The Balance Sheet reclassification

The balance sheet, besides showing the breakdown of the assets and the amount of net equity at a certain date, makes it possible to show the correlation existing between investments made and sources of finance, necessary for the purposes of analysing liquidity and the solidity of equity.

In particular, reclassification of the balance sheet makes it possible to overcome the purely statutory logics involved in drawing it up in favour of genuinely "company" logics so as to build aggregates with a higher information level, especially in view of a balance sheet analysis, and therefore of the construction of indices and margins. Two criteria for balance sheet reclassification can be identified in order to acquire better information on company dynamics: the financial criterion, and the functional criterion. With the financial criterion the assets (uses) are classified and grouped according to the degree that they can be liquidated, that is, as a function of their ability to be converted into liquidity in more or less short periods, while for liabilities (sources) it is a matter of their temporal duration, that is, on the basis of their speed of repayment.

The time span taken as reference with a congruous term to circumscribe the short term from the medium-long term is 12 months.
The uses are therefore subdivided, as a function of their actual possibility of being converted into liquidity, into:

- current assets, suitable for liquidation in a time span of less than 12 months, that is, assets destined for sale within 12 months, financial assets held for the purpose of negotiation, receivables falling due within 12 months, stocks and work in progress (for the part that presents a rate of rotation of less than 12 months), liquidity, and accruals and deferrals;
- non-current assets, destined to remain constrained in the medium-long term, that is, tangible, intangible and financial assets (except those intended for sale in the short term), payables falling due after 12 months, and stocks and work in progress (for the part that presents a rotation rate of less than 12 months).

The sources are instead subdivided into:

- net equity, a constrained magnitude and therefore a long-term source;
- current liabilities, destined to be repaid within 12 months, i.e., accounts payable (including short-term instalments on medium-long term financing), accrued liabilities and deferred income, and provisions for liabilities and charges (for the part that will have a financial manifestation in the short term);
- non-current liabilities falling due after 12 months, i.e., medium-long term payables, multi-year deferred income, and provisions for liabilities and charges (for the part that will have a financial manifestation after 12 months).

According to the functional criterion, instead, the assets (uses) and liabilities

The Balance Sheet reclassification

(sources) are reclassified on the basis of the operating area to which they belong:

- characteristic/operating area (in which to include, if marginal, also the auxiliary area), comprising all the values pertaining to the core business;
- financial area, comprising all the values relating to liquidity negotiation.

The uses are therefore subdivided into:

- operating assets: tangible and intangible assets, operating receivables, stocks and work in progress, and accruals and deferrals;
- financial assets: financial investments (both short and medium-long term), financial receivables, and cash and cash equivalents.

The sources are instead subdivided into:

- net equity, a magnitude not ascribable either to the operating area or to the financial area;
- operating liabilities: provisions for liabilities and charges, operating payables, and accrued liabilities and deferred income;
- financial liabilities, that is, financial payables irrespective of due date.

The two classification criteria described above make it possible to develop a different level of analysis:

- the balance sheet classified according to the financial logic makes it possible to verify the company's ability to meet its short-term commitments with uses of equal duration (working capital), and is therefore preparatory to the liquidity analysis;

- the balance sheet classified according to the functional logic aims at verifying the equilibrium between investments and sources of finance, and is therefore helpful for developing the analysis of solidity.

Proper classification of the items, in both of the reclassification cases, is therefore particularly important in the analysis logic that one wishes to develop.

Among the cases to underscore, we point to the item relating to "member financing" (item D.3 of the balance sheet liabilities), particularly used by "undercapitalized" Italian companies to meet temporary liquidity needs, avoiding constraining equity resources and therefore avoiding bringing in resources as risk capital.

In substance, however, especially if it is a question of non-interest-bearing loans without reimbursement constraints and perhaps with a deferment clause with respect to payables to third parties, it comes very close to a capital injection,

The Balance Sheet reclassification

consequently in the reclassification of sources it is recommended that they be inserted in the area of net equity and not be kept among the liabilities, and therefore among the stable medium-long term sources.

"FINANCIAL" BALANCE SHEET	
USES	**SOURCES**
Non-current assets	Net equity
	Non-current liabilities
Current assets	Current liabilities

"FUNCTIONAL" BALANCE SHEET	
USES	**SOURCES**
Operating assets	Net equity
	Operating liabilities
Financial assets	Financial liabilities

By exploiting the significant experience of **Clarkson Hyde Global** in business consulting, companies using its services can achieve excellent performances and generate value for the entire company mainly due in the balance sheet which is one of the most important part of each company.