The balance sheet (part 1)

Well, in this video we're going to focus on discussing some of the different elements of the balance sheet.
Beforehand we're going to provide a brief overview of some of the different financial statements, including balance sheets, but also discussing income statements and statements of cash flows.
In this particular video we're going to focus more specifically on the balance sheet and review some of the more common entries that you'll see.
So, as you can see here from your screen, I've already written out some of the more common entries.
This isn't all encompassing: if you were to pull up a balance sheet for a publicly traded company through Yahoo Finance or Google Finance, you would find that they have a lot of different entries.
So there are many different entries that you have to consider.
These are some of the more common ones that should get you started in being able to—you know—look at these types of things and inferring some type of meaning based upon the numbers that you're looking at.
So we're going to go through these just kind of line by line—nothing real fancy, but, hopefully, to give you a better understanding over this type of statement.
Now, as I mentioned before, a balance sheet provides you information at a specific point in time.
Now, we're specifically looking at the firm's financial position.
And so, if you were to look at that—you know—two months after the balance sheet was created, you probably wouldn't be looking at accurate information, because things can change on a daily basis.
So make sure that you, of course, check that.
Now, as we know, the balance sheet is based upon the accounting equation—now—which is assets equals liabilities plus owner's equity.
And the reason for that, as we know, is that a company has two primary sources of funding its operations: either through liabilities (i.e., debt) or stockholders' equity, also referred to as owner's equity—now—which is money we obtained from investors who become shareholders.

And so, if we go through what is commonly referred to as an initial public offering, or IPO, or a secondary offering, we essentially provide the market with shares of our company, which is a share of ownership.
In return, they invest money in our company, which we can use to purchase equipment, pay employees, and all sorts of different things.
So now that you kind of get the structure of it, let's get through each of the areas line by line.
Now, we separate these in the three areas—just like the accounting equation.
Now—so you'll notice we already have Assets here, we have your Liabilities over here, and then you have Stockholder's Equity, or Owner's Equity, on this side right here.
And so we separate them in those three areas.
Now, within those three areas, we also break things down a little bit further.
And so, looking at Assets over here, you can already see that we have Current Assets.
Now, the way that this is done, actually—the way that they're listed, is in order of what we call *liquidity*.
And so liquidity is how quickly something can be turned into cash.
The reason that's important is because, obviously, if you don't have the money in your possession, you can't do anything with it.
And so the goal of a company is to make sure and generate, obviously, as much revenue, but to try and turn that revenue into cash so it can, in turn, use that to pay for operations, to pay employees for their services, purchase inventory, and a host of other things.
Now—so, of course, cash is the most liquid form of currency.
And so in this particular example we have 188,000 dollars worth of Cash.
Now, the next is what we call Accounts Receivable.
Accounts Receivable is money that is owed to you by creditors—or let's just say other businesses.
And so, if you—and in the business world a lot of things are done based upon credit—

So let's say, for example, if you sell something to another company, you supply them with a particular good that they need to go ahead and produce their products, and they—
You ship the products to them—you know, your components, whatever that might be—
They may not pay you for thirty, sixty, maybe even ninety days.
Usually it's thirty days, and you give them a certain discount if they pay you within the first ten days—usually about two percent on average, but it can vary—right?—the business will set the terms of that—now—but potentially sixty, ninety days, depending upon the arrangement.
And so these 187,000 dollars is money that we expect to receive but haven't.
Technically, we delivered the actual goods, but we haven't received payment yet.
And so the goal is to convert this money into cash as quickly as possible, because—once again—cash is something tangible that we can do something with.
Accounts Receivable is a promise to pay.
It isn't necessarily cash in our hand.
And so we want to go through a lot of steps to make sure and convert this as quickly as possible.
Now, you'll find that the longer a particular debt stays as an Accounts Receivable—the longer it's not paid—the likelihood of you getting paid for it diminishes completely—
which is why a lot of companies usually sell off their Accounts Receivable to like collections agencies, or debt companies,
because they view it as not being able to collect on it after a certain period of time, so they try and get at least something for it.
And then it goes to a debt-collection company, who then tries to collect, of course.
Now, after Accounts Receivable we have our Inventory.
And the Inventory, obviously, consists of the different goods that we have, the products that we have, that we are not necessarily—haven't been sold yet.
They are worth something to us—right?
Now, but—once again—it isn't necessarily being sold.
So it's products that we have, that could include finished goods—right?

It could be Work in Process—so if we assemble things like furniture, and then we have a bunch of like table legs and legs for chairs, and they haven't been put together, they still have some type of value.
And so we have to add up the cumulative value of the Inventory that we own.
And—once again—Inventory ideally would be sold and turn itself into Accounts Receivable or, potentially, Cash, but we still account for it as something that holds value.
Now, we add up those three categories, and then we get to this area here which is called our Total Current Assets.
And right here we have 771,000 dollars in Total Current Assets.
So this is—a current asset is something that either is cash or be converted—can be converted to cash in less than one year.
And so, ideally, everything here would be able to be converted to cash in less than a year.
And anything outside of that is not considered to be a current asset.
Now, in addition we also have to include Plant, Property, and our Equipment.
And so this includes any physical structures that we own—the actual property—so that—the land that it's located on, and any heavy machinery and equipment that we purchase.
It could be vehicles—now—it could be bulldozers—could be a variety of different pieces of equipment depending upon what type of business that we're in.
And so we add up the value of those particular pieces of equipment, the plants, the property—everything—together.
So for this example we have 997,000 dollars worth of Plant, Property, and Equipment.
Now, because equipment specifically deteriorates over time—right?—
When you purchase a vehicle, if it's brand new, ten years later it's not the same vehicle—right?—due to maintenance, wear and tear, now it doesn't run the same, it has higher millage—you know—it gets nicks and dings in the door, the fabric on the interior gets worn.
And so it isn't worth the same thing.
And so, because of that, we have to take what we call *depreciation.*

68 And so depreciation is essentially taking into account the fact that equipment will wear over time.
69 And so what is unfair that we purchase a brand new car for 20,000 dollars, and it's five years later—we can't say that it's worth 20,000 dollars—right?
70 That's kind of an overstatement.
71 And so we have to take depreciation to reduce the value of what we claim.
72 Now, there's a number of different ways you can use depreciation.
73 A very easy method is what we call the *straight-line depreciation method*—now—which I'll make a separate video available on that.
74 I don't want to take up too much time.
75 But we certainly have to depreciate the value of our asset, because it's not going to be worth the same years later.
76 Now, once we factor out depreciation, we get what we call Net Plant, Property, and Equipment, which is 993,000 dollars.
77 And so if we add these Total Current Assets together with our Plant, Property, and Equipment—of course, factoring out depreciation—we essentially come to our Total Assets.
78 And so these are all of the assets that the company owns: roughly 1.7 million dollars.