

## The Balance Sheet Pg 21

The formal way of presenting financial position is by means of a balance sheet. A **balance sheet** is a statement showing the financial position of a person, business, or other organization. Figure 2.1 contains the balance sheet that shows the financial position of Chris Turner whom you met on page 18.

$$A = L + OE$$

Chris Turner										
Balance Sheet										
September 15, 20-										
Assets					Liabilities					
Cash	\$		5	5	00	Owed to brother Philip	\$	2	2	00
Bank Balance			2	4	00	Owed to Dad		3	0	00
Canada Savings Bonds		3	0	0	00	Mobile Phone Bill		4	0	00
Mountain Bike			6	2	00	Total Liabilities	\$	9	2	00
Snowboard			7	5	00					
Computer and Electronics		1	9	0	00	<u>Owner's Equity</u>				
Mobile Phone			5	0	00	Chris Turner, Capital		8	8	50
Clothes			2	7	00					
Total Assets	\$	9	7	7	00	Total Liabilities and Equity	\$	9	7	70

**Figure 2.1**  
A personal balance sheet

Formats of balance sheets vary. The slight differences are due in part to the accounting standards that govern private businesses and public companies. You will learn more about these standards in Section 2.4.

Although you will work with balance sheets that have small differences in appearance, remember that they all share a common purpose—that is, to show financial position. The balance sheet in Figure 2.2 shows the financial position for a small business.

Easy Rent-Alls															
Balance Sheet															
September 30, 20–															
Assets					Liabilities										
Cash	\$	6	7	5	0	20	Accounts Payable								
Accounts Receivable							– Arrow Supply	\$	3	9	5	0	40		
– W. Boa		2	2	3	1	50	– Best Repairs		6	2	5	0	00		
– T. Burns		4	3	5	0	00	Bank Loan		3	5	0	0	00		
Supplies		2	9	6	5	10	Mortgage Payable		9	5	2	0	00		
Land		1	4	8	0	00	Total Liabilities	\$	1	4	0	4	40		
Buildings		1	3	4	0	00									
Rental Equipment		7	5	3	6	4	70	Owner's Equity							
							J. Salas, Capital		2	3	2	6	1	10	
Total Assets	\$	3	7	3	6	6	Total Liabilities and Equity	\$	3	7	3	6	6	1	50

**Figure 2.2**

A balance sheet of a small business

## Important Features of the Balance Sheet

Examine the two balance sheets (Figures 2.1 and 2.2) carefully. In particular, observe the following:

1. The balance sheet is set up in the form of the fundamental accounting equation

$$A = L + OE$$

The assets appear on the left side, and the liabilities and the owner's equity appear on the right side.

2. A three-line heading is used. The heading tells
  - WHO?—the name of the individual, business, or other organization
  - WHAT?—the name of the financial statement (in this case, the balance sheet)
  - WHEN?—the date on which the financial position is determined

- \* 3. The assets are generally listed in the order of their *liquidity*. **Liquidity** means the order in which the assets could be most quickly converted into cash. Accordingly, Cash is listed first. Accounts Receivable are amounts that will be paid to the business by customers in a month or two. They appear on the balance sheet soon after Cash. Long-lasting assets, such as equipment and buildings, are listed later because normally they are not converted into cash but are used in the operation of the business.

Liquidity  
Order

- \* 4. The liabilities are generally listed in the order in which they are normally paid. *The order of retiring debts*
5. The financial details of any item are fully disclosed on a balance sheet. For example, on the balance sheet for Easy Rent-Alls, Land and Buildings are listed in the Assets section at their respective values of \$148 000 and \$134 000. The amount that is owed against the property, the Mortgage Payable of \$95 200, is listed in the Liabilities section. This is a more informative presentation than if, for example, Land and Buildings had just been shown as a total of \$186 800 (\$148 000 + \$134 000 - \$95 200).
6. The two final totals, one on each side of the balance sheet, are recorded on the same line and underlined with a double line.

### Preparing a Balance Sheet

The steps in preparing a simple balance sheet are shown in the following illustrations. The balance sheet of Easy Rent-Alls is used in the example.

**Step 1** Write in the statement heading on columnar paper as shown in Figure 2.3 below. The heading must indicate the name of the business, the name of the statement, and the date of the statement.

	Easy Rent-Alls													
WHO: the name of the business	Balance Sheet												WHAT: the name of the statement	
	September 30, 20-													
WHEN: the date of the statement														

**Figure 2.3**  
The heading on a balance sheet

**Step 2** Write in the subheading “Assets” at the top of the left-side column. Underline the sub-heading or make it stand out by using a different writing style or colour. Then write in the individual assets on the left side as shown in Figure 2.4 below.

Easy Rent-Alls												
Balance Sheet												
September 30, 20--												
Assets												
Cash	6	7	5	0	20							
Accounts Receivable												
– W. Boa	2	2	3	1	50							
– T. Burns	4	3	5	0	00							
Supplies	2	9	6	5	10							
Land	1	4	8	0	0 0 0							
Buildings	1	3	4	0	0 0 0							
Rental Equipment	7	5	3	6	4 70							

**Figure 2.4**  
The assets listed on a balance sheet

Small businesses generally list their assets in the order of their liquidity. Cash is listed first. Accounts receivable are listed next because they are usually collected within 30 days. (The balance sheets in the first part of this text show the names of customers and list them in alphabetical order.) Supplies and long-lasting assets, such as delivery trucks, equipment, and buildings, are listed later because normally they are not converted into cash.

**Step 3** Write in the subheading “Liabilities” at the top of the right-side column. Format the subheading the same way you formatted “Assets.” Then write in the liabilities on the right side as shown in Figure 2.5. The liabilities are listed in the order in which they will be paid. Suppliers’ names are usually placed in alphabetical order.

Draw a line below the last liability amount to indicate that you are adding up the figures above the line. Then write in “Total Liabilities” and the total.

Liabilities are listed in the order in which they must be paid.

In this text and in business, you will see several balance sheets showing Bank Loan before Accounts Payable. This is because the loan may be repayable on demand, which gives the bank the right to call in the loan at any time. Bank management will occasionally use this right to demand repayment if they think the funds they lent are at significant risk.

Easy Rent-Alls										
Balance Sheet										
September 30, 20–										
Assets					Liabilities					
Cash	6	7	5	0	20	Accounts Payable				
Accounts Receivable						– Arrow Supply	3	9	5	0
– W. Boa	2	2	3	1	50	– Best Repairs	6	2	5	0
– T. Burns	4	3	5	0	00	Bank Loan	35	0	0	0
Supplies	2	9	6	5	10	Mortgage Payable	95	2	0	0
Land	148	0	0	0	00	Total Liabilities	140	4	0	0
Buildings	134	0	0	0	00					
Rental Equipment	75	3	6	4	70					

**Figure 2.5**  
The liabilities listed on a balance sheet

**Step 4** Beneath the liabilities, write in the subheading “Owner’s Equity” and format it so it looks like the subheadings for “Assets” and “Liabilities.” Then write in the owner’s name plus the word “Capital” and the equity figure, as shown in Figure 2.6 on the next page. As you know, the equity amount is the difference between the total assets and the total liabilities. You have to know the amount of total assets to calculate equity, but do not write it in until step 5 on the next page.

Easy Rent-Alls									
Balance Sheet									
September 30, 20–									
<u>Assets</u>					<u>Liabilities</u>				
Cash	6	7	5	0	20	Accounts Payable			
Accounts Receivable						– Arrow Supply	3	9	5
– W. Boa	2	2	3	1	50	– Best Repairs	6	2	5
– T. Burns	4	3	5	0	00	Bank Loan	35	0	0
Supplies	2	9	6	5	10	Mortgage Payable	95	2	0
Land	148	0	0	0	00	Total Liabilities	140	4	0
Buildings	134	0	0	0	00				
Rental Equipment	75	3	6	4	70	<i>Owner's Equity</i>			
						J. Salas, Capital	233	2	6

**Figure 2.6**  
The owner’s equity recorded on a balance sheet

**Step 5** Complete the balance sheet by writing in the final totals as shown in Figure 2.7. These totals are written on the first fully open line.

On this line, write in “Total Assets” on the left side and “Total Liabilities and Equity” on the right side. Write in the totals. The two totals must be on the same line and must agree. Place a single ruled line above and a double ruled line below each of the two totals.

**Step 6** To help you develop the habit of correctly using dollar signs, this text shows them on most balance sheets. In Figure 2.7, notice a dollar sign is placed with the first amount in every column. A dollar sign is also used beneath each single ruled line in each column.



For an online demonstration of the steps to follow to create a balance sheet, visit the *Accounting 1* website.

Easy Rent-Alls														
Balance Sheet														
September 30, 20–														
Assets					Liabilities									
Cash	\$	6	7	5	0	20	Accounts Payable							
Accounts Receivable							– Arrow Supply	\$	3	9	5	0	40	
– W. Boa		2	2	3	1	50	– Best Repairs		6	2	5	0	00	
– T. Burns		4	3	5	0	00	Bank Loan		35	0	0	0	00	
Supplies		2	9	6	5	10	Mortgage Payable		95	2	0	0	00	
Land		148	0	0	0	00	Total Liabilities	\$	140	4	0	0	40	
Buildings		134	0	0	0	00								
Rental Equipment		75	3	6	4	70	Owner's Equity							
							J. Salas, Capital		233	2	6	1	10	
Total Assets	\$	373	6	6	1	50	Total Liabilities and Equity	\$	373	6	6	1	50	

**Figure 2.7**  
The completed balance sheet for a business with dollar signs included



## Homework

Page 28 Section 2.2

Review # 1-17

Exercises 1-3

**SECTION 2.2 REVIEW QUESTIONS** (page 28)

1. *A balance sheet is a statement showing the financial position of a person, business, or other organization.*
2. *The name of the business appears in the first line of the heading of the balance sheet.*
3. *The assets are listed on the left side of the balance sheet. The liabilities are listed on the right side of the balance sheet.*
4. *The full cost of the automobile is listed as an asset, and the amount owed on the automobile is listed as a liability.*
5. *Dollar signs are placed with the first amount in every column and beneath each single ruled line on a balance sheet.*
6. *A creditor appears under the liabilities on the right-hand side of the balance sheet.*
7. *A single ruled line drawn beneath a column of figures means that the column is to be totalled.*
8. *An accountant's work must be neat because the financial information prepared by an accountant must not be misinterpreted and therefore must be perfectly legible.*
9. *A double ruled line is drawn beneath a total in a column of figures to indicate a final total.*
10. *A short form or abbreviation may be used on financial statements when it is part of a company's formal name.*
11. *The most liquid asset is cash. Liquidity is based on how quickly and easily an asset can be converted to cash, so something that is already cash has the most liquidity.*
12. *Liabilities are listed on the balance sheet in the order in which they will be paid.*
13. *Assets are generally listed on the balance sheet in the order of their liquidity.*
14. *Accounts receivable are the debts owed to a business by its customers.*
15. *Accounts payable are the debts owed by a business to its suppliers.*
16. *Any supplier to whom the business owes money is called a creditor.*
17. *Any company or person who owes money to the business is called a debtor.*

**SECTION 2.2 EXERCISES** (page 28)

**Exercise 1, p. 28**

A. THE KRAMER COMPANY  
BALANCE SHEET  
SEPTEMBER 30, 20-

<i>Assets</i>						<i>Liabilities</i>							
Cash	\$	1	6	3	6	-	Accounts Payable						
Accounts Receivable							—Able Supply Company	\$	4	7	4	0	-
—J. Crothers		1	1	0	0	-	—C.P. Gregg		3	0	0	0	-
—R. Zack			3	7	0	-	Bank Loan		10	0	0	0	-
Supplies		1	2	0	0	-	Total Liabilities	\$	17	7	4	0	-
Furniture and Equipment		14	7	0	0	-							
Delivery Equipment		20	1	0	0	-	Owner's Equity						
							Kate Kramer, Capital		21	3	6	6	-
Total Assets	\$	39	1	0	6	-	Total Liabilities and Equity	\$	39	1	0	6	-

B. A retailing business buys goods and resells them at a higher price. Merchandise Inventory is the cost of the goods that will be resold. If sales are brisk, Merchandise Inventory is turned into cash quickly and is therefore quite liquid. So Merchandise Inventory should probably be listed right after Cash and Accounts Receivable.

## Exercise 2, p. 29

## NEW WESTERN COMPANY

## BALANCE SHEET

MARCH 31, 20-

Assets					Liabilities								
Cash	\$	1	8	9	6	-	Accounts Payable						
Accounts Receivable							—General Trading Company	\$	2	3	5	6	-
—Food Haven			4	0	0	-	—Household Finance Company		19	3	4	5	-
—Metro Mall		1	2	3	5	-	—Lightning Electronics		3	3	7	8	-
—Tasty Beverages				7	5	0	Bank Loan		10	0	0	0	-
Supplies				8	5	0	Mortgage Payable		95	0	0	0	-
Land		90	0	0	0	-	Total Liabilities	\$	130	0	7	9	-
Building		140	0	0	0	-							
Furniture and Equipment		75	8	4	0	-	Owner's Equity						
Trucks		35	0	0	0	-	Guy Albrecht, Capital		215	8	9	3	-
Total Assets	\$	345	9	7	1	-	Total Liabilities and Equity	\$	345	9	7	1	-

## SECTION 2.2 EXERCISES (continued)

## Exercise 3, p. 29

## TRAVIS AND COMPANY

## BALANCE SHEET

MARCH 31, 20-

Assets							Liabilities							
Cash	\$	4	9	4	6	03	Accounts Payable							
Accounts Receivable							—Beacon Company	\$	1	5	6	7	25	
—G. Fordham		1	0	4	2	16	—Gem Finance		1	2	3	6	45	
—W. Gaines			7	4	3	86	—General Supply		15	5	4	0	-	
—D. Samuelson		1	3	4	6	95	—Raymond and Company			1	2	5	-	
Office Supplies				3	2	6	40	Bank Loan		25	0	0	0	-
Land		146	0	0	0	-	Mortgage Payable		92	0	0	0	-	
Building		135	0	0	0	-	Total Liabilities	\$	135	4	6	8	70	
Office Equipment		11	9	6	0	-								
Delivery Equipment		14	2	4	0	-	Owner's Equity							
							Michael Travis, Capital		180	1	3	6	70	
Total Assets	\$	315	6	0	5	40	Total Liabilities and Equity	\$	315	6	0	5	40	

### 2.3 ► Claims against the Assets

In the previous section, you saw that a business lists the assets it owns on the left side of a balance sheet. Who is entitled to these assets? The answer is shown on the right side of the balance sheet. That is, both the creditors and the owner have a claim on the assets.

Why do the creditors and owner have a claim on the assets? Part of the answer is that they have either provided the funds used to acquire the assets, or they have provided the assets themselves.

Figure 2.8 below shows the balance sheet of Pacioli Designs, owned by Grace Cho. It shows clearly all the business assets that can be claimed and who has a right to claim them.

Pacioli Designs									
Balance Sheet									
December 31, 20--									
Assets					Liabilities				
Cash	\$	16	18	00	Bank Loan	\$	9	00	00
Accounts Receivable					Accounts Payable				
– J. Tenney		13	50	00	– CMYK Supplies		19	05	15
– V. Weiss		18	50	50	– Golden Art Store		22	99	90
Supplies		17	50	50	– Premium Printing		1	75	095
Furniture		47	02	00	Total Liabilities	\$	14	95	600
Equipment		16	00	00					
Automobile		21	85	00	Owner's Equity				
					Grace Cho, Capital		34	16	500
Total Assets	\$	49	121	00	Total Liabilities and Equity	\$	49	121	00

Creditors (Borrowed)  
Owner(s) (Invested)

**Figure 2.8**

The balance sheet of Pacioli Designs showing its assets and the claims against those assets

As shown on the left side of the balance sheet, the business assets are \$49 121.00. The right side of the balance sheet shows that these assets, or the funds to obtain them, were provided by the bank, \$9000; the other creditors, \$1905.15, \$2229.90, and \$1750.95; and by Grace Cho herself, \$34 165.00.

The total amount of assets is subject to claims from two sources: the creditors and the owner. Thinking about assets and the claims against them will help you understand why the fundamental accounting equation is written as  $A = L + OE$ .

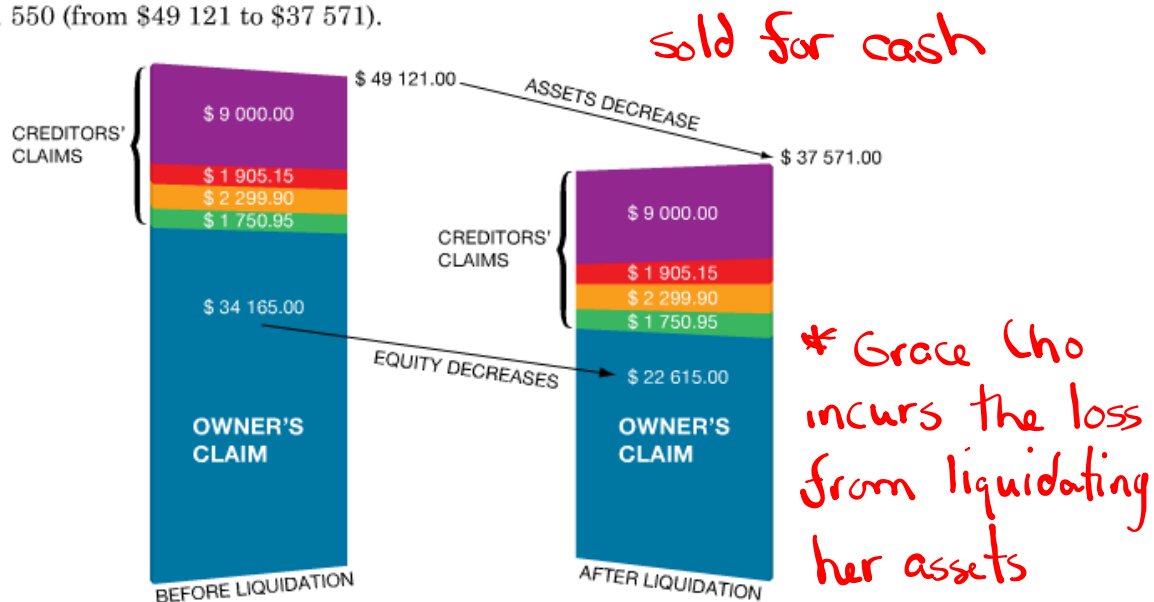
<u>\$49 121.00</u>	=	\$9000 + \$1905.15 + \$2229.90 + \$1750.95	+	<u>\$34 165.00</u>
Assets	=	Creditors' claims against the assets	+	Owner's claim against the assets

### Creditors' Claims First

If a business is closed down, who takes possession of the assets? They still belong to the owner and to the creditors. The claims of the creditors will be settled first, followed by the claim of the owner. This means that the owner has to accept any losses that might occur from selling off any assets. On the other hand, the owner benefits from any profits that might occur. The owner always gets what is left after the claims of the creditors have been paid.

Selling the assets of a business for cash is called liquidation.

Suppose that Grace Cho closed down Pacioli Designs, collected the accounts receivable, and then sold the supplies, furniture, equipment, and automobile. Further assume that she did not sell her assets for the values listed on the balance sheet shown in Figure 2.8. In fact, after liquidation, the business was left with total assets of \$37 571 in cash. This represents a decrease or loss of \$11 550 (from \$49 121 to \$37 571).



**Figure 2.9**

The change in claims after the assets of Pacioli Designs are liquidated

From the graphs in Figure 2.9, you can see that the claims of the creditors (the liabilities) do not change. The drop in the value of assets simply means that the owner has less to claim (equity). This loss can be shown using the assets equation.

$$\underbrace{\$37\,571}_{-11\,550} = \underbrace{\$9\,000 + \$1\,905.15 + \$2\,299.90 + \$1\,750.95}_{\text{Creditors' claims against the assets}} + \underbrace{\$22\,615.00}_{-11\,550}_{\text{Owner's claim against the assets}}$$

Easy Rent-Alls															
Balance Sheet															
September 30, 20-															
Assets					Liabilities										
Cash	\$	6	7	5	0	20	Accounts Payable								
Accounts Receivable							- Arrow Supply	\$	3	9	5	0	40		
- W. Boa		2	2	3	1	50	- Best Repairs		6	2	5	0	00		
- T. Burns		4	3	5	0	00	Bank Loan		35	0	0	0	00		
Supplies		2	9	6	5	10	Mortgage Payable		95	2	0	0	00		
Land		148	0	0	0	00	Total Liabilities		\$140	4	0	0	40		
Buildings		134	0	0	0	00									
Rental Equipment		75	3	6	4	70	<u>Owner's Equity</u>								
							J. Salas, Capital		233	2	6	1	10		
Total Assets		\$373	6	6	1	50	Total Liabilities and Equity		\$373	6	6	1	50		

Creditors

Suppose Easy Rent-Alls has to close. When liquidating their assets they are able to get \$315000.00.  $(373661.50 - 315000.00 = \$58661.50)$

a) Who gets paid first?

Creditors

b) Show what happens to the owners capital amount.

• Pre-Liquidation:

$$\begin{matrix} \text{Assets} & = & \text{Liabilities} & + & \text{Owner's Equity} \\ 373\,661.50 & & 140\,400.40 & & 233\,261.10 \end{matrix}$$

• Post-Liquidation:

$$\begin{matrix} \text{Assets} & = & \text{Liabilities} & + & \text{Owner's Equity} \\ 315\,000.00 & & 140\,400.40 & & 174\,599.60 \end{matrix}$$

c) What would happen if the company only had \$130000.00 in cash after liquidation?

The creditors could take the owner to court.

## Homework

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Section 2.3

Review Questions 1-5

Exercises 1-2





**SECTION 2.3 EXERCISES** (continued)**Exercise 2, p. 32**

A.

*CARLA'S INTERIOR DESIGN**BALANCE SHEET**JULY 31, 20-*

<i>Assets</i>					<i>Liabilities</i>							
<i>Cash</i>	\$11	9	0	0	-	<i>Bank Loan</i>	\$	9	5	0	0	-
<i>Automobile</i>	17	5	0	0	-	<i>Accounts Payable</i>		1	2	5	0	-
						<i>Total Liabilities</i>		\$10	7	5	0	-
						<i>Owner's Equity</i>						
						<i>Carla Mann, Capital</i>		18	6	5	0	-
<i>Total Assets</i>	\$29	4	0	0	-	<i>Total Liabilities and Equity</i>		\$29	4	0	0	-

B. To dispose of the remaining assets and close the business, Carla could use the business's cash to pay off the creditors. She could then pay herself by taking the balance of the cash and the automobile.