

## BALANCE SHEET

### MEANING OF BALANCE SHEET

Balance sheet is a summarised statement of assets and liabilities, prepared generally at the end of the financial year to show the financial position of the business. In other words, after preparing trading and profit & loss account, all the balances of personal and real accounts are grouped in a statement which represents the financial position of a business on a particular date. It is a screen picture regarding financial position of a business whether position of concern is solvent or insolvent.

### DEFINITIONS OF BALANCE SHEET

A balance sheet has been defined as follows :

- (1) According to **Karlson**, "A business form showing what is owed and what is the proprietor's worth, is called a balance sheet."
- (2) According to **Pamer**, "The balance sheet is a statement at a particular date showing on one side the trader's property and possession and on the other hand the liabilities."
- (3) According to **J.R. Batliboi**, "A balance sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date."

From the above definitions, it is clear that (i) balance sheet shows the financial position of a concern and (ii) it shows its financial position on a particular date. Thus, balance sheet is a summary regarding complete record of accounting.

### CHARACTERISTICS OF BALANCE SHEET

- (1) A balance sheet is only a statement and not an account. It has no debit side and credit side. The headings of the two sides are 'assets' and 'liabilities'. The words 'To' or 'By' is not used.
- (2) A balance sheet is prepared at a particular point of time and not for a particular period. The information contained in a Balance Sheet is true only at that particular point of time at which it is prepared.
- (3) A balance sheet is a summary of balances of those ledger accounts which have not been closed by transfer to Trading and Profit & Loss Account.
- (4) A Balance Sheet shows the nature and value of assets and the nature and the amount of liabilities at a given date.
- (5) Balance Sheet presents the financial position of a concern based on the principle of going concern.
- (6) Total of both sides of Balance Sheet must be equal failing which it indicates the existence of some error.

### NEED AND IMPORTANCE OF BALANCE SHEET

- (1) A balance sheet shows the cash in hand and cash at bank. It is possible to have the information about net profit and drawings from balance sheet. In other words, it can be found out how much capital is invested in the business.
- (2) It helps us to ascertain the nature and cost of sundry assets such as amount owing from debtor, value of closing stock etc.
- (3) It helps us to ascertain the nature and amount of various liabilities such as amount owing to creditors, amount of external liabilities etc.



- (4) It enables us to find out whether the position of a business is solvent or insolvent. The position is solvent if assets is more than external liabilities and *vice-versa*.
- (5) It enables us to prepare the opening entries at the beginning of the next year.

## ■ DRAFTING A BALANCE SHEET

Balance sheet is divided into two parts, viz., right hand side and left hand side. The debit balances are shown on the right hand side of the balance sheet known as *assets side* and credit balances are shown on the left hand side, i.e., *liabilities side*. The total of two sides must be equal.

## ■ MARSHALLING OF ASSETS AND LIABILITIES

In order to express clearly the financial position of business, the assets and liabilities should be arranged in balance sheet in some specific order. Such type of arrangement of assets and liabilities in the balance sheet is called 'Marshalling.' However, the assets and liabilities may be arranged either in order of liquidity or in order of permanence.

**(1) Order of Liquidity :** Under this method, the assets which are more readily convertible into cash, are shown first and those which cannot be so readily converted into cash come next and so on. Similarly, those liabilities which are to be paid immediately, are shown first on the *liabilities side* and those, payable later, come next and so on. Normally, sole trader and partnership concern prepare the balance sheet in order of liquidity. Form of Balance sheet in this order will be as ahead :

### Balance Sheet

as on or as at .....

| Liabilities                             | Amount  | Assets                  | Amount |
|---|---------|-------------------------|--------|
|   | ₹       |                         | ₹      |
| <b>Current Liabilities :</b>            |         | <b>Current Assets :</b> |        |
| Bank Overdraft                          | .....   | Cash in hand            | .....  |
| Bills payable                           | .....   | Cash at bank            | .....  |
| Sundry creditors                        | .....   | Bills receivable        | .....  |
| Outstanding expenses                    | .....   | Short term investments  | .....  |
| Unearned income                         | .....   | Sundry debtors          | .....  |
| <b>Fixed or Long Term Liabilities :</b> |         | Closing stock           | .....  |
| Long term loans                         | .....   | Prepaid expenses        | .....  |
| <b>Capital :</b>                        |         | Accrued income          | .....  |
| Opening Capital                         | .....   | <b>Fixed Assets :</b>   |        |
| Add : Net profit                        | .....   | Furniture               | .....  |
| Less : Net Loss                         | (.....) | Patents                 | .....  |
| Less : Drawings                         | (.....) | Motor vehicle           | .....  |
| Less : Income tax                       | (.....) | Long term investments   | .....  |
| Less Life insurance premium             | (.....) | Plant and machinery     | .....  |
| <b>Contingent liabilities :</b>         |         | Land and buildings      | .....  |
| (a) Liability for bill discounted       | .....   | Goodwill                | .....  |
| (b) Liability for guarantee             | .....   |                         |        |
| (c) Suits under dispute                 | .....   |                         |        |
| <b>Total</b>                            | .....   | <b>Total</b>            | .....  |

**Note :** (1) The word 'As on ....' or 'As at ....' is used in the heading of the balance sheet because it tells the financial position of the business on a particular date.

- (2) Contingent liabilities are never recorded in the books but these liabilities are always stated by way of *footnotes* in the balance sheet as information.
- (3) Prepaid expenses are considered as current assets. Though cash cannot be realised from prepaid expenses but the utility will be available in lieu of that without further payment.
- (4) The total of both sides of the balance sheet must be equal.

**(2) Order of Permanence :** This method is exactly the opposite of *order of liquidity*. Under this system, assets which are most difficult to be converted into cash, are shown first and those, which are most liquid, are shown last. Similarly, those liabilities, which are to be paid last, are shown first such as capital, long term liabilities etc. and then the current liabilities which are payable immediately. Joint stock companies and co-operative society prepare their balance sheet under this system.

Thus, it is necessary to understand the classification of different assets and liabilities before preparing balance sheet.