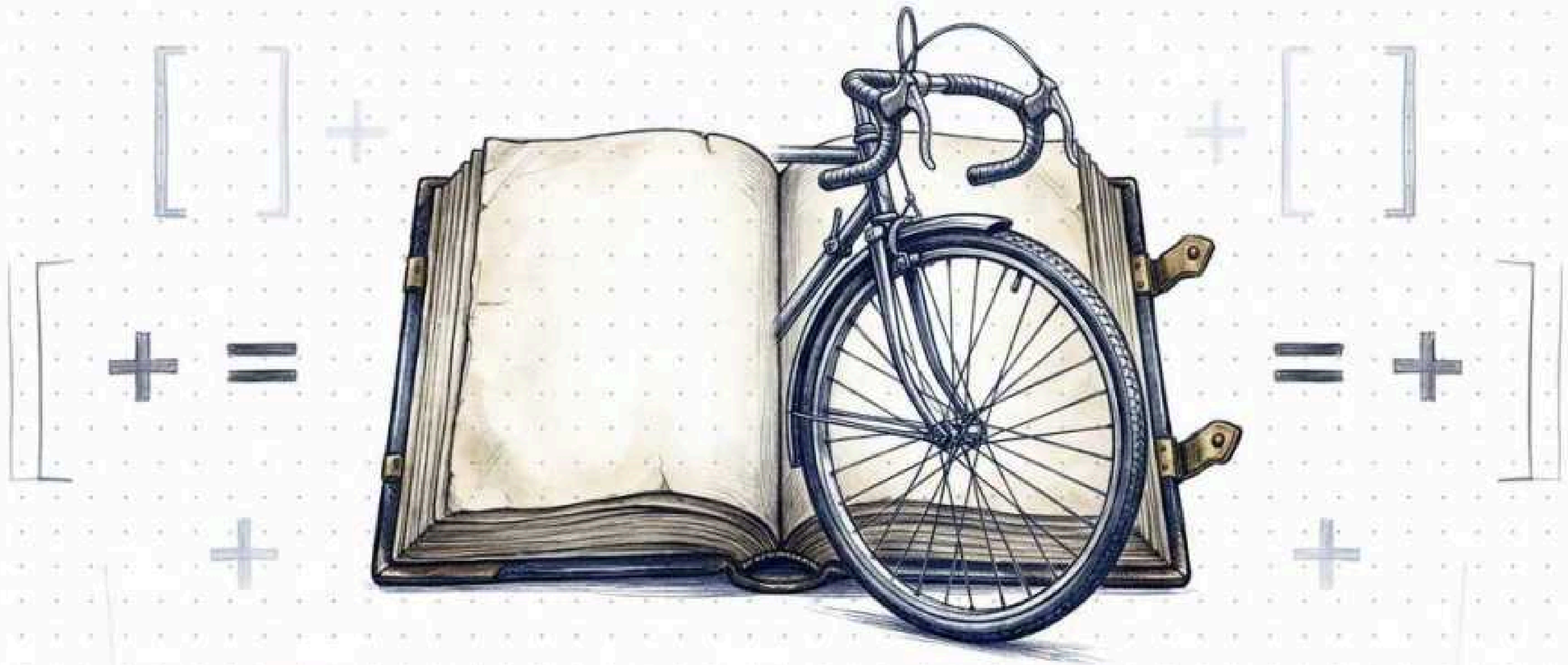


The Balance Sheet

ACCT 201 B — Lecture 2

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¶ 2.1



What does a balance sheet show?



How are assets, liabilities, and equity classified?



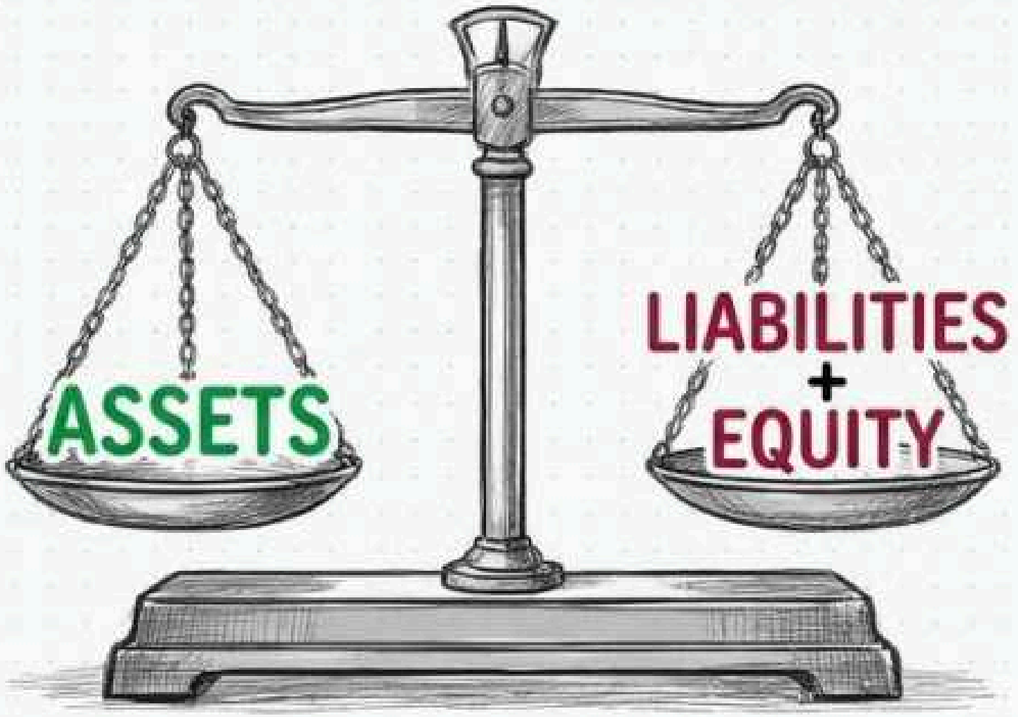
What are the limits of this statement?

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¶ 2.2



The Statement of Financial Position:
A snapshot at a single moment.



Assets = Liabilities + Equity (Always Equal)

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1 Year Boundary

Current Assets
(expected to turn to cash < 1 Year)



→ Cash

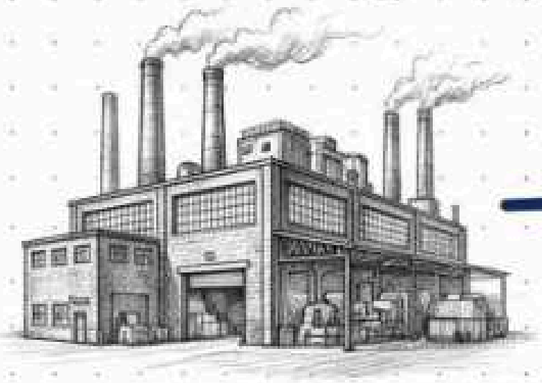


→ Accounts Receivable (money owed by customers)



→ Inventory

Noncurrent Assets
(last > 1 Year)



→ Property, Plant & Equipment



→ Long-term Investments



→ Intangibles

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1 Year Boundary

Current Liabilities
(due < 1 Year)



→ Accounts Payable



→ Wages Owed



→ Current part of loans

Noncurrent Liabilities
(due > 1 Year)



→ Long-term Bank Loans



→ Bonds

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EQUITY



Contributed Capital

Money owners have put in (e.g., buying shares).

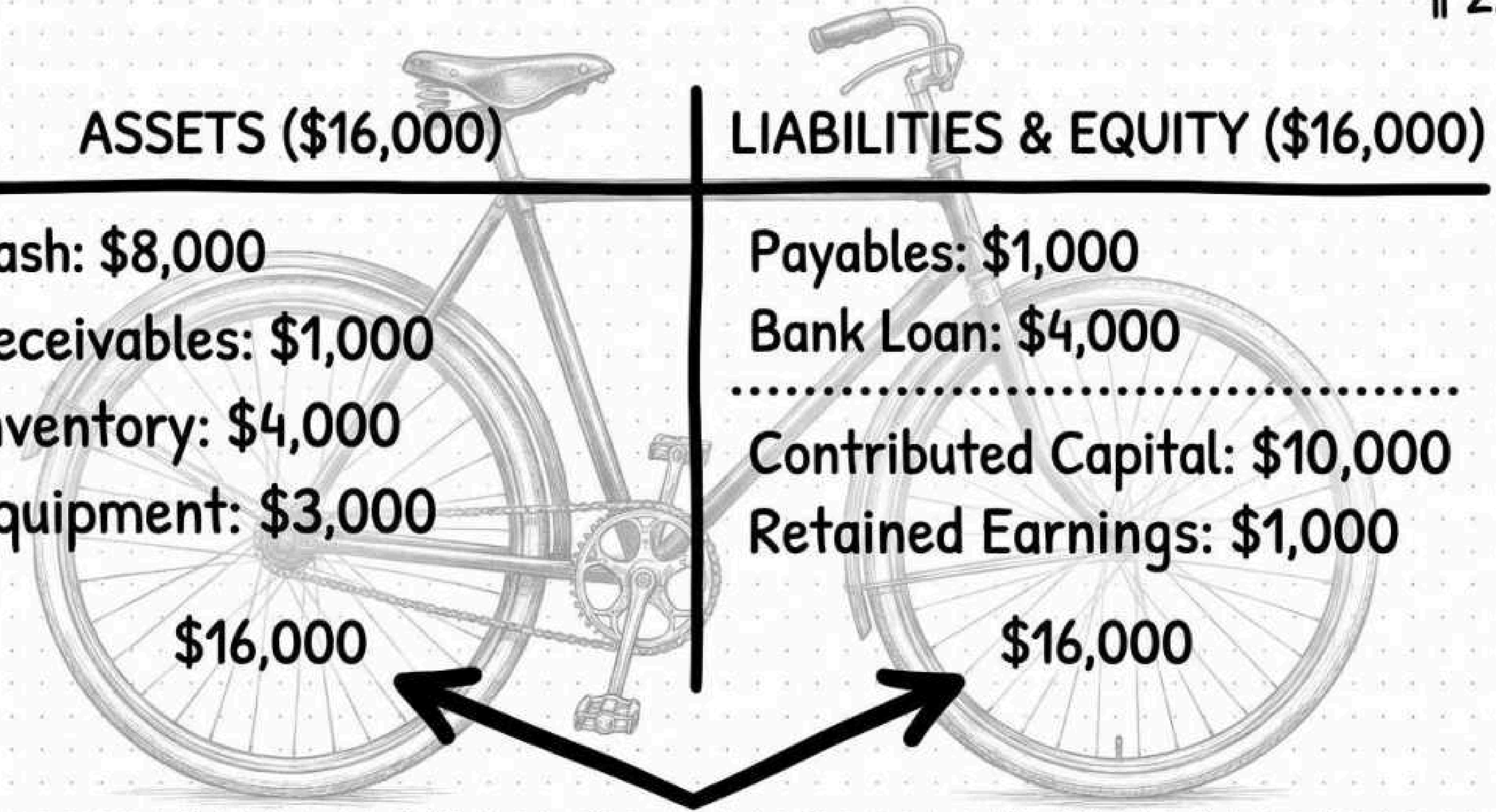


Retained Earnings

Profits the business has kept over its life.

+ Profits	− Dividends or Losses
→ Earnings Grow	→ Earnings Shrink

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ASSETS ($16,000)	LIABILITIES & EQUITY ($16,000)
Cash: $8,000	Payables: $1,000
Receivables: $1,000	Bank Loan: $4,000
Inventory: $4,000	Contributed Capital: $10,000
Equipment: $3,000	Retained Earnings: $1,000
$16,000	$16,000

The fundamental equation in action: perfectly balanced.

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Historical Cost



What was originally paid.
Objective and verifiable, but can become severely out of date.

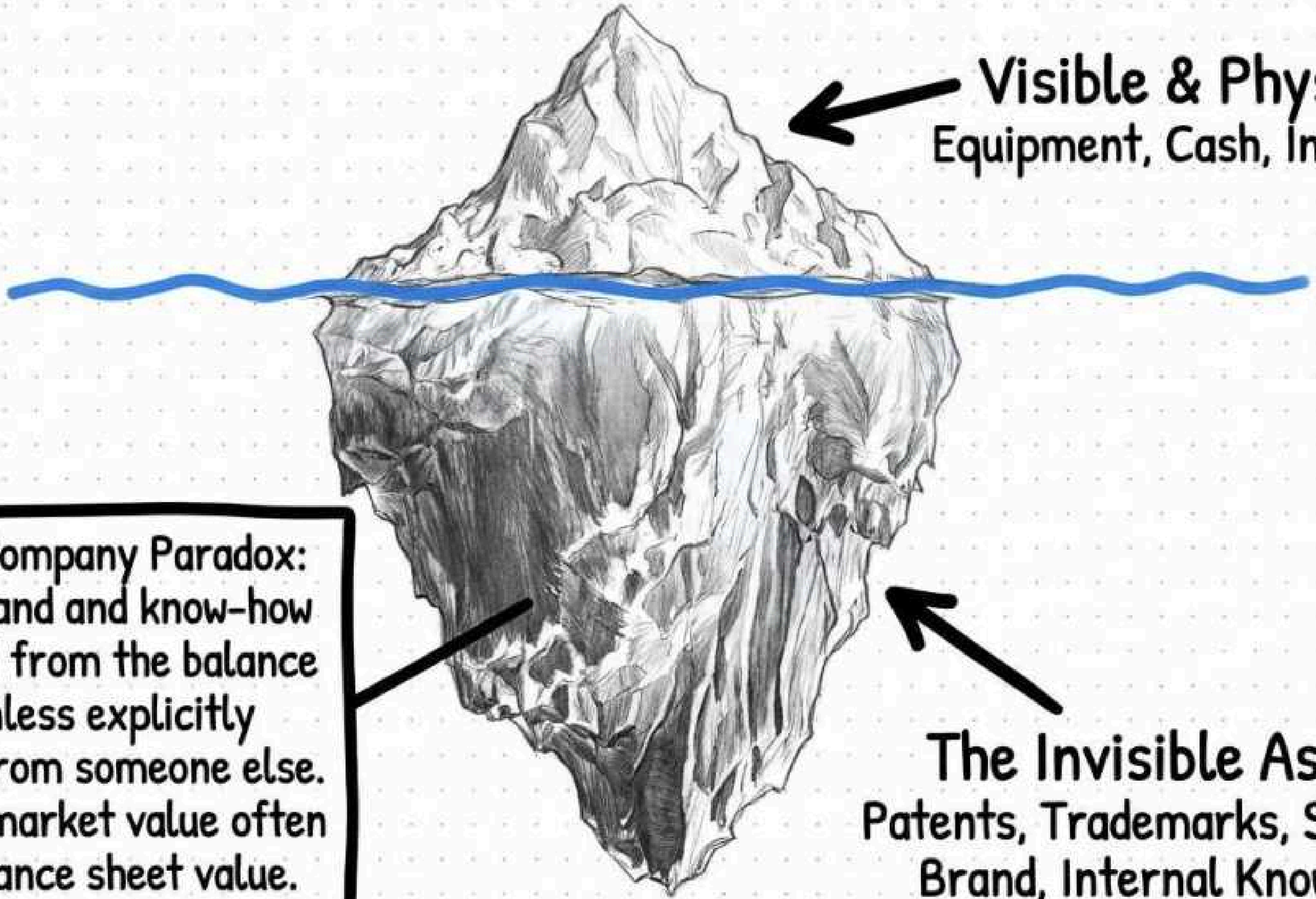
Fair Value



Current market price.
Used primarily for financial investments.

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¶ 2.8



Visible & Physical

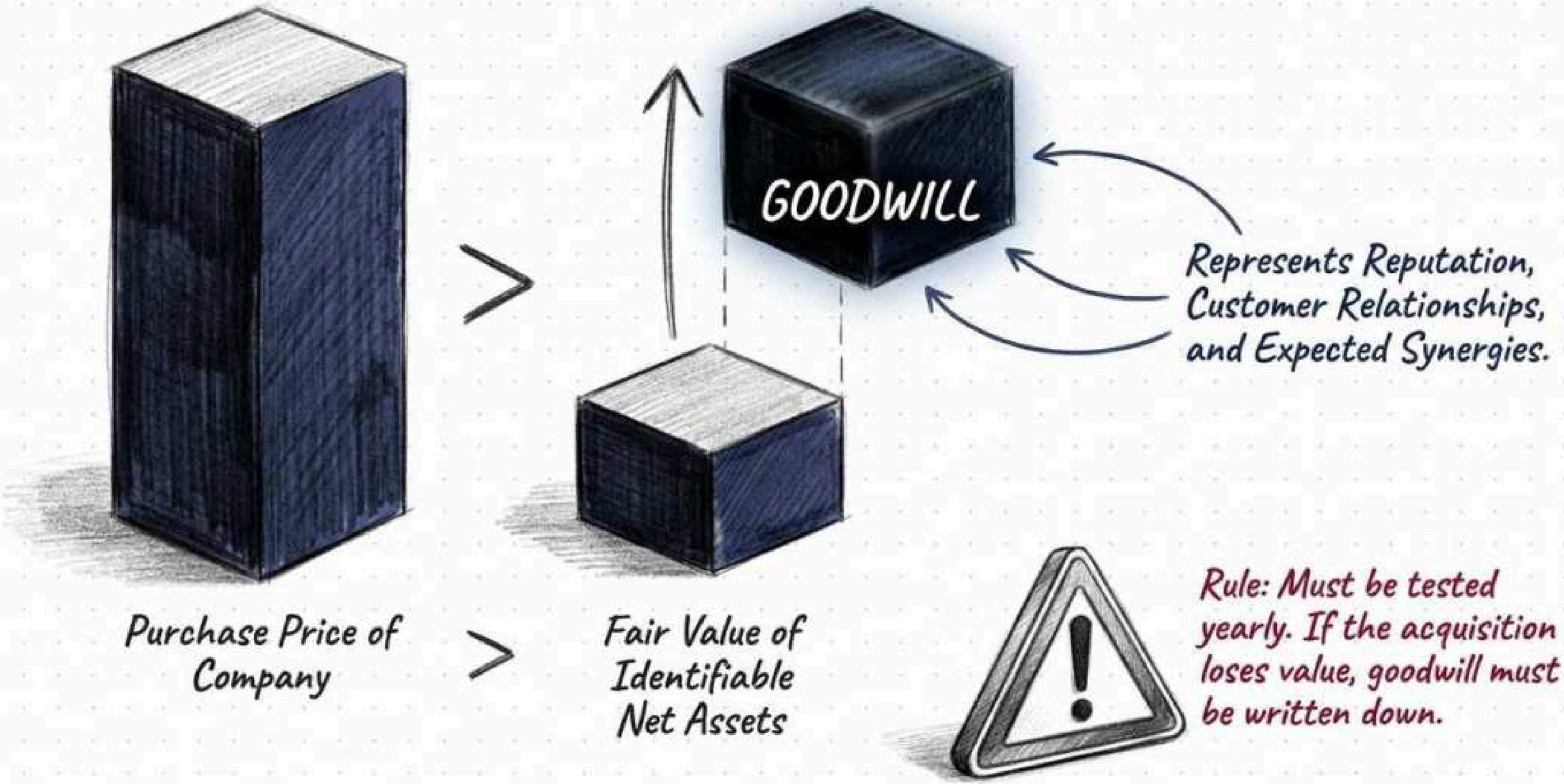
Equipment, Cash, Inventory

The Tech Company Paradox: Internal brand and know-how are omitted from the balance sheet unless explicitly purchased from someone else. This is why market value often dwarfs balance sheet value.

The Invisible Assets

Patents, Trademarks, Software, Brand, Internal Know-How

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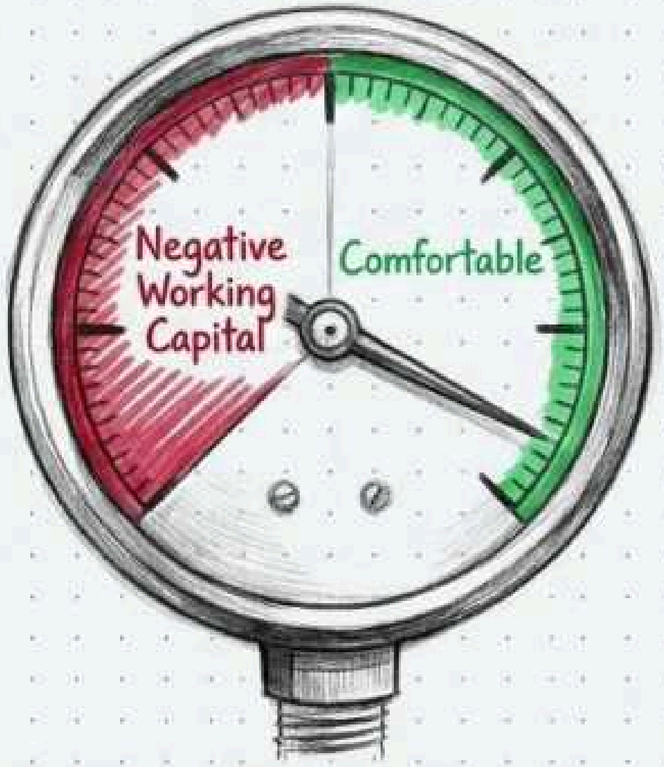
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Current Assets – Current Liabilities = Working Capital

(Short-term survival metric)

$13,000 – $2,000 = $11,000

Danger:
The business will struggle to pay its suppliers.



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Market Value

The total price investors are willing to pay for its shares.

Book Value

Literally just Assets minus Liabilities.

=

Price-to-Book Ratio

Ratio > 1

Investors see highly valuable intangibles not on the balance sheet.

Ratio < 1

Investors believe the company is in trouble/distress.

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The Snapshot Flaw:

Easily flattered by temporary window dressing right before Dec 31.

The Blind Spot:

Entirely omits internally generated intangibles.



The Time Lag:

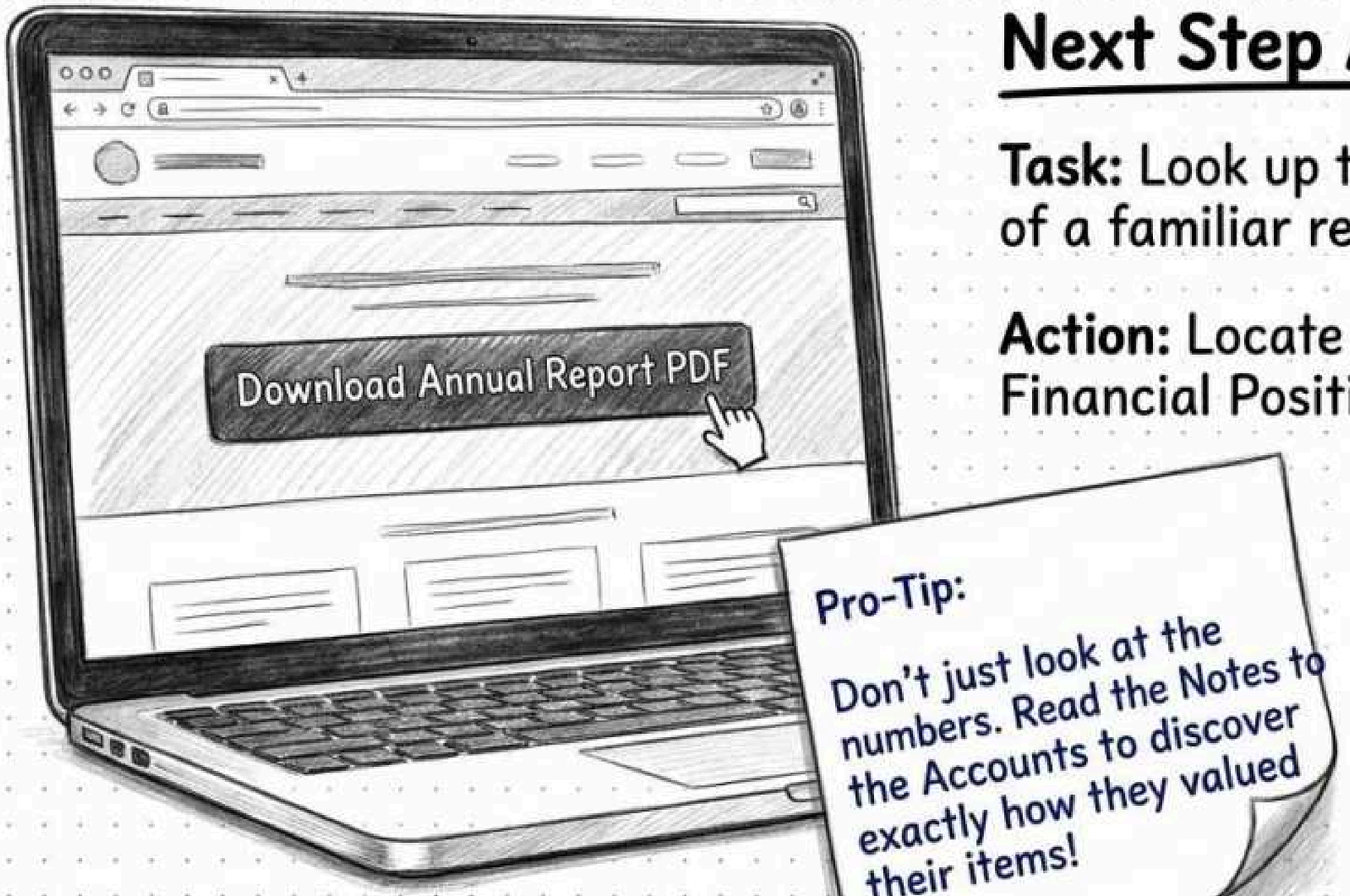
Heavy reliance on outdated historical costs.

The Guesswork:

Relies on estimates (e.g., guessing exactly how many receivables will actually be collected).

Never read it in isolation. Always pair with notes and other statements.

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Next Step Application:

Task: Look up the latest annual report of a familiar retailer or carmaker.

Action: Locate their Statement of Financial Position (Balance Sheet).

Pro-Tip:

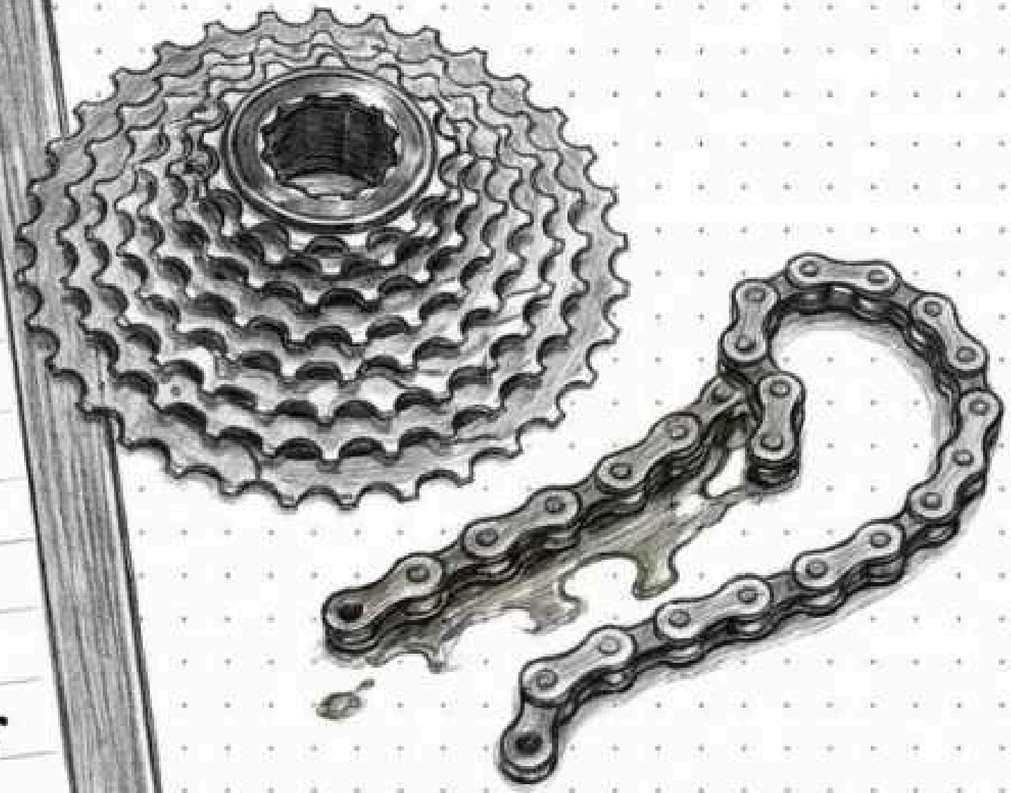
Don't just look at the numbers. Read the Notes to the Accounts to discover exactly how they valued their items!

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Closing Exercise:

Task 1: Calculate the bicycle shop's working capital. (Assumption: $1,000 of the bank loan is due within this year).

Task 2: Explain in a single sentence why the shop's book value might differ from the actual price a buyer would pay to acquire it today.



→ Next Up (Lecture 3): The Income Statement.

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