

Balance Sheet

Chapter 11

Unit 3

Performance Objectives:

You will read definitions of common financial terms. You will read and discuss the purpose of balance sheets and the basic structure of the balance sheet. You will work with a partner to complete two practice problems involving balance sheets. You will create a balance sheet for your business in Microsoft® Excel.

Evaluation Criteria:

Successful completion of this chapter requires you to:

- 1 Read definitions of common financial terms.
- 2 Participate in class discussion regarding the purpose, content and structure of balance sheets.
- 3 Complete two practice balance sheet problems.
- 4 Write balance sheets for your business in Microsoft® Excel.

Task 1: Definitions

Read through the following definitions of common financial terms.

Accounts Payable: money your business owes to suppliers or vendors.

Accounts Receivable: money your customers owe you on goods/services received.

Accrued Expenses: expenses incurred but not yet paid such as salaries, wages, taxes, and social security.

Assets: anything owned by an individual or business that has commercial value. Some examples include cash, stocks, savings bonds, inventories, insurance, and supplies.

Balance Sheet: a financial statement that summarizes the assets, liabilities and owner's equity of a business at a given moment in time. Assets must equal liability + owner's equity.

Capital Equipment: equipment with a taxable life span of several years that a business uses in its daily operations and is not sold to customers. Examples are the company truck, machinery used to make a product, fixtures in a store, etc.

Depreciation: the decrease in value of a machine or piece of equipment through age, wear, or deterioration.

Equity: ownership or percentage of ownership in a company or items of value; the value of the business to the owner.

Fixed Assets: something that you own that is essential to the business and is not depleted every month. If you mow lawns during the summer and you own your own mower, then the mower is a fixed asset. Other examples include land, plant, equipment, leasehold improvements (improvements you have made to rental property), etc.

Liability: loan, expense, or any other form of claim on the assets of a person or a company that must be paid by that person or company (e.g. money owed to someone else).

Liquidity: the ability of a company to quickly convert its assets into cash without a loss.

Long-term Liabilities: liabilities owed for more than one year. Examples of long term liabilities are mortgages, bank loans, and equipment.

Notes Payable: a loan that will be mostly repaid within 30, 60, or 90 days.

Prepaid Expenses: monthly expenses that you have paid upfront in one lump sum (such as insurance).

Short-term Liabilities: a liability that is due within 12 months. Some examples of short term liabilities are accounts payable and loan payments due within 12 months.

Term Loan: a loan paid off over one to ten years. Most commonly used for equipment, other fixed assets, real estate, or working capital.

Total Equity: an individual or business's assets minus liabilities. Some examples are owners' equity, retained earnings, or other equity.

Task 2: Why a Balance Sheet?

Read the information below about balance sheets.

There are three main financial statements that you will need to understand as a business owner: the income statement (also called profit & loss or P&L), the cash flow statement, and the balance sheet. These three statements work together to provide you and other interested individuals with a complete picture of the financial health of your business.

A balance sheet shows your business's assets and liabilities (how much you have vs. how much you owe). You can glance at a company's balance sheet and determine how the company is doing.

Some banks and other lenders may want to see a balance sheet projected each quarter for the first year. In the business world you will only need to do a year-end balance sheet. Doing monthly balance sheets is acceptable, but may just be unnecessary work. For the purposes of this class (since you may not have a year's worth of financial data), we will only create a monthly balance sheet using Jack N' Jill's Lawn Care as an example. After completing the practice example, you will calculate your own balance sheet.

Balance sheets are always laid out in the same format. Your dollar amounts may differ because you are a small business, but even big companies use this same format for their balance sheets.

The reasons for making a balance sheet are:

- To summarize a business's assets and liabilities.
- To demonstrate the liquidity of the company.
- To demonstrate the ability of the company to meet current obligations.

This is the basic format for a simple balance sheet. Assets are listed on the left side and liabilities (debts) are listed on the right. Underneath the liabilities is listed Owner's Equity.

The table shows which items are placed in each category.

ASSETS	LIABILITIES
Cash	Accounts Payable
Accounts Receivable	Loans
Inventory	
Supplies/Equipment	
Prepaid Insurance	
	OWNERS EQUITY

Task 3: Practice Problems

Follow along with the instructor to complete the balance sheet in Problem 1. Then find a partner to complete the balance sheet in Problem 2.

Problem 1: Jack N' Jill's Lawn Care

CURRENT ASSETS

1. For **Cash** they added up all income from the various jobs done and subtracted cash payment for goods needed to do the jobs (maintenance, oil and gas, fertilizer and mulch). *The \$650 for landscaping materials is an account payable (charged on credit) and is not included here.*
 $\$6,385 - \$925 = \$5,460$
2. They have no accounts **receivable** because they get paid on completion of each job.
3. They had a small amount of landscaping materials left over from this month's jobs, giving them \$50 in **inventory**.
4. Jack and Jill paid their insurance for the year in advance in a lump sum of \$1,200 on April 30. Since they've used up three months of their insurance, the value of their insurance is only \$900. This is considered a **prepaid expense asset** of \$900.

FIXED ASSETS

1. They don't own any **buildings** or **lease any space** so they don't have any **fixtures** or **leasehold improvements** either. Examples of fixtures are counter-tops, special lighting, supermarket shelving, etc.
2. The original purchase price of vehicles such as their **truck** and **equipment** are included as fixed assets. (Refer to the capital equipment list.)
3. Remember, the reason we set up a capital equipment list and calculated depreciation was so we can use it in the balance sheet. The difference between the total purchase cost and total current value of the capital equipment is the number you put in for depreciation. This figure is the dollar value recorded as accumulated depreciation so far.

CURRENT LIABILITIES

1. All outstanding debts that must be paid in the short term are listed under **Accounts Payable**. For Jack N' Jill's Lawn Care, that means \$650 to the Landscaping Supplies Wholesaler for landscaping supplies and \$35 for the phone (\$685).
2. **Current Portion Long-Term Debt** is the fancy accounting way of saying loan payment. This is where Jack and Jill list their monthly \$150 payment on their equipment loan.
3. **Accrued Expenses** is where **unpaid salaries**, wages, taxes, and social security get listed. (In this case the only accrued expenses are the salaries = \$408.)
4. **Note payable** is a short term business loan which is usually mostly repaid within ninety days. Jack and Jill do not hold any notes.

LONG TERM LIABILITIES

1. The balance of the \$3,000 equipment loan that Jack and Jill owe is listed under **Equipment Loan**. Since they took out the loan on December 31, 2009, for \$3,000, they've made seven payments of \$150 (\$1,050) so the loan balance is \$1,950.
2. **Equity**: ownership or percentage of ownership in a company or items of value

$$\text{Total Equity} = \text{Total Assets} - \text{Total Liabilities}$$

NOTE: In a balance sheet, **Total Assets** must be equal to **Total Liabilities plus Equity**, that is, the balance sheet must balance.

Jack N' Jill's Lawn Care Balance Sheet For Month Ended July 31, 2010

Assets		Liabilities	
CURRENT ASSETS		CURRENT LIABILITIES	
Cash	\$5,460	Accounts Payable	\$650
Accounts Receivable	0	Current Portion Long-Term Debt	150
Inventory	50	Accrued Expenses	408
Prepaid Expenses	900	Notes Payable	0
Total Current Assets	\$6,410	Total Current Liabilities	\$1,208
FIXED ASSETS		LONG-TERM LIABILITIES	
Fixtures and		Equipment Loan	\$1,950
Leasehold Improvements	\$0	Total Long-Term Liabilities	\$1,950
Building	0	Total Liabilities	\$3,158
Trucks	1,500	EQUITY	
Machinery and Equipment	3,725	Total Equity	\$7,705
Depreciation - Equipment	(772)	Total Liabilities and Equity	\$10,863
Total Fixed Assets	\$4,453		
Total Assets	\$10,863		

Problem 2: JR's U\$ed CDs

Step 1: Create Capital Equipment List

JR's U\$ed CDs Capital Equipment List April 30, 2010

Item	Purchase Date	Purchase Cost	Monthly Depreciation	Current Value
Point of Sale (POS) System	10/31/09			
Computer w/ monitor		\$599.00	\$9.98	\$539.12
Scanner		163.00	2.72	146.68
Cash Drawer		150.00	2.50	135.00
Receipt Printer		267.00	4.45	240.30
POS Software		749.00	12.48	674.12
Stereo System	4/30/07	899.00	14.98	359.72
CD Racks & Benches	10/31/09	2,000.00	33.33	1,800.02
Digital Listening Equip.	10/31/09	400.00	6.67	359.98
Neon Sign	1/31/10	1,000.00	16.67	949.99
Specialty Lighting	10/31/09	1,500.00	25.00	1,350.00
Total Capital Equipment		\$7,727.00	128.78	\$6,554.93

Finally, determine the total amount of depreciation by writing your figures in the formula below and subtracting:

Total Purchase Cost *minus* Total Current Value = Total Depreciation

\$ _____ - \$ _____ = \$ _____

JR consulted the IRS B1 and B2 tables and determined that all of his assets listed above could be depreciated over five years.

Step 2: Study JR's Income Statement

**JR's U\$ed CDs
Income Statement
For Month Ended April 30, 2010**

Sales	\$2,975
Total Sales	<u>\$2,975</u>
Cost of Goods Sold	<u>\$1,080</u>
Gross Margin	<u>\$1,895</u>
Operating Expenses	
Rent	\$500
Bill from Athens local daily paper for ad	75
Bill from Office Max for wrapping and custom bags	50
Depreciation on equipment	129
Insurance payment to MyState Insurance	75
Bill from WPLQ Radio Station for five-minute radio spot	75
Jill's and Mike's salaries (part-time employees)	560
Payment to Bell Phone Company	<u>35</u>
Total Operating Expenses	<u>\$1,499</u>
Other Expenses	\$0
Total Other Expenses	<u>\$0</u>
Total Expenses	<u>\$1,499</u>
Net Profit Pretax	<u>\$396</u>

Step 3: Read about JR's Finances

1. JR has been making a small profit during his first six months of operation and now has a cash reserve of \$1,245 in the bank.
2. A local Beatles collector asked JR if he could find him the Complete Works of the Beatles on 12-inch vinyl records. JR paid \$400 for a set and billed the collector for \$640. He expects the payment check in the mail soon.
3. JR recently took delivery of a new stock of posters and owes the Poster Company \$220. He also has accounts with the newspaper company and the radio station that each bill him \$75 per month for services.
4. JR's annual insurance premium of \$900 was paid in early January.
5. He owes \$50 per month since January 31 to the Neon Sign Company that made his \$1,000 neon sign. This is considered a "note payable."
6. He owes \$150 per month to the Athens National Bank for his \$3,900 term loan taken out in October 31, 2009 (CD benches, listening station, and lighting).
7. A recent audit by the insurance company showed that JR had \$2,400 worth of inventory.
8. JR spent \$1,080 buying used CDs, tapes, and records from the public.
9. He pays each of his two employees \$6 per hour and they each work twelve hours per week. (*Hint: When calculating accrued expenses, say that two employees worked twelve hours each from April 27- 30.*)
10. The pay period ended on Friday, April 26.

Step 4: JR's Balance Sheet April 30, 2010

To complete the balance sheet below, use the information from JR's

- Income Statement
- Capital Equipment List
- Step 3 reading

**JR's U\$ed CDs
Balance Sheet
For Month Ended April 30, 2010**

CURRENT ASSETS	CURRENT LIABILITIES
Cash	Accounts Payable
Accounts Receivable	Current Portion Long-Term Debt
Inventory	Accrued Expenses
Prepaid Expenses	Notes Payable
Total Current Assets	Total Current Liabilities
FIXED ASSETS	LONG-TERM LIABILITIES
Fixtures, Leasehold Improvements	Term Loan
Building	Notes Payable
Trucks & Vehicles	Total Long-Term Liabilities
Machinery & Equipment	
Depreciation	Total Liabilities
Total Fixed Assets	EQUITY
	Total Equity
Total Assets	Total Liabilities and Equity

Task 4: Writing a Balance Sheet for Your Business

Use the model below for writing your own business plan in Microsoft® Excel. Remember to use formulas.

Use the table below to create a balance sheet for your business.

CURRENT ASSETS		CURRENT LIABILITIES	
Cash	_____	Accounts Payable	_____
Accounts Receivable	_____	Current Portion Long-Term Debt	_____
Inventory	_____	Accrued Expenses	_____
Prepaid Expenses	_____	Notes Payable	_____
Total Current Assets	_____	Total Current Liabilities	_____
FIXED ASSETS		LONG-TERM LIABILITIES	
Fixtures & Leasehold Improvements	_____	Equipment Loan	_____
Building	_____	Total Long-term Liabilities	_____
Trucks & Vehicles	_____		
Machinery & Equipment	_____		
Depreciation	_____	Total Liabilities	_____
Total Fixed Assets			
		EQUITY	
		Total Equity	_____
Total Assets	_____	Total Liabilities and Equity	_____

Task 5: Creating Your Balance Sheet in QuickBooks Basic 2002[®]

Open QuickBooks Basic 2002[®] and follow the directions below to write a balance sheet for your business.

1. Go to **Reports** → **Report Finder** and Select **Balance Sheet Standard**.
2. Select the date range.
3. Click Display.

Notes: