IE – Business Economics Fundamentals – Lesson 5 – Balance Sheet Statement – Video

Balance sheet shows the financial status of a business at a certain point in time. Assets = Liabilities + Shareholder Equity is the "balance" that is reflected.

- It shows the assets the business owns, how much it owes (liabilities) and the shareholder's equity.
- The assets always equal the liabilities + shareholders' equity. (In fact, the definition of "shareholder's equity" is assets minus liabilities).
- The balance sheet balances because every transaction is recorded in at least two accounts that reflect an increase in one area and corresponding impact in the other. For example, if a business buys a car for 5,000 by taking a loan for 2,500 and raising investment of 2,500 (increasing shareholder equity.) Thus its assets grow by 5,000 and its liabilities increase by 2,500 and its shareholders equity increases by 2,500.

Left column is a summary of the company's assets. These are broken down into Current Assets and Fixed Assets.

- Current Assets are things like Accounts Receivables, Cash, Inventory, Pre-paid expenses – assets that are typically changing all the time.
- Fixed Assets are things that are acquired for long term usage and not likely to be quickly converted into cash. They are typically subjected to depreciation that eventually reduces their book value to zero (even if the company still uses it).

Right Column is a summary of companies liabilities & value of investment of owners (shareholder's equity)

- As with Assets, Liabilities are broken down into Current Liabilities and Long Term Liabilities.
- Current Liabilities are things like Accounts Payable, Taxes Payable, Salaries Payable – any kind of liability that will be paid in the near term.
- Long Term Liabilities are debts that are paid for over years (vs weeks or months). These are typically loans with a payment schedule.

The other element of the Right Column is Shareholder Equity. Shareholder Equity is defined as Assets minus Liabilities, but is typically not calculated this way. Two items are used to determine Shareholder Equity:

1. Paid in capital (amount invested for shares).

2. Retained earnings, which are calculated by adding in net income (or subtracting net losses) from the previous period's retained earnings. Net dividends paid to shareholders are subtracted from retained earnings.

In our example, at the end of M6, we see:

On the Asset side of the Balance Sheet

- from the Cash Flow statement we have Current Assets -12,100;
- from the Cash Flow statement, we have a Fixed Asset worth 2,000 (that has not depreciated yet)
- Giving us total assets of -10,100

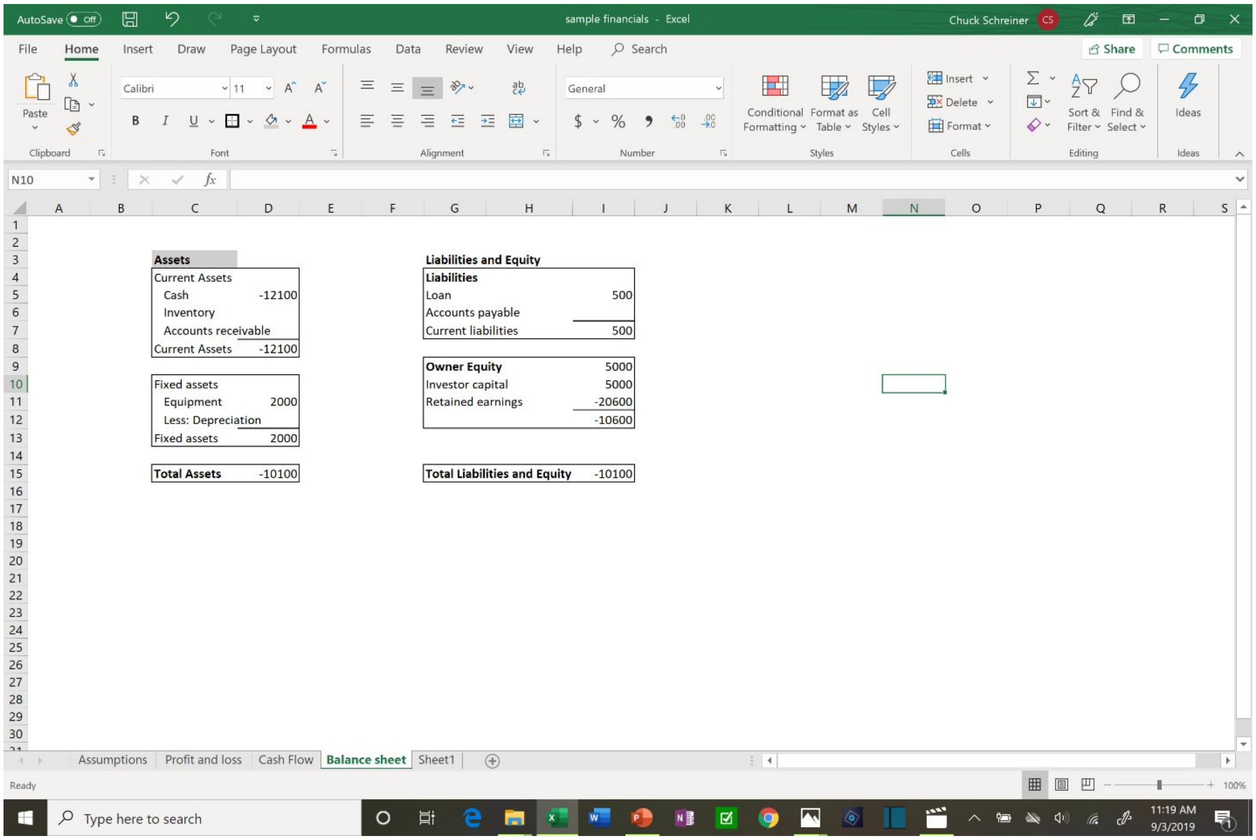
On the Liabilities side of the Balance Sheet

- We have a loan with an outstanding balance of 500 (recall we have already repaid 500 in the Cash Flow Statement) which is all the liabilities in this simple example

On the Shareholder Equity side of the Balance Sheet

- We had raised 5,000 of investment altogether
- We showed a Retained Earnings of -20,600 from the Net Income of the P&L
- These combine for Shareholder Equity of -10,600

The combined total of Liabilities and Shareholder Equity equal -10,100 – and the Balance Sheet is in balance.



Assets	
Current Assets	
Cash	-12100
Inventory	
Accounts receivable	
Current Assets	-12100
Fixed assets	
Equipment	2000
Less: Depreciation	
Fixed assets	2000
Total Assets	-10100

Liabilities and Equity	
Liabilities	
Loan	500
Accounts payable	
Current liabilities	500
Owner Equity	5000
Investor capital	5000
Retained earnings	-20600
	-10600
Total Liabilities and Equity	-10100

Assignment - Tweak assumptions so that they reflect your best guestimate of your first 6 months. At high level, get these spreadsheets to work and reflect your business.

Assets = Current Assets + Long Term Assets

Liabilities = Current Liabilities + Long Term Liabilities

Shareholder Equity = Investor Capital + Retained Earnings

Assets = Liabilities + Shareholder Equity

Reflection Task:

Tweak assumptions so that they reflect your best estimate of your first 6 months. At high level, get these spreadsheets to work and reflect your business.