Balance Sheets of Limited Companies

A Plea for Greater Detail

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Those of us who read the Financial Press will have noticed during the last few years that a good deal of criticism has been directed to the balance sheets of limited companies, whose sole desire seems to be to give to their shareholders and creditors as little information as possible. That there is cause for this complaint I think none of us will deny, because, if we closely examine the balance sheets which are issued to shareholders, we must confess that it is impossible for a banker or business man to form a clear idea as to whether it is wise for him to invest in the company whose balance sheets are submitted to him.

It was pointed out in *The Times Financial and Commercial Supplement* of some years ago "That to the average investor the balance sheet of a limited company in which he is financially interested generally appears to be a miracle of diabolical ingenuity specially designed to bewilder the inquirer, and to obstruct any desire that he may entertain to arrive at a correct conclusion concerning the position of the property which it ostensibly purports to make clear. The first stumbling block is the position of the capital amongst the liabilities on the debit side, for, as the puzzled observer is apt to ask, if the company does not possess its own capital, what does it possess? And if the capital is a possession, it is obviously an asset, and ought to be on the other side of the account."

If it is necessary for *The Times* to call attention to this matter, there is no doubt a general feeling that balance sheets of limited companies should contain more information and greater detail than some of them do.

Sec. 26 of the Companies (Consolidation) Act sets out that the annual list and summary must be filed once at least in every year, and Subsec. (3) states that—

> "The summary must also (except where the company is a private company) include a statement made up to such date as may be specified in the statement, in the form of a balance sheet, audited by the company's auditors, and contain a summary of its share capital, its lilabilities, and its assets, giving such particulars as will disclose the general nature of those liabilities and assets, and how the value of the fixed assets have been arrived at; the balance sheet need not include a statement of profit and loss."

Now, from this, it is clear that it was intended by by the framers of the Act that—

> "the summary of its share capital, its liabilities and its assets, giving such particulars as will disclose the general nature of those liabilities and assets, and how the value of the fixed assets have been arrived at,"

should set out clearly, in a summarized form, what the liabilities and assets consisted of, and that it should be such a summary as would enable the shareholder to understand what his property was composed of, and the values of the various kinds of assets. Do all the balance sheets which have recently been issued fulfil the obligation laid down in this section; and has the shareholder creditor, or prospective investor, any cause to complain?

In my opinion, a large number of balance sheets now issued do give this information, but there are many which do not. The questions which bewilder the investor on the contemplation of a balance sheet are based on sound common sense, but it is difficult to answer the arguments laid down in the extract read from *The Times*, because it must be borne in mind that every shareholder or investor is not an accountant or expert bookkeeper, consequently he does not understand why certain items appear in the balance sheet. To the uninitiated it would appear that the contention that assets, such as preliminary expenses, advertising, goodwill, and loss on trading, have no right to appear as such, and that the company should be debited with the amount of its capital and profits earned is misleading. Now, this depends to some extent on the point of view from which the balance sheet is considered. Balance sheets of commercial concerns are not statements which show in simple form the actual assets and liabilities of the concern. The expression "balance sheet" has a technical meaning quite apart from the popular notion that it is simply a statement of assets and liabilities, although they are frequently almost identical. The general misapprehension with regard to balance sheets is due to the fact that it was formerly frequently the practice to place the words "Liabilities" and "Assets" at the head of every balance sheet issued, in place of the ordinary abbreviations "Debtor" and "Creditor," a mischievous practice which has not even at the present time altogether disappeared. A balance sheet is, strictly speaking, a sheet of balances grouped together in debit and credit form, and not necessarily a list of liabilities and assets.

The balance sheet is, or should be, an exposition of its affairs drawn up from the point of view of the company. The company has received the capital from the shareholders, and owes it to them, and has to account for it to them at any time, and return it to them if it can. It is, no doubt, confusing to any one who is not a trained accountant to understand why the items: preliminary expenses, goodwill, advertising, and loss on trading, should be brought in as assets; but I am of opinion that matters would be made clearer if the headings