## Accounting / How to read a balance sheet / Transcript

Produced by companies to provide users with information about the company. Typical financial statement packets include a balance sheet, an income statement, and a statement of cash flows. These reports are produced regularly, usually monthly and annually. We will learn about the balance sheet today and look in depth at income statements in another session.

The balance sheet is a financial report that is prepared at the end of an accounting period. It reports on a company's assets, liabilities, and ownership at a single moment in time. You can think of it like a snapshot of what a business looks like on a particular day.

The first section of the balance sheet lists the assets. Assets are things owned by the company or due to the company. They are resources that are controlled by the business. In this example, the assets of the company total $171,900.

The first category of assets is current assets. These are items on the report that are either cash or can be converted into cash within one year. In this example the current assets are cash, accounts receivable, prepaid rent, and inventory. We will look at each one of these items.

Cash is pretty simple. It would be any amount in the company's bank accounts as well as any cash on hand.

Accounts receivable are the monies that are owed to a company. If a company sends a customer an invoice and that customer has not yet paid, the amount is owed to the company or is receivable by the company.

Prepaid expense is interesting and sometimes difficult to understand. In this example, the $1,000 for prepaid rent reflects a payment that was paid before it was due. Another example would be pre-paid. insurance. The company might pay an annual premium but expense a portion of that payment monthly. The company has paid for something, insurance coverage, that is not yet received or used.

Suppose company A paid $2,400 for insurance for a year. The company would initially record that amount as a prepaid expense. Each month they would record a $200 expense and reduce the prepaid account by the same $200. At the end of the 12 months, when the insurance is used up, the prepaid expense account would have a zero balance. Inventory represents the goods that are considered to be the portion of a business's assets that are ready or will be ready for sale. In the case of our example, Paul's guitar shop, it would likely be guitars and accessories. These items are always valued at their cost to the company.

The total value of cash, accounts receivable, prepaid rent, and inventory is $73,900 and represents the total current assets at the date of the report. Again, current assets are those items that can be readily converted to cash within one year.

Long-term assets are those that are not easily converted to cash. In this case, the long-lived asset is leasehold improvements. Other examples are buildings, computers, computers, vehicles, equipment, and the like. These are recorded at the purchase price.

The next line on the balance sheet is accumulated depreciation. Depreciation is the reduction in the value of an asset over time. A vehicle loses value over time, for example. You can't sell a used vehicle for the same price you purchased it for. Depreciation is taken as an expense each month and the total of the depreciation is recognized and recorded in the accumulated depreciation account. Thus, on the balance sheet, the value of the items and the related accumulated depreciation are netted together, resulting in a number that reflects the value of an asset at a given time. In our example, the value of the leasehold improvements is really $98,000, not the original $100,000 which represents the amount paid for the asset.

The next section in the balance sheet is liabilities. Liabilities are amounts the company owes to others. Just like current assets, current liabilities are amounts that can or will be paid within a one -year period.

Accounts payable represents the amount a company owes to vendors. When an invoice is received, it is recorded in this account until the invoice is paid. In this example, Paul's guitar shop owes vendors $49,000, which is the total of their accounts payable.

Accrued expenses are those that a company has incurred but has not been invoiced for. This could be interest on a loan that has not yet been billed, receiving goods that the company has not received an invoice for yet, or wages earned by employees that have not yet been paid.

Unearned revenue relates to funds received by a company where services have not yet been performed. This could be a down payment for services to be received in the future. For example, a contractor might be hired for a building improvement project. A down payment may be required before the contractor starts work on the project. That amount would be considered unearned revenue by the contractor for the time before the work begins. In the case of Paul's guitar shop, this thousand dollars may have been a down payment on some repairs that were going to be performed and have not yet been started or billed for.

Long-term liabilities are amounts owed that will not likely be paid within a year. Most of the time these are things like notes or loans payable.

The last section of a balance sheet is owner's equity. Owner's equity can be presented in different ways depending on the structure of the company. Sometimes it is labeled as equity and sometimes as capital. It represents the value of the ownership of the company.

Retained earnings represent the cumulative earnings of the company and stock is the value of money that has been invested by outside investors.

One thing to note when reviewing a balance sheet is that the total assets should equal the total of the liabilities plus the owner's equity. In this case, both totals equal $171,900.

All companies use balance sheets to show the strength of the company. Those for small companies like Paul's Guitar Shop and those for large multi-million dollar companies follow the same format. If you know how to read a balance sheet you can really analyze the strength of a company.

 If you want to learn more about balance sheets or financial statements, there are other resources available in the office.