

# AccountAble

Balance Sheet

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A Balance Sheet is, to a true accountant, the crowning glory of an year's hard work. To an auditor, it is the beginning of an exciting hunt.

What does a Balance Sheet mean to you — a piece of paper with meaningless figures? An annual ritual to keep the authorities and donors happy?

If you say yes, you are probably right. Many Balance Sheets are the result of careless or 'creative' accounting.

But not all. An honest Balance Sheet can give you invaluable insights into an organization. To find out how, read on...

## *How to read a Balance Sheet*

Quite simply, the Balance Sheet is a sheet of Balances to be carried forward to next year. However, accountants are rarely satisfied with simple things. They have divided the Balance sheet into two parts: Assets and Liabilities. To make things more complicated, they offer you two forms of Balance Sheet: the traditionally Horizontal and the trendy Vertical (See pages 2 & 3). But the Balance sheet is merely one part of the Final Accounts.

**Final Accounts:** Final Accounts are also called Financial Statements. Apart from the Balance Sheet, there are two other statements which form the Final Accounts: 'Income & Expenditure Account' and 'Receipts & Payments Account'. All three are prepared at the end of each financial year. In India, the financial year now is uniform and runs from 1st April to 31st March. In other countries, the financial year varies.

**Audit Report:** In addition to these three, there is an important statement called the 'Audit Report'. The audit report contains comments of the auditor regarding the truth and fairness of the first three statements. The Audit Report is prepared by an independent auditor (normally a Chartered Accountant).

**Income & Expenditure Account:** The Income & Expenditure Account is like an activity report. It tells you the income earned during one particular year (e.g. 1st April 1996 to 31st March 1997). It also shows all the expenses for that year. For IGPs, this is called a Profit & Loss Account.

**Receipt & Payment Account:** The Receipt & Payment Account is also like an Income & Expenditure Account. But there are two important differences: one, it includes capital transactions (like loans taken and assets purchased) *during the year*; and, two, it shows only those transactions where cash or cheque has been given or received during the year.

**Balance Sheet:** The Balance Sheet is like a status report. It will tell you what were the assets and liabilities of the NGO on, say, 31st March 1997. It will show all their assets (buildings, vehicles, investments, cash in hand, bank balances). If the NGO has taken loans these will also be shown here. The Balance Sheet will also show you whether the NGO has a Corpus or Endowment Fund. Other things to look for:

**Dynamic or Stable:** You can often tell the age of an organization by its Balance Sheet. As it grows older, its Balance Sheet grows heavier. Assets acquired for operations over the years get accumulated in the Balance Sheet. The organization's need for a secure future leads to a larger corpus. But insecurity is often a spur to action. Once there is a feeling of stability, the organization becomes less dynamic. This is reflected by the less active Income & Expenditure Account.

**How much cash:** Cash in hand is important for day to day expenditure. But large amount of cash increases risk of theft and misuse. Normally a cash balance for three days' payments is sufficient. A larger balance may mean unusual circumstances (planned purchase of land), several field offices, lack of planned withdrawals or even a partially fictitious cash balance.

**Bank Balance:** Money lying in a savings account or current account is no good for anyone except the Bankers. Good financial management will show up in small bank balances (sufficient for a month or 45 days), with the rest of the money lying in short term bank deposits. Most funding agencies now accept this so long as the program is not affected.

**Ratio Analysis:** While the word 'ratio' has links to the word 'rationality', some of the ratio analysis can be quite hilarious and irrational (see 'Business India Index'). Ratio analysis means analyzing a relationship between two figures when there *is* a relationship.

*You call this a Balance Sheet? Why, even a child could understand it!*



(Continued on page 4)

# The Horizontal Balance Sheet

Most NGO Balance Sheets are prepared in the Horizontal form. This has two sections: right and left. Assets are shown on the right side; liabilities are shown on the left. There is an interesting history to this. Traditionally, left has been considered evil: at one point in Europe's history, left handed persons were thought to be witches and magicians and burnt at the stake. As we all know, all liabilities are also 'evil' — these are therefore shown on the left side of the Balance Sheet.

**Assets:** All the assets which you own are put on the Right Hand side. Secondly, these are put in a descending order of 'durability' or 'ease of realization'. This means 'Land' comes right on top. 'Cash in Hand' comes right at the bottom. Buildings, equipment, furniture, debtors, recoverable advances, investments, bank balances come somewhere in between.

**Fictitious Assets:** The last line shows the total of all the assets. But watch out for the 'fictitious assets'. These should be deducted from the total of assets side, if you want to make any sense out of the Balance Sheet. Examples of fictitious assets are: 'accumulated deficit'; 'Miscellaneous expenditure remaining to be written off'. These are normally shown at the bottom, below 'cash in hand'.

**Liabilities:** On the left side, the most pressing liabilities are put at the bottom: these include bills payable, creditors, provision for expenses. Above these come short term 'unsecured loans' taken by you. Going upwards, you then put the 'secured loans' taken from people. Then come the Endowment Funds. Corpus comes right at the top: this is a notional figure and shows the net worth of the organization.

The net worth of Lok Jagran Manch. Don't rely too much on this figure — generally it gives the wrong picture because of accounting policies.

Title tells you that this is Lok Jagran Manch's Balance sheet. This one shows the position on the evening of 31st March 1997.

On 31.3.97, LIM's total fixed assets were Rs.2.45 lacs. Get breakup of these assets from schedule A, attached to the Balance Sheet.

**Balance Sheet of Lok Jagran Manch as at 31st March 1997**

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Trust Fund:		Fixed Assets (schedule A)	245,670
Opening Balance	200,720	Endowment Investments	730,445
Add: This year's surplus	50,450	Revolving Fund Loans	242,600
	251,170	Other loans	175,000
Endowment Fund	1,000,000	Grants receivable	315,270
Revolving Fund	400,000	Advances recoverable	8,340
Unspent grants	29,075	Cash in Bank	26,995
Loan from Secretary	50,000	Cash in Hand	2,570
Sundry creditors	12,145		
Provision for Audit Fees	4,500		
Total	1,746,890	Total	1,746,890

Value of investments made out of the Endowment Fund of Rs.10 lacs (see liabilities side)

Money on loan to beneficiaries out of Revolving Fund of Rs.4 lacs

Money spent on projects for which grants are yet to be received

Lok Jagran has total assets worth Rs.17.46 lacs

Funds for specific purpose. See assets sides to check how these are utilized by your organization

Grants not fully spent as yet

This means that Lok Jagran is following 'accrual accounting'.

What do these loans mean?

Why was this loan taken? Is it a genuine transaction?



When accountants are asked for the result of adding one and two, the following may occur:

- A newly qualified accountant may need to refer to the senior partners to see if there is a previous ruling on what the answer might be.
- A long-established accountant may take a year to arrive at an answer and will be unable to explain how it was derived.
- A professional accountant may respond with a question: 'What sort of a figure did you have in mind, sir?'

*Nigel Rees: Guinness Book of Humorous Anecdotes*



A Balance Sheet Artist...

## The Vertical Balance Sheet

Some people find this easier to prepare: you do not need a double-spread sheet for typing this. Most companies use this format — however, it is rarely seen in NGOs. The vertical form has given up its prejudice against left handed people — there are no left or right sides to this. It has two sections: 1. Sources of funds and 2. Application of Funds.

**Application:** The second section (Application of Funds) shows the assets of the organization in descending order of durability. Fixed assets come first, Investments second and current assets come third. Current assets include debtors, advances, stocks, cash at banks, cash in hand.

However, the current liabilities (bills payable, creditors) are deducted from the current assets to give a figure of net current assets. Only the net figure is shown in the total column.

The fictitious assets ('accumulated deficit'; 'Excess of expenditure over income') are shown at the absolute bottom, below the current assets.

**Sources:** Going back to the first section, this shows the sources of these funds. At the bottom of this section, you have your unsecured loans (received), preceded by secured loans (received). Above this come the Endowment Funds. Right at top is the corpus, which is a difference between the total assets reduced by loans taken.

In many ways, vertical form is easier to understand. The information is more organized and it is easier to work out ratios. Being typed on single sheets means less complications in xeroxing, filing and physical handling.

Unfortunately, in several states (e.g. Gujarat and Maharashtra), local regulations do not allow NGOs to use the vertical format.

### Balance Sheet of Lok Jagran Manch as at 31st March 1997

Sources of Funds	Rs.	Rs.
<i>Trust Fund:</i>		
Opening Balance	200,720	
Add: This year's surplus	50,450	
		251,170
Endowment Fund		1,000,000
Revolving Fund		400,000
<b>Total</b>		<b>1,651,170</b>
<b>Application of Funds</b>		
Fixed Assets (schedule A)		245,670
Endowment Investments		730,445
Revolving Fund Loans		242,600
<i>Current Assets, Loans &amp; Advances</i>		
Other loans	175,000	
Grants receivable	315,270	
Advances recoverable	8,340	
Cash in Bank	26,995	
Cash in Hand	2,570	
Total Current Assets (A)	528,175	
<i>Less: Current Liabilities</i>		
Loan from Secretary	50,000	
Unspent grants	29,075	
Sundry creditors	12,145	
Provision for Audit Fees	4,500	
Total Current Liabilities (B)	95,720	
Net Current Assets (A-B)		432,455
<b>Total</b>		<b>1,651,170</b>

Expenditure on other projects may have been funded from Secretary's loan and Endowment Fund

Where is the missing Revolving Fund of Rs.1.6 lacs

Here!

How 16.5 lacs have been 'sourced' and 'applied' (invested)

Other loans and Grants receivable make up bulk of the Current Assets

Your views, comments and questions are welcome. Please send these to:

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Balance Sheets often look better with some window dressing...

## ...Ratio Analysis

(Continued from page 1)

For example, there is a relationship between amount of work done and infrastructure needed. So you can see the relationship between value of fixed assets and amount of program expenditure. This can be done by dividing the total program expenditure by the value of fixed assets. A ratio of '1' will raise eyebrows while a ratio of '5' may be quite acceptable.

*Window dressing:* Very common in the corporate sector. Virtually unknown in the voluntary sector — it prefers to keep the windows closed rather than resort to dubious window dressing!

**Notes to Accounts:** Some of the figures in the Final Accounts often need additional explanation. These are given in the Notes to Accounts. Read these for better understanding of the Balance Sheet. Often important accounting Policies are also given here.

### More tips on reading a Balance Sheet:

- If the Balance Sheet is not consolidated, it will carry some comment below the heading (such as FCRA Accounts; CRY Project etc.).
- It is also useful to compare this year's figures with last year. See if some of the amounts have remained unchanged.
- If creditors or debtors appear on the Balance Sheet, they are probably following Mercantile Basis (accrual) of accounting.
- Revolving Fund loans are often treated as expenditure in accounts (though not in reality). In such a case, no such loans will appear on the assets side.
- Grants are sometimes not taken to Income & Expenditure Account — balance of amount received and spent is shown in the Balance Sheet.
- Fixed Assets are sometimes charged off to program expenditure.
- Surplus shown in the Income & Expenditure is often due to expenditure on fixed assets — it is not a real saving of funds.
- Endowment Funds are often not properly set aside on the Liabilities side but merged with surplus for the year.



### References:

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