Completing and Analyzing the Balance Sheet

Objectives:

- The student will learn how to complete the financial balance sheet.
- The student will calculate and analyze net worth statements.
- The student will calculate and interpret financial ratios from a balance sheet.

Name the four major categories needed on the balance sheet?

- Current assets – items that can be used or sold and converted to cash within one year, without disrupting the business
- Non-current assets – long term items used to produce a product, not sold within a year
- Current liabilities – debt payable within one year
- Non-current liabilities – debt due beyond one year

List examples of current and non-current assets:

- Current assets – cash, checking accounts, savings accounts, stocks, life insurance, market livestock, harvested and growing crops, accounts receivable, inventory purchased for resale, consumable supplies

- Non-current assets – breeding livestock, equipment, machinery, buildings, land, improvements to land (fences, etc.).

What should be done to complete filling out the balance sheet?

- Accurately list the value of all assets and liabilities in the appropriate categories.

- Current assets are listed first followed by non-current assets, current liabilities and non-current liabilities.

What should be done to complete filling out the balance sheet?

- There are two ways to assign valuation for the assets and liabilities:

1. <u>Cost Valuation</u> – better evaluation of performance

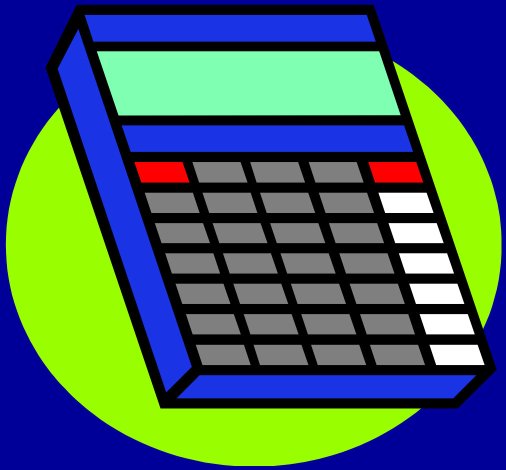
2. <u>Market Valuation</u> – truer representation of asset values

How is Net Worth (Owner’s Equity) Calculated?

- Net Worth = Total Assets – Total Liabilities
- If Net Worth is positive, then total assets exceed total liabilities.
- If Net Worth is negative, then debt is greater than the assets

Calculate Net Worth from the following numbers:

- Current Assets = $5,432
- Non-current Assets = $246,810
- Current Liabilities = $1,234
- Non-current Liabilities = $135,790

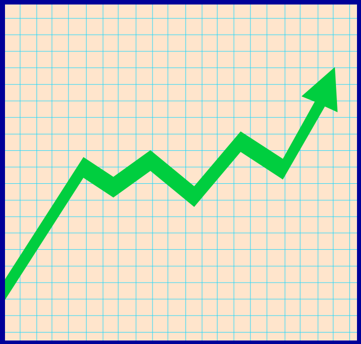


Solution:

Total Assets = $252,242
-<u>Total Liability = $137,024</u>
Net Worth = $115,218

What are two ways to increase net worth?

- increase assets



- decrease liability

Explain liquidity and how it is measured.

- Liquidity is the ability of a business to convert assets to cash quickly. It can be measured two ways:

1. Working Capital = current assets - current liabilities

2. Current Ratio = current assets / current liabilities

Working Capital

- businesses strive for a positive working capital figure

- business size has a large impact on working capital

Current Ratio

- a ratio of 1.5 to 1 indicates flexibility to withstand a business crisis

- the higher the ratio, the more liquid the business

What is solvency and how is it measured?

- a business is solvent if total assets exceed total liabilities
- therefore, <u>solvency</u> is the ability to pay debts or liabilities.

Measures of Solvency

1. Debt to Asset Ratio (total liabilities / total assets)

    - measures proportion of total assets owed to creditors

    - a ratio greater than .50 to 1 is risky

2. Equity to Asset Ratio (net worth / total assets)

    - also called the percent ownership ratio

    - the higher the ratio, the more capital supplied by owner

Measures of Solvency

3. Debt to Equity Ratio (total liabilities / net worth)
   - also called the Leverage Ratio
   - less than 1:1 is preferred

4. Another measure is the Net Capital Ratio (also called Non-current Ratio)
   - non-current assets / non-current liabilities