



How to Understand Balance Sheets

A Delicate Balancing Act

What is a Balance Sheet?

A **Balance Sheet** is a snapshot of a company's financial health.

The goal of a Balance Sheet is to make sure that your company's assets are equal to the combination of your liabilities and owners' equity.

$$\text{Assets} = \text{Liabilities} + \text{Equity (Net Worth)}$$

As such, it shows your collection of total assets plus how they were paid for.

KEY TERMS:

Asset: something owned by a company that holds value; assets can be physical, like equipment and inventory, or nonphysical, like trademarks and patents or goodwill.

Cash on hand: the money you can currently access or will be able to access within 90 days. It can be cash held in a financial institution, a safe or another location where it is readily available.¹

Current assets: the sum of cash and cash equivalents, accounts receivable, inventory, marketable securities, prepaid expenses and other assets that could be converted to cash in less than one year.²

Fixed assets: long-term assets that a company owns and aren't usually consumed or used for cash.³ These can be physical items such as land, machinery, equipment and furniture.

Liabilities: an obligation that the company owes, either to vendors, suppliers or lending institutions.

Current liabilities: the sum of all money owed by a company and due within one year.⁴

Long-term liabilities: debt that will be due more than one year away.

Depreciation: a calculation to show how your tangible assets lose value over time. While there are

several ways to account for depreciation, the most basic is for an asset's salvage value subtracted from its cost to determine the amount to be depreciated.

Equity: ownership shares in a business.

Intangible assets: long-term assets that are not physical. These can be items such as copyrights, patents, trademarks, intellectual property (IP), goodwill and brand.

Goodwill: includes intangible assets such as reputation, brand and domain names.

Accrued expenses: a method of accounting for when a business received a service or item for which it has not yet paid (e.g., utilities).

How to Use A Balance Sheet

To create your balance sheet, follow these steps:

- Itemize all your **current assets**, such as **cash on hand**, your accounts receivable, inventory, prepaid expenses and any other current assets.
- Itemize your **fixed assets**, such as machinery, equipment, furniture and fixtures, leasehold improvements, land and building holdings, and any other fixed assets. Factor in the **accumulated depreciation**.
- Next, think about your other assets, such as intangibles, like intellectual property, patents and trademarks. Factor in the **goodwill** your company has.
- Itemize all your **current liabilities** and **long-term debts** to arrive at your total liabilities.
- Combine your total liabilities and your **owners' equity**.

Tip: With a balance sheet, you can also project totals for future years. A projection doesn't have to be perfect—it's intended to help you see what additional resources you might need in the future and where they might come from. Check out the Financial Projections excursion to learn more!

EXAMPLE: JAYNE'S LOCKSMITH COMPANY (JLC)

JLC is a small business that installs locks in commercial buildings. Jayne runs her business as a cash business, so her business has no liabilities for Year 1.

	Beginning (as of 01/01/xx)	Y1	Y1 Notes	Definitions
Current Assets				
Cash in bank	\$50,000	\$85,520	Jayne Invested \$50k of her own money. Net profit + beginning cash.	
Accounts receivable	—	—	N/A	
Inventory	—	—	N/A	
Prepaid expenses	—	—		
Other current assets	—	—		
Total Current Assets	\$50,000	\$85,520		Your current assets are items that could be converted to cash in less than one year. ⁵
Fixed Assets				
Machinery & equipment	—	—		
Furniture & fixtures	—	—		
Leasehold improvements	—	—		
Land & buildings	—	—		

Other fixed assets	—	—		
(LESS accumulated depreciation on all fixed assets)	—	—		Here, less accumulated depreciation refers to the depreciation built up over time on the fixed assets owned by the company.
Total Fixed Assets (net of depreciation)	\$ —	\$ —		Your fixed assets are long-term assets that a company owns and aren't usually consumed or used for cash. These can be physical items such as land, machinery, equipment and furniture.
Other Assets				
Intangibles	\$ —	\$ —		
Deposits	—	—		
Goodwill	—	—		Goodwill includes reputation, brand and domain names.
Other	—	—		
TOTAL ASSETS	\$50,000	\$85,520		

	Beginning (as of 01/01/xx)	Y1	Y1 Notes	Definitions
Current Liabilities				
Accounts payable	\$ —	\$ —	Owe \$5,000 for last 50 locks	
Payroll and taxes payable	—	—		
Interest payable	—	—		
Taxes payable	—	—		
Accrued expenses	—	—		
Notes, short-term (due within 12 months)	—	—		
Current portion, long-term debt	—	—		
Other current liabilities	—	—		
Total Current Liabilities	\$ —	\$ —		
Long-Term Debt				
Bank loans payable	\$ —	\$ —		
LESS: Short-term portion				

Notes payable to stockholders	—	—		
Other long-term debt	—	—		
Total Long-Term Debt	—	\$ —		
Total Liabilities	\$ —	\$ —		
Owners' Equity				
Invested capital	\$50,000	\$50,000		
Retained earnings--beginning	—			
Retained earnings--current	—	\$35,520	Net Profit Y1	
Total Owner's Equity	\$50,000	\$85,520		
TOTAL Liabilities & Equity	\$50,000	\$85,520		

The example shown has been created using modified SCORE Excel templates.

Develop Your Own Balance Sheet

Now that you've seen how a balance sheet works for a small business, you can create one for your own business. Use the tool you downloaded to practice creating a balance sheet for your business.

Disclaimer: *The business appearing in this work is fictitious. Any resemblance to an actual business is purely coincidental.*

¹ Lee Nicols, *The Difference between Petty Cash and Cash on Hand*, Chron (April 10, 2019), <https://smallbusiness.chron.com/difference-between-petty-cash-cash-hand-51922.html> (accessed April 11, 2019).

² *Glossary of Financial Terms*, U.S. Small Business Administration (June 20, 2018), <https://www.sba.gov/document/support--glossary-business-financial-terms> (accessed April 11, 2019).

³ Will Kenton, *Fixed Asset*, Investopedia (Dec. 12, 2017), <https://www.investopedia.com/terms/f/fixedasset.asp> (accessed April 11, 2019).

⁴ *Glossary of Financial Terms*, U.S. Small Business Administration (June 20, 2018), <https://www.sba.gov/document/support--glossary-business-financial-terms> (accessed April 11, 2019).

⁵ *Ibid.*