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# LET'S LOOK AT THE BALANCE SHEET

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*Senior accountants and managers must know how to read and analyse a balance sheet as part of their routine work. But many of the younger members have little opportunity to acquire this skill.*

*Mr. Wilson has written the article, not for the expert, but for the person with very little understanding of the subject.*

*The clarity and simplicity of his descriptions and his method of presentation bear witness, not only to his knowledge, but to the skill with which he has reduced a specialised subject to terms which can be understood by those without that knowledge.*

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# Let's Look at the Balance Sheet

### Part I—FORM AND CONTENTS

WHEN, for the first time, one examines a balance sheet there may appear amongst the common everyday commercial phrases such as Sundry Creditors or Cash at Bank, a number of other items whose titles do not, at a glance, convey their exact nature.

In an endeavour to explain the form and the items making up the usual balance sheet we will tell a hypothetical story of the growth of an enterprise.

Let us suppose that a young man by the name of Don Hope has, by one means or another, accumulated a sum of **£4000,** which, for safety, is deposited in his bank account. He has no liabilities; in other words he owes nothing, and has not other assets apart from a few personal effects.

Ignoring the few personal effects, let us make out a simple balance sheet to show his financial position at this stage:—

**Balance Sheet of Donald Hope as at 1st January, 1950**

| *Liabilities and Capital* | | *Assets* | |
|---|---|---|---|
| Liabilities . . . . . . | Nil | Cash at Bank . . . . | £4,000 |
| Capital . . . . . . | £4,000 | | |
| | £4,000 | | £4,000 |

And there it is, but perhaps it would be wise, before proceeding further, to consider "what is a balance sheet?"

Briefly, it lists the assets and liabilities of the individual or concern and sets out the equity of the proprietor(s) in the enterprise. This is the basic accounting equation, *i.e.* Assets — Liabilities = Equity.

The balance sheet may be likened to the photograph of the finish of a race—it reflects the financial position of the concern as at the particular time it is stated to be drawn up, just as if the flow of business, when moving past the stated point of time, has been frozen.

To be more specific, it has been defined as a classified summary of all the balances of the ledger accounts in a set of books kept by double entry (a debit for every credit), which remain open after all items affecting profit or loss have been transferred to the Profit and Loss Account, and the balance of the profit has either been transferred to Capital Account, or has been otherwise dealt with.

The date "as at" which the balance sheet is compiled should always be shown. It is important to know at what point of time the financial position of the concern was as stated. Balance sheet figures relating to a date more than a year earlier are often of little value other than for historical or comparative purposes.



The items appearing in this balance sheet are:—

*"Cash at Bank"*: This is the bank balance, at balance sheet date, according to the concern's cash book, after reconciliation with the bank statement. It includes outstanding cheques and is not necessarily the balance as shown by the bank statement at that date. All cheques issued are recorded in the cash book, but a number of them may not have yet been presented for payment at the bank. Charges made by the Bank (e.g. exchange, interest, etc.) not appearing in the cash book are discovered upon reconciliation of the bank statement and thereupon entered in the cash book.

*"Capital"*: This is the amount of money or value of the assets invested by the proprietor(s) in the business—it is the surplus of what the business possesses over what it owes.

Don had heard it said "you've got to speculate to accumulate" and, whilst being of a cautious nature on one hand, he felt on the other the urge of adventure, and so decided to invest his capital—represented solely by money in the bank—in a business venture.

After due consideration and some friendly advice Don purchased a well-situated block of land, upon which stood a newly erected brick lock-up shop in a new and growing suburb.

This little speculation set him back to the tune of **£750** for the land and a further **£2750** for the shop.

Over the past few years Don had made rather a name for himself in the cycling world, both at home and overseas, and, so whilst bathing in the glow of recent favourable publicity, he decided the bicycle sales and repair game was for him.

Of course, you just can't start this kind of business without some stock to sell or tools with which to do repairs, so Don got busy to do something about getting these essential things. He initially invested **£200** in stock (cycles, tyres, tubes, etc.) and a further **£150** in plant, tools, etc.

Let us now take a look at Don's balance sheet and observe the results of his speculation:—

**Balance Sheet of Donald Hope as at 1st February, 1950**

| *Liabilities and Capital* | | *Assets* | | |
|---|---|---|---|---|
| **Current Liabilities—** | | **Current Assets—** | | |
| Trade Creditors . . . . | £50 | Cash at Bank | £200 | |
| Proprietor's Funds— | | Stock . . . . | 200 | |
| Capital A/c . . . . | £4,000 | | | £400 |
| | | **Fixed Assets—** | | |
| | | Land & Bldgs. | £3,500 | |
| | | Plant, Tools, etc. | 150 | |
| | | | | £3,650 |
| | £4,050 | | | £4,050 |

One of the first things we notice is that the assets have been divided into two classes, namely, "Current" and "Fixed."

What is the significance of these terms?

"*Current*" is that category of assets which are acquired for the purpose of either re-sale in the form purchased or further processing and then re-sale for the age-old custom of making a profit. This category also includes assets which represent various stages of the conversion of stock into cash, *e.g.* Sundry Debtors, Work in Progress, etc.

"*Fixed Assets*" are those which have been purchased, not for re-sale, but for the purpose of producing, storing, distributing and otherwise processing raw materials and stock for sale or providing services for profit. (For example, in the case of a bus line its fleet of buses would be shown as a fixed asset). The term "fixed" relates to the nature of the investment of funds, it does not imply that the particular asset lacks mobility.

The new items that appear in this balance sheet are:—

*Stock* (or stock in trade): This heading covers all items held for sale or for further processing then sale. The valuation of this item is vitally important for trading account, and balance sheet purposes. The accepted rule for valuing stock is "the lower of cost or market value."

*Land and Buildings*: This is the book value of the land and buildings owned by the concern, which is normally shown at cost. However, depreciation may be written off the value of buildings.

*Plant, Tools, etc.*: Whilst in the category of "fixed assets" these items are not as permanent as land and buildings and their value in the balance sheet is usually stated at cost less any depreciation that has been written off.

*Trade Creditors*: This item represents the amounts owing to suppliers of goods to the concern.

Don has obtained credit for **£50** from a firm who supplied him with stock. If he had been required to pay cash for all his purchases then his bank balance would have been **£150**, instead of the **£200** shown.

His capital is still shown at **£4,000**, and no trading profit or loss has been made.

This may be called Don's "Formation Balance Sheet" as it is a statement of his financial position immediately prior to the commencement of trading.

In common with all balance sheets, this formation one discloses Don's equity in the enterprise—*i.e.*:—

Assets — Liabilities = Equity
£4,050 — £ 50 = £4,000.

From the start Don's business progressed favourably, and after five months' trading the end of the usual financial year arrived, namely 30th June, 1950.

The public accountant engaged by Don to attend to his accounting requirements drew up the Trading and Profit and Loss Accounts for the five months ended 30th June, 1950, and compiled Don's balance sheet as at the same date.

Before the balance sheet can be compiled certain adjustment entries must be made in the accounts and the profit (or loss) on trading ascertained for the period.



Firstly, let us look at the Trading and Profit and Loss Accounts for the five months' period.

**Trading and Profit and Loss Accounts for Five Months ended 30/6/1950**

| | | | |
|---|---|---|---|
| *Sales* | | | £2,500 |
| **Less** cost of goods sold— | | | |
| Stock, 1/2/1950 | £200 | | |
| Purchases | £1,950 | | |
| | £2,150 | | |
| Deduct stock 30/6/50 | 750 | | |
| *Cost of goods sold* | | | £1,400 |
| *Gross Profit* | £1,100 | | |
| **Marketing and Selling Expenses—** | | | |
| Wages | £315 | | |
| Advertising | £35 | | |
| | | 350 | |
| **Administration and General Expenses—** | | | |
| Salaries | £400 | | |
| Printing and stationery | 5 | | |
| Rates and taxes | 10 | | |
| Insurance | 5 | | |
| Light and Power | 7 | | |
| Telephone | 8 | | |
| Depreciation | 15 | | |
| Provision for bad debts | 7 | | |
| | | 457 | |
| **Financial Expenses—** | | | |
| Bank interest and charges | | 5 | |
| | | | 812 |
| NETT PROFIT | | | £288 |

The principal of arriving at the result for a given period of trading is to take from the total sales for the period the cost of the goods sold. This gives what is termed the "Gross Profit" and the account through which the entries are passed to enable such calculation is the "Trading Account."

In the case of a manufacturer, it is necessary to ascertain the cost of producing the goods made up for sale—this is done through a "Manufacturing Account" which, briefly, is constructed as follows:—

To the cost of raw materials used is added—

(i) wages expended directly on productive operations, and
(ii) expenses incurred directly or indirectly in connection with the factory (e.g. lighting, power, rent, depreciation of machines, etc.).

The resulting figure is the "Cost of Production." This item would appear in the trading account of a manufacturer instead of the item "Purchases" in the above Trading and Profit and Loss Account.

A manufacturer's balance sheet is set out similarly to that of any other merchant with the exception that in the case of a manufacturer the stock in trade may be set out in three categories, viz., Raw Materials, Work in process and Finished goods.

To ascertain the "net" result, all expenses and charges applicable to the period are taken from the "Gross Profit" and income from sources other than trading, *e.g.*, interest on investments, etc., added, the resulting figure being "Net Profit" (or, if the expenses, etc., exceed the gross profit plus other income, then there is a "net loss").

It was mentioned that before the balance sheet can be compiled certain adjustments have to be made, these are mainly:—

(1) *Prepayments*: Certain charges have to be paid in advance (*e.g.* telephone rental, insurance premiums). On balance date the Profit and Loss Account should only be charged with the portion of the rental, premium, etc., applicable to the period to which that account relates—in this instance five months. The unexpired portion of the rental or premium paid is treated as an asset and grouped with other items of this nature under the heading of "Prepayments" with the " Current Assets " in the balance sheet.

(2) *Charges accrued*: On the other hand, on balance date there will be certain charges or expenses accrued (*e.g.* wages, light and power) which have not been paid because the regular day for such payments has not come round. The actual amounts accrued are calculated and charged to the Trading and/or Profit and Loss Account. They are part of the cost of running the business during the period under review. Such items are grouped separately as " Accrued Charges " under the heading of " Current Liabilities " in the balance sheet.

(3) *Depreciation*: As mentioned previously, the fixed assets are acquired for the purpose of producing, storing, distributing and otherwise processing raw materials and stock for re-sale for profit. It will be realised that certain of these fixed assets will decrease in value because of:—

(i) Wear and tear (*e.g.* wear occasioned by constant use).
(ii) Obsolescence (*e.g.* machinery becoming out-of-date due to technological improvements).
(iii) Effluxion of time (*e.g.* running out of a lease).

It is only equitable, therefore, to charge to the Profit and Loss Account for any period the calculated (or estimated) value of the asset which has been used up during such period in production of the goods, etc., for sale, due to the above-mentioned factors.

(4) *Provisions, Reserves, etc.*: It is prudent to make provision for any loss that may either be contingent or certain to occur at a future date (*e.g.* provision for bad debts, provision for income tax) and set aside a portion of the profit where possible as a reserve to meet future contingencies. The amounts of such provisions are normally decided upon by management and charged against the profits before arriving at the net profit.

Now let us turn to the balance sheet:

**Balance Sheet of Donald Hope as at 30th June, 1950**

| *Liabilities and Capital* | | | *Assets* | | |
|---|---|---|---|---|---|
| Current Liabilities— | | | Current Assets— | | |
| Bank overdraft .. | £200 | | Cash .. .. .. | £10 | |
| Sundry creditors .. | 522 | | Debtors .. .. | 420 | |
| Accrued charges .. | 10 | | Stock .. .. .. | 750 | |
| | —— | £732 | Prepayments .. .. | 15 | |
| Proprietor's Funds— | | | | —— | £1,195 |
| Capital, 1/2/50 .. | £4,000 | | | | |
| Add profit .. .. | 288 | | Fixed Assets | | |
| | ——— | | Land and buildings | £3,500 | |
| | £4,288 | | Plant, tools, etc., | | |
| Less drawings .. .. | 150 | | (less depreciation) | 175 | |
| | —— | 4,138 | | —— | 3,675 |
| | | £4,870 | | | £4,870 |



On the Assets side of the balance sheet we have the following new items appearing:—

*Debtors*: This item represents the amount owing to the firm by customers who have been allowed credit, or, in other words, been permitted to " book up " their purchases instead of paying cash. The amount of this item shown in a balance sheet is normally the total book debts less any provision for bad debts and/or the amount of any bad debts written off during the period.

*Prepayments*: This item refers to items paid in advance as already mentioned.

It will be noticed that the value of the Plant, Tools, etc., has changed. How has the figure now shown been arrived at?

| | |
|---|---|
| The value of this item in the previous balance sheet was .. | £150 |
| From this amount, 10 per cent. depreciation has been written off | 15 |
| leaving .. .. .. .. .. .. .. .. .. | £135 |
| and during the period additional tools, etc., have been purchased at a cost of .. .. .. .. .. .. .. .. | 40 |
| making the value of Plant, Tools, etc., on balance sheet date.. | £175 |

(Of course reference would have to be made to the accounts to ascertain the amount of depreciation written off and new tools, etc., purchased during the period).

Now, turning to the other side of the balance sheet, we find the following new items:

*Bank Overdraft*: This is the amount of the bank overdraft plus outstanding cheques, etc., as shown by the firm's cash book after reconciliation with the bank statement.

*Accrued Charges*: This represents the total of expenses accrued although not actually due for payment as previously mentioned in dealing with the balance day adjustments.

It will also be seen that there is a change in the amount of the Proprietor's Funds. To his capital (or equity) as at the date of the previous balance sheet, there has been added the net profit earned during the period under review (as ascertained by the Trading and Profit and Loss Accounts) and deducted therefrom the total amount the proprietor has drawn out over the period in cash or goods (but excluding his salary of **£400**, which is charged to the Profit and Loss Account) in anticipation of the profit that was being earned. The resultant figure of **£4,138**, was then Don Hope's equity or capital in the enterprise on 30th June, 1950.

Now, let us jump on a year or two, and we find that the business is flourishing and that it has become a partnership. During 1952, Mr. I. B. Glory, who was the proprietor of a bicycle manufacturing business, entered into partnership with Don Hope to form the firm of Hope and Glory.

The joint venture was advantageous to both parties.

The basis of formation of the partnership was that Glory would bring in capital in the form of cash and/or stock to the value of £6,000, being the amount at which Hope's capital stood in his firm's balance sheet at the date the partnership deed was executed. Profits to be shared equally, and Hope to manage the business at a salary of **£1,750** per annum.

The partnership progressed, and its balance sheet as at 30th June, 1953, was as follows:—

**Balance Sheet of Hope & Glory as at 30th June, 1953**

| *Liabilities and Capital* | | |
|---|---|---|
| Current Liabilities— | | |
| Bank Overdraft .. | £1,432 | |
| Sundry Creditors .. | 3,220 | |
| Accrued Charges .. | 115 | |
| | | £4,767 |
| Deferred Liabilities— | | |
| I.B. Glory Loan A/c | | 2,300 |
| Proprietors' Funds— | | |
| Capital A/cs | | |
| D. Hope .. .. | £6,000 | |
| I. B. Glory .. .. | 6,000 | |
| | £12,000 | |
| Current A/cs | | |
| D. Hope .. .. | £275 | |
| I. B. Glory .. .. | 753 | |
| | | 13,028 |
| | | £20,095 |

| *Assets* | | |
|---|---|---|
| Current Assets— | | |
| Cash .. .. .. | £50 | |
| Debtors .. .. | 2,725 | |
| Stock .. .. .. | 5,375 | |
| Deposits .. .. | 50 | |
| Prepayments .. | 75 | |
| | | 8,275 |
| Fixed Assets— | | |
| Land and Buildings | £7,525 | |
| Plant, Tools, etc. .. | 1,730 | |
| Motor Vehicles .. | 1,315 | |
| | | 10,570 |
| Intangible Assets— | | |
| Goodwill .. .. | | 1,250 |
| | | £20,095 |

Now, what new items appear?

On the "Liabilities and Capital" side of the balance sheet we have a deferred liability, being the "Loan Account" of one of the partners. I.B. Glory has brought into the partnership further funds amounting to **£2,300.** So as not to alter the relationship of the capital accounts, and so that it may be withdrawn in part or whole at any time convenient to the business, it has been brought in as a "loan" and not capital. Undoubtedly, like all loans, it would earn an agreed rate of interest, which would be credited at stipulated intervals to I. B. Glory's current account in the partnership books.

You may well ask, "Why a deferred liability and not a current one?"

A deferred liability is one that would not normally require settlement on demand, or, say, within 12 months, as do trade creditors, etc. Fixed and long-term loans are usually shown under the heading of "Deferred Liabilities"— they are liabilities which will not have to be met in the immediate future, and so are not taken into consideration when ascertaining working capital (Current Assets less Current Liabilities equal Working Capital).

You will also notice that Proprietors' Funds are divided into two categories, namely, Capital Accounts and Current Accounts.

It is normal to keep the amount of each partner's capital in the business at a constant figure, and it is common (although this does not necessarily apply) for profits to be shared in proportion to the amount of capital supplied.

The current account is the one to which profits, interest, salary and other earnings are credited, and to which drawings and any charges are debited.

These current accounts may or may not bear interest according to the partnership deed.

On the "Assets" side a new current asset, "Deposits," has appeared. This item represents deposits made by the partnership with other organisations, *e.g.,* to Electricity Commission prior to the supply of power.

Among the fixed assets "Motor vehicles" appears. This amount represents the cost price of the motor vehicles less the amount of depreciation written off.



We now encounter the intangibles:—

In this balance sheet appears the item "Goodwill, **£1,250.**" This represents the value of the goodwill attaching to the old firm of Don Hope at the date of the partnership agreement between Glory and Hope. At that time, in assessing the equity Don Hope had in the old business, **£1,250,** was allowed as the amount mutually considered as the value of goodwill attaching to the old business. It is outside the scope of this article to enter into a description of the nature of goodwill and the methods and principles of valuing it. Suffice it to state one accountancy principle, namely—goodwill should not appear in the accounts of a concern unless it has been purchased. In this case, **£1,250** of the **£6,000** brought into the partnership by I. B. Glory was the purchase price of the assessed goodwill.

However, let us return to the narrative.

The partnership business continued to expand and, early in 1954, the partners realised that the step-up in production necessary to meet the increased demand for the firm's products would require a substantial investment in fixed assets which was beyond their personal resources.

The partners were advised to form an incorporated company for the purpose of raising the additional capital required and also to be in a position to make further approaches to the capital market if and when necessary. For this purpose, in conjunction with the other advantages of incorporation, they agreed to float the "Hope and Glory Company Ltd."

Thus the old firm ceased to exist and the company took its place.

The class of company that we will now be concerned with is that known as a "Limited Liability Company," which has its capital divided into shares of a fixed nominal amount. In this class of company the liability of the shareholder is limited to the amount (if any) unpaid on the shares he has taken or agreed to take in the company. He cannot be compelled to pay anything further after he has paid for his shares in full, even though the company may become insolvent and be unable to meet its liabilities.

The formation of "Hope and Glory Company Ltd." was successful and its business continued to progress steadily under the capable guidance of Mr. I. B. Glory, the managing director.

Its published balance sheet as at the 30th June, 1960, issued to the shareholders, was as follows:—

**Balance Sheet of Hope & Glory Company Ltd. as at 30th June, 1960**

| *1959* | | | |
|---|---|---|---|
| | *Authorised Capital—* | | |
| | 25,000 6% Preference Shares of £1 each .... .... .... .... | £25,000 | |
| | 50,000 Ordinary Shares of £1 each | 50,000 | |
| | 25,000 Employees' Shares of £1 each | 25,000 | |
| *£100,000* | | £100,000 | |
| | *Issued Capital—* | | |
| *£10,000* | 10,000 6% Preference Shares of £1 each | .... | £10,000 |
| *30,500* | 30,000 Ordinary Shares of £1 each .... | .... | 30,500 |
| *4,050* | 5,050 Employees' Shares of £1 each .... | .... | 5,050 |
| *£44,550* | **Issued Capital** .... .... .... | .... | **£45,550** |

| Previous Year | | | | |
|---|---|---|---|---|
| | *Less*—Uncalled Capital— | | | |
| 2,025 | 10/- per share on 5,050 Employees' Shares | | | 2,525 |
| £42,525 | **Paid-up Capital** .... .... .... .... | | | **£43,025** |
| 295 | Profit and Loss Appropriation A/c. .... .... | | | 1,235 |
| 2,500 | Premium on Shares .... .... .... .... | | | 2,500 |
| 5,000 | General Reserve .... .... .... .... .... | | | 10,000 |
| £50,320 | **SHAREHOLDERS' FUNDS** .... .... | | | £56,760 |
| | **These Funds are represented by:—** | | | |
| | *Fixed Assets—* | | | |
| £30,753 | Land and Buildings at cost .... | | £30,753 | |
| 14,867 | Plant and Equipment at cost .... | | 20,540 | |
| £45,620 | | | £51,293 | |
| £4,785 | *Less Depreciation written off* .... | | 6,063 | |
| £40,835 | **Net Fixed Assets** .... .... | | | £45,230 |
| | *Investments—* | | | |
| 1,015 | Shares in Other Companies at cost | | | 1,015 |
| £41,850 | | | | £46,245 |
| | *Current Assets—* | | | |
| £12,424 | Stocks on hand, at cost or market value, whichever is the lower | £15,523 | | |
| 6,327 | Trade and Other Debtors after making provision for doubtful debts .... .... | 9,784 | | |
| 235 | Cash on hand .... | 252 | | |
| 154 | Payments in advance .... | 176 | | |
| £19,140 | | | £25,735 | |
| | *Less—* | | | |
| | *Current Liabilities and Provisions—* | | | |
| 2,109 | Bank Overdraft .... | £539 | | |
| 1,053 | Bills Payable .... .... | 754 | | |
| 5,002 | Trade and Other Creditors .... .... | 4,451 | | |
| 1,155 | Provision for Taxation | 1,225 | | |
| 2,226 | Provision for Dividend | 2,251 | | |
| 625 | Provision for Long Service Leave .... .... | 1,000 | | |
| £12,170 | | | £10,220 | |
| 6,970 | **Net Current Assets** | | | £15,515 |



| Previous Year | | | |
|---|---|---|---|
| | *Intangible Assets—* | | |
| 5,000 | Goodwill .... .... .... .... | | 5,000 |
| £53,820 | | | £66,760 |
| | *Deduct—* | | |
| | *Long-term Liabilities—* | | |
| — | Loan on Mortgage .... .... .... | £6,500 | |
| £3,500 | Debentures—6 1/8 %—35 of £100 each fully paid. Redeemable 1970 (Secured by Trust Deed dated 4th Jan., 1955) .... .... .... | 3,500 | |
| | | | 10,000 |
| £50,320 | **NET ASSETS** .... .... .... | | **£56,760** |

*Contingent Liabilities:* There are contingent liabilities for Bank Guarantees and partly-paid shares.

The first thing that we notice about this balance sheet is the changed form of presentation. This is the modern version or statement form as opposed to the older " T " form of balance sheet presentation. The statement form of setting out the balance sheet is not common to companies only, it may be applied to the balance sheet of any concern or sole trader; and, of course, a company is under no obligation to use the modern form of balance sheet presentation.

Those who favour the modern version contend it allows greater detail and description of the various items to be given, and that it is more easily understood by laymen shareholders and others not versed in accounting techniques.

What new items appear here?

Firstly, we have the statement setting out the "*Authorised Capital*" of the company and details of the numbers, classes and denominations of the various shares into which it is divided. These particulars are as set out in the company's Memorandum of Association (which was registered upon its incorporation) and also include any subsequent amendments thereto.

The "*Issued Capital*" of the company then follows. It sets out in similar detail the number of each class of share issued. In the case of partly paid shares, the amount unpaid is deducted, particulars being shown under the heading "Uncalled Capital." For example, there are 5,050 employee shares of a nominal value of £1 each, on which only 10/- per share has been called up and paid.

Should certain shareholders have not paid a "call" when due on the shares held by them, the total of such amounts unpaid is shown as "Calls in Arrears," and is also deducted from the total of Issued Capital.

The net total represents the amount of subscribed capital that has been paid up by the shareholders.

"*Premium on Shares*": This item represents the amount obtained by the company by the issue of certain shares at a price above their par or nominal value.

For example: £1 ordinary shares issued at 25/-. When received by the company, each 25/- is subdivided in its books as follows:—

20/- to Issued Capital account.
5/- to Premium on Shares account.

The "*General Reserve*" represents amounts set aside or appropriated from profits over the past years to meet (if and when necessary) any unforeseen contingencies that may rise.

"*Profit and Loss Appropriation A/c*" is really a further subdivision of the Profit and Loss Account wherein net profit, together with any balance brought forward, is appropriated to Provision for Taxation, Dividends, Transfers to General Reserves, etc. The balance not specifically appropriated is carried forward, and it is this balance that is shown in the balance sheet.

The total of the foregoing items indicates the funds of the shareholders invested in the enterprise.

The next stranger we find is under the heading, "Investments," and represents the cost of shares purchased in the name of Hope and Glory Company Ltd., in other companies for trade association or other reasons.

Amongst the Current Liabilities we encounter "*Bills Payable.*" This item relates to promissory notes and/or bills of exchange made or accepted by the company which are payable at a future fixed date. This is another method of financing purchase of stock, plant, etc.

The nature and purpose of the "Provisions" have already been dealt with. In the case of the "*Provision for Dividend,*" a little explanation may be helpful. This item represents the amount of dividend recommended by the directors which, to be legally payable, must be adopted by the shareholders at the annual meeting, which will be held in, say, August, 1960. This item is made up as follows:—

| | | | | | | |
|---|---|---|---|---|---|---|
| 6% | Dividend on | 10,000 | Preference Shares | £1 f.p. | .... .... | £600 |
| *5% | ,, ,, | 30,500 | Ordinary ,, | £1 f.p. | .... .... | £1,525 |
| *5% | ,, ,, | 5,050 | Employees ,, | £1, paid to 10/- | | †£126 |
| | | | | | | £2,251 |

**Note:* Rate of dividend recommended by the directors.

†As is normal, the dividend is declared as a percentage of the "paid-up" value of the share, *i.e.,* 5% of £2,525 = £126.

Finally, we come to the "Long Term" or "Deferred" Liabilities. The "*Loan on Mortgage*" speaks for itself. It is a fixed loan against security of a mortgage over, say, freeholds.

In the case of the *"Debenture,"* let us quote a simple definition: "A debenture is a document under the seal of the company binding it to pay a certain sum of money at a determinable or indeterminable date, with interest thereon, payable at fixed intervals, with or without a charge on the property of the company as security for payment."

The debenture holder is therefore a creditor of the company and not a shareholder.



The company has, by this method, obtained finance to the extent of £3,500 for a fixed term at a fixed rate of interest.

It has now become standard practice to show the previous year's figures for comparison purposes.

A footnote informs us that there are certain contingent liabilities. The liability as to the partly-paid shares relates to the item under the heading, "Investments."

The modern trend is towards the giving of more information and greater disclosure of sale figures and other items which, in the past, have either been amalgamated with a number of other items and one amount shown for the group, or the item not published at all.

In the case of registered companies, the various Companies Acts require certain details to be shown in the balance sheet and accounts, and the directors are required to make certain specific statements in the annual report and accounts issued to the shareholders.

We have broadly examined the form and contents of the balance sheet. We have seen how the various items come to appear, what they represent, and how they are valued by the enterprise for balance sheet purposes.

In Part II we shall consider what pertinent information may be obtained from the balance sheet and how we may assess the financial well-being (or otherwise) of the concern.

## Part II—INTERPRETATION

IT may be truly said that the financial statements of a concern, whilst reflecting the results of its past and current operations, are important indicators of its future prospects and also of the welfare of the bank's support.

*What are we looking for?*

At the outset, it is most important to know clearly what we are looking for in a concern's financial statements. Broadly speaking, a banker examines the financial statements of his customer in order to answer the following three questions:

1. Is the customer's financial position sound?
2. Are earnings satisfactory, or will they be so enhanced by the employment of the additional funds requested, so as to enable the advance to be comfortably serviced?
3. Do the future prospects of the customer, and his standing, justify confidence and indicate the repayment of the debt within a reasonable period?

*Where shall we look?*

To evaluate these matters, the banker will normally require copies of the customer's financial statements over the period of the last five years. If the customer has more recently commenced business, it would, of course, be necessary to manage with the information available for such lesser period. However, it is desirable that the financial statements for a period of not less than three years, when available, should be obtained and closely examined.

The banker will not only require the published financial statements duly audited, but should also obtain copies of the operating statements (Manufacturing, Trading and Profit and Loss Accounts) for a similar period.

Amplification of certain items appearing in these accounts or the balance sheets may also be required. In some cases further information as to the methods of taking and valuing stock, or a dissection of the debtors' accounts may have to be called for.

It is normal practice for the auditors of a concern to submit to its proprietors a comprehensive report on the operations for the year. This report usually sets out variations in trading, profit and loss and balance sheet items, together with the auditors' considered explanations therefor, supported by statements which indicate movements in working capital, assets, liabilities and proprietors' funds.

The percentage of the various items of expense and profit, etc., to turnover may also be given.

A copy of this report should, whenever possible, be obtained (even if only on loan), as it will be of great assistance in evaluating the customer's progress or otherwise.

*How shall we look?*

Having decided upon what we want to know and where we can look for it, all that remains is to know the technique.

Firstly, let us consider the financial soundness of a concern as indicated by its balance sheet. For this purpose, let's look at the balance sheet of Don Hope as at 30th June, 1950, which may be summarised as follows:—

| | | | |
|---|---|---|---|
| Current Liabilities .... .... | £732 | Current Assets .... .... .... | £1,195 |
| Proprietor's Funds .... .... | £4,138 | Fixed Assets .... .... .... | £3,675 |
| | £4,870 | | £4,870 |

This simple financial statement will serve to indicate the rudimentary essentials of balance sheet soundness.

We will commence by examining the relationships the various groups bear to one another:—

1. *Proprietor's Funds* (£4,138) more than cover the *Fixed Assets* (£3,675), indicating that the proprietors have provided all the funds for this long-term investment. Normally, proprietors are expected to provide the funds for the fixed and intangible assets investment. A concern engaged in an industry where the fixed assets (see definition of "Fixed Assets" near beginning of Part I) are necessarily a very high percentage of the total asset investment (e.g., a bus line, foundry, etc.) is the exception to the general rule here.

2. *Proprietor's Funds* (£4,138) also comfortably cover *Outside Liabilities* (£732). This is an important relationship. It is most desirable for the proprietor's investment in the undertaking to be greater than that of outsiders. Should the figures have been reversed, a serious weakness would be apparent —the outsiders would have a far greater equity in the concern than the proprietor himself. This could prove most embarrassing if a substantial creditor served demand for payment.



3. *Current Assets* (£1,195) less *Current Liabilities* (£732) equal *Working Capital* (£463). This is also an important ratio, as it indicates the ability of the concern to carry on and meet its day-to-day commitments. The ratio is usually expressed as follows:—

$$\frac{\text{Current Assets.}}{\text{Current Liabilities.}} = \frac{1195}{732} = 1.6$$

or it may be expressed : 1195 : 732 = 1.6 : 1.

A ratio of 2 (or 2 : 1) is regarded as the fundamental rule. In normal trading, on say 30 days' terms, it is necessary to have sufficient working capital to finance one month's purchases, wages and other expenses. The subsequent month's expenses are theoretically financed by collections in respect of the previous month's sales. Therefore, to ensure continuity of trading a concern requires sufficient current assets to cover not only the first month's outgoings, but also those of the following month. In other words, Current Assets (2) to Current Liabilities (1).

With these ratios a degree of tolerance must of course be allowed as between various types of undertakings. Their application must be tempered with sound common sense. A cash grocer, for example, will not require to maintain a working capital ratio as high as say a radio retailer who sells goods on terms. The former will normally be able to replace stock and meet expenses out of his normal monthly cash takings.

4. *Quick Assets Ratio.* Another important relationship is revealed by the "*Quick Assets*" ratio. This is calculated by eliminating both "Stock" and "Bank Overdraft" from their respective groups of the Current Assets-Current Liabilities ratio. It is really the "acid test" of the concern's liquidity and a 1 : 1 ratio is looked for. In the balance sheet we are at present examining the ratio is 445 : 532 or say 1 : 1.2. It is obvious that should all his creditors demand payment immediately, Don Hope would not be able to make a full settlement. His liquidity position may be said to be fair, but it requires to be watched.

It is the trend, indicated by the various ratios, which is the important thing and it is for this reason the financial statements for three to five succeeding years are required when evaluating a concern's creditworthiness.

For example, take the following working capital ratios:

| *Year* | 1950 | 1951 | 1952 | 1953 | 1954 |
|---|---|---|---|---|---|
| Customer X .... .... | 3.3 | 3.1 | 3.0 | 2.5 | 2.0 |
| Customer Y .... .... | 1.2 | 1.3 | 1.5 | 1.7 | 2.0 |

If these ratios were compared for the year 1954 only, it might be thought, so far as working capital is concerned, that the customers' positions are equal.

However, a study of the five years' trend clearly shows customer Y in a much better light than customer X, whose ratio is growing weaker.

Any decline in the working capital or quick assets ratios should serve as a danger signal that liquidity problems may be looming up. A slowing down in stock-turn (number of times the average stock holding is turned over per year), a heavy increase in stocks carried and financed by the forbearance of creditors, or a slowing down of debtors' payments, may all contribute to the decline.

To recapitulate, the general requirements for a sound balance sheet position are briefly:

1. That the Proprietors' Funds should compare favourably with the Fixed Asset Investment (including intangibles).
2. That the Proprietors' Funds should comfortably cover the Outside Liabilities.
3. That the working capital should be sufficient to meet normal trading requirements of the particular concern.
4. That a reasonable state of liquidity should always be maintained.

Of course, whilst a sound balance sheet position is most desirable, we also need to be sure that the customer's earning capacity can be maintained or increased in order that any advance granted can be serviced and the debt cleared in accordance with arrangements.

For information as to these matters we must also look at the revenue statements, and as an example we will examine Don Hope's Trading and Profit and Loss accounts for the five months ended 30th June, 1950.

The pertinent figures from this statement may be set out for our purposes as follows:

| | | | | |
|---|---|---|---|---|
| *Sales* .... .... .... | | | £2,500 | 100% |
| Cost of goods sold .... .... .... | | | 1,400 | 56% |
| *Gross Profit* .... .... | | | £1,100 | 44% |
| Marketing and Selling Expenses | £350 | (14%) | | |
| Administration and General Expenses .... .... .... | 457 | (18%) | | |
| Financial Expenses .... .... | 5 | (.5%) | 812 | 32.5% |
| *Net Profit* .... .... | | | £288 | 11.5% |

For comparison purposes it is normal practice to express as a percentage of sales the various items in the operating statements. This materially assists in assessing the efficiency of the concern's management.

If we are able to do this, whilst bearing in mind current economic trends and conditions in the particular trade, we should be able to make a reasonable estimate of the concern's trading results for at least the ensuing year and at the same time sum up its future prospects.

Looking at the above statement we find:

The cost of the goods sold was 56% of the selling price and the gross profit was 44% of sales. This shows a satisfactory result for the type of business (cycle sales and repairs). A low-gross profit percentage (say 10%) would require explanation—perhaps there has been bad buying of unsuitable stock, or severe competition has resulted in too small a mark-up on cost giving an insufficient profit margin, or perhaps a proportion of cash sales is going into a dishonest employee's pocket instead of into the till.

The various expense groups aggregated 32.5% of sales, leaving a net profit percentage of 11.5, which would appear to be reasonable. However, the percentage of Administration and General Expenses (18%) appears high in comparison with Marketing and Selling Expenses (14%)—the latter, in this type of business, should be much the larger of the two. The manager's salary (£400) comprises the main portion of the former group, and it would therefore seem that an increase in turnover is required to cover the overhead of administration and general expenses. (Of course, we must bear in mind that this statement relates to the first five months' operations and therefore portion of the concern's establishment period, when certain costs can well be out of line with turnover.)



Whilst the net profit percentage of 11.5 would appear reasonable, let us relate it to the Proprietor's Funds. After all, the return the proprietor gets from his investment is the real test. In the example before us the net profit for five months was **£288**, so on that basis we could say **£690** for 12 months (12/5ths of £288) or 16.6% of Proprietor's Funds (£4,138), which could be considered a reasonable return.

Again, with the revenue statements, as with the balance sheet, the trend is important if we are to gauge the efficiency of management. By taking the statements for one year only our conclusions could be most misleading—a particular year might have been just a " flash in the pan " and to base our confidence on such a result could surely invite disaster.

Let us then look at the trends in this statement over a period of five years:—

| | 1950 | 1951 | 1952 | 1953 | 1954 |
|---|---|---|---|---|---|
| Sales ... .... | 100% | 100% | 100% | 100% | 100% |
| Cost of goods sold .... | 56 | 60 | 52 | 50 | 51 |
| Gross Profit .... .... | 44 | 40 | 48 | 50 | 49 |
| Marketing Expenses .... | 14 | 20 | 20 | 24 | 18 |
| Administration Exp. .... | 18 | 15 | 14 | 14 | 13 |
| Financial Expenses .... | .5 | 1 | 1 | 1 | 1 |
| Total Expenses .... .... | 32.5 | 36 | 35 | 39 | 32 |
| Net Profit .... .... .... | 11.5 | 4 | 13 | 11 | 17 |

From this comparative statement of percentages it would be ascertained:

1. Cost of goods was too high in 1951, and caused the low percentage of net profit. Remedial action brought this item back into line in 1952, since when it has remained constant at a reasonable figure.
2. Marketing expenses took a sudden jump in 1953; this, it is found, was due to an intensive advertising campaign which yielded a most satisfactory increase in sales in 1954, resulting in an increase in the net profit percentage gained solely through greater turnover.
3. Administration expenses are being controlled, and the percentage thereof to sales is being gradually reduced.
4. After a poor year in 1951, due to a sharp falling off in sales, the management has rehabilitated the concern's trading and, with increased turnover, reduced the expense percentage. The 1952, 1953 and 1954 results can be considered satisfactory and the profit for the ensuing year may be expected to be at the same level as for 1954 or perhaps a little higher. Management is controlling the concern along sound lines.

*Let's take a practical example*:

These ratios and comparisons seem useful, but how can we apply them in actual practice?

As a practical example, let us proceed to examine the 1961 balance sheet of the Hope and Glory Company Ltd.

First we recast the balance sheet in columnar form to assist in the comparison of the various items. (See over page.)

Looking at the trend in the various balance sheet items over the period of three years there has been a general increase evidencing the growth of the company's business.

The main variations worthy of note are:—

(i) The decrease in bank overdraft, bills payable and creditors in 1960 —this was due to the mortgage loan of **£6,500** being obtained and used to finance the increase in stock and debtors, enabling bank overdraft, etc., to be reduced and a strong working capital position to be achieved.

In 1961 the company relied on bank overdraft and creditors once again to finance the increase in stock and debtors. This resulted in a slight weakening of the strong working capital position achieved the previous year.

(ii) A steady **£5,000** has been transferred to the general reserve each year, which, together with an increased balance carried forward in the P. & L. Appropriation Account each period, has effected a reasonable increase in shareholders' funds.

In examining the 1961 balance sheet structure for soundness we find that shareholders' funds (£62,987) comfortably cover the fixed and intangible assets (£52,844) and compare favourably with the outside liabilities (£31,299).

Current assets at £40,427 cover current liabilities (£21,299) almost twice with working capital at a satisfactory figure of £19,128.

The quick asset ratio is 17,784 to 18,258, which is approximately 1 : 1 and can be considered satisfactory.

Turning to the trading results we find:

Turnover (sales, £125,718) show a 50% (approx.) increase on the previous year and the gross and net profit percentages to sales are 32.3 and 11.9 respectively, which may be considered a satisfactory result on turnover.

Net profit at 23.7% of shareholders' funds is a reasonable return on the capital invested and indicates that the company is not over capitalised.

Stock £22,643 (cost price), plus a mark-up of say 25%, equals £28,304 (selling price), which is approximately 2/9ths of turnover, indicating that the stockturn is 4½ (stock turned over 4½ times a year). For the type of business this is a normal stockturn and shows that the company is not overstocking.



**Comparative Balance Sheet of the Hope & Glory Company Ltd., as at 30th June, 1961**

| | 1959 £ | 1960 £ | 1961 £ |
|---|---|---|---|
| *Current Liabilities*: | | | |
| Bank Overdraft | 2,109 | 539 | 3,041 |
| Bills payable | 1,053 | 754 | 1,279 |
| Creditors | 5,002 | 4,451 | 7,206 |
| Prov. for tax | 1,155 | 1,225 | 6,022 |
| Prov. for dividend | 2,226 | 2,251 | 2,251 |
| Prov. for long service leave | 625 | 1,000 | 1,500 |
| **Total Current Liabilities** | £12,170 | 10,220 | 21,299 |
| *Deferred Liabilities*: | | | |
| Mortgage Loan | — | 6,500 | 6,500 |
| Debentures 6 1/8%—1970 | 3,500 | 3,500 | 3,500 |
| **Total Liabilities** | £15,670 | 20,220 | 31,299 |
| *Shareholders' Funds*: | | | |
| Authorised Capital | £100,000 | 100,000 | 100,000 |
| Issued Capital | 44,550 | 45,550 | 45,550 |
| Less Uncalled | 2,025 | 2,525 | 2,525 |
| Paid-up Capital | £42,525 | 43,025 | 43,025 |
| Premium on Shares | 2,500 | 2,500 | 2,500 |
| General Reserve | 5,000 | 10,000 | 15,000 |
| P. & L. Appropriation A/c. | 295 | 1,235 | 2,462 |
| **Total Shareholders' Funds** | £50,320 | 56,760 | 62,987 |
| **Total Liabilities and S/hs.' Funds** | £65,990 | 76,980 | 94,286 |

| | 1959 £ | 1960 £ | 1961 £ |
|---|---|---|---|
| *Current Assets*: | | | |
| Stock | 12,424 | 15,523 | 22,643 |
| Debtors | 6,327 | 9,784 | 17,401 |
| Cash | 235 | 252 | 202 |
| Prepayments | 154 | 176 | 181 |
| **Total Current Assets** | £19,140 | 25,735 | 40,427 |
| *Investments* | £1,015 | 1,015 | 1,015 |
| *Fixed Assets*: | | | |
| Land and Buildings | 30,753 | 30,753 | 30,753 |
| Plant and Equipment | 14,867 | 20,540 | 23,233 |
| | £45,620 | 51,293 | 53,986 |
| Less depreciation write-off | 4,785 | 6,063 | 6,142 |
| **Total Fixed Assets** | £40,835 | 45,230 | 47,844 |
| *Intangible Assets* | £5,000 | 5,000 | 5,000 |
| **Total Assets** | £65,990 | 76,980 | 94,286 |
| **TRADING RESULTS:—** | | | |
| Sales | £62,721 | 86,343 | 125,718 |
| Gross Profit | £20,073 | 28,568 | 40,639 |
| Net Profit | £7,321 | 9,969 | 14,978 |

Debtors at £17,401 equal approximately 1/7th of turnover—say 8 weeks' sales—credit control is therefore reasonable.

From our examination thus far we can conclude that the company's balance sheet position is sound and that its earning capacity is satisfactory.

The next step is to look at the company's future prospects. If the company prepares budgets, then these will give a good forecast of future results as expected by the company. If the company does not prepare such forecasts then we must get a lead by examining the trends which are the pointers to future trading results, and which also measure the efficiency of management.

To enable us to place the trading trends in their correct perspective it is first necessary to express gross profit, net profit, debtors and stock as a percentage of turnover:

| | 1959 | % | 1960 | % | 1961 | % |
|---|---|---|---|---|---|---|
| Sales .... .... .... | £62,721 | 100 | £86,343 | 100 | £125,718 | 100 |
| Gross profit .... .... | 20,073 | 32.3 | 28,568 | 33.1 | 40,639 | 32.3 |
| Net profit .... .... | 7,321 | 11.6 | 9,969 | 11.5 | 14,978 | 11.9 |
| Debtors .... .... .... | 6,327 | 10.1 | 9,784 | 11.3 | 17,401 | 13.8 |
| Stock .... .... .... | 12,424 | 19.8 | 15,523 | 17.9 | 22,643 | 18.0 |

The percentages to sales of gross profit, net profit and stock remain almost constant notwithstanding the great increase in turnover (more than 100% over the 3 years). However, the percentage of debtors shows a decided increase. At 13.8% (1/7th) debtors represent 7 to 8 weeks' sales. Whilst this figure is not unreasonable, the upward trend will require watching to ensure that remedial action may be taken before the percentage of this item gets too high and too many losses through bad debts occur. A percentage of say 20% (or 1/5th) equalling 10 to 11 weeks' sales would indicate lax credit control and suggest that a dissection of debtors' accounts should be made to ensure that an adequate provision for bad debts exists.

The current assets to current liabilities ratio trend is as follows:

| 1959 | 1960 | 1961 |
|---|---|---|
| 1.57 | 2.5 | 1.9 |

which shows an overall improvement. However, the satisfactory position achieved in 1960 has not been maintained. The drift requires the closest watching to ensure that it is arrested during the next accounting period—it would be wise to have interim financial statements furnished for the first six months to test this trend.

The other trends we will examine relate to Proprietorship:

| | 1959 | % | 1960 | % | 1961 | % |
|---|---|---|---|---|---|---|
| Shareholders' funds | £50,320 | 100 | £56,760 | 100 | £62,987 | 100 |
| Sales .... .... .... | 62,721 | 124.6 | 86,343 | 152.1 | 125,718 | 199.5 |
| Net profit .... .... .... | 7,321 | 14.5 | 9,969 | 17.5 | 14,978 | 23.7 |

The steep rise in the percentage of sales is indicative of the rapid expansion of business with little additional capital investment. Whilst the percentage of net profit to sales has remained constant (see previous percentage statement), the company has benefited from the increased turnover as the percentage of net profit to shareholders' funds has risen from 14.5 to 23.7, which is a satisfactory return on the shareholders' investment in the undertaking.



The figures above indicate (economic conditions being equal) that the forthcoming year's results should follow a similar pattern with an increase in turnover and profit.

The management is sound.

The principle of analysing any financial statement is to examine the relationship the various items bear to one another and to draw logical conclusions from the ratios and percentages disclosed.

To be able to do this it is necessary to have a sound knowledge of the form and contents of the average balance sheet. To assist in this prerequisite a large section of this article has been devoted to that subject.

In the examples given it has not been possible to cover all the situations that may be encountered. A check list of the more important features to be considered when examining financial statements is therefore set out as a guide:—

*Revenue Accounts*:

Is the turnover being maintained or increased?

How do the percentages of purchases and/or cost of manufacture, gross and net profit to turnover compare to those of previous periods?

Are provisions for bad debts, depreciation, taxation, repairs and maintenance being made and are they adequate?

*Balance Sheet*:

Debtors: Does the total bear a reasonable relationship to turnover?

Are there any stagnant large debtors and what is the percentage of bad debts written off?

Is the concern's credit control satisfactory?

Stocks: Ensure that the volume and value of stock is not out of proportion with the concern's capital structure and turnover.

On what basis is stock valued?

Is stock being turned over within a reasonable period and what percentage (if any) of stock is obsolete?

Plant, Machinery, etc.: These are the working tools of a concern which affect the quality and quantity of production. Relationship to the customer's needs, care and maintenance and the existence of reserves for obsolescence and replacement require examination. Where the bank's security comprises a mortgage debenture, the re-sale or break-up value of this item is important.

Land and Buildings: How do the balance sheet values compare with present market values? Has the customer too much of his capital tied up in this asset? Are they adequate for the concern's requirements, or will additional capital be required in the near future for further expansion? N.B.—In the case of all assets, the basis of valuation for balance sheet purposes should be ascertained if it is not stated.

Creditors: Trade creditors should be in conformity with the normally accepted terms of trade and their relationship to the concern's turnover is important. The terms of repayment of fixed loans and the concern's ability to meet such payments need investigation. Pressure from creditors can cause embarrassment.

Provision for Taxation: Whilst the assessment for tax will not issue for some time after the close of the financial period, sufficient provision should be made for this ascertainable liability.

Shareholders' Loans: This is a common item in the balance sheets of private (or proprietary) companies, the shareholders preferring to supply additional capital required in this form rather than to increase paid-up capital. Often these loans comprise the major capital resources of the company, and in such instances where the company requests an overdraft the banker should obtain a letter of undertaking from the shareholders concerned to the effect that no portion of such loans will be withdrawn without the prior consent of the bank.

Shareholders' Funds: This item is peculiar to company customers. It may be said to be made up of three distinct classes of capital:

1. Paid-up capital—Permanent.
2. Reserves—Semi-permanent.
3. P. & L. Appropriation A/c.—Fluid.

Shareholders' funds should comfortably cover the fixed assets and should be greater than the outside liabilities.

A general " rule of thumb " is that the company's paid-up capital should be at least twice the amount the bank is requested to advance. The Bank should not be asked to risk its funds to a greater extent than the shareholders are prepared to risk their capital.

Reserves: The extent and nature of reserves and provisions require investigation. Are they adequate?

In addition to the above matters, the insurance cover relative to stock, plant, machinery, motor vehicles, buildings, workers' compensation, loss of profits, public risk, etc. (as applicable) is an important consideration.

The above check list is not intended as a procedure for the complete analysis of a balance sheet. It does, however, attempt to indicate, as far as possible in non-technical terms, the main points to which a banker should give consideration when examining a customer's financial statements.

In some cases the ratios or pointers may suggest weaknesses, and it will then be advisable to make further investigations relative to the particular items.

The comparisons and ratios mentioned should, as a general rule, enable a reasonable view to be obtained of a customer's financial standing and the trends in his trading operations.