UNIT- 2

Trail Balance

Meaning of Trial Balance: -

A trial balance gets prepared just before preparing final accounts, which includes a balance sheet, Profit and loss statement, Cash flow, and notes to Accounts. In layman's terms, we can assume that it is the basic structure behind preparing the final accounts. It is the third step in the road map to prepare final accounts after the entries are passed in journal-register followed by classification and grouping of transactions to their respective ledgers. These ledgers, i.e., the principal book containing all sets of accounts, are then accumulated in a single place to constitute a Trial balance.

Definition of Trial Balance: -

In the words of J.R Batliboi, "A trial balance is a statement, prepared with the debit and credit balances of the ledger accounts to test the arithmetical accuracy of the books."

Purpose of Trial Balance: -

The purpose of a trial balance is to ensure that all entries made into an organization's general ledger are properly balanced. A trial balance lists the ending balance in each general ledger account. The total dollar amount of the debits and credits in each accounting entry are supposed to match. Therefore, if the debit total and credit total on a trial balance do *not* match, this indicates that one or more transactions were recorded in the general ledger that were unbalanced.

From a practical perspective, accounting software packages do not allow users to enter unbalanced entries into the general ledger. This means the trial balance is not needed by entities that have computerized systems. If a business is still using manual record keeping, then the trial balance has more value, since it is possible to create unbalanced entries in such a system.

When a manual recording keeping system is used, the trial balance is also used to create the financial statements. This means that the account balances in the trial balance are manually aggregated into the line items found in the financial statements.

Auditors also use the trial balance. They request it early in an audit, and transfer the ending account balances from this report into their auditing software. They then use audit procedures to test these balances.

Features of Trial Balance: -

- It is a summary of debit and credit balances which are extracted from various ledger accounts
- It is a summary of debit and credit balances
- The motive behind the preparation of Trial balance is to establish arithmetical accuracy of the transactions recorded in the Books of Accounts
- Trial balance does not prove any arithmetical accuracy of accounts which can only be determined by the audit
- It is not an account. It is only a statement of account
- It is not a part of the final statements
- A Trial balance at the end of the accounting year but it can also be prepared anytime as and when required like weekly, monthly, quarterly or half-yearly
- It acts as a bridge between books of accounts and the Profit and Loss Account and Balance sheet.

Preparation of Trial Balance: -

1. Calculate the Balances of Each of the Ledger Accounts

Business transactions are first recorded in the form of journal entries following the basic accounting principles. These journal entries then go into the ledger accounts involved in the various business transactions.

For instance, consider the cash account of Kapoor Pvt Ltd in the above example. The cash transactions are recorded and the cash account is closed with the remaining debit balance of Rs 6,50,000 as on May 1, 2018. Likewise, balances of other ledger accounts are ascertained and accordingly the accounts are closed with the remaining debit or credit balances.

2. Record Debit or Credit Balances in Trial Balance

The remaining debit or credit balances in various accounts of ledger as ascertained above are then recorded in the Trial Balance. The balances of each of the accounts of ledger are recorded in the debit or the credit columns as the case may be.

For example, the remaining debit cash balance as on May 1, 2018 is recorded in the debit column of the trial balance. Further, the remaining credit balance of capital account of Rs 8,00,000 is recorded in the credit column of the trial balance. Similarly, the remaining debit or credit balances of all the accounts of ledger are recorded in the debit or credit columns of trial balance respectively.

3. Calculate Total of The Debit Column
Ascertain the total of the debit column. This is done after recording all the debit balances of the various accounts of ledger put into debit column of Trial Balance.

For instance, consider the total of the debit column of the Trial Balance of Rs 10,20,000. This is calculated after recording all the closing debit balances of various accounts of ledger. These accounts include cash, stock, furniture, drawings etc.

4. Calculate Total of The Credit Column
Ascertain the total of the credit column. This is done after recording all the credit balances of the various accounts of ledger put into credit column of Trial Balance.

For instance, consider the total of the credit column of the Trial Balance of Rs 10,20,000. This is calculated after recording all the closing credit balances of various accounts of ledger. These accounts include capital, interest etc.

5. Check if Debit is Equal to Credit

Finally, you need to check if the total of the debit column matches the total of the credit column. As specified earlier, trial balance is prepared to check the accuracy of the debit and credit balances of various accounts of ledger. Both the debit and credit columns of the Trial Balance must tally since every debit has every credit. However, it is an indication that there were some errors made while recording transactions in ledger or trial in cases where they are not equal.

You must note that as per the accounting principle:

- All assets, expenses and receivables must have debit balances and all
- Liabilities, incomes and payables must have credit balances

Final Accounts: -

Introduction: -

Accounting is the recording and reporting of business transactions. Business transactions involve activities of actual business (selling goods or services), investment (purchasing assets) and financing (raising money for investment). In accounting, Business activities give rise to revenue income and revenue expenditure, Investment activities give rise to capital expenditure, Financing activities give rise to capital receipts. P & L A/c is a summary of revenue income and revenue expenses, Balance sheet is summary of capital receipts and capital expenditure. Thus, preparation of final accounts is the last step in the accounting cycle. In fact, final accounts include a number of accounts such as (i) trading accounts (ii) profit and loss account, and (iii) balance sheet. Though balance sheet is a statement, for all practical purposes, it is treated as one of the final accounts. Once the “trial balance” is extracted and ‘errors’ rectified, a trader prepares the “final accounts” so as to know the final results (i.e., net profits or loss) and the financial position (i.e., assets and liabilities) of his business. Trading account and profit and loss account concerning goods by passing entries known as “closing entries”. All remaining accounts, viz., real and personal account pertaining to properties, debtors and creditors are just shown in statement called balance sheet

Features of Final Accounts: -

1. **To know the Profitability of the business:** – Final accounts help to business to get know the profitability of the business in a particular accounting year.
2. **Financial Strength: –** Final account provide information about the financial strength of the business. it means, help in deciding whether the business can purchase new assets with its own fund or not.
3. **Forecasting and Budgeting: –** Final Accounts are the basis of the forecasting and the budgeting for the top management. On the basis of last year’s final accounts, management decides the business new goal for the current year and preparing the budget for expenses.
4. **Communication: -** We need final accounts or financial Statements to communicate our financial position with different parties (i.e. Investors, Lenders of Money, Supplier and Trade Creditors and Government etc.)
5. **Growth Rate of business: –** With the help of the final account can calculate the growth rate or our business by comparing the financial statement of the current year with last year.

Adjustments Before Preparing Final Accounts: -

Final accounts are prepared for a completed period. It must be kept in mind that expenses and incomes for the full accounting period are to be taken while preparing final accounts. If an expense has been incurred but not paid during the period, a liability for the unpaid amount should be created before finding out the operating results and financial position of a concern. In order to prepare the final accounts on mercantile system of accountancy, all expenses and incomes relating to the period whether incurred or not, received or not should be brought into account. For doing this, a concern is required to pass certain entries at the end of the year to adjust the various items of incomes and expenses. Such entries are called adjusting entries. The various adjustments required are given below:

(i) Closing Stock: It refers to the value of unsold goods lying in stock at the end of the accounting period. It should be valued either at cost price or market whichever is lower. It consists of three items, i.e., raw materials, work-in-progress and finished goods. The adjustments entry is

Closing stock, A/c Dr. xxx

To Trading A/c xxx

The value of closing stock will appear on the assets side of balance sheet and on the credit side trading account.

(ii) Outstanding Expenses: These are certain expenses which relate to a particular accounting period but they are not paid in that accounting period due to certain reason, i.e., all expenses which are due for payment in one accounting year but actually paid in future accounting years or payment on which it postpones are all outstanding or unpaid expenses. At the end of the accounting year, all such expenses must be brought into books, otherwise the profit will be overstated. The adjustment entry is

Expenses A/c Dr. xxx

To Expenses outstanding A/c xxx

Expenses outstanding are added to the respective expenses' accounts in trading or profit and loss A/c and also shown on the liabilities side of the balance sheet. Next year, the expenses outstanding account will be transferred to the expenses account. If the outstanding expenses A/c appears in the trial balance, it means that the adjustments has already has been made and hence nothing has to be done in trading or profit and loss account. But the liability already appearing in the trial balance should be shown in the balance sheet.

(iii) Prepaid Expenses: Prepaid expenses are those expenses which have been paid in advance but relating to the future accounting period. These are also called the unexpired expenses.

The adjustment entry is:

Prepaid expenses A/c Dr. xxx

To expenses A/c xxx

Prepaid expenses account is shown no asset side of balance sheet and expense account is shown as a deduction from the respective expense account in trading and profit and loss account prepaid expenses appear in the trial balance, it means that the adjustments has already been made nothing is to be done in trading and profit and loss accounts. But the prepaid expense will appear as an asset in the balance sheet. Generally, insurance, taxes, telephone subscription, and etc., are paid in advance thus, requiring adjustments.

(iv) Accrued Income: Outstanding or accrued income is the income which has been earned but not received during the accounting period.

The adjustment entry is: -

Accrued income A/c Dr. xxx

To income A/c xxx

Accrued income is shown on the asset side of balance sheet and it is added to the respective income account in profit and loss account credit side. No adjustment is required in the profit and loss account if accrued income A/c appears in the trial balance, but such an account must be shown as an asset in balance sheet

(v) Income Received in Advance: Many a time, traders receive money during a particular trading period for the work to be done in future period. Thus, without rendering any service they receive income. Such an income is known as income received in advance, i.e., the income received but not earned during the accounting period.

The adjustment entry is

Income A/c Dr. xxx

To income received in advance A/c xxx

Income received in advance is shown as deduction from the respective income in profit and loss account is shown on the liabilities side of the balance sheet. No treatment is required in the profit and loss account if income received in advance account appears in the trial balance. But such account must be shown as a liability in the balance sheet.

(vi) Depreciation of Assets: Depreciations is a permanent decrease or reduction in the value of a fixed asset. The asset may reduce in value due to its constant use or even sometimes due to its non-use, i.e., merely by passage of time. Whatever may be the cause for decline, the fact is that such reduction is a loss to the business. Therefore, it must write off from the asset so as to arrive at the true results of the business.

The adjustment entry for depreciation assets is:

Depreciation A/c Dr. xxx

To Asset A/c xxx

Depreciation is shown on the debit side of profit and loss account and is deducted from the asset in the balance sheet. Depreciation account (Dr.) appearing in the trial balance has to be debited to profit and loss account and no deduction from asset balance is required because this has already been done.

(vii) Interest on Capital: In order to see the real profitability of the business, it is desirable to charge interest on capital treating it as a business expense. In order to bring this interest books.

The following adjustment entry is passed:

Interest on capital A/c Dr. xxx

To Capital A/c xxx

Interest on capital is shown on the debit side of profit and loss account is added to the capital on the liabilities side of balance sheet. Interest on account appearing in the trial balance is only to be shown in profit and loss account inside and it is not required to be included in capital account because such it has been already included.

(viii) Interest on Drawings: When the proprietor withdraws money from the business for personal use almost to temporary loan by the business to the proprietor. This should be treated on par with loan to an outsider from whom interest in receivable by the business. Therefore, the business charges the proprietor with interest on amounts drawn by him. Thus, interest on drawings is a business income.

The following adjustment entry is to be passed on bring this item into account: -

Capital A/c Dr. xxx

To interest on drawings A/c xxx

Interest on capital is shown on the credit side of profit and loss account and it is deducted from the capital account on the liabilities side of balance sheet. Interest on drawings account appearing in the trial balance has to be transferred to profit and loss account credit side alone.

(ix) Bad Debts: When a claim against a debtor becomes irrecoverable, it is called bad debt. If a person files a petition in bankruptcy, his creditors generally write-off the irrecoverable amount due as a bad debt.

The entry in the books of the creditor is:

Bad debts A/c Dr xxx

To Debtor's A/c xxx

Bad debts is shown on the debit side of profit and loss account also deducted from debtors in the balance sheet. Alternatively, bad debts amount is closed by transfer to the debit of provision for bad and doubtful debts.

Provision for doubtful debts A/c Dr. xxx

To bad debts A/c xxx

If the bad debt amount is recovered in future years, the cash is debited and bad debts recovered A/c is credited in that year. The balance in the later account is closed by transferring it to the credit of profit and loss account as revenue in that year. If the bad debt appears in the trial balance, it means that adjustments has already been made and this will appear only in the debit side of profit and loss account. It need not be reduced from debtors in the balance sheet.

(x) Provision for Bad and Doubtful Debts: Sometimes, a merchant feels that there are certain debtors from whom the money may or may not be realizable. As there is a possibility of anticipated losses and in order to provide for such loss in the accounts, a provision or doubtful debts is required to be made. It generally a percentage on the debtors and the percentage is fixed on the basis of past experience.

The following adjusting entry will be made in order to bring the provision for doubtful debts into the books:

Profit and loss A/c Dr. xxx

To provision for doubtful debts A/c xxx

In this case also the amount of 'provision required' should be shown as a deduction from the existing debtors on the assets side of the balance sheet. The object of making the provision is to show the debtors on the balance sheet at a realistic value. Sometimes, bad debts may be written off during the year. Some additional bad debts are to be written off at the time of finalizing the accounts. There may be existing provision for doubtful debtors (old provision). Provision is required on the debtors as on the closing date. The following is the usual way of dealing with all these items.

Profit and loss A/c (debit side)

Bad debts (as per trial balance)	xxx
Add: bad debts (as per adjustments)	xxx
Add: new provision required	xxx
Less: existing provision (given in trial balance)	xxx
Net debit to profit and loss account	xxx

The new provision required is to be reduced from the debtors in the balance sheet along with additional bad debts as per adjustments

(xi) Provision for Discount on Debtors: The provision for discount on debtors is calculated at a certain percentage on good debtors. No discount is allowed on doubtful debtors. This is to provide a certain amount for allowing discount to customers for prompt payment.

The adjustment entry is

Profit and loss A/c Dr. xxx

To Provision for discount on debtors xxx

The provision for discount on debtors is shown as a deduction from good debtors on the asset side of balance sheet and is debited to profit and loss account.

(xii) Provision for Discount on Creditors: The creditors may offer some discount for prompt payment by the firm. This is calculated at a certain percentage on sundry creditors.

The adjustment entry is

Provision for discount on creditors A/c Dr. xxx

To Profit and Loss A/c xxx

The provision for discount on creditors is shown as a deduction from sundry creditors on the liabilities of balance sheet and is credited to Profit and Loss A/c.

(xiii) Loss of Stock by Accident, Fire, etc.: Stock of goods destroyed due to abnormal causes must be treated as abnormal loss. If there is no insurance the entire stock lost should be treated as abnormal loss.

The entry is:

Abnormal loss A/c Dr. xxx

To Trading A/c xxx

Since there will be no recovery, the abnormal loss has to be closed.

Profit and loss A/c Dr. xxx

To Abnormal Loss A/c xxx

If there is insurance, amount recoverable from the insurance company has to be debited to insurance company and the balance of abnormal loss is written off to Profit and Loss A/c.

Profit and loss A/c Dr. xxx

Insurance company A/c Dr. xxx

To Abnormal Loss A/c xxx

Preparation of Trading Account: -

Preparation of Trading Account Trading account is a ledger account. Therefore, its form and construction conform to the rules of double entry principles of debit and credit. As the trading account contains the results of operations over a period, the heading should be "Trading account for the year (or any period) ended…..". A proforma of a trading account is given below.

*Balancing figure will be either gross profit or gross loss. Items Appearing on the Debit Side of Trading Account

1. Opening Stock: Stock on hand at the beginning of the year is called opening stock. This item is usually shown as the first item on the debit side of the trading account. The figure is available from the trial balance. It may include raw materials, work-in-progress and finished goods.

2. Purchases: It shows the gross amount of purchase made of the materials, and saleable goods. It includes both cash and credit purchases of goods made during the year which are meant for resale.

3. Purchase Returns: The purchase returns are a credit balance showing the return of goods to the suppliers. It should be subtracted from the total purchases to get the net purchases. Net purchases are shown in the trading account.

4. Direct Expenses: It refers to those expenses which are incurred for making the goods saleable. It may include factory or manufacturing expenses incurred on purchase of goods. Factory rent, wages, octroi, freight on purchases, manufacturing expenses, import duty, carriage inward, customs duty, dock dues, clearing charges, motive power, oil, grease and waste, packing charges, wages and salaries, cartage, royalty on production etc., these expenses are shown on the debit side of the trading account.

Items Appearing on the Credit Side of Trading Account

1. Sales: It is a credit balance indicating the total sales of goods made during the year. It includes both cash and credit sale of goods.

2. Sales Return: This is a debit balance, showing the total amount of goods returned by the customers. Sales returns should be subtracted from the total sales to find net sales which are shown on the credit side of trading account.

3. Closing Stock: It refers to the unsold goods which is lying in the godown at the end of the accounting year. Generally, the closing stock does not appear in the trial balance. It appears outside the trial balance. But when purchases are adjusted with opening and closing stocks, closing stocks appears as a debit balance in the trial balance. If it is given outside the trial balance, it will be shown on the credit side of trading account and also in the assets side of the balance sheet. If it is given in the trial balance, it will have to be shown only in assets side of the balance sheet. It may include raw materials, work-in-progress and finished goods.

Closing Entries in Respect of Trading Account

The following entries are passed in the journal to transfer the relevant ledger balances to the trading account.

(i) For transferring opening stock, net purchases and direct expenses to trading account

Trading account Dr. xxx

To Opening stock A/c xxx

To Purchases (net) A/c xxx

To Direct expenses A/c xxx

(ii) For transferring net sales and closing stock to trading account

Sales (net) A/c Dr. xxx

Closing stock, A/c xxx

To Trading A/c xxx

(iii) (a) For gross profit: (b) For gross loss:

Trading A/c Dr. Gross loss A/c Dr.

To Gross profit A/c To Trading A/c

Profit and Loss Account: -

According to Prof. Carter, "profit and loss account is an account into which all gains and losses are collected in order to ascertain the excess of gains where the losses or vice versa". Profit and loss account is prepared in order to calculate the net profit or net loss of the business. This account starts with the credit from the trading account in respect of gross profit (or debit if there is gross loss). From gross profit, operation and non-operating expenses are deducted and operating and non-operating income is added in order to calculate the net profit. When total of all the expenses is more than gross profit and other income, there remains a deficit and this is called net loss. The net profit or net loss ultimately transfers to capital account of the proprietor or to partners' capital accounts in case of partnership firm.

Preparation of Profit and Loss Account

As in the case of a trading account the profit and loss account is an account and hence, its form and construction conform to the rules of ledger account and principles of double entry system. Since the profit and loss account is prepared to show the net profit earned to net loss incurred during a particular period, it should be headed as under: “Profit and Loss A/c of 2014 for the year ended” The specimen proforma of a profit and loss account is given below:

Profit and Loss A/c of for the year Ended 2014

Items Appearing on Debit Side of Profit and Loss A/c

The business expenses are divided into two types: direct expenses which are recorded in the Trading A/c and indirect expenses which are recorded in the debit side of Profit and Loss A/c. indirect expenses can be further divided into two varieties:

(i) Operating expenses, and

(ii) non-operating expenses.

(i) Operating Expenses: It refers to those expenses which are incurred in order to operate the business efficiently and smoothly. These include administration, selling, distribution, finance and maintenance expenses.

(ii) Non-operating Expenses: The expenses are not related to the operation of the business and include capital losses as loss on the sale of furniture, etc., writing off fictitious assets, as preliminary expenses, underwriting commission, etc., writing off intangible assets as goodwill, copyright, patents, etc.

Items Appearing Credit Side of Profit and Loss Account

Gross profit is shown on the credit side of profit and loss account. Also, other gains and incomes of the business are shown on the credit side. The other incomes are generally classified into two types, i.e.

, (a) operating income, and

(b) non-operating income.

(**a) Operating Income:** It refers to that portion of income which is earned for the operations of the business. Examples: interest, commission and discount earned, etc.

(b) Non-Operating Income: This income is not earned from the routine operations of the business. Examples are profit on sale of any fixed assets, refund of tax.

Closing Entries for Profit and Loss A/c

(i) For transferring the various expenses to Profit and Loss A/c

Profit and loss A/c Dr.

To Various expenses A/c

(ii) For transferring the various incomes again to Profit and Loss A/c.

Various incomes gains A/c

To Profit and loss A/c

(iii) (a) For net profit:

Profit and loss A/c

To Capital A/c

(b) For net loss:

Capital A/c Dr.

To Profit and loss A/c

Balance sheet

It is a classified summary of balances remaining open in the general ledger after all the income and expenditure accounts have been closed off by transfer to trading and profit and loss account. It shows readily the financial position of the business at a given date by disclosing the amount of capital contributed and how the same has been invested and the values of assets and liabilities and their nature. The capital and liabilities of the business are shown on the left-hand side and assets and other debit balances are shown in the right-hand side. It is a statement containing all the unclosed balance “real” and “personal” accounts. Balance sheet is prepared with a view to measure the correct financial position of a business enterprise on a certain fixed date. It is a device for describing the financial position of a business in systematic standard form. By putting the financial position into such a form, it is possible to tell a complicated story of the enterprise in less time and space than if the same story were to be written as an extended narration: “Balance Sheet is a snapshot of the financial condition of the business”. At one glance, the situation of the enterprise at certain date, can be understood. Therefore, it is rightly called as “Mirror” of the business, wherein the business can see its face, i.e., its true position. An important thing to note about the balance sheet is that it always balances; that is to say; the total value of the assets is always equal to the total value of the claims or liabilities. In other words, Assets = Liabilities + Capital (or) Assets – Liabilities = Capital In the other words of Fransis R. Stead "Balance sheet is a screen picture of the financial position of a going business at a certain moment". According to R.N. Antony "Balance sheet is a statement which reports the property values owned by the enterprise and the claims of the creditors and owners against the properties. It shows the status of the business as at a given moment of time, in so far as a counting of figures can show its status".

Classification of Assets and Liabilities Assets

Assets represents everything which a business owns and has many values. Assets are always shown as debit balances. The various types of assets are:

(i) Fixed Assets: It refers to those assets which are held by way of equipment and not for the purpose of resale. They are of a permanent nature and it is by their help that the business is carried on. These are acquired for the purpose of creating production capacity, e.g., plant and machinery, building, furniture, fixtures and motor, vehicles, etc., the assets may be further subdivided into (a) tangible assets, and (b) intangible assets.

(a) Tangible Assets: it refers to those assets which can be seen, touched and have volume such as machinery, land and building, furniture, etc.

(b) Intangible Assets: These assets do not have physical existence. Goodwill, patents, trademarks and copyrights are examples of intangible assets. Though they are intangible, they are fixed assets as they are represented by certain values. Further, patents, trademarks and copy rights are all useful for earning revenues.

(ii) Current Assets: Current assets are those assets which are to be converted into cash within one year or during the normal operating cycle of the business. E.g., cash, bank, marketable securities, debtors, bills receivable and inventory which consists of debtor's materials, work-in-progress and finished goods. These are also called floating assets because their value is constantly floating, i.e., changing from one form to another as given in the following chart.

(iii) Liquid Assets: Liquid assets are readily convertible into cash at short notice with little or no risk of loss. Conversion of inventory into cash will take more time and hence it is not a liquid asset. Example: cash, bank, marketable securities, debtors and bills receivable.

(iv) Fictitious Assets: As the name implies such “assets” are to really assets. Only for the sake of convenience the amount is shown as an asset in the balance sheet. No amount can be realized or further benefit derived from the expenditure concerned. These assets are shown on the assets side of balance sheet till they are fully written off. It is prudent to write-off these assets to profit and loss account as early as possible

Examples would be:

Preliminary expenses

Expenses on issue of Share and debentures

Discount on issue of Shares and debentures

Debit balance of profit and loss A/c

(v) Contingent Assets: Contingent asset is one, the existence of which depends upon the happening of a certain event which may or may not take place. Examples would be (a) claim for income tax refund (b) uncalled share capital of a public limited company (c) claim by the firm for infringement of trade-marks or patent or copy right, etc., by others. These assets need not be shown in the balance sheet. They are usually shown as a footnote to the balance sheet.

(vi) Wasting Assets: The fixed assets which have a limited useful life and which, by nature, depreciate rapidly are termed as wasting assets. A wasting asset is as asset that diminishes in value by reason of and commensurately with the extraction or removal of a natural product. As soon as, say all the oil in an oil well has been extracted, the oil well becomes valueless. Mines and quarries have the same characteristics.

Liabilities

All that the business owes to others are called liabilities. It also includes proprietor's capital They are known as credit balances in the ledger. Liability is a claim by an outsider on the assets of the business. Liabilities may be classified into four categories:

(i) Proprietor’s capital or net worth: Proprietor’s capital is the original fund with which he entered a business. Later on, he may introduce further amounts towards capital and he may withdraw some amounts from the business. Net worth means the amount of capital outstanding on the particular date plus any profits retained in the business. The total amount belongs to the proprietor. This is shown on the liabilities side of the balance sheet as it is payable by the business to the proprietor.

(ii) Long-term liabilities: The liabilities which are repayable after a long period of time are known as fixed liabilities, i.e., they do no become due for payment in the ordinary course of the business within a relatively short period, E.g. long-term loans and debentures. These may be secured or unsecured. But generally, they are secured.

(iii) Current liabilities: It refers to those liabilities which are repayable within one year or during the normal operating cycle of the business by the use of the existing resources of current assets or by the creation of similar current liabilities. E.g., trade creditors, bills payable, accrued expenses, bank overdraft, provision for taxation, proposed dividend, etc.

(iv) Contingent liabilities: Contingent liability will become an actual liability only on the happening of a certain event which may or may not happen. These are: (a) Bills discounted and endorsed which may be dishonored. (b) Claim by others which has been disputed by the firm or pending in the court of law. (c) Unpaid call amounts on investments. These are to be disclosed by way of not to the balance sheet.

Grouping and Marshalling of Assets and Liabilities A balance sheet is usually prepared in the form of a statement, with assets on the right-hand side and liabilities and capital on the left-hand side. The component items of a balance sheet should be arranged in an orderly manner and in a sequence that should be adhered to year-by-year. Such an arrangement of the items in a balance sheet is known as 'Marshalling'. There are two ways in which the assets and liabilities can be arranged in balance sheet. They are: (a) Order of performance, and (b) order of liquidity.

The first method is commonly used by companies, whereas the second one is popular among sole traders and partnership firms. However, in case of certain concerns, such as banking companies, insurance companies, railway companies, other joint stock companies, etc., form of balance sheet is prescribed by the law. (i) Proforma of balance sheet in the order of permanency.