4. BALANCE SHEET

4.1 Format of Balance Sheet

1. **Meaning:** The Balance Sheet is a statement of financial position which sets out the Assets and Liabilities of an enterprise as at a certain date.

2. **Features:**
   (a) Assets are shown on the Right Hand Side (RHS) and Liabilities are shown on the Left Hand Side (LHS) of the Balance Sheet.
   (b) It is prepared **as at a particular date**, rather the close of a day and **not** for a period. So, it is a Position Statement, and not a Performance Statement.
   (c) It will be meaningful only when it is accompanied by the Profit and Loss Account. Infact, the Balance Sheet is prepared only after the P&L Account is prepared.
   (d) The Balance Sheet is **not an account**, its two sides represent Liabilities and Assets and not the Debit and the Credit sides of an account.
   (e) The Balance Sheet represents the confirmation of the **basic accounting equation,** i.e. Equity + Liabilities = Assets. Hence, the total of both the sides should agree.
   (f) Balance Sheet only the result of all transactions, i.e. the balances in the various accounts at the end of the period. It does not show the transaction itself.
   (g) The Ledger Account Balances of all **Personal and Real Accounts** will flow into the Balance Sheet.

3. **Format:** The Format / Ruling of the Balance Sheet is as under –

Balance Sheet of .... as at ... ...

Liabilities	₹	Assets	₹
Capital **Loans:** Secured Unsecured **Current Liabilities:** Sundry Creditors Outstanding Expenses		**Fixed Assets** (Net Block, i.e. after depreciation) **Investments,** (if any) **Current Assets:** Stock Debtors B/R, Cash at Bank, Cash in Hand	
Total		**Total**	

Note: Though the LHS is titled as "Liabilities" Side, in effect, it represents "Capital (i.e. Equity) + Liabilities".

4.2 Assets and Liabilities

Assets

Fixed Assets
i.e. Assets which are to be used in the business for a longer span of time and which are not meant for sale

Land and Building, Furniture, Plant and Machinery, Goodwill, etc. are Fixed Assets.

Current Assets
i.e. Assets which are intended to be converted into cash within a period of 12 months.

Stock, Debtors, Bills Receivable, Prepaid Expenses, Bank Balance, Cash in Hand, etc. are Current Assets.

Liabilities

Long Term Liabilities
i.e. Liabilities that fall due for payment after a period of 1 year are called Long Term Liabilities.

Secured Loans, Unsecured Loans, etc. are Long–Term Liabilities.

Current Liabilities
i.e. Liabilities which fall due for payment within a period of 12 months.

Sundry Creditors, Bills Payable, Outstanding Expenses, etc. are Current Liabilities.

4.3 Arrangement of Assets and Liabilities

	Method 1: Permanence Approach	Method 2: Liquidity Approach
Assets	Assets which are to be used in the business for a longer span of time and which are not meant for sale, are shown first. These items are followed by Current Assets / Liquid Assets. So, the order of Assets will be – 1. **Fixed Assets:** • Goodwill • Patents • Land and Building • Furniture • Machinery 2. **Investments**, if any. 3. **Current Assets:** • Stock of Work–In–Progress (Partly Finished Goods) • Stock of Raw Materials • Stock of Finished Goods • Sundry Debtors • Short Term Loans and Advances • Cash at Bank • Cash in Hand	Assets which are readily convertible into cash are shown first and which are not readily convertible are shown subsequently in the Balance Sheet. So, the order of Assets will be – 1. **Current Assets:** • Cash in Hand • Cash at Bank • Short Term Loans and Advances • Sundry Debtors • Stock of Finished Goods • Stock of Raw Materials • Stock of Work–In–Progress (Partly Finished Goods) 2. **Investments**, if any. 3. **Fixed Assets:** • Machinery • Furniture • Land and Building • Patents • Goodwill
Liab.	Capital is shown first, Long–Term Liabilities are shown next, and finally Short Term / Current Liabilities.	Current Liabilities are indicated first, thereafter followed by Long–Term Liabilities, and finally Capital at the end.

Note: The **Permanence Approach** is generally adopted for presentation of Balance Sheet.

4.4 Limitations of Financial Statements

1. **Historical Costs not Current Values:** Fixed Assets appear in the Balance Sheet at Historical Cost less Depreciation till date. A conventional Balance Sheet cannot give the correct value or current market value of such assets.
2. **Intangible Assets:** Intangible Assets appear in the Balance Sheet at Book Values, which has no relationship with the market values. Further, certain intangible strengths like loyalty and calibre (talent) of the Employees and Officers, are not reflected at all.
3. **Inflation:** Since only Historical Costs / Book Values are shown in Balance Sheet, it may not guide the readers properly in inflationary conditions.
4. **Assets vs Asset Side Items:** Balance Sheet may show some Asset–side Items like Preliminary Expenses, Debenture Discount, Deferred Revenue Expenditure, etc. which have **no market value**. These Fictitious Assets unnecessarily increase the total value of the Assets.
5. **Estimated Position:** Values of most Current Assets are found from **estimates,** an hence the Balance Sheet does not present the true financial position of the business.
6. **Different Accounting Policies:** Different accounting policies followed by management of the entity, e.g. depreciation, writing off Goodwill, Deferred Revenue Expenditure, etc. may not promote comparability of Financial Statements.

Note: Qualitative Features of Financial Statements are described in **Chapter 1.**

4.5 Reserves and Provisions

Particulars	Reserves	Provisions
1. **Meaning**	Reserve may be defined as "portion of earnings, receipts or other surplus of an enterprise appropriated by the management for a general or a specific purpose".	Provision is "any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy".

Particulars		Reserves	Provisions
2.	**Relation to Profit**	**Appropriation** of Profits.	**Charge** against Profits.
3.	**When it can be created?**	Reserves cannot be created unless there is a profit.	Provision (for Deprn, other Exps and liabilities) should be created even if there is no profit.
4.	**Nature**	Generally, Reserves are **optional**, based on Managerial discretion to appropriate profits.	Provisions are a **necessity**, based on the accounting principles.
5.	**P & L A/c Disclosure**	Appropriation for Reserves is made **below the line.**	Provisions are shown **above the line.**
6.	**B/Sheet Disclosure**	Reserves are shown generally on the **Liabilities** side.	Provisions are shown as a deduction from the respective assets, on the **Assets** Side.
7.	**Inter–relationship**	There is no concept of Excess Reserve created.	Excess Provision over and above what is required, must be treated as **Reserve.**

4.6 Reserves

1. **Meaning:** See previous Paragraph for meaning of Reserves.
2. **Certain Provisions excluded:** It excludes a provision – (a) for depreciation or diminution in the value of assets, or (b) for a known liability the amount of which cannot be determined with substantial accuracy.
3. **Excess Provisions:** Where a provision is, in the opinion of the Company's Directors, in excess of that which is reasonably necessary for the purpose, such excess must be treated as a Reserve and not as a Provision.
4. **Types:** Reserves may be analysed as – (a) General & Specific Reserves, and (b) Revenue & Capital Reserves.
5. **Reserve Fund:** The term Reserve Fund (or simply Fund) signifies an amount which has been invested in outside securities, for a specified purpose, e.g. Sinking Fund and Sinking Fund Investment. So, every Fund is also supported by a corresponding Investment. Interest on such Fund is credited to the Fund A/c, and is not taken to the P&L A/c.