

NORMALIZING YOUR FINANCIAL STATEMENTS

Before evaluating your business financial situation, you will need to "Normalize" the Financial Statements so that they reflect the **actual** or "**normal**" operating and accounting conditions of the company, not extraordinary situations.

First, the **balance sheet** needs to be adjusted to ensure that assets are properly valued and that depreciation represents an actual decline in useful life. *As a general rule of thumb, depreciation can be calculated as 10% of fixed assets.* It is not uncommon for small business owners to list fixed assets at grossly under estimated values. This situation normally results from carrying an asset that was acquired at a very low cost or as a result of the application of accelerated depreciation to fixed assets. Inventory should be sellable, deferred income taxes are added to owner's equity. Also, accounts receivable may include uncollectable amounts and intangible assets, which may have to be significantly reduced or be removed completely.

After the balance sheet has been adjusted to provide a realistic look at the asset and liability structure of the business, the **income statement** needs to be examined to see if changes should be made to it. For example, many small business owners are either over or under compensated and it is important to adjust the operating statement to reflect a "normal" or realistic owner's compensation level. Depreciation expenses should also be examined and adjusted to reflect the decline in useful life especially when accelerated methods of depreciation have been used. Also, extraordinary income and expense items should be adjusted out of the income statement, for example, fire damage, land sale or purchase, selling of large assets like a building or machinery, etc. All income and expenses should be ordinary.

Your accountant can help you with these and other adjustments that are needed to normalize the financial statements for your firm. Once your financial statements have been normalized, they become useful tools for financial management decision-making.