What Do I See on Balance Sheets?

Learning Objectives

After completing this module you will be able to:

- Identify things to look for on all financial statements.
- Apply a hierarchical approach to analyzing numbers reported on balance sheets.

Key take-aways:

- Balance sheets are vertical expressions of the balance-sheet equation and illustrate that the financial measures of a company's assets and claims must always be equal: Assets (A) = Liabilities (L) + Owners' Equity (OE)
- There are several things to look for on all financial statements, including balance sheets: the reporting dates and periods, fiscal year ends, reporting entity, currency, and rounding (e.g., millions or thousands). In the accompanying notes in annual reports, companies disclose the generally accepted accounting principles (GAAP) to which the reports comply. These notes are especially important to consider when comparing two or more companies.
- Balance sheets help insiders and outsiders assess a company's financial condition: ability to execute its strategies, meet its financial obligations, and respond quickly to unforeseen opportunities and challenges. You should start your assessment with the primary balance-sheet classes, examine the current and non-current assets and liabilities, and then the individual balance-sheet line items.
- Balance sheets are often described as financial pictures of a company at a point in time. However, they are fuzzy pictures. Companies have many resources and obligations that are not on their balance sheets. This means it is particularly important to interpret the numbers in a broader context. In the next module, we start by considering what's behind the numbers and relating this to the business and the environment in which the company competes. This will help you better interpret a company's balance sheet and other financial information.

Key terms:

- **Asset**- Resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.[1]

1 International Accounting Standards Board Framework, ¶ 49(a)

- **Liability**- Present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.[2] Liabilities are creditors' claim on entity's assets. Companies incur liabilities when they do something today, or discover they did something in the past that indicates they are obligated to sacrifice economic benefits in the future to other entities (creditors) to meet an obligation.
- **Equity**- Residual interest in the assets of the entity after deducting all its liabilities.[3] Total owners' equity is the accounting or book value of the owners' claims, which generally differs from fair values. Owners have residual claims on a company's assets, meaning creditors are paid first in the event the company goes out of business or files for bankruptcy. Also called stockholders' equity or shareholders' equity.
- **Financial leverage**- Measures the degree to which a company's assets are funded through owners' equity versus liabilities. Also, extent to which owners can amplify their expected returns by issuing debt rather than issuing stock.

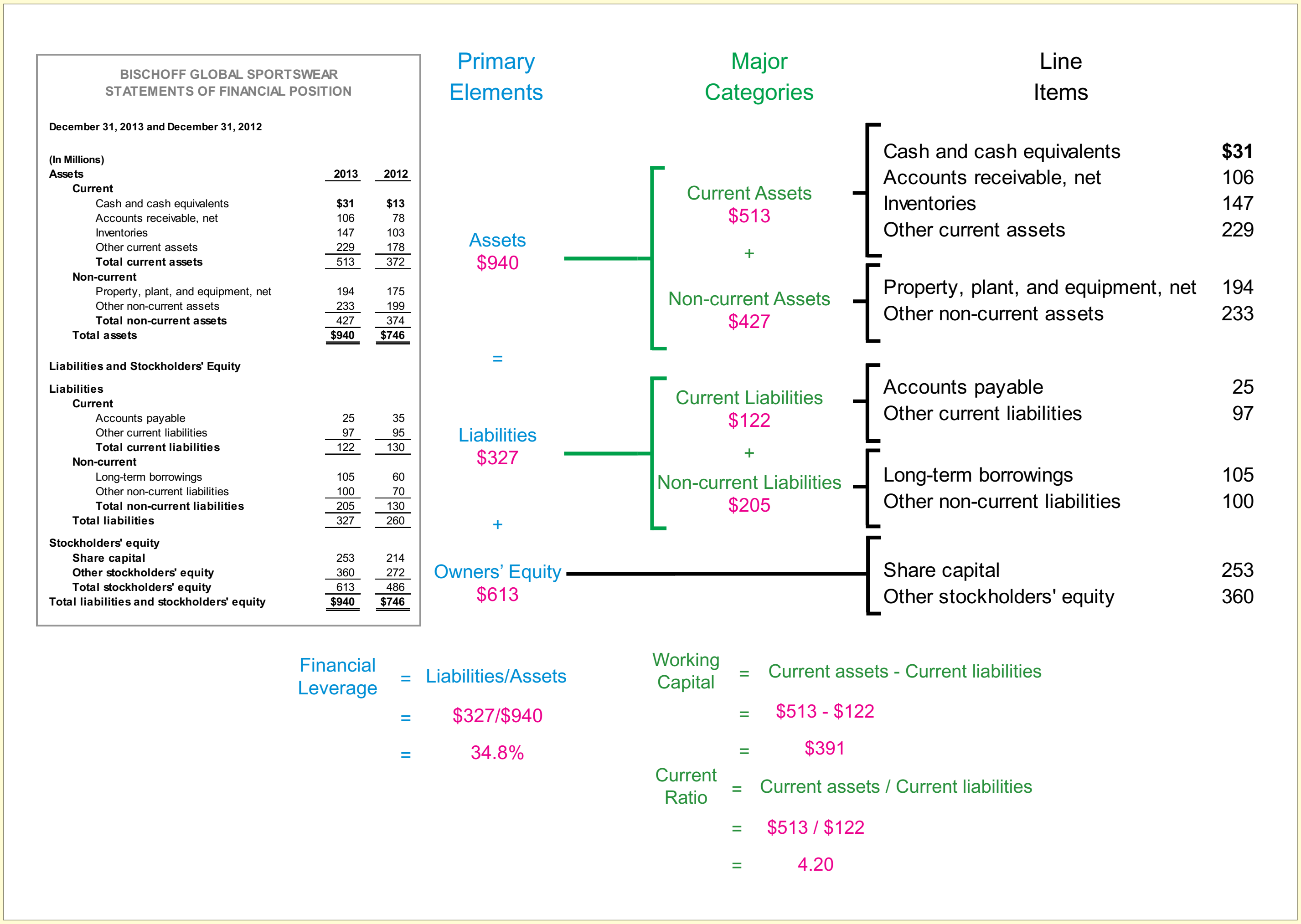
Key formulas:

- Financial leverage[4] = total liabilities / total assets
- Working capital = current assets – current liabilities
- Current ratio = current assets / current liabilities

2 IASB Framework, ¶ 49(b)
3 IASB Framework, ¶ 49(c)
4 There is no universally accepted measure for financial leverage. Typically, it's measured using one of the following: L/A, A/OE, or L/OE, also called debt-to-equity ratio. The financial leverage numbers differ for the formulas, but the conclusions you draw when comparing financial leverage across companies (or over time for the same company) will be the same, providing you use the same formula for all computations.

Figure 1 Hierarchical Analysis of Balance Sheets

This figure illustrates how balance sheets can be analyzed hierarchically.



BISCHOFF GLOBAL SPORTSWEAR
STATEMENTS OF FINANCIAL POSITION

December 31, 2013 and December 31, 2012

(In Millions)	2013	2012
Assets		
Current		
Cash and cash equivalents	$31	$13
Accounts receivable, net	106	78
Inventories	147	103
Other current assets	229	178
Total current assets	513	372
Non-current		
Property, plant, and equipment, net	194	175
Other non-current assets	233	199
Total non-current assets	427	374
Total assets	$940	$746
Liabilities and Stockholders' Equity		
Liabilities		
Current		
Accounts payable	25	35
Other current liabilities	97	95
Total current liabilities	122	130
Non-current		
Long-term borrowings	105	60
Other non-current liabilities	100	70
Total non-current liabilities	205	130
Total liabilities	327	260
Stockholders' equity		
Share capital	253	214
Other stockholders' equity	360	272
Total stockholders' equity	613	486
Total liabilities and stockholders' equity	$940	$746