

1-1938

Accounting Questions: Classification of Balance-Sheet Items

American Institute of Accountants. Bureau of Information

Follow this and additional works at: <https://egrove.olemiss.edu/jofa>



Part of the [Accounting Commons](#)

Recommended Citation

American Institute of Accountants. Bureau of Information (1938) "Accounting Questions: Classification of Balance-Sheet Items," *Journal of Accountancy*. Vol. 65: Iss. 1, Article 7.

Available at: <https://egrove.olemiss.edu/jofa/vol65/iss1/7>

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

Accounting Questions

[The questions and answers which appear in this section of THE JOURNAL OF ACCOUNTANCY have been received from the bureau of information conducted by the American Institute of Accountants. The questions have been asked and answered by members of the American Institute of Accountants who are practising accountants and are published here for general information. The executive committee of the American Institute of Accountants, in authorizing the publication of this matter, distinctly disclaims any responsibility for the views expressed. The answers given by those who reply are purely personal opinions. They are not in any sense an expression of the Institute nor of any committee of the Institute, but they are of value because they indicate the opinions held by competent members of the profession. The fact that many differences of opinion are expressed indicates the personal nature of the answers. The questions and answers selected for publication are those believed to be of general interest.—EDITOR.]

CLASSIFICATION OF BALANCE-SHEET ITEMS

Question: Much has been written recently regarding the classification of the accounts appearing on the standard balance-sheet.

It seems to be a fairly well established fact that the first two headings appearing on the balance-sheet should read—"Current assets" and "Current liabilities," respectively. Further than this, there seems to be no uniformity as various and sundry terms are used in classifying the remaining accounts on the asset side as well as the liability side.

The query which I would like to propound relates to the classification of the item appearing on the right-hand side of the balance-sheet of many financial institutions, namely, unearned discount or interest. Usually this item appears between the liabilities and the items comprising the net worth of the company. While it is not so stated, this item seems to be in the nature of a valuation reserve; yet it is not shown as a deduction from the asset account to which it refers. Along this line, the statement has frequently been made that only three general classifications should appear on the face of the balance-sheet, namely, assets on the left side and liabilities and capital or net worth on the right side.

Answer No. 1: I think that a few general comments are in order in connection with this question. There is no question in my mind that a reasonably adequate classification of accounts for balance-sheet purposes and for other purposes is very helpful. On the other hand, it should be remembered that balance-sheets are made up for many different kinds of businesses, operated by many different kinds of organizations, in many cases under control of Federal or state laws, in some

cases influenced by long-established precedents, the violation of which would result in misunderstandings which might be serious, and that balance-sheets are used for many different purposes.

Fundamentally, the purpose of a balance-sheet is to make information available to one or more readers. The information may be presented from the viewpoint of a "going concern," or it may be presented from the viewpoint of "liquidation." In most of the ordinary balance-sheets of industrial and commercial concerns and public utilities, the current assets and current liabilities are presented principally on a "liquidation" basis, the other assets are presented from the viewpoint of showing funds invested in them, and the capital-stock and surplus accounts are presented from the viewpoint of showing the sources from which funds have been received. Actually, in most balance-sheets, there is no real attempt to show "net worth." It is my opinion that this expression is now greatly overworked, however valuable it may have been as an appropriate description for the excess of assets over liabilities in the balance-sheets of the small merchants of many years ago, as their balance-sheets were then prepared.

I think it is impracticable to attempt a hard and fast general classification of all of the items on balance-sheets as either (a) assets, (b) liabilities or (c) capital or net worth. This may be workable in those balance-sheets which are prepared on a "liquidation" basis and where there is no legal or other requirement to interfere. For purposes of the ordinary balance-sheet prepared from the viewpoint of a "going concern," however, and having in mind the varieties of conditions and purposes to be met, I think we can hardly attempt to make this classification.

From the viewpoint of a balance-sheet prepared to show the results of "liquidation" as at a given date, the item of unearned discount or interest may be in the nature of a valuation reserve; from the viewpoint of a "going concern," it may be an item which could properly be credited to surplus, except for the time element and the element of general overhead charges properly allocable for such period of time as must elapse before the interest or discount is earned.

Mention is not made in the inquiry of the particular kind of financial institution which the inquirer had in mind in writing his letter. There is no doubt, however, that many financial institutions are bound, more or less, by laws and rulings, as to their form of balance-sheet. It may be that proper accounting theories can be used as a basis of correcting laws, if they are in need of correction, but we can hardly set aside a law arbitrarily, while it is still in effect, for an accounting theory, no matter how sound the accounting theory may be.

As previously indicated, it seems to me that the fundamental accounting factor to be considered in this matter is that of presenting

information. If the balance-sheets in question present the required information so that it can be practically understood by the readers of the balance-sheets, if there is no conflict with law or rulings which must be followed, and if the balance-sheets are reasonably comparable with any other information with which it is necessary to compare them, then I do not see that there is any sound objection to including unearned discount or interest as stated in the inquiry, "between the liabilities and the items comprising the net worth of the company." (As previously indicated, I do not accept the use of the term "net worth" unreservedly.)

The inquiry, as stated, is so broad and so lacking in definite application that one might easily write dozens of pages on the subject of accounting classifications and still miss the particular point which the inquirer had in mind. There is no practical point in attempting to reduce the subject of accounting classifications to a few brief statements. It is a subject which involves too many variations of conditions, requirements, and purposes to be covered in such a manner.

Answer No. 2: We regard the statement that "only three general classifications should appear on the face of the balance-sheet, namely, assets on the left side and liabilities and capital or net worth on the right side," as being true only in a very general sense, and that it cannot be considered as a practical rule.

In our opinion, unearned discount or interest represents revenue recorded before it is earned and is properly classifiable as a deferred credit on the credit side of the balance-sheet. We do not believe that this item should be shown as a valuation reserve and deducted from the asset account to which it refers.