TAKING THE BS OUT OF THE BALANCE SHEET

Financial Statements can be a bit of a mystery to the uninitiated. If you begin to glaze over when it comes to looking through your Balance Sheet - you're not alone. We are often asked "What's the Balance Sheet for and what does it really mean?" It often comes as a shock that the Balance Sheet can make or break a business.

The Profit and Loss Statement is probably easier to understand, in that it simply shows the Income at the top, Costs and Overheads below and the difference is your profit or loss. Profit and Loss is reported over a period – usually monthly and for the year to date. The figures are usually based on invoices in and out i.e. not just cash transactions. This means when an invoice is raised it's accounted for in the Profit and Loss even though payment may not have been received. This is referred to as 'Accrual Accounting'.

So who's interested in the balance sheet?

Lenders and investors - Government departments – Shareholders - Potential purchasers & MANAGEMENT !!!

The Balance Sheet lists the balance of what the business 'owns' and what it 'owes' at a given point in time – usually the end of the month. It's a bit like a personal financial position e.g. you own your home, motor vehicle and furniture and you owe the mortgage, vehicle loan and credit cards. The difference between what you own and what you owe is your personal equity in your belongings.

Some examples of what a business owns (Assets):

Current Assets (Short Term Possessions)

- Cash in the bank – positive bank balance or Cash Deposits
- Amounts owed by customers (Debtors or Accounts Receivables)
- Stock – finished goods and raw materials
- Deposits paid such as rental bonds
- Work in Progress or costs on jobs not yet invoiced
- Prepaid expenses

Fixed Assets – Tangible (Long Term Possessions)

•Assets such as vehicles, equipment, furniture & fittings, Office or Factory premises

<u>Less any depreciation as all things have a limited life span (the asset loses value every year!)</u>

Intangible Assets

Goodwill, patents trade marks (Coca Cola)

Some examples of what a business owes (Liabilities):

Current Liabilities (owed and payable in the short term)

- Bank Overdraft – negative bank balance
- Amounts owed to suppliers (Creditors or Accounts Payables)
- Outstanding Lease amounts payable this year
- Taxes due e.g. GST and PAYG
- Staff Superannuation amounts due
- Unused staff leave

Long Term Liabilities

Loans and Mortgages payable over a number of years, Leases on equipment

The above lists are not exhaustive but are an example of typical Assets (what you own) and Liabilities (what you owe).

As described in the personal financial situation, the difference between what the business owns and what it owes is referred to as equity.

A balance sheet shows:

- how solvent the business is
- how liquid its assets are - how much is in the form of cash or can be easily converted into cash, ie stocks and shares
- how the business is financed
- how much capital is being used

In the Equity section of the Balance Sheet is also shown the balance of previous and current year profits and losses carried forward. Simply, it's where the 'wash up' of the Profit and Loss Statement sits and how the two reports link together.

Compare balance sheets to assess business performance

There are some simple balance sheet comparisons you can make to assess the strength or performance of your business against earlier periods, or against direct competitors. The figures you study will vary according to the nature of the business. Some comparisons draw on figures from the profit and loss (P&L) account.

Liquidity Ratios – Solvency Ratios – Efficiency Ratios – Profitability Ratios

Your Account or Financial Controller can help you with these.

The important issue to understand is that if you only look at the Profit and Loss Statement you are seeing half the picture about what is going on in the business.

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