Balance Sheet

(Cheat Sheet)

Balance Sheet

The balance sheet is also known as the *statement of financial position* and it is one of the five external financial statements issued by U.S. corporations. The balance sheet reflects the balances in all of the corporation's *asset*, *liability* and *stockholders' equity* accounts as of the *final moment of the date shown in the heading*.

> Note: Typically the *final moment* of the balance sheet is the last instant of the last day of an accounting period, such as midnight of December 31, June 30, etc. This is different from the *other four external financial statements* (income statement, statement of comprehensive income, statement of stockholders' equity, and statement of cash flows) which report the amounts that occurred during a *period of time* such as the year ended December 31, the three months ended June 30, etc.

The format for the balance sheet is similar to the accounting equation:
assets = liabilities + stockholders' equity

Assets

Assets are the resources that a corporation *owns* as a result of a purchase transaction. Examples of a corporation's assets include cash, accounts receivable, inventory, prepaid insurance, investments, land, buildings, equipment, vehicles, etc.

Liabilities

Liabilities are the obligations that a corporation *owes* as of the final moment of the date shown in the heading of the balance sheet. Examples of liabilities include accounts payable, loans payable, accrued expenses payable, customer deposits, deferred revenues, bonds payable, etc. Liabilities are *claims* against a corporation's assets. Liabilities can also be thought of as a *source* of a corporation's assets.

Stockholders' Equity

Stockholders' equity is equal to the amount of a corporation's assets minus the amount of its liabilities. The stockholders' equity section of the balance sheet is divided into several parts:

- paid-in (or contributed) capital
- retained earnings
- accumulated other comprehensive income
- treasury stock

Stockholders' equity (along with liabilities) can be thought of as a *source* of a corporation's assets. (Liabilities are the other source.) Stockholders' equity is also viewed as a *claim* against the assets, however, it is a residual claim since the creditors' claims (liabilities) must first be satisfied.

Generally Accepted Accounting Principles

A balance sheet distributed by a U.S. corporation must comply with generally accepted accounting principles, which are commonly known as *GAAP* or *US GAAP*. US GAAP is very comprehensive and includes a wide range of concepts, rules, practices, etc. Currently the authoritative group for establishing the U.S. accounting standards is the *Financial Accounting Standards Board or FASB* (pronounced faz-bee).

As a result of the accounting rules, assets may be reported at various amounts. Here are a few examples:

- Certain marketable investment securities will be reported at *market value*
- Inventory is often reported at the *lower of cost or market*
- Land used in a business will be reported at its cost and will *not* be depreciated
- Buildings and equipment will be reported at *cost minus accumulated depreciation*
- Some very *valuable intangible assets* (trade names, logos, excellent reputation, management, etc.) that were not purchased in a transaction are not reported

The above list reveals that the amounts reported or not reported for assets means that the amount reported for stockholders' equity is NOT the fair market value of the corporation.

Classified Balance Sheet

A classified balance sheet is a balance sheet having various groupings or classifications. For example, the *assets* will be presented under one of the following classifications:

- current assets
- investments
- property, plant and equipment
- other assets

Liabilities will be classified as follows:

- current liabilities
- noncurrent liabilities (or long-term liabilities)

Current Assets

Current assets include cash and assets that will turn to cash within one year of the balance sheet's date (unless the operating cycle is longer than one year). Examples of current assets include cash, temporary investments, accounts receivable, inventory, supplies, and prepaid expenses.

Current Liabilities

Current liabilities are obligations that have occurred as of the date in the heading of the balance sheet and must be paid within one year of the balance sheet date (unless the operating cycle is longer than one year). Examples of current liabilities include accounts payable, short-term loans, current portion of a long-term loan, wages payable, customer deposits, deferred revenues, and income taxes payable.

Working Capital

Working capital is the amount of *current assets* minus the amount of *current liabilities*. If a corporation has $150,000 of current assets and $120,000 of current liabilities, its working capital is $30,000.

Current Ratio

The current ratio is calculated as current assets divided by current liabilities. Hence if a corporation has $150,000 of current assets and $120,000 of current liabilities, its current ratio is $150,000/$120,000 or 1.25 to 1.

Property, Plant and Equipment

This section of the classified balance sheet reports the long-term assets used in a business. These assets are sometimes referred to as fixed assets and/or plant assets. Some of the assets in this category are:

- Land
- Land Improvements
- Buildings
- Machinery and Equipment
- Vehicles
- Furniture and Fixtures

The property, plant and equipment section will also report the **accumulated depreciation** pertaining to these assets. Accumulated depreciation is presented as a subtraction and the remainder is often shown with the word "net". This net amount is the book value of the property, plant and equipment, and it is also the amount that has not yet been allocated to depreciation expense. The book value of these assets should not be interpreted to be the assets fair market value (FMV). FMV could be more than or less than the book value of any or all of these assets.

Notes to the Balance Sheet

In addition to the amounts appearing on the face of the balance sheet, there needs to be a reference such as "See notes to the financial statements." or "The accompanying notes are an integral part of the financial statements." The notes to the financial statements are especially important because a corporation may have a significant liability for which the amount of the obligation cannot be determined as of the final moment of the accounting period. Therefore, this significant liability and other important information must be disclosed in the notes to the financial statements.