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

**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 vailable 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 prepairing balance sheet.

## ▣ CLASSIFICATION OF ASSETS

Classification of assets may be divided into two parts :

(a) According to nature of assets

(b) According to physical existence of assets

**(a) According to the nature of assets,** these may be classified mainly into the following groups :

**(1) Fixed assets :** The assets of a durable nature, are acquired and intended to be retained permanently for the purpose of carrying on the business such as land, building, machinery, furniture, vehicle, etc. to be known as *fixed assets.* In other words, they are bought to be used in the business and not to be sold at a profit. They are also sometimes called as *block assets* or *long term assets*. These assets are always shown in the balance sheet at cost less depreciation. These assets may again be classified into two categories such as (i) Tangible Assets, (ii) Intangible assets. Those fixed assets, which have their real existence and can be felt by our senses are tangible assets, *e.g.*, building, plant, furniture, etc. On the other hand, those which have no real existence but have value and cannot be felt by our senses are intangible assets, *e.g.*, goodwill, patent right, etc.

**(2) Current Assets :** Assets, which are meant for resale or assets which change from one form to other, are known as *current assets or floating assets.* For example, cash in converted into stock, stock into debtors, debtors into bills receivable, bills receivable into cash and again so on. These assets are temporarily held, therefore, they are also known as *circulating assets.* Similarly, these assets consist of items, each of which is held for a short time- less than a year, therefore, these are called as *short-lived* or active *assets.*

**(3) Liquid assets :** Liquid assets are those which are in the form of cash or those which are readily convertible into cash such as cash, bank balance, bills receivable, saleable securities, etc.

**(4) Fictitious or nominal assets :** They are the items appearing on the asset side of the balance sheet for the purpose of transferring them to the profit & loss account gradually over a period of time but not represented by any tangible thing, *e.g.*, miscellaneous expenses, discount on shares, etc. They represent only those past losses or expenses which are not yet written off.

**(5) Wasting assets :** These are those assets which are exhausted in the course of working of the business, *e.g.*, mines quarries etc.

**(6) Contingent Assets :** It is an asset, the existence, value and ownership of which depend upon the occurance or non-occurances of a specific event or upon the performance or non-performance of a specified act. For example, the firm has filed a suit for some property now in the possession of someone else. If the suit is decided in the firm's favour the firm will get the property, at the moment it is a contingent asset.

**(b) According to physical existence of assets,** all assets may be divided into two parts :

**(1) Tangible assets :** Tangible assets are those assets which have a physical existence or which can be seen and felt *e.g.*, building, furniture, computers.

**(2) Intangible assets :** Intangible assets are those assets which do not have any physical existence or which cannot be seem or felt such as goodwill, trade, patents etc.

## CLASSIFICATION OF LIABILITIES

Like assets, the liabilities may also be classified as follows :

**(1) External liabilities :** These consist of claims of outside persons (*i.e.,* people other than the owner of the business). These may again be grouped into two categories :

(a) ***Fixed liabilities*** **:** These are the liabilities which are not payable in near future and certainly not within a year. Examples are : capital, long term loan etc. They are also known as *long-term liabilities.*

(b) ***Current liabilities*** **:** These are the liabilities which must be paid quickly and in any case within about a year. Examples are : bills payable, creditors, bank overdraft, outstanding expenses etc. They are also called as *short term liabilities.*

**(2) Internal liabilities :** These consist of all debts of the business to its owner or owners such as capital, revenue reserves, credit balance of profit & loss account. They are also called as *long term liabilities.*

**(3) Contingent liabilities :** These are liabilities which have not arisen but may arise upon the happening of a certain event. It means those liabilities which may or may not occur. Following are some examples of contingent liabilities :

(a) ***Liability for bills discounted*** **:** In this case if the acceptor has dishonoured the bill on due date, we shall become liable to pay the bank.

(b) ***Liability for guarantee*** **:** If the persons, for whom the guarantee is given, fails to meet his liability, we shall become liable to pay such amount.

(c) ***Suits under dispute*** **:** This would become an actual liability if the suit is not decided in our favour.

Contingent liabilities are always stated by way of foot notes in the balance sheet. Thus, the amount of these liabilities is never shown in the amount column of liabilities.

**ILLUSTRATION 5.** ***(Perpration of balance sheet)***