

Chapter 2 Balance Sheet

The Balance Sheet

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.

Chris Turner									
Balance Sheet									
September 15, 20–									
<u>Assets</u>					<u>Liabilities</u>				
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	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	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	00	Total Liabilities and Equity	\$	9	7	00

Figure 2.1

A personal balance sheet

What do you notice about the Owner's Equity Section?

Only shows Chris Turner, Capital

Equity Relationships and the Balance Sheet

◀ 5.3

Understanding Equity Relationships

You are now familiar with the expanded ledger, and you have learned how to show the balances of new accounts on an income statement. You also now know that the income statement is the second major financial statement in accounting. The first major statement you learned was the balance sheet. To show equity on the balance sheet—and to ensure your balance sheet balances—it is important to fully understand equity accounts and how they relate to each other mathematically.

Consider again the trial balance for Eve Boa, LLB.

EVE BOA, LLB TRIAL BALANCE JANUARY 31, 20—		
	Dr	Cr
Bank	2 439	
A/R – H. Geroux	1 420	
A/R – J. Magill	757	
BANK LOAN		940
E. Boa, Capital		21 878
E. Boa, Drawings	3 950	
Fees Earned		23 660
Advertising Expense	1 321	
Car Expense	615	
Rent Expense	3 300	
Sundry Expense	385	
Wages Expense	9 830	
	<u>52 078</u>	<u>52 078</u>

NET INCOME 8 209	}	26 137 BALANCE OF CAPITAL
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Figure 5.7

Eve Boa's trial balance with components of the equity section highlighted

The trial balance is in balance with totals of \$52 078. These totals include the new equity accounts. To make the balance sheet totals agree, each amount in the trial balance could be transferred to the balance sheet, but this would be impractical, especially in the case of large companies with many revenue and expense accounts. Instead, equity calculations can be developed and recorded on the balance sheet.

You will now examine Figure 5.7 carefully. The debit and credit amounts listed in the equity section will help you understand the mathematical calculations needed for the balance sheet.

E. Boa, Capital (\$21 878) is the starting capital and is a credit balance. The other blue numbers represent changes to equity during the month. The numbers with the blue shading make up the income statement. If revenues are greater than expenses (net income), the balance of the shaded numbers (\$8209) is a credit. Since credits are added to credits, we can start to build an equity equation by writing the following:

$$\text{Beginning Capital} + \text{Net Income}$$

The net income figure summarizes all the revenue and expense amounts. The only remaining amount unaccounted for in the equity section of Figure 5.7 is E. Boa, Drawings. It is a debit and therefore is subtracted from credits. To finish the equation, subtract drawings, and write the result:



$$\text{Beginning Capital} + \text{Net Income} - \text{Drawings} = \text{Ending Capital}$$

We will call this formula the equity equation. The **equity equation** is a mathematical description of the relationship between the different components of the equity section in the expanded ledger. For Eve Boa, the amounts in her equity equation are

$$21\,878 + 8\,209 - 3\,950 = 26\,137$$

If there is a net loss, you need to adjust the equity equation because expenses are greater than revenues. If this were the case for Eve Boa, the balance of the shaded area in Figure 5.7 would be a debit. The net loss (a debit) would be subtracted from the beginning capital (a credit). The adjustment to the equity equation is



$$\text{Beginning Capital} - \text{Net Loss} - \text{Drawings} = \text{Ending Capital}$$

Showing Equity on the Balance Sheet

To prepare a balance sheet, you need to take the equity equation and present it in good form. For example, the balance sheet for Eve Boa would look similar to Figure 5.8 (on the next page).

EVE BOA, LLB BALANCE SHEET JANUARY 31, 20--		
ASSETS		
<i>Current Assets</i>		
Bank	\$ 2 439	
A/R – H. Geroux	1 420	
A/R – J. Magill	757	
A/R – E. Parsons	1 395	
Supplies	<u>2 316</u>	
<i>Total Current Assets</i>		\$ 8 327
<i>Long-Term Assets</i>		
Office Equipment	\$ 7 550	
Automobile	<u>16 800</u>	
<i>Total Long-Term Assets</i>		<u>24 350</u>
Total Assets		<u>\$ 32 677</u>
LIABILITIES		
<i>Current Liabilities</i>		
A/P – OK Supply	\$ 4 400	
A/P – Computer Outlet	1 200	
Bank Loan	<u>940</u>	
<i>Total Current Liabilities</i>		\$ 6 540
OWNER'S EQUITY		
<i>Eve Boa, Capital</i>		
Balance January 1	\$ 21 878	
Net Income*	\$ 8 209*	
Less: Drawings	<u>(3 950)</u>	
Increase in Capital	<u>4 259</u>	
<i>Balance January 31</i>		26 137
Total Liabilities and Owner's Equity		<u>\$ 32 677</u>

For this balance sheet, the ASSETS section is placed above the LIABILITIES and EQUITY sections instead of beside them. This format is referred to as the report form of the balance sheet.

This balance sheet also classifies assets and liabilities as either current or long-term. (See Chapter 2.)

Recall that under IFRS, the balance sheet is called the Statement of Financial Position.

Figure 5.8

Eve Boa's balance sheet with an expanded equity section

What do you notice about the Owner's Equity section now?

- It is expanded
 - ↳ Contains Capital, Net income, and Drawings

*
$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$

$$\text{Net Loss}$$

Other Possible Changes to Equity

In Eve Boa's case, net income was greater than drawings. This caused an increase in equity. Consider other cases that can describe what happens to equity over a fiscal period.

Owner's Equity

The net loss and drawings are added first because both have the effect of reducing capital.

Drawings greater than Net Income			
<i>T. Smith, Capital</i>			
Balance January 1		\$ 20 376.64	
+ Net Income	\$ 10 594.03		
- Less: Drawings	(15 376.70)		
- Decrease in Capital		(4 782.67)	
Balance December 31			15 593.97
Net Loss			
<i>S. Brown, Capital</i>			
Balance July 1		\$ 31 216.40	
- Net Loss	(\$ 5 147.62)		
+ Plus: Drawings	(19 400.00)		
- Decrease in Capital		(24 547.62)	
Balance June 30			6 668.78
Additional Investments			
<i>S. D'Angio, Capital</i>			
Balance January 1		\$ 47 005.12	
+ Plus: Additional Investments		30 000.00	
+ Net Income	\$ 23 604.89		
- Less: Drawings	(20 000.00)		
+ Increase in Capital		3 604.89	
Balance December 31			80 610.01

Figure 5.9

Three other equity sections showing how equity changes in a fiscal period

Homework

Section 5.3 on page 156

Review Questions #1-9

Exercises #1-3

SECTION 5.3 REVIEW QUESTIONS (page 156)

1. *The two major financial statements learned so far are the balance sheet and the income statement.*
2. *The equity equation for a profit situation is*
Beginning Capital + Net Income - Drawings = Ending Capital.
3. *The equity equation for a loss situation is*
Beginning Capital - Net Loss - Drawings = Ending Capital.
4. *You will find the beginning equity figure in the Capital account.*
5. *Changes to equity are recorded in the Revenue, Expense, and Drawings accounts. Occasionally, changes will be entered directly in the Capital account, such as an additional investment by the owner (debit Bank, credit Capital).*
6. *Drawings do not affect the calculation of net income. Drawings affect the calculation of the ending capital on the balance sheet.*
7. *If Drawings are greater than net income, there will be an overall decrease in equity.*
8. *The statement is most often true. A net loss represents a decrease in equity from normal business operations. Therefore, in most cases, equity would decrease with a net loss, even if drawings are zero.*
9. *Equity could increase if there was a net loss if the owner invested additional funds in the business.*

Exercise 1, p. 157

Items	Opening Capital	Net Income or Net Loss (+)	Drawings	Ending Capital
A.	\$ 30 000	\$ 15 000	\$ 10 000	<i>\$ 35 000</i>
B.	50 000	-2 000	7 000	<i>41 000</i>
C.	70 000	32 000	<i>26 500</i>	75 500
D.	<i>36 700</i>	16 000	19 500	33 200
E.	56 000	<i>14 000</i>	30 000	40 000
F.	45 000	<i>-5 000</i>	25 000	15 000
G.	22 000	<i>16 000</i>	10 000	28 000
H.	<i>35 000</i>	25 000	18 000	42 000
I.	120 000	42 000	<i>50 000</i>	112 000

Exercise 2, p. 157

Financial Information	Company 1	Company 2	Company 3	Company 4	Company 5
Beginning capital	\$ 6 000	\$ 6 000	\$ 15 000	<i>\$ 5 000</i>	\$ 62 000
Total revenues	10 000	<i>25 000</i>	29 000	<i>50 000</i>	<i>30 000</i>
Total expenses	8 000	11 000	<i>18 000</i>	30 000	35 000
Net income or loss (-)	<i>2 000</i>	14 000	11 000	20 000	-5 000
Drawings	3 000	12 000	<i>17 000</i>	15 000	<i>5 000</i>
Increase or decrease (-) in equity	<i>-1 000</i>	<i>2 000</i>	-6 000	<i>5 000</i>	-10 000
Ending capital	<i>5 000</i>	<i>8 000</i>	<i>9 000</i>	10 000	<i>52 000</i>

Exercise 3, p. 158

G. Benvie

<i>G. Benvie, Capital</i>												
<i>Balance January 1</i>						\$27	0	4	2	62		
<i>Net Income</i>	\$39	1	7	1	04							
<i>Less: Drawings</i>	(35	0	0	0	-)							
<i>Increase in Capital</i>						4	1	7	1	04		
<i>Balance December 31</i>						\$31	2	1	3	66		

S. Robb

<i>S. Robb, Capital</i>												
<i>Balance January 1</i>						\$19	6	4	1	25		
<i>Net Income</i>	\$22	4	6	2	67							
<i>Less: Drawings</i>	(25	5	7	5	-)							
<i>Decrease in Capital</i>						(3	1	1	2	33)		
<i>Balance March 31</i>						\$16	5	2	8	92		

J. Bedford

<i>J. Bedford, Capital</i>												
<i>Balance May 1</i>						\$20	1	9	6	74		
<i>Net Loss</i>	(\$	3	7	5	0 20)							
<i>Less: Drawings</i>	(10	0	4	7	17)							
<i>Decrease in Capital</i>						(13	7	9	7	37)		
<i>Balance May 31</i>						\$6	3	9	9	37		