The Balance Sheet

At its essence the balance sheet is a short, intuitive equation positioned at the foundation of the entire financial reporting structure. Its name is derived from the equal sign positioned in the center of what is commonly described as the **fundamental equation of accounting**:

Assets	=	Liabilities	+	Shareholders' Equity

Assets are often referred to as the left-hand side of the balance sheet with, obviously, liabilities and equity on the right-hand side. Every economic event that is to be captured by the financial reporting system must leave intact the fundamental equality of assets balanced by liabilities and equity. Thus, for example, anything that creates an asset must either simultaneous reduce another asset, increase a liability or increase equity. In short, the balance sheet must balance.

> **Unscrambling "Accountingese"**
>
> **Alternative Names for the Balance Sheet**
>
> - Balance Sheet (Amazon.com)
> - Statement of Financial Position (General Electric)
> - Statement of Financial Condition (Eastman Kodak)

Loosely speaking, **assets** are the economic resources that the enterprise owns or controls. **Liabilities** are the amounts owed by the entity to outside entities such as employees, suppliers and lenders. Finally, **equity** (or *shareholders'* equity in the case of a corporation) is the residual claim on the firm by the owners – in other words, the excess of the firm's assets over its liabilities. One interpretation of a balance sheet is a depiction of the economic resources under the control of an enterprise (assets) and the means by which those resources are financed (debt versus equity).

Perhaps the simplest illustration of these three fundamental elements of a balance sheet is provided from the example of personal home ownership. An individual that owns a $500,000 residence with a $300,000 mortgage to Wells Fargo Bank has a

$500,000 asset on the left-hand side of the balance sheet and a $300,000 liability on the right-hand side. And what is the common vernacular for the $200,000 of home value in excess of the mortgage? *Equity*.

Fundamental Characteristics of a Balance Sheet

Reproduced here are comparative balance sheets of The Finish Line, Inc. They illustrate the structure and common components of a typical corporate balance sheet.[2] This example will be used throughout this Module to demonstrate the form, content and articulation of the four financial statements.

The company is one of the largest mall-based specialty clothing retailers in the United States, and operates under the Finish Line brand name and Running Specialty Group. The term "Consolidated" in its title refers to the fact that financial statements under U.S. GAAP combine the accounts of the parent company (in this case, The Finish Line, Inc.) with its subsidiaries (i.e., other legal entities in which the parent has more than 50% ownership interest). The parent company, Finish Line, Inc., operates 637 mall-based retail stores in 47 states selling brand name athletic apparel and footwear,

√ Reality Check

Finish Line

Consolidated Balance Sheets

(in thousands)	March 3, 2012	February 26, 2011
Current Assets		
Cash and cash equivalents	$ 307,494	$ 299,323
Accounts receivable	9,041	10,552
Merchandise inventories	220,405	193,505
Other	15,808	6,304
Total current assets	552,748	509,684
Property and equipment	126,997	126,510
Intangible assets	25,941	23,795
Other assets	5,810	4,856
Total assets	$ 711,496	$ 664,845
Current Liabilities		
Accounts payable	$ 67,246	$ 72,780
Employee compensation	22,403	18,516
Accrued taxes payable	30,728	18,134
Other accrued liabilities	18,306	16,990
Total current liabilities	138,683	126,420
Non-current Liabilities	43,276	48,180
Shareholders' Equity		
Common stock	211,864	197,629
Retained earnings	445,884	372,047
Treasury stock	(128,211)	(79,431)
Total shareholders' equity	529,537	490,245
Total liabilities and shareholders' equity	$ 711,496	$ 664,845

primarily running shoes. In August 2011, Finish Line acquired 100% of the stock of a company operating 18 retail stores offering men's and women's precision-fitting running shoes operating under the name Running Specialty Stores. The accounts of this subsidiary and six other companies wholly-owned by Finish Line, Inc. are consolidated into a single balance sheet for the entire corporate group.

A second feature of the balance sheet is that it is shown comparatively – in other words, with the current year's balances laid side-by-side those of the prior year to enable comparisons of financial positions across time. Typically the older year is present on the right with the more recent year to the left, but there is no requirement to follow this convention and the analyst must be careful to ascertain in which direction time runs (right to left versus left to right) before comparing the numerical values.

KEY CONCEPT

The balance sheet is a "snapshot" picture of the financial condition of the firm valid only for the instant in time at which it was taken – the balance sheet date.

It is the only one of the four financial statements with this characteristic.

Perhaps the most essential characteristic to understand about a balance sheet is that the statement portrays the firm's financial position (assets, liabilities and shareholders' equity) **at an instant in time**. The balance sheet can be thought of as a still-frame digital photograph of the financial position of an enterprise which is valid only for the instant in time at which it is taken – the balance sheet date. In the case of Finish Line the most recent balance sheet was prepared as of midnight, Saturday, March 3, 2012. As such it presents the ***levels*** of the various assets and liabilities existing at that instant in time.

As made obvious by The Finish Line example, public companies are not required to file financial statements on a calendar year basis with December 31 mandated as the balance sheet date.[3] Finish Line, as is the case with many retailers, selects the Saturday closest to the last day in February for its fiscal year-end. This is done out of a matter of convenience to avoid closing the accounting records (including determining inventory levels) in the midst of the highest sales (and sales returns!) season of the year during December. For companies that are highly seasonal the analyst should recognize that the picture presented on the balance sheet "snapshot" might be highly influenced by the balance sheet date itself. December 31 is, of course, the most prevalent balance sheet date – with 371 firms (74%) of the members of the S&P 500 having their fiscal year-end in December. Figure 2.1 shows the distribution of balance sheet dates by month for the remaining 129 firms in the S&P 500 with fiscal year-ends outside of December.

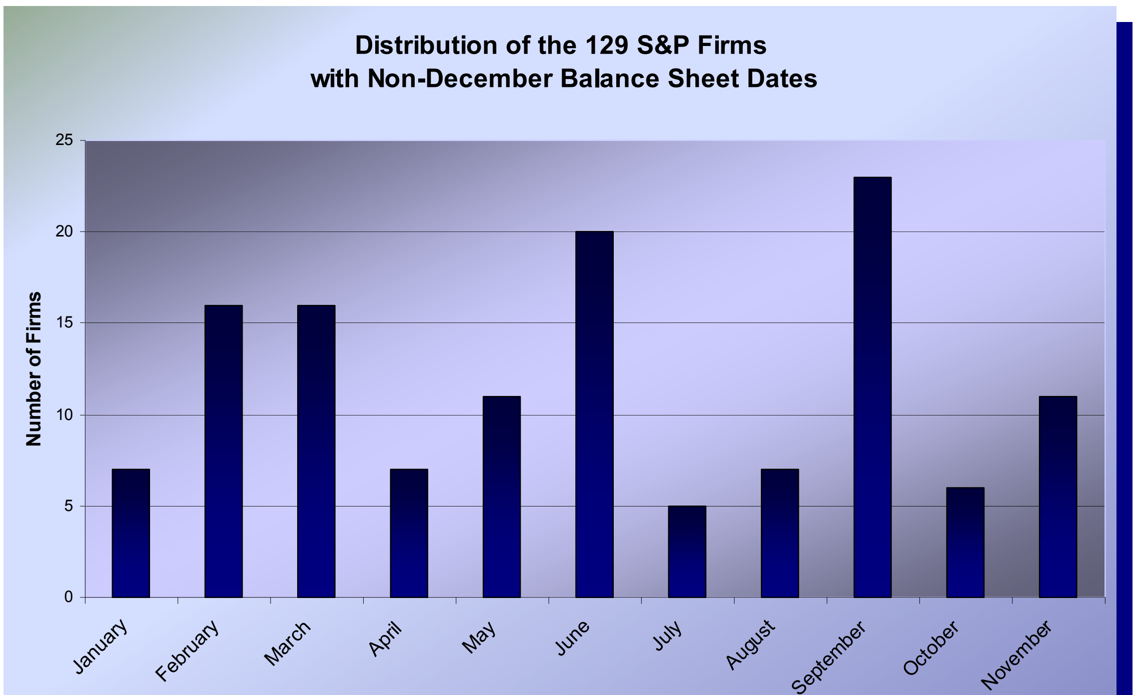

Figure 2.1

A final, and more subtle, characteristic of a balance sheet is that it presents the financial condition of an enterprise resulting from **the cumulative result of all prior events**. The amounts on a balance sheet do not "zero out" at the beginning of every fiscal period with a "fresh start" as will be the case on the income statement and the statement of cash flows. Instead, every amount listed on the balance sheet can be thought of as a ***level*** obtained from the preceding period's reported amount plus and minus the current year's activity.