

WHAT ARE THE COMPONENTS OF A BUSINESS BALANCE SHEET?

The Balance Sheet represents one day in the life of a business. It shows how much of a business is owned (assets) and how much it owes (liabilities) on that one day in time. In other words it is a snap shot of a specific day in the life of a business. The difference between what is owned and what is owed on that day is the business's net worth or equity.

A business Balance Sheet has 3 components: assets, liabilities, and net worth or equity. The Balance Sheet is like a scale. Assets and liabilities (business debts) are by themselves normally out of balance until you add the business's net worth.

Assets minus Liabilities always = Net Worth or Equity

What are Assets?

An asset is a resource with economic value that a business owns with the expectation that it will provide future benefit to the business. As an example, a business owns a forklift with the expectation that it will assist in moving product that will be sold and upon the sale of the product income or value will be added to the business. Therefore, the forklift has brought economic value to the business.

Business assets are broken into 2 categories: current assets and non-current assets. The liquidity of the asset determines into which category it falls. Liquidity is the ease in which an asset can be converted to cash. Assets that will be or should be converted to cash within 12 months are considered current assets. The most common current assets of course include cash on hand, but also inventory and accounts receivable. An Account Receivable is short term financing a business offers to its customers. Normally a business will offer its customers 30 to 60 days from the day of delivery of a product or the performance of service to pay for the product or service. They show this in dollar form on the Balance Sheet as Accounts Receivable until the customer pays and it is converted to cash. Inventory that a business holds is considered a current asset because the likelihood that the inventory will be sold within the next 12 months, which will then convert it to cash. Non-current assets are assets that will not be converted to cash within 12 months and are normally used on-going to run the business, such as, the forklift in our prior example. Most non-current assets are considered fixed assets, and include equipment used in the running of the business, furniture and fixtures and also any real estate the business owns.

What are Liabilities?

A business's liabilities are obligations the business owes. As with assets the liabilities are broken into current liabilities and non-current liabilities, most often called Long Term Debt. Current liabilities are obligations that are scheduled to be paid over the next 12 months. Most common current liabilities include accounts payable, business line of credit and the current portion of long term debt. Accounts payable are short term obligations owed to suppliers or other creditors and are normally paid within 30 to 60 days from the day of a delivery of a product or the performance of a service. Business Lines of Credit are used by businesses to service some short term needs and are paid generally from the collection of the businesses accounts receivable. The current portion of long term debt is the amount scheduled to be paid on long term obligations over the next 12 months. Long term debt are loans incurred by the business to finance long term or fixed assets for the business.

What is Net Worth?

Sometimes referred to as the businesses equity, it refers to value of ownership. The ownership is limited by the businesses assets and debts. The ownership of the assets is only the value of

the assets less any debts with a pledge against those assets. This meaning is encapsulated in the fundamental accounting equation, which defines the owner's equity in the business as equal to Assets minus Liabilities.

How does a business grow its Net Worth or Equity?

Businesses grow through building their Net Worth or Equity. A main goal of every business is to see this growth. There are various ways a business can grow their Net Worth, most evident is to decrease debt. This means a business will have more ownership in the businesses assets, since less of the assets will be pledged to debt. The greatest contributor to the growth in a business's equity or net worth is retained earnings. The earnings of the business become equity in the business in the form of retained earnings, which is listed as such under the equity section of the Balance Sheet. Another way to grow a business's net worth is through an outside capital injection. This is most often money put into the business by ownership or by outside investors. This normally shows as Capital under the equity section of the businesses Balance Sheet.

This represents a general overview and is not considered accounting advice. Please seek direction from an accounting professional for detailed information regarding your business financials.