Cured Finance

# Balance Sheet

## Where is my money?

It is important to develop a solid understanding of a company's balance sheet and gain valuable insights into its financial health and position.

### Key questions to answer

* Is the company's financial position improving or deteriorating over time?

* Does the company have sufficient liquid assets to meet its short-term obligations?

* Is the company relying too heavily on debt financing?

* Are there any significant or unusual changes in account balances that warrant further investigation?

* Are the company's accounting policies consistent with industry practices and prior periods?

## Step-by-Step Guide to Reviewing a Balance Sheet

The balance sheet provides a snapshot of a company's assets, liabilities, and equity at a specific point in time. Think of it as a picture of the company's financial health on a particular day. The fundamental accounting equation that underpins the balance sheet is:

Assets = Liabilities + Equity

Here's how to approach reviewing a balance sheet:

**Step 1: Understand the Basic Structure**

* Identify the Three Main Sections: Ensure you can clearly distinguish between Assets, Liabilities, and Equity.

  * Assets: What the company owns. Assets are typically listed in order of liquidity (how easily they can be converted into cash).

  * Liabilities: What the company owes to others. Liabilities are generally listed in order of their due date.

  * Equity: The owners' stake in the company's assets after deducting liabilities.

* **Check the Date:** Note the specific date the balance sheet covers. It's a "point-in-time" statement, so the balances are only accurate as of that date.

Step 2: Examine the Assets

* Review Current Assets: These are assets expected to be converted to cash or used up within one year.

  * Cash and Cash Equivalents: This is the most liquid asset. Look for significant fluctuations compared to previous periods.

  * Accounts Receivable: Money owed to the company by customers. Analyze trends in the aging of receivables (how long invoices are outstanding). A significant increase in older receivables might indicate potential collection issues.

* Inventory: Goods held for sale. Understand the company's inventory valuation method (e.g., FIFO, LIFO) and look for significant changes in inventory levels, which could indicate overstocking or potential obsolescence.

* Other Current Assets: Review any other significant current asset balances.

* Review Non-Current Assets (Long-Term Assets): These are assets not expected to be converted to cash or used up within one year.

* Property, Plant, and Equipment (PP&E): Tangible assets used in the company's operations. Look for significant additions or disposals and understand the depreciation methods used.

* Intangible Assets: Non-physical assets that have value (e.g., patents, trademarks, goodwill). Understand how these assets were acquired and how they are being amortized or tested for impairment.

* Long-Term Investments: Investments held for more than one year. Understand the nature of these investments.

**Step 3: Examine the Liabilities**

* Review Current Liabilities: Obligations expected to be settled within one year.

* Accounts Payable: Money the company owes to its suppliers. Monitor changes in payment terms and outstanding balances.

* Salaries Payable: Wages owed to employees.

* Short-Term Debt: Loans or other borrowings due within one year.

* Deferred Revenue: Payments received for goods or services that have not yet been delivered or performed. Track the recognition of this revenue over time.

* Other Current Liabilities: Review any other significant current liability balances.

* Review Non-Current Liabilities (Long-Term Liabilities): Obligations not expected to be settled within one year.

  * Long-Term Debt: Loans or bonds payable over a period longer than one year. Understand the terms and maturity dates of these debts.

  * Deferred Tax Liabilities: Taxes that are owed in the future.

  * Other Long-Term Liabilities: Review any other significant long-term liability balances.

**Step 4: Examine the Equity**

 * Review Components of Equity:

  * Common Stock: The value of shares issued to owners.

  * Retained Earnings: Accumulated profits that have not been distributed as dividends. Monitor changes in retained earnings, which reflect the company's profitability over time.

  * Other Equity Accounts: This may include items like additional paid-in capital or accumulated other comprehensive income. Understand the nature of these accounts.

**Step 5: Analyze Relationships and Trends**

 * Calculate Key Ratios: Use the balance sheet data to calculate important financial ratios that provide insights into the company's liquidity, solvency, and efficiency. Some common ratios include:

  * Current Ratio (Current Assets / Current Liabilities): Measures the company's ability to pay its short-term obligations. A ratio greater than 1 generally indicates good liquidity.

  * Quick Ratio (Acid-Test Ratio) ((Current Assets - Inventory) / Current Liabilities): A more conservative liquidity measure that excludes inventory.

  * Debt-to-Equity Ratio (Total Liabilities / Total Equity): Measures the extent to which a company is financed by debt versus equity. A higher ratio may indicate higher financial risk.

 * Compare to Previous Periods: Analyze the balance sheet over several periods (e.g., quarterly or annually) to identify trends and significant changes in account balances. Understand the reasons behind these changes.

* Compare to Industry Benchmarks: Compare the company's balance sheet and key ratios to those of its competitors and industry averages to assess its relative financial position.

### Step 6: Read the Notes to the Financial Statements

* Crucial Context: The notes provide important details and explanations about the items presented on the balance sheet. They often include information about accounting policies, significant assumptions, contingent liabilities, and other relevant information that is essential for a thorough understanding.