Balance sheets

What is a balance sheet and why is it important?

The balance sheet of a social enterprise is a statement of the enterprise's net worth on a particular date. The net worth is the difference between what a company owns and what it owes and your balance sheet will provide an overview of this.

What a company owns is called an **Asset** and what a company owes is called a **Liability**. There are different subcategories within assets and liabilities which are explained below.

Assets

There are two types of assets: long term and current (or short term).

Long term assets
These consist of fixed assets and investments.

Fixed assets
These are items that a company has purchased that are:

- not for resale
- will last more than 12 months
- have a high relative value

Examples are:

- PCs
- printers
- furniture
- fixtures & fittings
- equipment
- motor vehicles, vans, mini buses
- web site
- machinery
- leasehold
- land and buildings

Investments
An investment is something that a company has purchased with the intention of retaining it for some time and which produces a passive income for the owner. That is the investment generates an income in its own right without any active participation from the owner.

Examples are:

- shares (depending on your legal structure)
- property that is rented out

Current (or short term) assets
Current assets are items that the business can convert into cash within the next 12 months.

Examples are:

- cash and bank accounts
- trade debtors (see below)
- other debtors (such as VAT recoverable)

- stock (items purchased for resale)
- pre payments (cash paid in advance e.g. a quarter's rent)

Debtors are created when a business raises an invoice for services delivered or goods sold but for which payment has not been received at the balance sheet date. This is normal for most businesses that give credit where there may be many months before an invoice is settled. (A cash business such as a shop or a restaurant should not have this issue).

Liabilities

These are categorised between Long term liabilities and Short term liabilities

Long term liabilities
These are amounts that are payable beyond the next 12 months. For example, if the business has a five year loan, then the amount due in the next 12 months is shown a short term liability, but the remainder is shown as a long term liability.

Short term liabilities
These are liabilities that need to be paid within the next 12 months.

Examples are:

- bank overdraft
- trade creditors (see below)
- statutory creditors (VAT or other tax payable)
- loan (amount repayable within the next 12 months)
- accruals (amounts due but not yet paid e.g. charges paid in arrears)

Net worth

The net worth is the difference between the total assets less the total liabilities. The greater the net worth the more value the company has and the safer it is considered to be by lenders, suppliers and statutory authorities seeking to give out contracts.

If a company has a negative net worth it is effectively bust and the directors should be taking advice as to whether they should be trading at all.

Balancing the balance sheet

A balance sheet gives more information than the net worth alone. The balance sheet also shows how the net worth was created.

Usually the net worth (the net assets) is an accumulation of cash and fixed assets. The accumulation has come about because of money that has been invested in the business and also the accumulation of profits over the years.

The investment and the profits belong to the owners of the business, whereas the net worth belongs to the company, which is a separate legal entity.

So, as far as the company is concerned, the accumulated profits and the investments are liabilities that will at some point be paid back, usually when a company stops trading. When the company stops trading the assets will be sold, the resulting cash will be used to settle liabilities, and the balance will equate to the "net worth" of the company which will be used to repay the owners their investment and the accumulated profit that they are entitled to.

This liability to the owners is therefore "balanced" by the net assets.

Balance sheet example

An example of a balance sheet is set out below.

	£	£	£
Fixed assets			25,000
Investments			15,000
Total long term assets			**40,000**
Current assets			
Bank	2,500		
Trade debtors	15,000		
Stock	12,000		
Prepayments	500		
Total current assets		**30,000**	
Current Liabilities			
Trade creditors	16,000		
Accruals	500		
PAYE	1,500		
VAT	2,500		
Loan repayable in 12 months	5,000		
Total current liabilities		**(25,500)**	
Net current assets			**4,500**
(Net Worth)			**44,500**
Owners funds			
Investment			20,000
Current year profit			9,500
Prior year profits			15,000
			44,500

Further information

Read our guide on Profit forecasts:
www.bllondon.com/SocialEnterprise/Fundingandfinance/Financialplanning/Profitforecasts.aspx

Read our guide on Cash flow forecasts:
www.bllondon.com/SocialEnterprise/Fundingandfinance/Financialplanning/Cashflowforecasts.aspx

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