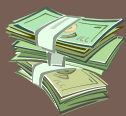


THE BALANCE SHEET

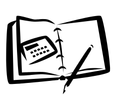
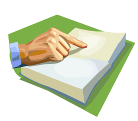
Chapter 2

AGENDA

- What is a balance sheet?
- Fundamental accounting equation
- Assets, liabilities, owner's equity
- What does a balance sheet look like?
- Important features of a balance sheet
- Accounts receivable & accounts payable
- Preparing a balance sheet
- Accounting standards
- GAAP – business entity concept, going concern principle, the cost principle

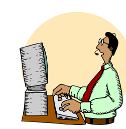
What is a balance sheet?

- A balance sheet is a financial statement where the <u>final balances</u> of all <u>permanent accounts</u> are listed and balanced using the fundamental accounting equation
- It's a snapshot, providing the financial position of a business – i.e. the financial status *at a particular point in time*.

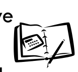




Fundamental Accounting Equation

- A = L + OE
- Assets = Liabilities + Owner's Equity
- A – L = OE
- OE = A – L
- The most important equation in accounting!



A = L + OE




- Assets are items that a business **<u>owns</u>** and have future economic *value*
- Liabilities are items that a business **<u>owes</u>** to others and have future economic *value*
  - these can be referred to as claims against the assets
- Owner's equity is the *<u>difference</u>* between assets and liabilities
  - This is what is owned by the business owner
  - The owner can keep this after paying off the liabilities

What does a Balance Sheet look like?

Pacioli Designs
Balance Sheet
December 31, 20–

Claims of the creditors

Assets		*Liabilities*	
Cash	$ 1618 00	Bank Loan	$ 9000 00
Accounts Receivable		Accounts Payable	
– J. Tenney	1350 00	– CMYK Supplies	1905 15
– V. Weiss	1850 50	– Golden Art Store	2299 90
Supplies	1750 50	– Premium Printing	1750 95
Furniture	4702 00	Total Liabilities	$14956 00
Equipment	16000 00		
Automobile	21850 00	*Owner's Equity*	
		Grace Cho, Capital	34165 00
Total Assets	$49121 00	Total Liabilities and Equity	$49121 00

Assets available to be claimed

Claim of the owner

Important Features of a Balance Sheet

- The setup is in the form of the fundamental accounting equation:

  A = L + OE

- A 3-line heading is used:
  - Who – the name of the person / business
  - What – the name of the financial statement
  - When – the date on which the B/S is prepared

Important Features of a Balance Sheet

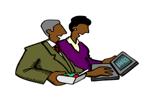
- Short-term Assets are listed in *Liquidity Order*
  - **Order of Liquidity** – the order in which assets would be used or most quickly converted into cash.
- Long-term Assets are listed in *Permanency Order*
  - **Order of Permanency** – the order of their useful life to the business (usually longest lasting listed first)
- Liabilities are generally listed in the order in which they are (due) normally paid: (**maturity date**)
- The financial balances as of the date of the balance sheet are disclosed (assets values, loans, etc)
- There are 2 final totals:
  - Total Assets, Total Liabilities & Owner's Equity

Accounts Receivables – A/R

- A/R: the *customers of a business* often buy goods/services with the understanding that they will pay for them later. These customers owe money to the business. This *debt owed to the business* has a dollar value. So, it is an asset to the business. A/R can be converted into cash very quickly.

Accounts Payable – A/P

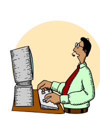
- A/P: the business often purchases goods/services from its suppliers with the understanding that payment will be made later. The business is in debt to those suppliers. This *debt owed to the suppliers* have a dollar value. So it is a liability for the business. A/P needs to be paid very quickly.



Note: Sales create **A/R**
Purchases create **A/P**

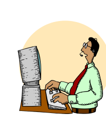
Preparing a Balance Sheet

- Step 1: Write the 3-line statement heading
- Step 2: Write the subheading "Assets" and then list the individual assets.
- Step 3: Write the subheading "Liabilities" and then list the individual liabilities. Write in "Total Liabilities" and add the liabilities.



Preparing a Balance Sheet

- Step 4: Write the subheading "Owner's Equity". Write in the owner's name plus the word "Capital" (e.g. Imran Khan, Capital). OE = A – L.
- Step 5: Write "Total Assets" and total the assets. Write "Total Liabilities & Owner's Equity" and total the liabilities and owner's equity.



Basic Bookkeeping Practices

- Do not use abbreviations on the financial statements.
- Use single underline when sub-totalling and **double** underline when totalling.
- Use dollar signs with the 1st asset and liability, total assets, total liabilities, total liabilities and owner's equity.
- Be neat.

Balance Sheet

Formal statement showing the financial position of a business at a specific date

W. Puma Tutoring Company → who
Balance Sheet → what
March 31, 2004 → when

	Assets		Liabilities	
Short term assets listed in terms of liquidity	Cash	$4600	Accounts Payable	$1100
	Accounts Receivable	840	Bank Loan	1800
	Supplies	400	*Total Liabilites*	$2900
Long term assets listed by length of life	Office Equipment	700	Owner's Equity	
	Automobile	5000	W. Puma, Capital	8640
	Total Assets	$11540	*Total Liabilites and Equity*	$11540

Single lines imply addition or subtraction

Dollar signs on top of all columns and below any line

Two Final Totals: One on each side. Double underline all major totals

Types of Assets

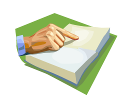
- **Cash** – Currency (bills and coins), bank deposits, cheques, money orders, debit and credit card receipts
- **Accounts Receivable** – The total amount due from debtors (customers)
- **Office Supplies** – Items purchased for use within the business office

Order of Assets

Ex.

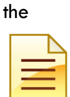
Short term
- Cash → Most liquid
- Accounts Receivable A/R → Received within 30 days
- Office Supplies → Quickly used

Long term
- Land → Longest lasting
- Building → Long Lasting
- Equipment → Somewhat Long Lasting



Types of Liabilities

- **Accounts Payable** – Total amount owed to creditors for the purchase of goods or services by the business.
- **Bank Loan** – The amount of loan(s) owing to a bank. They vary in length (typically 1 – 5 years).
- **Mortgage Payable** – The amount borrowed from a financial institution or individual, usually for the purchase of a building and/or land.

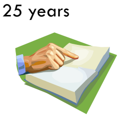


Order of Liabilities

- Liabilities are listed by the date they are due to be paid, by their **maturity date**

Ex.

Accounts Payable A/P → usually payable within 30 days
Bank Loan → usually payable within 1-5 years
Mortgage Payable → usually payable within 25 years



CLAIMS AGAINST THE ASSETS

- **Liabilities =** CREDITORS CLAIM of the Assets
- **Owner's Equity =** OWNER'S CLAIM of the Assets

CREDITORS' CLAIMS FIRST

- Claims of the creditor's are always settled first, followed by claims of the owner
- The owner always gets what is left over, after the claims of the creditors are paid

An Example:

Who has claims over the assets of our business?

Who has first claim?

Accounting Class Tutorials
Balance Sheet
As at September 15, 2018

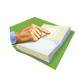
Assets			Liabilities		
Cash		$ 550.00	Accounts Payable		
Accounts Receivable				F. Myers	$ 400.00
	T. Jones	$ 200.00		T. Smith	$ 400.00
	L. Jackson	$ 100.00	Total Liabilities		$ 800.00
Supplies		$ 150.00			
Equipment		$ 800.00	Owner's Equity		
Building		$45,000.00	BAF Class, Capital		$46,000.00
Total Assets		$46,800.00	Total Liabilities and Owner's Equity		$46,800.00

What happens if we sell our building for $60,000?

GAAP
Generally Accepted Accounting Principles

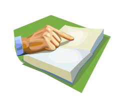
- GAAP – ***Laws or Rules*** that all accountants must follow
  - **ASPE** : accounting standards for private enterprises – usually for small businesses
  - **IFRS** : international financial reporting standards – usually for large businesses

CICA – Canadian Institute of Chartered Accountants
- *establishes rules and standards of practice for all Canadian accountants*
- *most of the rules of accounting are found in the CICA Handbook*



Accounting Standards

- **Income Tax Act**
  - Standards and rules to prepare income tax returns
  - Income tax returns are documents that are prepared every year and submitted to the government
  - An individual / business can receive a tax refund or end up with tax payable


Balance Sheet Presentation

BALANCE SHEET

Short Term Assets	Short Term Liabilities Long Term liabilities
Long Term Assets	Owner's Equity

IFRS

STATEMENT OF FINANCIAL POSITION

Long Term Assets	Owner's Equity Long Term liabilities
Short Term Assets	Short Term Liabilities

Short Term vs. Long Term

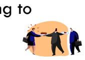
- Assets
  - Short Term: *converted to cash* or *used* within **a year**
  - Long Term: *converted to cash* or *used* longer than **a year**
- Liabilities
  - Short Term: *paid back* within **a year**
  - Long Term: *paid back* longer than **a year**

Introducing GAAP

- **Business Entity Concept:**
  - each business is considered a separate entity, and the financial info for the business must be kept separate from the owner's personal financial info.
- **The Cost Principle:**
  - assets, liabilities, equity investments are to be shown on the balance sheet using the original cost of purchase.

Introducing GAAP

- **The Going Concern Assumption:**
  - we operate on the assumption that a business entity will continue to operate as normal. This justifies continuing to record transactions such as amortization of assets.



- **The Principle of Conservatism**
  - It provides that accounting should be fair and reasonable.
  - Accountants are required to make estimates, evaluations and deliver their opinions – they need to always ensure that assets and profits are never overstated or understated