

KEY SERVICE INSIGHTS



ACCOUNTING AND BOOKKEEPING NEWSLETTER

THE BALANCE SHEET: A KEY FINANCIAL STATEMENT

The balance sheet is a key financial statement to understanding the performance of a business. The balance sheet offers crucial insights into the health of a business that can be used by:

- Potential investors to decide whether to invest in a company;
- Business owners to craft more effective organizational strategies; and
- Employees to adjust their processes to better reach shared organizational goals.

Whether you are a business owner, employee, or investor, understanding how to read and understand the information on a balance sheet is an essential financial accounting skill.

Definition and Purpose of a Balance Sheet

A **balance sheet** is a financial statement prepared to reflect how much a company or organization is worth. The balance sheet achieves this by listing out all of the company's assets, liabilities, and owner's equity as of a particular date. Typically, the balance sheet will be prepared and distributed on a quarterly or monthly basis, depending on the frequency of the reporting as determined by law or company policy.

Insights Provided by the Balance Sheet

The balance sheet provides a summary of a business at a given point in time. It is a snapshot of a company's financial position, as broken down into:

- Assets
- Liabilities
- Equity

Internal Review of the Balance Sheet

When a balance sheet is reviewed internally by the executive and/or the board, the balance sheet provides insights into whether a company is succeeding or failing. Based on this information, the



company can shift their policies and approach, look to increase the successes, correcting failures, and pivot where needed toward new opportunities.

External Review of the Balance Sheet

When a balance sheet is reviewed externally, the balance sheet is designed to give insight into what resources are available to a company on how the company was financed, based on this information, potential investors can decide whether it would be wise to invest in a company. Similarly, the external reviewer of the balance sheet can leverage the information in a balance sheet to calculate important metrics, such as:

- Liquidity
- Profitability
- Debt-to-equity ratio

External auditors may use the balance sheet of a company to ensure the company is complying with any reporting laws that the company is subject to.

Limitations of the Balance Sheet

It is important to remember that a balance sheet communicates information as of a specific date which by its specific nature is based on past data. The balance sheet can be used to predict future performance, but it is important to note that past performance is no guarantee of future results.

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Fundamental Balance Sheet Equations

There are three basic equations of the balance sheet:

- **Assets = Liabilities + Owner's Equity**
- **Liabilities = Assets – Owner's Equity**
- **Owner's Equity = Assets – Liabilities**

A balance sheet must always balance. If a balance sheet does not balance, the balance sheet was prepared incorrectly. It is important that for the balance sheet to serve its purpose, to give a snapshot of the company's value, that the balance sheet is prepared correctly otherwise incorrect decisions will be made as the information on which the decisions are being made is wrong.

Importance of Understanding a Balance Sheet

The information found in a company's balance sheet is among some of the most important information for a business leader, regulator, or potential investor to understand. Without this knowledge, it can be challenging to know whether a

company is struggling or thriving, highlighting why learning how to read and understand a balance sheet is a crucial skill for anyone interested in the company.

Our Commitment to Clients

As part of our services to our clients, we want to provide simplified information as to the information on their company's financial statements so they can better understand the significance of the financial statements that are being prepared with the goal of empowering our clients to be more informed and make better decisions.

We focus on representing small and mid-size businesses. We advise our clients as to the implications of their financial statements and empower our clients to make informed decisions about the direction of their company based in part on the financial statements. At Praestans, we can handle these important accounting and bookkeeping functions while coordinating professional services customized to the client's needs.

Praestans Global Advisors is neither a law firm nor a CPA firm.

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Strategic Business Planning that is collaborative, integrated, and bespoke.

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