Financial Statements

Balance Sheet

Financial Statements :Balance Sheet

- Provides information about the financial position of a company at a specific point in time
- The balance sheet is sometimes referred to as the statement of financial position or the statement of financial condition.
- The
  - left side lists ***assets***
  - the right side lists ***liabilities*** and ***owners' equity***

Financial Statements :Balance Sheet

- Elements of the balance sheet:
  - **Assets** - resources of the firm that are expected to increase or cause future cash flows (everything the firm owns)
  - **Liabilities** - obligations of the firm to outsiders or claims against its assets by outsiders (debts of the firm)
  - **Owners' Equity** - the residual interest in, or remaining claims against, the firm's assets after deducting liabilities (rights of the owners)

Questions Answered by a Balance Sheet . . . Among Others

- How much cash does a firm have on hand?
- Does a company have sufficient cash to pay off its debts that are coming due in the next few months?
- Does a firm have more long-term debt than its major competitor?

Financial Statements :Balance Sheet

- A guide to the structure of the assets of a company
- A guide to the level of **gearing** – the ratio of loan to share capital
- Gives a guide as to the degree of **working capital** – the amount the company has to be able to pay its everyday debts (current assets – current liabilities)
- Shows the total value of a firm at that moment in time

Financial Statements :Balance Sheet

- **Balance sheets** supply detailed information about the accounting equation factors:
  - ***Assets***
    - *Current Assets* (Cash, Short-Term Investments, Accounts Receivable, Inventory, and Prepaid Expenses)
    - *Fixed Assets*
    - *Intangible Assets*
    - *Long term investments*

Financial Statements :Balance Sheet

- ***Liabilities***
  - *Current Liabilities* (Accounts Payable, Accrued Liabilities, Notes Payable)
  - *Long-Term Liabilities* (Long-Term Notes Payable, Mortgages Payable, Long-Term Accrued Liabilities)
- ***Owner's Equity***
  - Owner's contributions and revenues increases equity
  - Owner's withdrawals and expenses decreases equity
  - Revenue – sales, interest, dividends ..
  - The revenue earned is measured by the assets received in exchange, usually in the form of cash or debtors
  - Expenses – costs incurred by a business in the process of earning its revenue

The Accounting Equation

Asset = Liability + Owners' equity

- **Asset** is any economic resource expected to benefit a firm or an individual who owns it
- **Liability** is a debt owned by a firm to an outside organization or individual
- **Owners' equity** is the amount of money that owners would receive if they sold all of a firm's assets and paid all of its liabilities

Example

WAL-MART STORES, INC.
Comparative Balance Sheet (all dollar amounts in millions)

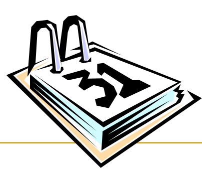
	January 31	
	Year 9	Year 10
Assets		
Cash	$1,856	$2,054
Accounts Receivable	1,341	1,768
Inventories	19,793	21,442
Prepayments	1,366	1,291
Total Current Assets	$24,356	$26,555
Property, Plant and Equipment (net)	39,001	45,417
Other Assets	10,024	10,641
Total Assets	$73,381	$82,613
Liabilities and Shareholders' Equity		
Accounts Payable	$13,105	$15,092
Notes Payable	3,323	2,286
Current Portion of Long-term Debt	1,085	1,375
Other Current Liabilities	6,290	7,196
Total Current Liabilities	$23,803	$25,949
Long-Term Debt	20,706	23,138
Other Noncurrent Liabilities	3,038	2,183
Total Liabilities	$47,547	$51,270
Common Stock	$1,160	$1,858
Retained Earnings	24,674	29,485
Total Shareholders' Equity	$25,834	$31,343
Total Liabilities and Shareholder' Equity	$73,381	$82,613

Balance Sheet Transactions

- The balance sheet is affected by every transaction that an entity encounters.
- Each transaction has counterbalancing entries that keep total assets equal to total liabilities and owners' equity, i.e., the balance sheet equation and the balance sheet ***must always*** be balanced.

Balance Sheet Transactions

- A balance sheet could be prepared after every transaction, but this practice would be awkward and unnecessary.
  - Therefore, balance sheets are usually prepared monthly or on some other periodic schedule.



Transaction Analysis

- Transactions are recorded in accounts, which are summary records of the changes in particular assets, liabilities, or owners' equity.
- The account balance is the total of all entries to the account.

Transaction Analysis

- For each transaction, the accountant determines:
  - Which specific accounts are affected
  - Whether the account balances are increased or decreased
  - The amount of the change in each account

Transaction Analysis

Some definitions to remember:

- Inventory - goods held by a firm for resale to customers
- Account payable - a liability that results from the purchase of goods or services on account
- Compound entry - a transaction that affects more than two accounts
- Creditor - one to whom money is owed
- Debtor - one who owes money

Transaction & Their Effects on Balance Sheet

(Including Examples)

Effect of Transaction on Balance Sheet

- Transactions are ***economic events** or **activities*** that effect the financial position of a business entity (measured in Rupees).
- Ordering supplies, bidding for contract, negotiate to purchase a land are ***not*** transactions (since these are not changing the assets, owners equity or liabilities)
- Primary goal of a business is to increase the owners' equity.
- Certain transactions effect the assets and liabilities.
- Hence, the transaction always effect on the accounting equation.

Effect of Transaction on Balance Sheet

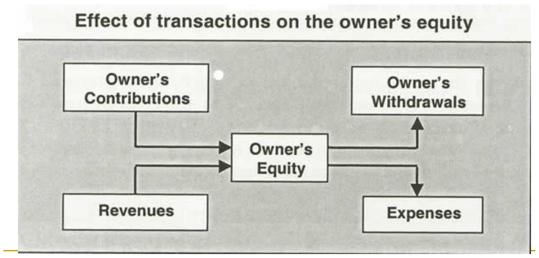
- Transaction the are **not affecting** the owners' equity (OE)
  - Purchase of assets for cash or on credit owns
  - Collection of money from debtors
  - Payment to creditors
  - Repayment of loans
  - Example below – *No changes in OE*

A	OE	L
Transaction: Purchase of office equipment for cash, Rs. 50,000		
+ Rs. 50,000 (Office Equipment) **– Rs. 50,000 (Cash)**		
Transaction: Collection from debtors (a customer pays cash to settle his account), Rs. 30,000		
+ Rs. 30,000 (Cash) **– Rs. 30,000 (Debtors)**		
Transaction: Purchase of office equipment on credit, Rs. 50,000		
+ Rs. 50,000 (Office Equipment)		**+ Rs.50,000 (Creditors)**
Transaction: Payment to creditors (payment to a supplier to settle the amount due), Rs. 25,000		
– Rs. 25,000 (Cash)		**– Rs. 25,000 (Creditors)**

Effect of Transaction on Balance Sheet

- Transaction **affecting** on the owners' equity (OE)
  - Owners' capital contributions
  - Owners' withdrawals
  - Revenues
  - Expenses
  - Example below – C*hanges in OE*

Effect of Transaction on Balance Sheet



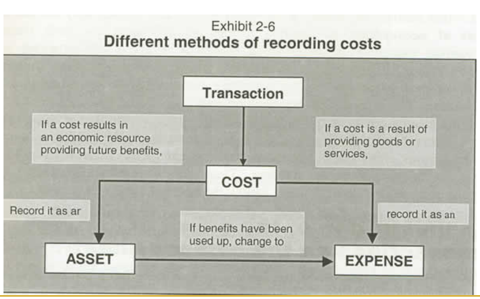
Revenue

- A business earns revenue by providing services or goods for its customers
  - Sales, fees, interests, dividends, royalties and rent
- Revenue is earned
  - cash is received in sale ***at the time***
  - services are rendered or goods are sold on ***credit***
  - collection of credits **does not** mean a revenue
- Borrowing money or owners' contributions are not increase in the assets - ***not*** the revenue.

Expenses (Cost)

- Expense are the cost incurred by a business in the process of earning its revenue - that ***reduce the assets*** and ***increase the liabilities***
  - **cost of assets consumed**
  - **services used**
  - loses of **service potential** or **future economic benefits**
- Example - Employee salary - Electricity bill - Premises rent
- Transaction of cost or expenses can be recorded as
  1) Asset – acquiring economic resources (Unexpired cost)
  2) Expenses – goods or service for a period of time (Expired cost)

Expenses : Recording Cost



Matching: Expenses against Revenue

- Matching expenses against revenue is referred to as **Matching Principle**
- Used to determine ***the profit*** and **the net income** of a business for an accounting period
- Revenue and expenses transactions are recorded in the accounting period when the time of goods or services provided (***Not the time of cash is received or paid***)

Illustrated Examples

1.

Manjula Real Estate
Balance Sheet
As at 1 March 20X1

Assets	
Cash	**Rs. 1,000,000**
Total Assets	Rs. 1,000,000
Owner's Equity	
Capital, M. Mendis	**Rs. 1,000,000**
Liabilities	
(None)	
Total Owner's Equity	Rs. 1,000,000

Illustrated Examples…

2.

Manjula Real Estate
Balance Sheet
As at 27 March 20X1

Assets	
Land and Building	Rs. 850,000
Office Supplies	15,000
Prepaid Insurance	12,000
Debtors	**20,000**
Cash	**158,000**
Total Assets	Rs. 1,055,000
Owner's Equity	
Capital, M. Mendis	Rs. 1,045,000
Liabilities	
Creditors	10,000
Total Owner's Equity and Liabilities	Rs. 1,055,000

Illustrated Examples…

3.

Manjula Real Estate
Balance Sheet
As at 20 March 20X1

Assets	
Land and Building	Rs. 850,000
Office Supplies	15,000
Prepaid Insurance	12,000
Debtors	45,000
Cash	**133,000**
Total Assets	Rs. 1,055,000
Owner's Equity	
Capital, M. Mendis	Rs. 1,045,000
Liabilities	
Creditors	**10,000**
Total Owner's Equity and Liabilities	Rs. 1,055,000