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Understanding the Balance Sheet

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Course Outline

Table of Content

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At the end of the webinar you will know:

- How to compile a Balance Sheet;
- How the Balance Sheet relates to other financial reports and the interdependency thereof; and
- How to calculate, use and interpret Balance Sheet ratios.

Theory

Background

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Annual Financial Statements:

Annual financial statements are financial reports based on a 12-month consecutive time period. They consist of or include:

- Statement of Comprehensive Income (Income Statement)
- **Statement of Financial Position (Balance Sheet)**
- Statement of Changes in Equity
- Statement of Cashflow
- Notes to the Annual Financial Statements

Balance Sheet

- The **statement of financial position**, often called the balance sheet, is a **financial statement** that reports the assets, liabilities, and equity of a company on a given date.

- In other words, it lists the resources, obligations, and ownership details of a company on a specific day.

Balance Sheet - Components

- Assets (current and non-current)
- Liabilities (current and non-current)
- Owners' Equity

Formula

Total Assets

Current Assets

+

Non-Current Assets

Total Liabilities

Current Liabilities

+

Non-Current Liabilities

Owners' Equity

Share Capital

+

Retained Earnings

Assets

Definitions

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Asset

Previous Definition

A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Revised Definition

- *A present economic resource controlled by the entity as a result of past events*
- *An economic resource is a right that has the potential to produce economic benefits*

Definitions

Asset Definition

Changes made:

- Separate definition of an economic resource to clarify that an asset is the economic resource, not the ultimate inflow of economic benefits
- Deletion of ‘expected flow’—it does not need to be certain, or even likely, that economic benefits will arise
- A low probability of economic benefits might affect recognition decisions and the measurement of the asset

Definitions

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Types of Assets

Non-Current Assets

- *Non-current assets are a company's long-term investments or assets that have a useful life of more than one year. or*
- *Non-current assets are assets that cannot be easily and readily converted into cash and cash equivalents.*

Definitions

Non-Current Assets - Examples:

- Property Plan and Equipment
- Vehicles
- Intangible Assets like Patents, Copyrights, etc.
- Goodwill
- Long Term Investments
- Natural Resources

Definitions

Current Assets - Examples:

- Cash
- Cash equivalents
- Short-term deposits
- Stock / Inventories
- Marketable securities
- Office supplies

Liabilities

Definitions

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Liability

Previous Definition

A present obligation of the entity arising from past events, the settlement of w hich is expected to result in an outflow from the entity of resources embodying economic benefits

Revised Definition

- Present obligation of the entity to transfer an economic resource as a resul t of past events
- An obligation is a duty or responsibility that the entity has no practical abili ty to avoid

Definitions

Non-Current Liabilities - Examples:

- Bonds payable
- Long-term notes payable
- Deferred tax liabilities
- Mortgage payable
- Capital leases

Definitions

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Current Liabilities - Examples:

- Accounts payable
- Interest payable
- Income taxes payable
- Bills payable
- Bank account overdrafts
- Accrued expenses
- Short-term loans

Owner's Equity

Definitions

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Owners’ Equity

Owner's equity represents the owner's investment in the business minus the owner's draws or withdrawals from the business plus the net income (or minus the net loss) since the business began.

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10 MIN BREAK

Practical: Compilation of a Balance Sheet

Balance Sheet Ratios

Definitions

Ratios

1. Net working capital Ratio
2. Current ratio and quick ratio
3. Debt to asset ratio
4. Solvency ratio

Definitions

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Net Working Capital Ratio

Used to: Calculate how much money you have to put back into your business after you pay off your short-term debt.

Current assets – current liabilities = net working capital

Definitions

Current Ratio

Used to: Measure the liquidity of your company and see if you can pay for your short-term expenses with the liquid assets you have on hand.

Liquid assets are assets that easily convert into cash. If your business has high liquidity, it means you can quickly come up with the money to pay for an unexpected expense without going into debt.

Current Assets / Current Liabilities = Current Ratio

Definitions

Quick Ratio

The **quick ratio**, also known as the **acid-test ratio** is a type of liquidity ratio, which measures the ability of a company to use its near cash or quick assets to extinguish or retire its current liabilities immediately.

Total current assets – total current inventory) / total current liabilities = quick ratio

Definitions

Debt to asset ratio

Use it to: Calculate how much of your business's assets were purchased through debt rather than equity.

Total liabilities / total assets = debt to asset ratio

Definitions

Debt to asset ratio

Debt to asset ratio	Business risk level
Over 1	High—you have more debt than assets
0.6 and higher	High—you may have trouble borrowing money
0.4 and lower	Low

Definitions

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Solvency ratio

The solvency ratio is used to examine the ability of a business to meet its long-term obligations.

(Net after-tax income + Non-cash expenses) ÷ (Short-term liabilities + Long-term liabilities) = Solvency ratio

Conclusion

Q&A

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Thank you for your participation

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