Balance Sheet

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Table of Contents

What Is a Balance Sheet?

A balance sheet is a **financial statement** that shows the relationship between **assets**, **liabilities**, and shareholders' **equity** of a company at a specific point in time.

Measuring a company's net worth, a balance sheet shows what a company owns and how these assets are financed, either through **debt or equity**.

Balance sheets are useful tools for individual and institutional investors, as well as key stakeholders within an organization, as they show the general financial status of the company.

It is also possible to grasp the information found in a balance sheet to calculate important company metrics, such as profitability, liquidity, and debt-to-equity ratio.

However, it is crucial to remember that balance sheets communicate information as of a specific date. Naturally, a balance sheet is always based upon past data.

While **stakeholders** and investors may use a balance sheet to predict future performance, past performance does not guarantee future results.

In order to see the direction of a company, you will need to look at balance sheets over a time period of months or years.

Balance Sheet—Why Does It Matter? (Understand w/ Animation!) | Finance Stra...

How Balance Sheets Work

A balance sheet is guided by the accounting equation:

Accounting Equation

Assets = Liabilities + Shareholders' Equity

Both parts should be equal to each other or balance each other out. This means that the assets of a company should equal its liabilities plus any shareholders' equity that has been issued. Hence, a balance sheet should *always* balance.

For instance, if a company takes out a ten-year, $8,000 loan from a bank, the assets of the company will increase by $8,000. Its liabilities will also increase by $8,000, balancing the two sides of the **accounting equation**.

If the company takes $10,000 from its investors, its assets and stockholders' equity will also increase by that amount.

The **revenues** of the company in excess of its expenses will go into the shareholder equity account.

These revenues will be balanced on the asset side of the equation, appearing as inventory, **cash**, **investments**, or other assets.

Components of a Balance Sheet

A balance sheet has three primary components: assets, liabilities, and shareholders' equity.

Assets

Assets are anything the company owns that holds some quantifiable value, which means that they could be liquidated and turned into cash.

These can include cash, investments, and tangible objects.

Companies divide their assets into two categories: **current assets** and **noncurrent (long-term) assets.**

Assets Definition [2 Minutes] | Finance Strategists | Your Online Finance Diction...

Current Assets

Current assets are typically those that a company expects to convert easily into cash within a year.

These assets include cash and cash equivalents, prepaid expenses, accounts receivable, marketable securities, and inventory.

Current Assets - (Helpful Animation Video) [2 Minutes] | Your Online Finance Di...

Non-Current Assets

Noncurrent assets are **long-term investments** that the company does not expect to convert into cash within a year or have a lifespan of more than one year.

Noncurrent assets include **tangible assets**, such as land, buildings, machinery, and equipment.

They can also be intangible assets, such as trademarks, patents, goodwill, **copyright**, or intellectual property.

Liabilities

Liabilities are anything a company owes. These are loans, accounts payable, bonds payable, or taxes.

Like assets, liabilities can be classified as either current or noncurrent liabilities.

Current Liabilities

Current liabilities refer to the liabilities of the company that are due or must be paid within one year.

This may include accounts payables, rent and utility payments, current debts or notes payables, current portion of long-term debt, and other accrued expenses.

Noncurrent Liabilities

Noncurrent or long-term liabilities are debts and other non-debt financial obligations that a company does not expect to repay within one year from the date of the balance sheet.

This may include long-term loans, bonds payable, leases, and deferred tax liabilities.

Shareholder’s Equity

Shareholder’s equity is the net worth of the company and reflects the amount of money left over if all liabilities are paid, and all assets are sold.

Shareholders’ equity belongs to the shareholders, whether public or private owners.

Retained Earnings

Shareholders' equity reflects how much a company has left after paying its liabilities.

If the company wanted to, it could pay out all of that money to its shareholders through **dividends**. However, the company typically reinvests the money into the company.

Retained earnings are the money that the company keeps.

Share Capital

Share capital is the value of what investors have invested in the company.

For instance, if someone invests $200,000 to help you start a company, you would count that $200,000 in your balance sheet as your cash assets and as part of your share capital.

Stocks

Stocks can be common or **preferred stocks**.

Common stock is those that people get when they buy stock through the **stock market**. Preferred stock, on the other hand, provides the shareholder with a greater claim on the company's assets and earnings.

You can also see treasury stock on a balance sheet. This stock is a previously outstanding stock that is purchased from stockholders by the issuing company.

Example of a Balance Sheet

Below is an example of a **balance sheet of Tesla for 2021** taken from the **U.S. Securities and Exchange Commission**.

As you can see, it starts with current assets, then the noncurrent, and the total of both.

Below the assets are the liabilities and stockholders' equity, which include current liabilities, noncurrent liabilities, and shareholders' equity.

Tesla, Inc.

Consolidated Balance Sheets
(in millions, except per share data)

	December 31, 2021	December 31, 2020
Assets		
Current assets		
Cash and cash equivalents	$ 17,576	$ 19,384
Short-term marketable securities	131	—
Accounts receivable, net	1,913	1,886
Inventory	5,757	4,101
Prepaid expenses and other current assets	1,723	1,346
Total current assets	27,100	26,717
Operating lease vehicles, net	4,511	3,091
Solar energy systems, net	5,765	5,979
Property, plant and equipment, net	18,884	12,747
Operating lease right-of-use assets	2,016	1,558
Digital assets, net	1,260	—
Intangible assets, net	257	313
Goodwill	200	207
Other non-current assets	2,138	1,536
Total assets	$ 62,131	$ 52,148
Liabilities		
Current liabilities		
Accounts payable	$ 10,025	$ 6,051
Accrued liabilities and other	5,719	3,855
Deferred revenue	1,447	1,458
Customer deposits	925	752
Current portion of debt and finance leases	1,589	2,132
Total current liabilities	19,705	14,248
Debt and finance leases, net of current portion	5,245	9,556
Deferred revenue, net of current portion	2,052	1,284
Other long-term liabilities	3,546	3,330
Total liabilities	30,548	28,418
Commitments and contingencies (Note 15)		
Redeemable noncontrolling interests in subsidiaries	568	604
Convertible senior notes (Note 11)	—	51
Equity		
Stockholders' equity		
Preferred stock; $0.001 par value; 100 shares authorized; no shares issued and outstanding	—	—
Common stock; $0.001 par value; 2,000 shares authorized; 1,033 and 960 shares issued and outstanding as of December 31, 2021 and December 31, 2020, respectively	1	1
Additional paid-in capital	29,803	27,260
Accumulated other comprehensive income	54	363
Retained earnings (accumulated deficit)	331	(5,399)
Total stockholders' equity	30,189	22,225
Noncontrolling interests in subsidiaries	826	850
Total liabilities and equity	$ 62,131	$ 52,148

For example, this balance sheet tells you:

- The reporting period ends December 31, 2021, and compares against a similar reporting period from the year prior.
- The assets of the company total $62,131, including $27,100 in current assets and $35,031 in noncurrent assets.
- The liabilities of the company total $30,548, including $19,705 in current liabilities and $10,843 in noncurrent liabilities.
- The company retained $331 in earnings during the reporting period, greatly less than the same period a year prior.
- Adhering to the accounting equation, a balance is obtained by the total assets of $62,131 and the combined total liabilities and stockholders' equity which is $62,131.

It is crucial to note that **how a balance sheet is formatted differs** depending on where the company or organization is based.

How to Prepare a Balance Sheet

The balance sheet is prepared using the following steps:

Step 1: Determine the Reporting Date and Period

The balance sheet previews the total assets, liabilities, and shareholders' equity of a company on a specific date, referred to as the reporting date.

Often, the reporting date will be the final day of the reporting period. Companies that report annually, like Tesla, often use December 31st as their reporting date, though they can choose any date.

There are also companies, like publicly traded ones, that will report quarterly. For this case, the reporting date will usually fall on the last day of the quarter:

- Q1: March 31
- Q2: June 30
- Q3: September 30
- Q4: December 31

However, it is common for a balance sheet to take a few days or weeks to prepare after the reporting period has ended.

Step 2: Identify Your Assets

You will need to tally up all your assets of the company on the balance sheet as of that date. This will include both current and noncurrent assets.

Assets are typically listed as individual line items and then as total assets in a balance sheet.

This will make it easier for analysts to comprehend exactly what your assets are and where they came from. Tallying the assets together will be required for final analysis.

Step 3: Identify Your Liabilities

Like assets, you need to identify your liabilities which will include both current and long-term liabilities.

Again, these should be organized into both line items and total liabilities. They should also be both subtotaled and then totaled together.

Step 4: Calculate Shareholders' Equity

After you have assets and liabilities, calculating shareholders' equity is done by taking the total value of assets and subtracting the total value of liabilities.

Shareholders' equity will be straightforward for companies or organizations that a single owner privately holds.

The calculation may be complicated for publicly held companies depending on the various types of stock issued.

Line items in this section include common stocks, preferred stocks, share capital, treasury stocks, and retained earnings.

Step 5: Add Total Liabilities to Total Shareholders' Equity

and Compare to Assets

Adding total liabilities to shareholders' equity should give you the same sum as your assets. If not, then there may be an error in your calculations.

Causes of a balance sheet not truly balancing may be:

- Errors in inventory
- Incorrectly entered transactions
- Incomplete or misplaced data
- Miscalculated loan amortization or depreciation
- Errors in currency exchange rates
- Miscalculated equity calculations

How to Analyze a Balance Sheet

Financial ratio analysis is the main technique to analyze the information contained within a balance sheet.

It uses formulas to obtain insights into a company and its operations.

Using **financial ratios** in analyzing a balance sheet, like the debt-to-equity ratio, can produce a good sense of the financial condition of the company and its operational efficiency.

It is crucial to remember that some ratios will require information from more than one financial statement, such as from the **income statement** and the balance sheet.

There are two types of ratios that use data from a balance sheet. These are:

Financial Strength Ratios

Financial strength ratios can provide investors with ideas of how financially stable the company is and whether it finances itself.

It also yields information on how well a company can meet its obligations and how these obligations are leveraged.

Financial strength ratios can include the working capital and debt-to-equity ratios.

Activity Ratios

Activity ratios mainly focus on current accounts to reveal how well the company manages its **operating cycle**.

These operating cycles can include receivables, payables, and inventory.

Examples of activity ratios are inventory turnover ratio, total assets turnover ratio, fixed assets turnover ratio, and accounts receivables turnover ratio.

These ratios can yield insights into the operational efficiency of the company.

Importance of a Balance Sheet

There are a few key reasons why a balance sheet is important. Here are a few of them:

Balance Sheets Examine Risk

A balance sheet lists all assets and liabilities of a company.

With this information, a company can quickly assess whether it has borrowed a large amount of money, whether the assets are not liquid enough, or whether it has enough current cash to fulfill current demands.

Balance Sheets Secure Capital

A lender will usually require a balance sheet of the company in order to secure a business plan.

Additionally, a company must usually provide a balance sheet to private investors when planning to secure private equity funding.

These are some of the cases in which external parties want to assess and check a company's financial stability and health, its creditworthiness, and whether the company will be able to settle its short-term debts.

Balance Sheets are Needed for Financial Ratios

Business owners use these financial ratios to assess the profitability, solvency, **liquidity**, and turnover of a company and establish ways to improve the financial health of the company.

Some financial ratios need data and information from the balance sheet.

Balance Sheets Lure and Retain Talents

Good and talented employees are always looking for stable and secure companies to work in.

Balance sheets that are disclosed from public companies allow employees a chance to review how much the company has on hand and whether the financial health of the company is in accordance with their expectations from their employers.

Limitations of a Balance Sheet

Although balance sheets are important financial statements, they do have their limitations. Here are some of them:

Balance Sheets are Static

It may not provide a full snapshot of the financial health of a company without data from other financial statements.

In order to get a complete understanding of the company, business owners and investors should review other financial statements, such as the income statement and cash flow statement.

Balance Sheets Have a Narrow Scope of Timing

The balance sheet only reports the financial position of a company at a specific point in time.

This may not provide an accurate portrayal of the financial health of a company if the market conditions rapidly change or without knowledge of previous cash balance and understanding of industry operating demands.

Balance Sheets May Be Susceptible to Errors and Fraud

The data and information included in a balance sheet can sometimes be manipulated by management in order to present a more favorable financial position for the company.

Businesses should be wary of companies that have large discrepancies between their balance sheets and other financial statements.

It is also helpful to pay attention to the footnotes in the balance sheets to check what accounting systems are being used and to look out for red flags.

Balance Sheets Are Subject to Several Professional Judgment Areas That Could Impact the Report

For instance, accounts receivable should be continually assessed for impairment and adjusted to reveal potential uncollectible accounts.

A company should make estimates and reflect their best guess as a part of the balance sheet if they do not know which receivables a company is likely actually to receive.

Balance Sheets vs. Income Statements

Here are some key differences between balance sheets and income statements:

Balance Sheets vs. Income Statements

	BALANCE SHEET	INCOME STATEMENTS
Time	The balance sheet shows a summary of the financial position of a company at a specific point in time.	The income statement provides an overview of the financial performance of a company over a given period.
Key Items	Balance sheets include assets, liabilities, and shareholders' equity, further categorized to give more accurate information.	Income statements include expenses, revenues, gains, and losses obtained from the sale or disposal of assets.
Financial Analysis	Balance sheets assess the financial health of a company using financial ratio analysis.	Income statements use gross margins, operating margins, price-to-earnings, and interest coverage to assess the financial performance of a company.
Usage	Investors and lenders use balance sheets to assess creditworthiness and the availability of assets for collateral.	Investors, management, shareholders, and others use income statements to assess the performance and future prospects of a company.

The Bottom Line

Balance sheets are important financial statements that provide insights into the assets, liabilities, and shareholders’ equity of a company.

It is helpful for business owners to prepare and review balance sheets in order to assess the financial health of their companies.

Balance sheets also play an important role in securing funding from lenders and investors. Additionally, it helps businesses to retain talents.

Although balance sheets are important, they do have their limitations, and business owners must be aware of them.

Some of its limitations are that it is static, has a narrow scope of timing, and is subject to errors and frauds.

A balance sheet is also different from an income statement in several ways, most notably the time frame it covers and the items included.

It is important to understand that balance sheets only provide a snapshot of the financial position of a company at a specific point in time.

In order to get a more accurate understanding of the company, business owners and investors should review other financial statements, such as the income statement and cash flow statement.

Balance Sheet FAQs

What is included in the balance sheet?

Who prepares the balance sheet?

What is the balance sheet formula?

What is the purpose of the balance sheet?

How often are balance sheets required?

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Are Supplies a Current Asset?

Components of the Balance Sheet

Current Liabilities on the Balance Sheet

Difference Between Trial Balance and Balance Sheet

Effects of Transactions on a Balance Sheet

Functions and Limitations of Balance Sheet

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Is a Patent a Noncurrent Asset?

Is Accounts Payable a Current Asset?

Is Accounts Receivable a Current Asset?

Is Accounts Receivable a Material Component of a Company's Total Current Assets?

Is Accumulated Depreciation a Current Asset?

Is Bank a Current Asset?

Is Cash a Current Asset?

Is Current Assets the Same as Total Assets?

Is Deferred Tax a Current Asset?

Is Depreciation a Current Asset?

Is Equipment a Current Asset?

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