About a business

INFORMATION ABOUT BUSINESS STRUCTURES AND BUSINESS ACCOUNTS

A business can be set up in many different ways. The three most common are sole traders, partnerships and limited companies.

A sole trader owns and runs his or her own business. A partnership is owned and run by two or more individuals in the same business, such as a firm of accountants or a firm of solicitors. A limited company is owned by shareholders and run by directors. In a small company these could be the same people.

Other structures include charities, clubs and associations and pension schemes.

WHAT ARE ACCOUNTING RECORDS AND WHAT ARE FINANCIAL STATEMENTS?

Accounts are not only numbers. They also tell a story about a business if you know how to read them – how well it has done and how much it might be worth. One of the jobs of a chartered accountant is to read those numbers, interpret that story and explain it to their clients or their board of directors.

Why do businesses need accounting records?

- To provide a permanent record of transactions occurring in the business.
- To provide information so a set of financial accounts and management reports can be prepared.
- To control assets.
- To provide necessary information for decision making.
- To comply with statutory and regulatory requirements.

Why are financial statements/accounts prepared?

- To provide owners with information on the results of their business activities (have they made a profit?) and the financial position at the end of the year (how much money have they got in the bank?).
- To provide a basis for calculating tax liabilities.
- To comply with statutory and regulatory requirements.
- To give information to suppliers and lenders if the business is applying for a loan or for credit.

The two main statements in a set of accounts are: the profit and loss account and the balance sheet.

A profit and loss account shows the income earned and expenses incurred by the business over a period of time – usually an accounting year – and shows whether the business has made a profit or loss in that period.

A balance sheet shows the assets and liabilities of a business at a point in time. Examples of a profit and loss account and a balance sheet are shown below and overleaf, with an explanation for each one.

ANY OLD BUSINESS	31 MARCH 20XX		31 MARCH 20XX-1	
PROFIT AND LOSS ACCOUNT FOR THE YEAR TO 31 MARCH 20XX	£	£	£	£
Sales		296,650		345,456
Less: cost of sales				
Opening stock	54,456		49,568	
Purchases	123,564		134,546	
Closing stock	-48,564		-54,456	
		129,456		129,658
Gross profit		**167,194**		**215,798**
Wages and salaries		26,555		25,489
Motor expenses		15,564		18,895
Rent and rates		9,465		9,233
Postage and stationery		4,878		4,568
Heat and light		3,897		3,325
Sundry expenses		1,569		2,012
Repairs and renewals		7,564		5,566
Entertaining		1,458		1,888
Bank interest		998		899
Depreciation		4,888		5,564
Net profit		**90,358**		**138,359**

The trading and profit and loss account above shows the detail of the expenses incurred. We can see from this that the sales have fallen by 14% compared to the previous year, and that the gross profit margin has also fallen (this is the gross profit figure as a % of sales). The fall in the margin may be due to selling goods at a reduced price or it may be that the fall in sales was primarily in the higher margin goods.

The overheads of the business remain fairly consistent as you would expect. These are generally expenses that have to be paid regardless of how well the business performs in the year. This is why most businesses try to improve their margins either through increasing the volume of sales or by increasing prices of the goods they sell while trying to hold down expenses at the same time.

ANY YOUNG BUSINESS BALANCE SHEET AS AT 30 SEPTEMBER 20XX	30 SEPTEMBER 20XX £	 £	30 SEPTEMBER 20XX-1 £	 £
Fixed assets				
Motor vehicles		15,566		16,988
Fixtures and fittings		12,222		10,566
Computer equipment		8,540		9,265
Plant and machinery		5,556		6,886
		41,884		43,705
Current assets				
Stocks	48,564		54,456	
Debtors	32,223		36,897	
Cash in hand	12,140		15,465	
	92,927		106,818	
Current liabilities				
Trade creditors	19,546		22,832	
Bank loan	22,500		22,500	
	42,046		45,332	
Net current assets		**50,881**		**61,486**
Total assets less current liabilities		92,765		105,191
Long term liabilities				
Bank loan		35,500		58,000
Net assets		**57,265**		**47,191**
Financed by:				
Capital		57,265		47,191

The **balance sheet** is a snapshot of the finances of a business on a given day – normally at the end of the business's financial year.

Managing the balance sheet is a key role in larger businesses and if it's not done properly, a business can go bust – a company might have lots of profit, but if it doesn't have enough cash it will lead to difficulty in paying its creditors.

Fixed assets are assets used by a business to support its activities – usually represented by land and buildings, equipment and machinery, motor vehicles and fixtures, fittings and furniture. They are normally owned for more than one year.

Current assets are normally trading items – things that are bought (or made) and sold. Stocks are sold to customers at which point they are either converted to cash (by cash sales) or to debtors (by credit sales). When debtors pay their outstanding debts they are converted to cash. Cash is king! Cash is used to pay the creditors (the suppliers).