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The Effects of Equilibrium Balance Sheet on the Financial Standing of the Company

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Abstract: *The balance sheet and statement of financial position are confused by many to be the same thing, but there are, however, a number of differences between balance sheet and statement of financial position. Both, balance sheet and statement of financial position are financial statements that offer an overview of the manner in which the organization's assets, liabilities, capital, income and expenses have been managed. Companies prepare financial statements at the end of the accounting period to obtain a clear understanding of the way resources have been utilized to improve profitability over the financial year. The balance sheet in particular is an important financial statement as it shows changes in the company's assets, liabilities and capital. Statements of financial position are also prepared at the year end and offer an overview of the company's assets and liabilities as well as financial health and liquidity. Statements of financial position are generally created by not for profit organizations. A statement of financial position created by not for profits are mostly used to obtain an overview of the total assets held and liabilities owed. Unlike businesses that operate on a profit, not for profits do not have shareholder's equity as they do not sell shares to the public.*

Key words*: Balance sheet, assets, liabilities, financial position.*

INTRODUCTION

A Balance Sheet is fundamentally a statement of financial position as of a certain date. A balance sheet can be prepared for an individual, a partnership, a corporation or any other entity that has assets and debts. Balance sheets are typically compiled to report to owners or other interested parties such as lenders, exactly what the company looks like financially at a given point in time. In order to have amounts to report, an entity would need a financial record keeping system that would show balances at the end of a day, week or whatever reporting timeframe was needed. A basic balance sheet will have three sections; assets, liabilities, and owner's equity. A balance sheet is so named because it must be "balanced" using the formula; assets minus liabilities equals owner's equity

The **balance sheet** (**B/S,** or **statement of financial position**) is one of the four primary financial reports (financial accounting statements) that publicly held companies must file every quarter and year. The other three are the income statement, the statement of retained earnings, and the cash flow statement (or statement of changes in financial position, or financial cash flow statement). Balance sheets for government and non profit organizations are also published periodically, often called "Statement of Financial Position" More accurately, the balance sheet reports the end of period *balances* in the entity's asset, liability, and equity accounts. The balance sheet is normally prepared and published as one of the final closing events for an accounting period, after all the period's transactions are posted to general ledger accounts, after a trial balance period in which accountants search for and correct transaction and posting errors.

In principle, a company or organization could publish a new and different version of the balance sheet every day, but they normally do so at the end of fiscal quarters and years. The B/S heading identifies the time point with a phrase such as this: "...at 31 December 2013." The B/S is thus a "snapshot" of the entity's financial position at one time point, whereas the income statement and statement of changes summarize financial activity.

OBJECTIVES OF THE STUDY

1. To assess the financial position of the firm.

2. To know the impact of equilibrium balance sheet on financial position of the company.

3. To exhibit the true and correct view of the state of affairs of any concern.

4. To know the relevant information regarding sources of funds and the application and

its impact on company financial position.

5. To evaluate whether the management is achieving its objectives or not.
6. To investigate unexpected increases or decreases in financial statement items.
7. To evaluate overall performance of the company

REVIEW OF LITERATURE

The Balance Sheet's Main Three

Assets, liability and equity are the three main components of the balance sheet. Carefully analyzed, they can tell investors a lot about a company's fundamentals.

Assets

There are two main types of assets: current assets and non-current assets. Current assets are likely to be used up or converted into cash within one business cycle - usually treated as twelve months. Three very important current asset items found on the balance sheet are: cash, inventories and accounts receivables.

Investors normally are attracted to companies with plenty of cash on their balance sheets. After all, cash offers protection against tough times, and it also gives companies more options for future growth. Growing cash reserves often signal strong company performance. Indeed, it shows that cash is accumulating so quickly that management doesn't have time to figure out how to make use of it. A dwindling cash pile could be a sign of trouble. That said, if loads of cash are more or less a permanent feature of the company's balance sheet, investors need to ask why the money is not being put to use. Cash could be there because management has run out of investment opportunities or is too short-sighted to know what to do with the money.

Inventories are finished products that haven't yet sold. As an investor, you want to know if a company has too much money tied up in its inventory. Companies have limited funds available to invest in inventory. To generate the cash to pay bills and return a profit, they must sell the merchandise they have purchased from suppliers. Inventory turnover (cost of goods sold divided by average inventory) measures how quickly the company is moving merchandise through the warehouse to customers. If inventory grows faster than sales, it is almost always a sign of deteriorating fundamentals.

Receivables are outstanding (uncollected bills). Analyzing the speed at which a company collects what it's owed can tell you a lot about its financial efficiency. If a company's collection period is growing longer, it could mean problems ahead. The company may be letting customers stretch their credit in order to recognize greater top-line sales and that can spell trouble later on, especially if customers face a cash crunch. Getting money right away is preferable to waiting for it - since some of what is owed may never get paid. The quicker a company gets its customers to make payments, the sooner it has cash to pay for salaries, merchandise, equipment, loans, and best of all, dividends and growth opportunities.

Non-current assets are defined as anything not classified as a current asset. This includes items that are fixed assets, such as property, plant and equipment (PP&E). Unless the company is in financial distress and is liquidating assets, investors need not pay too much attention to fixed assets. Since companies are often unable to sell their fixed assets within any reasonable amount of time they are carried on the balance sheet at cost regardless of their actual value.

Liabilities

There are current liabilities and non-current liabilities. Current liabilities are obligations the firm must pay within a year, such as payments owing to suppliers. Non-current liabilities, meanwhile, represent what the company owes in a year or more time. Typically, non-current liabilities represent bank and bondholder debt.

When debt levels are falling, that's a good sign. Generally speaking, if a company has more assets than liabilities, then it is in decent condition. By contrast, a company with a large amount of liabilities relative to assets ought to be examined with more diligence. Having too much debt relative to cash flows required to pay for interest and debt repayments is one way a company can go bankrupt.

Equity

Equity represents what shareholders own, so it is often called shareholder's equity. As described above, equity is equal to total assets minus total liabilities.

$$\text{Equity} = \text{Total Assets} - \text{Total Liabilities}$$

The two important equity items are paid-in capital and retained earnings. Paid-in capital is the amount of money shareholders paid for their shares

when the stock was first offered to the public. It basically represents how much money the firm received when it sold its shares. In other words, retained earnings are a tally of the money the company has chosen to reinvest in the business rather than pay to shareholders. Investors should look closely at how a company puts retained capital to use and how a company generates a return on it.

ACCOUNTING EQUATION
Assets = Liabilities + Equity
Assets - What the company *owns*

- Like land, buildings, machinery, cash, goodwill, patents etc

Liabilities - What the company *owes*

- Loan from bank
- Trade payables

Equity - The difference between Assets and Liabilities.

Equity is nothing but owner's funds. At the end of the day, if you take all the assets of the business and deduct the amount of money that business owe to others, the residual amount belongs to the owner of the business because it is his business.

A business has nothing of its own. Whatever it owns, it owes it to someone. From the accounting point of view, the owner of the business and the business are two separate entities. The owner is just a lender to it. Whatever the business has, is borrowed. It cannot get ANYTHING on its own but from borrowing, be it from the owner or the creditors. So whatever it borrows, it will invest it somewhere, either assets or in building the assets i.e. the product or service it deals in.

A balance sheet is the statement of the sources of borrowing and the applications of the borrowing. It has to be equal because you can only invest what you have i.e. borrowed from the lender or the creditor.

About the profit part, it is treated as a liability which the business owes to the owner which reflects as an increase in assets on the assets side of the sheet. Therefore, what is invested is only borrowed.

DATA ANALYSIS

Vertical Analysis of the Balance Sheet

The central issue when creating a vertical analysis of a balance sheet is what to use as the denominator in the percentage calculation. The usual denominator is the asset total, but one can also use the total of all liabilities when calculating all liability line item percentages, and the total of all equity accounts when calculating all equity line item percentages. By considering the analysis, we know the purpose of equilibrium of balance sheet.

An example of vertical analysis for a balance sheet is shown in the far right column of the following condensed balance sheet:

Balance sheet for XYZ business on the 31st of December 2010		
	$	$
ASSETS		
Non-current assets		2,150,000
Land and buildings	2,000,000	
Furniture	12,000	
Machinery	18,000	
Investments	120,000	
Current assets		10,000
Inventory	1,000	
Debtors / receivables	3,200	
Bank and cash	5,800	
TOTAL ASSETS		2,160,000
EQUITY AND LIABILITIES		
Owner's equity		1,700,000
Capital	1,700,000	
Non-current liabilities		440,000
10% Loan	440,000	
Current liabilities		20,000
Creditors / payables	20,000	
TOTAL EQUITY AND LIABILITIES		2,160,000

The two corporate financial statements that contain most of the information used in this investigation are the Income Statement and Balance Sheet. Data is publically available unless stated otherwise.

The Balance Sheet summarizes the financial transactions of a company from one moment in time to a next. All the transactions of the Income Statement will be summarized into the Balance Sheet. Profit, hence capital, is reported as Net Worth. Insolvency is when Liabilities are greater than Assets. An important measure of organization success is having a Fair Market Value many times larger than Net Worth.

CONCLUSION

Statement of financial position helps users of financial statements to assess the financial health of an entity. When analyzed over several accounting periods, balance sheets may assist in identifying underlying trends in the financial position of the entity. It is particularly helpful in determining the state of the entity's liquidity risk, financial risk, credit risk and business risk. When used in conjunction with other financial statements of the entity and the financial statements of its competitors, balance sheet may help to identify relationships and trends which are indicative of

potential problems or areas for further improvement. Analysis of the statement of financial position could therefore assist the users of financial statements to predict the amount, timing and volatility of entity's future earnings

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