BALANCE SHEET STATEMENT: CONCEPT AND PRINCIPLES

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Abstract: *This article provides a practical analysis of the practical application of balance sheet statement and the problems in the transition to international financial reporting standards and ways to overcome them.*

Keywords: *international financial reporting, balance sheet, international financial reporting standards, business, investment.*

An important component of manager–owner communication is the firm's financial statements. Firms organized as proprietorships or partnerships are not required to prepare financial reports or statements except for tax purposes. Of course, proprietors and partners must gather financial data so as to be able to evaluate their financial performance over time. Requests for bank loans need to be accompanied by recent financial statements, too. In contrast, companies organized as corporations are required to prepare financial reports annually for the benefit of their shareholders. Public corporations are required to fi le annual reports with the SEC. An annual report contains descriptive information on operating and financial performance during the past year, a discussion of current and future business opportunities, and financial statements that provide a numerical record of financial performance. Usually, financial highlights are provided on the first page or two, followed by a letter to the stockholders by the fi rm's chairman of the board and chief executive officer (CEO). The CEO summarizes the financial results for the year and identifies the fi rm's strengths, such as employee talents and the size of its customer base. After the CEO's letter, most companies describe their current business areas, future opportunities, and financial goals, such as a target return on equity or earnings growth rate. Management provides detailed notes to these financial statements. Annual reports, typically, provide a five-year or ten-year summary of selected financial data for the firm.

The balance sheet is a statement of a company's financial position as of a particular date, usually at the end of a quarter or year. Whereas the income statement reflects the firm's operations over time, the balance sheet is a snapshot at a point in time. It reveals two broad categories of information:

(1) the assets, or the financial and physical items owned by a business,

(2) the claims of creditors and owners in the business assets.

The creditors' claims, which are the financial obligations of the business, are referred to as liabilities. The company's equity is the funds supplied by the owners and represents their residual claim on the fi rm. In addition to providing a snapshot of a fi rm's financial condition, the balance sheet reveals much of the inner workings of the company's financial structure. The various types of assets indicate the results of recent business operations and the capacity for future operations. The creditors' claims and the owners' equity in the assets reveal the sources from which these assets have been derived. The term "balance sheet" indicates a relationship of equality between the assets of the business and the sources of funds used to obtain them that may be expressed as follows: Assets = Liabilities + Owners' equity This "balance sheet equation" or "accounting identity" shows that every dollar of a fi rm's assets must be financed by a dollar of liabilities (typically some type of credit or borrowing), balance sheet statement of a company's financial position as of a particular date, usually at the end of a quarter or year assets financial and physical items owned by a business liabilities creditors' claims on a firm, which are the financial obligations of the business equity funds supplied by the owners and represents their residual claim on the firm Business Organization and Financial Data a dollar of owner's equity, or some combination of the two. The fi rm's asset total shows what the fi rm owns; the total of liabilities and equity shows what the fi rm owes to its creditors and owners. The current assets of a business include cash and other assets that are expected to be converted into cash within one year. Current assets thus represent the working capital needed to carry out the normal operations of the business. The principal current assets of a business are, typically, its cash and marketable securities, accounts receivable, and inventories. Cash and marketable securities include cash on hand and cash on deposit with banks; marketable securities, such as commercial paper issued by other firms; and U.S. government securities in the form of Treasury bills, notes, and bonds. Accounts receivable, generally, arise from the sale of products, merchandise, or services on credit. The buyer's debts to the business are, generally, paid according to the credit terms of the sale. Some fi rms have notes receivable, which are written promises by a debtor of the business to pay a specified sum of money on or before a stated date. Notes receivable may come into existence in several ways. For example, overdue accounts receivable may be converted to notes receivable at the insistence of the seller or upon special request by the buyer. Notes receivable may also occur as a result of short-term loans made by the business to its employees or to other persons or businesses. The materials and products that a manufacturing firm has on hand are shown as inventories on the balance sheet. Generally, a manufacturing fi rm categorizes its inventories in terms of raw materials, goods in the process of manufacture, and finished goods. Sometimes, the balance sheet will reveal the amount of inventory in each of these categories. Fixed assets are the physical facilities used in the production, storage, display, and distribution of the products of a fi rm. These assets normally provide many years of service. The principal fixed assets are classified into two categories: (1) plant and equipment and (2) land. Intangible assets, which are assets you cannot see or feel, are accounted for on the balance sheet as they are created as the firm conducts business. Liabilities are the debts of a business. They come into existence through direct borrowing, purchases of goods and services on credit, and the accrual of obligations, such as wages and income taxes. Liabilities are classified as current and long-term. The current liabilities of a business may be defined as those obligations that must be paid within one year. They include accounts payable, notes payable, and accrued liabilities that are to be met out of current funds and operations. Accounts payable are debts that arise primarily from the purchase of goods and supplies on credit terms. Accounts payable arising from the purchase of inventory on credit terms represent trade credit fi nancing as opposed to direct short-term borrowing from banks and other lenders. An account payable shown on one firm's balance sheet appears as an account receivable on the balance sheet of the fi rm from which goods were purchased. A note payable is a written promise to pay a specifi ed amount of money to a creditor on or before a certain date. The most common occurrence of a note payable takes place when a business borrows money from a bank on a short-term basis to purchase materials or for other current operating requirements. Current liabilities that refl ect amounts owed but not due as of the date of the balance sheet are called accrued liabilities, or accruals. The most common forms of accruals are wages payable and taxes payable. These accounts exist because wages are, typically, paid weekly, biweekly, or monthly and income taxes are paid quarterly.

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