

The Sole Trader Vertical Balance Sheet

The accounting equation

The accounting equation should always be remembered as the cornerstone of the accounting system:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

The Balance Sheet is just a rearrangement of this important equation.

$$\text{Non-Current Assets} + \text{Current Assets} = \text{Capital} + \text{Liabilities}$$

$$\text{N.-C. A.} + \text{C. A.} = \text{Capital} + \text{Current Liabilities} + \text{Non-Current Liabilities}$$

$$\text{N.-C. A.} + \text{C. A.} - \text{C. L.} - \text{N. C. L.} = \text{Capital}$$

New Capital Calculation

At the end of the financial year the Sole Trader will have to recalculate capital depending on whether they have made a Net Profit or Loss. It will also be necessary to deduct any withdrawals (Drawings) made.

$$\text{New Capital at year end} = \text{Old Capital at year beginning} + \text{Net Profit} - \text{Drawings}$$

$$\text{New Capital at year end} = \text{Old Capital at year beginning} - \text{Net Loss} - \text{Drawings}$$

Example:

Capital (1 January) = \$327,000

Net Profit (31 December) = \$13,336

Drawings (31 December) = \$336

$$\text{New Capital at year end} = \text{Old Capital at year beginning} + \text{Net Profit} - \text{Drawings}$$

$$\text{New Capital at year end} = \$103,000 + \$13,336 - \$336$$

$$\text{New Capital at year end (31 December)} = \$116,000$$

No double entry in balance sheets

It may seem very strange to you to learn that the balance sheet is **NOT** part of the double-entry system. In other words, the Balance Sheet is not a 'T' account.

In drawing up a balance sheet we do not transfer anything from the individual 'T' accounts. All we do is list the assets, capital and liabilities balances so as to form a balance sheet. Nothing is entered in the individual accounts.

If you see the word 'Account', you will know it is part of the double-entry system. If the word 'Account' cannot be used then it is not part of the double-entry system. For example the Trial Balance and the Balance Sheet are not part of the double-entry.

Balance Sheet Layout

The users of the balance sheet do not want all the items shown in any order. They will need to have the information laid out in a clear format so that it will be easier to understand.

Accountants within the UK generally keep to one format so that people such as bank managers and investors can easily compare figures between firms within the same industry. The layout used divides the accounting equation in to distinctive headings:

1- Assets

Assets are divided in to two categories:

One) Fixed or Non-Current Assets → Fixed assets are those assets used by the business that are of long a long life period. In addition these assets are never bought with the intention of resale. For example buildings, machinery, motor vehicles, fixtures and fittings are considered to be fixed assets.

Fixed assets are listed starting with those the business will keep the longest, down to those that will not be kept for so long. For instance:

Fixed Assets
1- Land and Buildings
2- Fixtures and Fittings
3- Machinery
4- Motor Vehicles

Two) Current Assets → Current assets are cash in hand, cash at bank. Stock and debtors. They are listed separately because they are seen as the working part of the firm.

Current assets are listed starting with the asset furthest away from being turned into cash, finishing with cash itself. The easier it is for a firm to change the asset into cash the more *Liquid* it is said to be. For instance:

Current Assets
1- Stock
2- Debtors
3- Cash at bank
4- Cash in hand

A common misconception amongst students is that stock is more easily turned into cash than debtors. In fact this is not true as in the worst case scenario debtors debts can be sold to factoring companies for an agreed amount. In return the factoring company gains by recovering more money from the debtor than it has paid for the rights to collect the debt.

2- Capital and Liabilities

The order on the other side of a horizontal style balance sheet is:

- *Capital*
- *Non-Current Liabilities or Long-term liabilities* → for instance, loans which do not have to be repaid in the near future (Over one year).
- *Current Liabilities* → items to be paid within the financial year (12 months).

A vertical drawn up balance sheet

Fixed Assets + Current Assets - Current Liabilities – Non-Current Liabilities = Capital
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A. Step 1 - A Vertical Balance Sheet (FA + CA – CL – NCL)

B Swift

Balance Sheet as at 31 December

<u>Non-Current or Fixed Assets</u>	Historic Cost	Depreciation	Net Book Value
	\$	\$	\$
Land & Buildings	100,000	-	100,000
Fixtures & Fittings	50,000	20,000	30,000
Machinery	80,000	10,000	70,000
Company Vehicles	40,000	30,000	<u>10,000</u>
			210,000
<u>Current Assets</u>			
Stock	3,000		
Debtors	10,000		
Bank	15,000		
Cash	<u>2,000</u>		
		30,000	
Less <u>Current Liabilities</u>			
Creditors	8,000		
Short-term Loan	<u>4,000</u>		
		<u>12,000</u>	
Working Capital			<u>18,000</u>
			228,000
Less <u>Non-Current Liabilities</u>			
Long-Term Loan (Mortgage)			<u>112,000</u>
			<u>116,000</u>

B. Step 2 - A Vertical Balance Sheet (FA + CA – CL – NCL = Capital)**B Swift****Balance Sheet as at 31 December**

<u>Non-Current or Fixed Assets</u>	Historic Cost \$	Depreciation \$	Net Book Value \$
Land & Buildings	100,000	-	100,000
Fixtures & Fittings	50,000	20,000	30,000
Machinery	80,000	10,000	70,000
Company Vehicles	40,000	30,000	<u>10,000</u>
			210,000
<u>Current Assets</u>			
Stock	3,000		
Debtors	10,000		
Bank	15,000		
Cash	<u>2,000</u>		
		30,000	
Less <u>Current Liabilities</u>			
Creditors	8,000		
Short-term Loan	<u>4,000</u>		
		<u>12,000</u>	
Working Capital			<u>18,000</u>
			228,000
Less <u>Non-Current Liabilities</u>			
Long-Term Loan (Mortgage)			<u>112,000</u>
			<u>116,000</u>
<u>Financed by</u>			
Opening Capital			103,000
Add Net Profit			<u>13,336</u>
			116,336
Less Drawings			<u>336</u>
			<u>116,000</u>