Introduction

Our balance sheet course is purely about helping you to present your company’s assets and liabilities as well as equity at a certain date. What we’ll do is start off with explaining the statement itself, how it’s composed and explain a bit different presentation opportunities. What you’ll get is a simple structure with the key messages underlined and explained. To support the content, we’ve also prepared a template for easier following and to also be used as a base for your very own balance sheet.

The course itself is structured with the aim to have it easily follow able and understandable with examples to illustrate where possible. There will be just simple words and everything written in “down to earth” style for an easy and quick understanding.

So let’s kick off!

What’s a balance sheet?

A balance sheet is probably the most important from the four main statements one presents for a company. As a balance sheet does not reflect a period, but a certain date, it reflects the assets and liabilities a company owns at a balance sheet date – term used to reflect the date in time the statement is prepared for. It’s not only assets and liabilities though, but also equity at the date. A balance sheet is also called a statement of financial position, which does describe it’s meaning pretty accurately if you think about it. At the end of the day, as it shows the balances the operations generated and used, it’s not about reflecting operations themselves, which is why the income statement is for, but showing where the company stands in terms of owning assets and owing money. That’s the general meaning behind the balance sheet really.

As was mentioned, a balance sheet is a statement showing the position of assets, liabilities and equity at a certain date. We’ll move onto explaining all those groups separately.

Components of a balance sheet

Assets

Assets are something the company has generated or bought usually as a result of normal course of business or through non-business related transactions, which result in assets the company owns at the balance sheet date. The ownership can be deemed over following types of assets (i.e. they can be recognized as assets) (do note that this is not a complete list and there may be other types of components):

- Cash and cash equivalents;
- Accounts receivables
- Prepaid expenses;
- Inventory;
- Financial assets (i.e. loans, deposits, derivatives, bonds, etc.)
- Property, plant and equipment, etc.

When we talk about composing a balance sheet and relating entries one uses to build up asset balances, there are a few examples we’d like to share with you. They are the most used and most common accounting entries as such when it comes to assets on the balance sheet.
Making a sale
As a general rule when you make a sale, you get revenue to your income statement and either cash or receivables to your balance sheet. What we will do now is take a look at both of those approaches.

In case you sell with an invoice meaning the client will pay for the received service or goods at a later date, you must account for the sale and a receivable balance. Note here that in most cases the accounting is done on accrual basis meaning that at the time of the transaction you need to account for it. Not when cash is paid, but when the transaction is made. As such the entry is as follows:

*Db Accounts receivable*
*Cr Sales revenue*

However, in case the amount is paid at the time of the sale, your entry is as follows:

*Db Cash and cash equivalent*
*Cr Sales revenue*

VAT is never part of revenue, but please do note that it’s the amount still receivable from the client. As such, if your company is registered for VAT and the selling price as a result includes VAT charge, the balance sheet amount always includes the VAT charge as well. An accounting entry in case of VAT is being charged (as an example, the VAT rate is 20% and the price of the product sold 120):

*Db Accounts receivable 120*
*Cr VAT payable 20*
*Cr Sales revenue 100*

Getting paid for the sale
One thing is getting paid right at the spot of making the sale, which we explained above, however, how to act when the receivable is paid up?

If your customer is paying up their debt, what you effectively do is decrease the receivable by the amount received and account for the received money:

*Db Cash and cash equivalent*
*Cr Accounts receivable*

Buying inventory
If you’re not in the business of providing services, but selling goods, you’re bound to have inventory in your accounts. To put producing goods aside as it’s an entirely different topic, buying goods for sale however is something that’s very common in most businesses.

Let’s say your company who’s not registered for VAT bought some goods with the price of 120 (including VAT of 20). Your accounting entry should be as follows:

*Db Inventory 120*
*Cr Payables to suppliers 120*

Provided that your company however is registered for VAT, the entry in the same case should be as follows:

*Db Inventory 100*
*Db Prepaid VAT 20*
*Cr Payables to suppliers 120*
Simply put you must include the VAT as the cost price of inventory bought if you’re not registered for VAT. Why? Because you cannot redeem it, whereas if you are registered, your obliged to charge VAT to your sales, but you also obtain the right to get back all the VAT paid on goods and services bought for business purposes. That’s how it works in most countries; however please do consult your local legislation for any variances.

**Using inventory**

Note how initial acquisition of goods isn’t an expense on the income statement. It’s just an asset that’s about to be involved in revenue generation.

One part of the revenue entry is accounting for the revenue itself and then for the relating receivable or cash. However, there are almost always expenses that are directly related to the sale and more often they include goods. Your accounting entry in this case is as follows:

\[
\begin{align*}
\text{Db Cost of goods sold} \\
\text{Cr Inventory}
\end{align*}
\]

With this you effectively account for the expense of goods sold and remove them from the balance sheet with one single accounting entry. You’ve affected your income statement and balance sheet.

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<td><strong>ASSETS</strong></td>
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<td><strong>Non-current assets</strong></td>
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<td>Property, plant and equipment</td>
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<td>Intangible assets</td>
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With this we’ve now covered the most common entries. In addition, please note that assets are grouped as current and non-current on the balance sheet. We will explain the reason and the measurement principles further in this course.

**Liabilities**

Liabilities are bluntly put company’s debt. It’s what the company owes to other parties for the assets bought and generated. It’s payables for services received from employees and loan debt incurred due to requiring extra financing to keep operations going. The payables on the balance sheet can be the following (do note that this is not a complete list and there may be other types of components):

- Accounts payables;
- Accrued expenses;
- Taxes payable;
- Payables to employees;
- Prepayments received;
- Borrowings;
- Provisions, etc.

Similarly to assets, there are entries which are the most used when it comes to accounting for liabilities. With following sections we’d like to give you an overview of the most common ones.

**Buying goods and paying for them**

As was mentioned above, in case of buying goods for sale, you initially recognize them as assets and accordingly book the payable to suppliers. Please refer above to **Buying inventory** section for relating
entries.

However, when with making a sale you get rid off the goods, how should you proceed with the remaining payable? The obvious and the right answer of course is that you pay off the debt in due time or before if possible to ensure you’re not facing any interest, fines or simply bad reputation. Your accounting entry should be as follows:

\[
\begin{align*}
\text{Db Payables to suppliers} \\
\text{Cr Cash and cash equivalents}
\end{align*}
\]

Now whilst this is the accounting entry, please take a note of actually paying the sum as well. Practice has shown that they do not go hand in hand at all times.

**Buying items of PPE**

Something we did not cover on the assets part is if you buy an item of PPE. The reason for it is merely the fact that PPE accounting is extensive on its own and hence we’ve made a separate course with that respect. However, to shortly give you an idea of how to initially recognize an item of PPE, here’s the entry:

\[
\begin{align*}
\text{Db Property, plant and equipment} \\
\text{Cr Payables to suppliers}
\end{align*}
\]

What you essentially do, is on one side account for the asset and on the other side book for the relating payable. Please note that paying up this payable is a similar entry as explained above in *Buying goods and paying for them* section.

**Buying services**

If goods and PPE items are assets that you require and do not initially go into expenses, services (i.e. marketing, salaries, rent, phone, petrol etc.) are something you account directly into expenses. They do not remain in assets unless they’re prepaid expenses for future periods.

Initially, when buying services etc. your entry is as follows:

\[
\begin{align*}
\text{Db Expense account} \\
\text{Cr Payables to suppliers}
\end{align*}
\]

Remember how we mentioned that accounting is usually done on accrual basis – it means first off that a transaction is accounted for when it’s done and not when money is paid. What this also means however is that the expenses are accounted for in the period they relate to. If for an example you pay your rental fee for the whole year with one payment, this expense should be spread across the period. For the sake of the example, let’s say the amount you paid for the whole 12 month period is 1,200.

Monthly charge in this example would be 100 (1,200 / 12) and your initial entry would be as follows:

\[
\begin{align*}
\text{Db Prepaid expenses 1,200} \\
\text{Cr Payables to suppliers 1,200}
\end{align*}
\]

At the very first period you account for the monthly charge:

\[
\begin{align*}
\text{Db Expense account 100} \\
\text{Cr Prepaid expenses 100}
\end{align*}
\]

And similarly really every month until the prepaid expense balance is 0 and it’s time for the payment for the next period. Please note that paying up this payable is a similar entry as explained above in
Buying goods and paying for them section.

Loans
Something that every now and then happens in business is that you need or want to take a loan. Whether it's a need or a wish depends on many things, however the accounting doesn't really differ for either of them.

Receiving a loan as such is booked with a following entry:

\[
\text{Db Cash and cash equivalents} \\
\text{Cr Loan payable}
\]

Repaying the loan either partially or in full is pretty much a reverse entry really:

\[
\text{Db Loan payable} \\
\text{Cr Cash and cash equivalents}
\]

Something to note here is that a loan itself is never an expense. The only effect it has on the income statement comes in the form of interests. They are something that's charged extra for the usage of the money. Accounting for the accrued interest expense would be done with the following entry:

\[
\text{Db Interest expense} \\
\text{Cr Interest payable}
\]

Paying up the interest balance:

\[
\text{Db Interest payable} \\
\text{Cr Cash and cash equivalents}
\]

Note here that accounting for loans is something we will address in a separate course.

And that's that. As with assets, the liabilities are also grouped in two – current and non-current liabilities. We will explain the reason and the measurement principles further in this course.

Equity
Equity is something that's company's own capital. Well, not its own, but its owners' capital that's paid in and earned profits which are accumulated and that can be taken out as dividends. It's effectively what the owners have invested into the company to participate in operations to generate assets and profits. Technically one could say that liabilities are external financing received and equity is internal financing obtained from owners. Components of equity are as follows (do note that this is not a complete list and there may be other types of components):

- Share capital;
- Share premium;
- Other reserves;
- Retained earnings, etc.

There are only a couple of types of accounting entries when it comes to equity accounts.
Making a payment into equity
Besides the regulatory considerations that may apply additionally, the basic accounting entry for any payment made into the equity is as follows:

Db Cash and cash equivalents / Other asset (in case non-monetary contribution was done)  
Cr Equity account

For an example, if a payment was done into share capital and into share premium let’s say accordingly in 10,000 and 20,000 the accounting entry would be as follows:

Db Cash and cash equivalents 30,000  
Cr Share capital 10,000  
Cr Share premium 20,000

Retained earnings
As you’ve noticed, there’s a line item called retained earnings as a part of equity. Whilst the other balances are more or less stable and do not change so much over periods without any special consideration, the retained earnings is something that’s ever in change. The reason behind it is simple really. It includes profit for the period. Every time you make an entry into the expenses or revenues, the retained earnings changes on the balance sheet.

Retained earnings comprises of two things – accumulated earnings and profit for the period. Combined they are total profits earned over the reporting periods less any payments made to owners. Technically how it works is that your prior reporting period’s profit is the accumulated balance and current years result is added to it. On your balance sheet you do nothing really (as there is no special profit account to make entries onto), but on the statement of changes in equity it’s shown as a movement in retained earnings.

Something that does require a specific entry though is payments out from retained earnings, i.e. dividends to owners. Your entry:

Db Retained earnings  
Cr Payable to owners

Once you make the payment, you use the same logic as with paying to your suppliers:

Db Payable to owners  
Cr Cash and cash equivalents

Equity

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<td>Share premium</td>
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<td>Other reserves</td>
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Equity is something where very little changes happen over the period. As such there isn’t much to disclose about it. Something to note however is that there is a separate main statement when it comes to equity and it’s called a statement of changes in equity.

Current and non-current
As was mentioned before, there are current and non-current balances disclosed on the balance sheet. Essentially what it means is that assets are divided into groups based on their liquidity and liabilities...
based on their due dates.

When we talk about assets and their separation what we mean is how soon the management expects to be realizing the assets and trade them for cash. As such, accounts receivables are more often current balances cause it’s expected that the payment periods are short as in not as long as 12 months. 12 months is really the borderline from where if exceeding, the assets should be considered as non-current. So as such, accounts receivable and inventory are considered as current assets due to the fact that they are easily tradable into cash. Everything that’s not as liquid, as in it’s harder to replace them and it’s not really in management’s intention to realize them in foreseeable future like PPE item, is considered as a non-current asset. Essentially think of it like this. If you expect to get rid of the asset in next 12 months, it’s possible the asset is current.

Now as for liabilities it’s far simpler. If the due date for the payment falls into the period of next 12 months, the liability is current and there’s nothing more to it. In case of let’s say a loan which you pay by portions, the payments falling into the 12 month period are classified as current and rest of the remaining balance as non-current.

**Presentation**

There are a couple of different approaches when it comes to displaying balances on balance sheet. We already explained the logic behind current and non-current separation and it really comes down to those two groups. Yes, a balance sheet starts from assets and the opposing items as liabilities and equity are to follow, that’s a given. However, there’s little bit more to it inside those groups.

Presenting the balances can be done in two ways – starting from more liquid or less liquid assets. The idea behind is that for an example if you company is more let’s say production based, the less liquid assets like property, plant and equipment are of more importance than inventory or cash. They are something that generates sellable units and as such, it’s possibly worth starting with the presentation from those. What’s left then are the current assets and they are of less importance in this example. Now, if however, your company is more buying goods than producing them and the fixed assets don’t really contribute into the revenue process this much, they can be shown as a second group on the balance sheet. This would mean that the assets start from current assets and are followed by non-current assets. It’s really dependant on the business type and management preference really.

However, the method you’ve chosen on the assets part of the balance sheet does direct which approach you should use on the liabilities side. If you start with less liquid assets, you also start with equity as the most fixed part of the liabilities side. It’s essentially something the company owes to the owners in the form of possible dividends. Following that ought to be the non-current liabilities and then the current ones. For the balance sheet to be easily comparable, both “sides” need to start with comparable items (comparable in terms of liquidity).

Hopefully this course gave you an idea of what a balance sheet essentially is and how it works. We did go over some general accounting entries to give you the initial base of how it’s composed together and what is affected with those basic entries. However, please note that some of those entries also include income statement lines so the statements to work together. As a result we strongly recommend you also take a look at our income statement course to get an idea of the second main statement works.