5.4. BALANCE SHEET

5.4.1. Meaning and Definition of Balance Sheet

A balance sheet is a statement of assets and liabilities of a business enterprise a given date. It is prepared at the end of the accounting period after the trad account and profit and loss account have been prepared. It shows the finan position of the business at the end of the accounting period. It is called a bala sheet because it is a sheet of balances of ledger accounts, which are still op after the preparation of trading, and profit and loss account.

According to Freeman, "A balance sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date".

According to American Institute of Certified Public Accountants, "Balance sheet is a list of balances in the assets and liability accounts. This list depicts the position of assets and liabilities of a specific business at a specific point of time".

5.4.2. Importance of Balance Sheet

The importance and objects of balance sheets preparation are as follows:

1) **Financial Position:** Balance sheet helps in assessment of financial position of the firm. It is the list of assets and liabilities of the firm on a specific date.

2) **Knowledge of Proprietary Ratio:** It tells funds and capital employed by the proprietor proprietary ratio shows the relationship between proprietors fund and total assets.

3) **Protection against Uncertainty:** It tells about current assets and current liabilities. If the current assets are less than double of the current liabilities, i.e., the ratio is less than 2 : 1 then it is said to be unhealthy. It also helps to calculate working capital which in excess of current assets over current liabilities.

5.4.3. Limitations of Balance Sheet

The limitations of balance sheet are as follows:

1) A balance sheet is prepared on the basis of historical cost and, as such, does not exhibit the current values. Thus, it fails to convey the true picture about the financial position desired by an analyst.

2) A balance sheet is prepared at the end of a particular period as per the requirements of the management when it shows a very favourable condition. This is particularly applicable in the case of seasonal firms.

3) Sometimes the historical cost of balance sheet does not convey any fruitful information to some of users accounting information. The same may become useful with the application of ratio analysis.

4) Balance sheet is affected by the accounting policies relating to inventory valuation, depreciation of assets, provision for bad and doubtful debts etc. Thus it becomes necessary to disclose such policies.

5) Sometimes a balance sheet cannot exhibit the real value of certain factors which are important to the business **(for example,** skill, technical experience, etc).

6) Sometimes a balance sheet is window-dressed which mislead us.

7) Values of some current assets (e.g., stock, debtors, etc.) are valued on the basis of some estimates which may not always prove worth in future. Thus, it does not convey the true financial position.

8) When there is inflationary situation or change in the purchasing power of money, a conventional balance sheet particularly mislead us since the assets purchased at various intervals are added up with the values which have already been changed.

9) Balance sheet is prepared with a lot of schedule of assets and liabilities for various information that is not sufficient. A detailed list of such assets and liabilities are required for correct analysis and interpretation.

10) A conventional financial report based on the conventional balance sheet is not able to throw light on social account which is the crying need of the day.