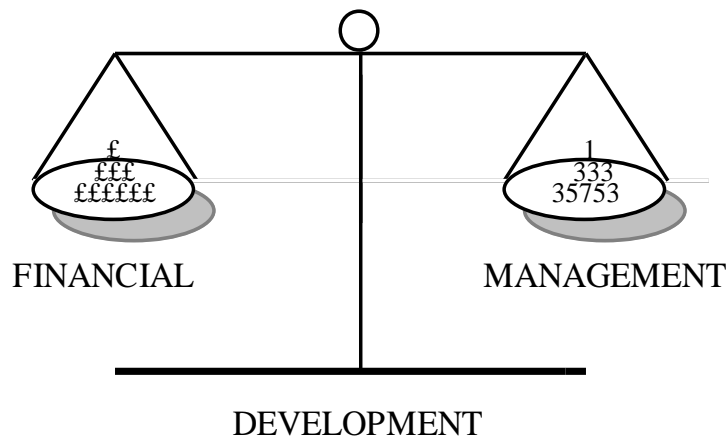
FINANCIAL MANAGEMENT DEVELOPMENT

Financial Accounting

Basic Accounting

NO 113

THE BALANCE SHEET



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

www.FinancialManagementDevelopment.com

This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

THE BALANCE SHEET

OBJECTIVE

The Balance Sheet, as its name implies, balances. It sets out items owned (assets) and items owed (liabilities) by an organisation. If there are Net Assets these will have been funded by either capital which has been paid in (share capital, capital introduced or some other form of equity) or by the retention of profits from the past.

The objective of the Balance Sheet is to identify the constituent parts of the Net Assets in order to show the owners of the Business where their money has been invested. It is not a statement of the value of the business. In the UK the layout and headings are defined by legislation.

ASSETS

Fixed Assets

Fixed Assets are items purchased by the business (or transferred to it) which are for use in the trade rather than for resale. There are four main categories.

1. Intangibles - Goodwill, Brand Names, Patent Rights etc. These are normally only shown when purchased.
2. Land and Buildings - Some organisations try to separate the value of the land from that of the Buildings. This also includes the value of any premiums paid for leasehold properties.
3. Plant & Machinery - Any asset live or dead used to assist the trade. The tax authorities have specific views about what is plant and machinery and what is not.
4. Vehicles - Lorries, cars etc.

It is normal to write off (charge against profits) the cost of a fixed asset by depreciating it. The annual depreciation charge is merely the cost less any expected value on disposal spread over the asset's useful life.

Land is not normally depreciated and some organisations recognise any increase in land value by showing the revalued amount in the Balance Sheet together with a balancing increase in the Equity (a Revaluation Reserve - see below).

Stocks and Work in Progress

Stocks are normally shown at cost. This includes the cost of any work done on them e.g. delivery or packing costs. If the value of the stock has declined then the reduction should be shown together with an equivalent charge against profits. In the oil industry some organisations show stocks at market value (replacement cost). This involves recognising a holding gain or loss in the reserves.

Prepayments

Where cash has been paid in advance of receiving a service, it is held as an asset and only charged against profit as it is used up or the service is received.

Debtors

The amounts owed by customers who have not yet paid are shown as assets. This will include any associated VAT i.e. the amount is the true cash owing. If there is any doubt about gaining payment then it is normal to make a provision against the debt. (Reduce its value in the Balance Sheet and charge the reduction against profit). Any such provision should identify specific debtors to gain tax allowability.

Cash

This is the cashbook cash figure and will therefore need to be reconciled to the bank statement to allow for un-presented cheques or lodgements in transit, credit card amounts due can be treated as cash in transit or debtors.

LIABILITIES

Creditors

Creditors are the amounts owed to third parties for goods or services received but not yet paid for. Normally this is the total of unpaid invoices including VAT. VAT is recoverable immediately even though the invoices are unpaid, provided the invoice date is before the end of the relevant quarter.

Accruals

Accruals are amounts owed for which no invoice has been received. They therefore exclude VAT. It is normal to have accruals for items such as electricity, phone etc. where bills are received in arrears as well as for bank interest, audit and professional fees.

VAT

The amount owed for VAT will consist of the tax charged on sales, less the recoverable tax payable on invoices received (input tax) for purchases. It is vital that VAT on purchases is identified since if it is not deducted from the amount of output tax it is lost forever.

Taxation

Most organisations will have tax to pay on profits. Companies pay Corporation Tax nine months after the relevant year end. Individuals pay Income Tax and National Insurance on the prior year or current year basis - half on 31 January and half on 31 July.

Overdrafts

Normally overdrafts are shown separately from cash balances. Again it is the cashbook figure which is shown.

Loans

Loans, whether from a bank or from individuals are liabilities and therefore will be shown at the amount owing. Normally any related interest is shown under accruals.

EQUITY

Also called shareholders' funds, Owners' Equity or Net Worth.

Share Capital

Amounts paid or due for shares issued for Companies.

Capital Account

The amount introduced to the business by a sole trader or partner in the business.

Retained Earnings

Profits or losses of the trade (after all costs including taxation have been deducted) since the trade started. These will have been reduced by any dividends paid (companies) or drawings (partnerships and sole traders).

Revaluation Reserve

In some organisations, where there has been a revaluation to recognise an increase in value of assets - particularly property - the resulting surplus is shown as a revaluation reserve (otherwise the Balance Sheet would not balance!) rather than as Retained Earnings because until the asset is sold the gain is only notional.

Rev. DAVID A. PALMER BA (Financial Control) FCA CTA MCIPD

David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:

FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).