Balance Sheet

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SUBJECT(S): Accounting, Management, Personal Finance

GRADE LEVEL(S): 9, 10, 11, 12

OVERVIEW:

This lesson focuses primarily on the balance sheet. Students will learn the definition of a balance sheet (and its component parts). Students will learn to read and decode an actual balance sheet from a 10-K filing. Finally, students will use balance sheets to reason about the well being of individual companies.

NBEA STANDARD(S):

- Personal Finance, I. Personal Decision Making
- Accounting, II. Financial Reports
- Management, II. Management Theories
- Accounting, III. Financial Analysis
- Accounting, VI. Interpretation and Use of Data

RELATED ARTICLES:

- "Research Strategies for New Investors"
- "Financial Ratios: Evaluating a Company's Health and Worth"
- "Career Spotlight: Inside Actuarial Science"
- "Big-Scale Buying and Selling: Dealing in Mergers & Acquisitions"
- "Behind the Puppy Dog Lenses, Snapchat Is a Living, Breathing Business"

- "5 Takeaways from the Disney-Fox Merger"
- "10 Terms New Investors Should Know"

Common Core Standard(s): Comprehension and Collaboration, Vocabulary Acquisition and Use, A-CED

Objectives/Purposes: The purpose of this lesson is for students to understand a balance sheet and why it is useful for investment analysis. Following this lesson, students should be able to 1) define, 2) read, and 3) analyze the balance sheet of a publicly traded company.

Tying It All Together:

The lesson is divided into five parts: (1) Introduction, (2) Definitions, (3) Guided Reading, (4) Practice, and finally (5) Closing

Introduction (5 mins)

Open the lesson with a brief review of financial documents. Remind students that all publicly traded companies must submit SEC filings providing financial documents. These filings (known as 10-K and 10-Q) contain three very important types of financial statements (income statement, balance sheet, cash flow statement) and each serves a different purpose.

Where appropriate, have students recount the key points from the previous lesson. An income statement gives investors a view of the sales and expenses of a company. By looking at the income statement of a company at different points in time, investors can see trends in sales, costs, and total income of a company.

Decisions (10-20 mins)

Today we will be looking specifically at the balance sheet. Once again using the 10-K filings from Apple Incorporated (available online), have students in the class look at the balance sheet. In this filing, the balance sheet is on page 44.

NOTE: The 10-K and 10-Q filings are very long documents that contain large amounts of information. For this and all other lessons, students only need to focus on the three financial statements (income statement, statement of cash flow, and balance sheet). In the Apple filing, these span ONLY pages 43-46. If you plan to print these documents out for class, print only pages 43-46.

Give students 3-5 minutes to look over the balance sheet. Provide students with some guiding questions: "What kinds of things are listed on the balance sheet? Why might these be important for an investor?"

After students read through the balance sheet, start providing them with definitions for each of the items on the sheet. Generally speaking, **assets** are things that the company owns and **liabilities** are things that the company owes. Money, inventory and offices are all different types of assets. Loans and debt are **liabilities.**

Introduce students to the fundamental formula:

Equity = Assets – Liabilities.

Equity refers to the difference between what a company owns and what a company owes. Equity is a measure of the value of a company at a specific point in time.

While looking through the balance sheet, there are many terms the teacher can define. Here is a large list of terms:

Within these three categories, we can be even more specific. **Current assets** are assets that will likely be used or turned into cash relatively within one-year. Similarly **current liabilities** are liabilities that will be paid within the year.

There are several types of current assets. **Cash and cash equivalents** are somewhat self-explanatory. They report the total cash held by a company. **Short-term marketable securities** refer to other liquid investments that usually pay-out within one year (i.e. short-term treasury bills). **Accounts receivable** refers to money that the company is owed, but has yet to collect. **Inventories** refer to the products a company has on hand in its inventory, yet to be sold.

Along with these current assets, there are other longer-term assets. **Long-term marketable securities** are other investments that the company will hold longer than one year. **Property, plant and equipment** refer to the physical assets the company owns, like buildings and machinery. **Goodwill** arises when a company purchases another company for more than its fair value of assets. **Intangible assets** are non-physical assets that a firm value's (e.g. the value of a brand name).

Looking at liabilities, there are also many different types. **Accounts payable** refers to immediate debts the company owes to creditors. **Accrued expenses** refer to expenses the company expects to pay, but has yet to pay for.

Later in this unit, students will be looking at specific financial ratios based on the income statement, balance sheet and statement of cash flows. While that lesson will focus on specific calculations, teachers may want to have students start thinking about these ideas earlier rather than later. After covering major items on the income statement, teachers should encourage students to think about numbers *in relationship to one another*, rather than as raw numbers. For example, instead of looking just at current assets, we can look at a ratio of current assets to current liabilities. These comparisons are important tools for understanding the information on financial documents.

Guided Reading (5-10 mins)

After working through the balance sheet for Apple Inc., have students read through the article "Big-Scale Buying and Selling: Dealing in Mergers & Acquisitions." Provide students with a few guided questions for the article. For example: What is a company actually *buying* in a merger or acquisition? How much is a company worth? How do you know?

After students finish the article, have a brief discussion around these guiding questions. Remind students that when someone purchases a company they not only accept the assets, but also the liabilities. Generally speaking, the value of the company is closely related to its current equity, along with its future prospects.

Practice (10-15 mins)

After the class discussion, have students break into small groups. During this activity, students will take on the role of financial analysts. Provide each group with a copy of pages 39-42 of Chipotle's 2012 10-K filings (available online) and pages 40-43 of Chipotle's 2011 10-K filings (available online). Using these two documents, each group must decide whether they would like to invest in Chipotle.

Groups will have 10-15 minutes to look at both sets of balance sheets. Encourage students to compare and contrast the two documents. Are things getting better or worse for Chipotle? How do they know? Which items are they looking at?

Just as in the previous lesson, after looking through the two 10-K forms each group will prepare a 2-3 minute investment brief. During this brief, the group must convince the teacher and the audience whether they should invest in Chipotle. Regardless of the group's decision (invest or not invest), the group must provide **evidence** based on the two balance sheets to support their claims.

NOTE: If there is enough time, encourage students to use both the income statement and the balance sheet in their presentations. They should be able to critically read both documents.

Closing (5 mins)

Close the lesson by discussing the main purpose of a balance sheet. The balance sheet gives investors a snapshot of a company's assets and liabilities at a given point in time. The balance, or difference, in assets and liabilities gives investors an idea of the value of that company. Combined with the income statement, this document provides investors with a large amount of information regarding the profitability of different firms. By looking at the balance sheet at different points in time, investors can better understand the future outlook of an investment company.

Practice Outside of the Classroom:

In the last lesson, students were encouraged to find 10-K forms from companies of their choosing as a homework assignment. For this lesson, students should compare the balance sheet of their chosen company to the balance sheet from Chipotle's 10-K filing. Compare and contrast the two companies. Which one is a better investment? Why?