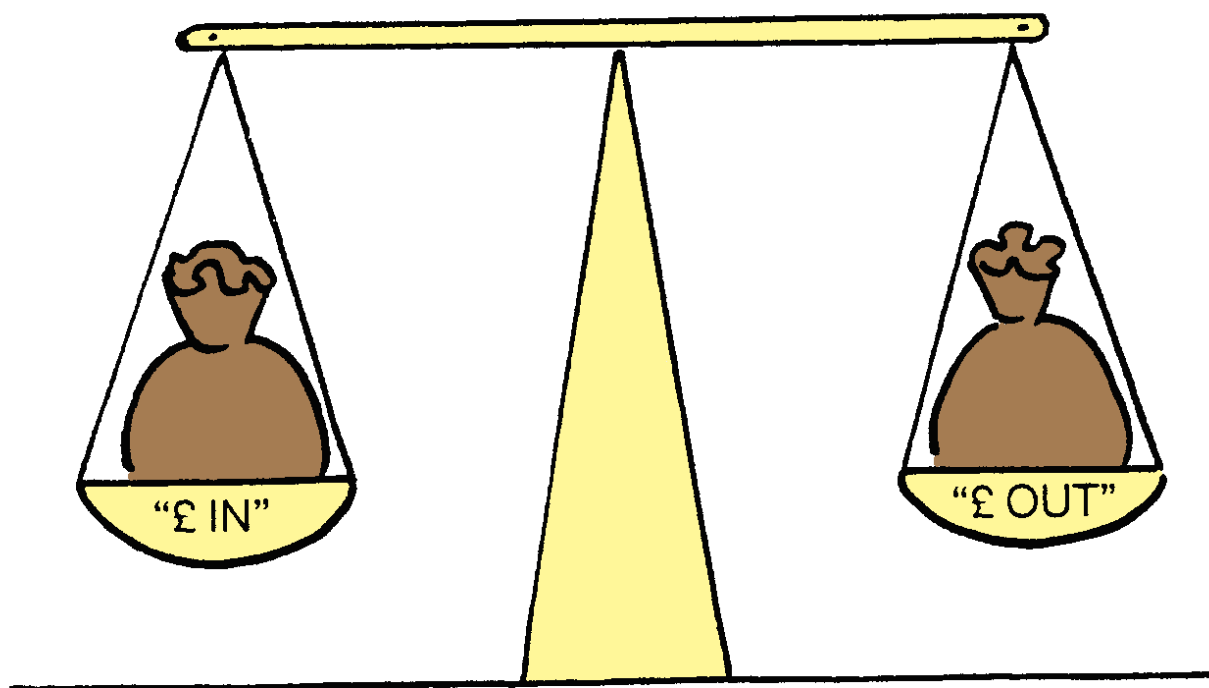


SIMPLE BALANCE SHEETS



The balance sheet is one of the last items to be written when a set of accounts is prepared. It may seem rather strange, therefore, to start looking at the mechanics of book-keeping with balance sheets. However, a balance sheet is so "pure" and absolute in its own right that it is an ideal means of illustrating the dual aspect of transactions.

A balance sheet is like a pair of scales or an equation of the sort you probably used to do at school in that both sides are equal. If we do something to one side, we must either do the same to the other side or make some further changes to the first side to compensate for the first action.

In other words, a balance sheet will always balance or – if you will excuse the double negative -

A BALANCE SHEET CAN'T NOT BALANCE!

To prepare a balance sheet, draw a line down the centre of a piece of paper like this:

<u>BALANCE SHEET</u>	

On the LEFT hand side, we list the ASSETS of the business, in other words everything the business OWNS.

On the RIGHT hand side, we list everything the business has borrowed or OWES to other people. What the business owes is in two parts, the CAPITAL and the LIABILITIES.

The CAPITAL is the amount that is owed to the owner(s) or proprietor(s) of the business. The LIABILITIES are the amounts owed to everyone else. Now we are ready to put headings into the balance sheet.

<u>BALANCE SHEET</u>	
ASSETS	CAPITAL & LIABILITIES

To see how this works in practice, we shall look at the effects of some transactions involved in setting up a new business.

JOHN SEAM has decided to start his own garment manufacturing business called JOHN SEAM FASHIONS. He invests £5000 of his own money in the firm to get it started and PUTS THE MONEY IN THE BUSINESS BANK ACCOUNT.

1. JOHN SEAM FASHIONS has acquired £5000 IN ITS BANK ACCOUNT.
2. JOHN SEAM FASHIONS now owes John Seam himself the £5000 CAPITAL which he has lent to the business.

Here are the entries in the balance sheet.

<u>BALANCE SHEET</u>			
ASSETS		CAPITAL & LIABILITIES	
Bank	5000	Capital	5000

POINT TO NOTICE!

John Seam and John Seam Fashions are treated as two entirely separate things. This is a basic rule of any business:

THE FINANCIAL AFFAIRS OF THE OWNER MUST BE KEPT SEPARATE FROM THE FINANCIAL AFFAIRS OF THE BUSINESS!

Every TRANSACTION in a business has to be broken down into the two aspects of DOUBLE ENTRY. Your job as a book-keeper will be to make sure that both sides of any transaction such as money out/goods in or goods out/money in are correctly entered in the records to show the equal and opposite effect they have on the financial standing of the business.

Now we shall look at some more transactions. In working through these transactions, keep the duality concept at the front of your mind. You will find that the concept is confirmed in the balance sheets you will see. You will also see that the balance sheets always keep in balance.

Take your time to go through these transactions. They may look a little daunting at first glance but you will find that they are really very straightforward and logical.

TRANSACTION 1 The firm buys some machinery for £1000, paying by cheque.
 EFFECT 1 The asset of money in the bank is reduced by £1000 whilst an
 additional asset of machinery worth £1000 is received.
 RESULT 1

<u>BALANCE SHEET</u>			
ASSETS		CAPITAL & LIABILITIES	
Bank	4000	Capital	5000
Machinery	1000		

YOU WILL NOTICE THAT EACH SIDE TOTALS £5000

TRANSACTION 2 The firm buys some stock (for re-sale) for £500, paying by cheque.
 EFFECT 2 The asset of money in the bank is reduced by £500 whilst an
 additional asset of stock to a value of £500 is received.
 RESULT 2

<u>BALANCE SHEET</u>			
ASSETS		CAPITAL & LIABILITIES	
Bank	3500	Capital	5000
Machinery	1000		
Stock	500		

EACH SIDE STILL TOTALS £5000

TRANSACTION 3 The firm buys some more stock for re-sale for £300, but this time it buys the goods on credit. In other words, it will receive the goods now but pay for them at a later date.

EFFECT 3 The asset of stock is increased by £300. Since the goods were bought on credit, the business has now acquired a LIABILITY in the form of a CREDITOR (someone owed money by the business) in the sum of £300.

RESULT 3

<u>BALANCE SHEET</u>			
ASSETS		CAPITAL & LIABILITIES	
Bank	3500	Capital	5000
Machinery	1000	Creditor	300
Stock	800		

Because the firm has now acquired a liability, the total of each side is no longer £5000. However, notice that both sides still balance!

TRANSACTION 4 The firm borrows £500 cash from H Melford

EFFECT 4 The firm acquires an additional asset of £500 CASH and at the same time acquires an additional liability in the sum of £500.

RESULT 4

<u>BALANCE SHEET</u>			
ASSETS		CAPITAL & LIABILITIES	
Bank	3500	Capital	5000
Cash	500	Loan	500
Machinery	1000	Creditor	300
Stock	800		