

## FAST FACTS 3

### UNDERSTANDING THE BALANCE SHEET

The Balance Sheet sets out your assets and liabilities to show the net worth of your business. Assets owned less liability owed equal the net worth of your business. By arranging the items in a balance sheet into different groupings, it is possible to understand a great deal about your own business and how it compares with other similar businesses.

The groupings you will see in a balance sheet are as follows:

#### **Current Assets**

These are cash and other assets that are regularly turned into cash or consumed during the normal operating cycle of the business. You use cash to buy materials, make the product, sell the product for gain, and return to cash.

#### **Non Current or Fixed Assets**

These are held by the business in order to carry out the revenue earning activities. They are intended primarily for use rather than trading. Examples are vehicles, plant & equipment as well as the premises that the business operates from (NB. These assets must be purchased by the business).

#### **Current Liabilities**

These are amounts owed to outside creditors that have to be met in the ordinary course of business either on demand or within a period not exceeding one year.

#### **Non Current or Deferred Liabilities**

These are amounts owed to outside creditors of a relatively long term nature such as loans.

#### **Proprietorship Equity**

This is made up of monies put into the business, which is called capital, and the accumulated surplus (or deficit) from business trading.

#### **Ratio Analysis of Your Balance Sheet**

The following ratios are the more common ones used by accountants and banks to measure whether your business, as reflected by the figures in the Balance Sheet, has improved, compared with earlier and forecasted figure.

#### **Working Capital (or current asset) ratio**

This measures the liquidity of your business by showing how many dollars of current assets are available to meet each one-dollar of current liability. Using the example Balance Sheet attached, the figures are calculated as follows:

	30/6/97	30/6/98
Current Assets	$\frac{107,000}{42,000} = \$2.54$	$\frac{112,000}{55,000} = \$2.03$
Current Liabilities	42,000	55,000

(In the above example the ratio has deteriorated)

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### Turnover of Book Debts

This ratio is used to show how quickly the outstanding debtors of the business are collected, and it is determined by dividing the average sales into the amount of debtors.

	30/6/97	30/6/98
Debtors	$\frac{40,000}{1,333} = 30 \text{ days}$	$\frac{45,000}{1,607} = 28 \text{ days}$
Average daily sales	1,333	1,607

(The example shows that the collection of debtors has actually improved)

### The Rate of Inventory Turnover

The rate of inventory turnover is calculated by dividing the cost of sales (cost of goods sold on the profit & loss statement), for a period of time, by the cost of the average inventory held during the period (stock on hand at the start of the period plus by the stock on hand at the end of the period divided by two).

	30/6/97	30/6/98
Cost of Goods Sold	$\frac{450,000}{60,000} = 7.5$ times	$\frac{500,000}{61,000} = 8.2$ times
Average Inventory	60,000	61,000

(The above shows an increase in the turnover of inventory which is a positive sign)

### Return on Capital

This ratio shows if you may be better off putting your capital into Government Bonds and working for someone else. If the ratio shows a return substantially in excess of Government Bonds then you had better stay with your business. The ratio looks at the profits made against the amount of capital invested in your business. Take the profit for the period and divide by the average of the start and end capital amounts.

	30/6/97	30/6/98
Profit x 100	$\frac{5,000 \times 100}{14,000} = 35.7\%$	$\frac{6,000 \times 100}{17,500} = 34.3\%$
Capital	14,000	17,500

### Summary

This business is good because of the high profit return on capital. However, watch that falling return on capital is not the beginning of a deteriorating trend. The problem the business has is that the owner has weakened the working capital by drawing out too much cash out of the business.

### Need More Help?

Your accountant is best placed to help you to analyse your financial statements. For more information visit the TBC website at [www.tbc.nt.gov.au](http://www.tbc.nt.gov.au).

**For an example balance sheet please see next page**

## FAST FACTS 3 UNDERSTANDING THE BALANCE SHEET

### EXAMPLE ONLY

#### Mr. & Mrs. Bill Smith Balance Sheet as at 30<sup>th</sup> June 1998

30 <sup>th</sup> June 1997		30 <sup>th</sup> June 1998
<b>Owners Equity</b>		
\$ 15,000	<b>Capital</b>	\$ 20,000
<u>\$ 10,000</u>	<b>Accumulated Surplus (Deficit)</b>	<u>\$ 6,000</u>
\$ 25,000	<b>Total Owners Equity</b>	\$ 26,000
These funds are represented by:		
<b>Current Assets</b>		
\$ 1,000	<b>Cash at Bank</b>	\$ 2,000
\$ 40,000	<b>Debtors</b>	\$ 45,000
\$ 4,000	<b>Prepayments</b>	\$ 5,000
<u>\$ 62,000</u>	<b>Stock on Hand</b>	<u>\$ 60,000</u>
<u>\$107,000</u>	<b>Total Current Assets</b>	<u>\$112,000</u>
<b>Fixed Assets</b>		
\$ 15,000	<b>Plant &amp; Equipment</b>	\$ 20,000
(\$ 3,000)	<b>Less provision for depreciation</b>	(\$ 4,000)
<u>\$ 12,000</u>	<b>Total Fixed Assets</b>	<u>\$ 16,000</u>
<u>\$119,000</u>	<b>TOTAL ASSETS</b>	<u>\$128,000</u>
<b>Current Liabilities</b>		
\$ 30,000	<b>Creditors</b>	\$ 40,000
<u>\$ 12,000</u>	<b>Accrued Expenses</b>	<u>\$ 15,000</u>
<u>\$ 42,000</u>	<b>Total Current Liabilities</b>	<u>\$ 55,000</u>
<b>Non Current Liabilities</b>		
\$ 30,000	<b>Bank Loan</b>	\$ 27,000
\$ 22,000	<b>Loan from J Smith</b>	\$ 20,000
<u>\$ 52,000</u>	<b>Total Non Current Liabilities</b>	<u>\$ 47,000</u>
<u>\$ 94,000</u>	<b>TOTAL LIABILITIES</b>	<u>\$102,000</u>
\$ 25,000	<b>Surplus of Assets over Liabilities</b>	\$ 26,000

## FAST FACTS 3 UNDERSTANDING THE BALANCE SHEET

For more information refer to other Fast Facts in this series or contact the Territory Business Centre on the numbers below or visit the TBC website.

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