

# *Finance and Accounting Basics*

*Presented by Mark R. Allio*

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*RI Small Business Development Center Network  
at University of Rhode Island*

*Sponsored and Hosted by:*

*SBA Rhode Island District Office*

*RI Small Business Development Center Network at URI*

*Celebrating*

*SBA Financial Literacy Month*

**RI SBDC: 401-874-7232 <https://web.uri.edu/risbdc/>**

# *Workshop Agenda*

- RI SBDC overview
- Speaker background
- The Big Picture
- Legal and Tax
- Finance and accounting
- Financial Statements
- Systems
- Questions and answers



## *RI SBDC Overview*

The Small Business Development Center Network is one of the three SBA resource partners (SBDC, SCORE, CWE) with offices located in all 50 states and territories

Core programs include:

- Education and training (courses and workshops)
- Business advisory services (technical assistance)
- Loan packaging (SBDC)
- Minority certification support

# *Speaker Background*

## *Mark Allio*



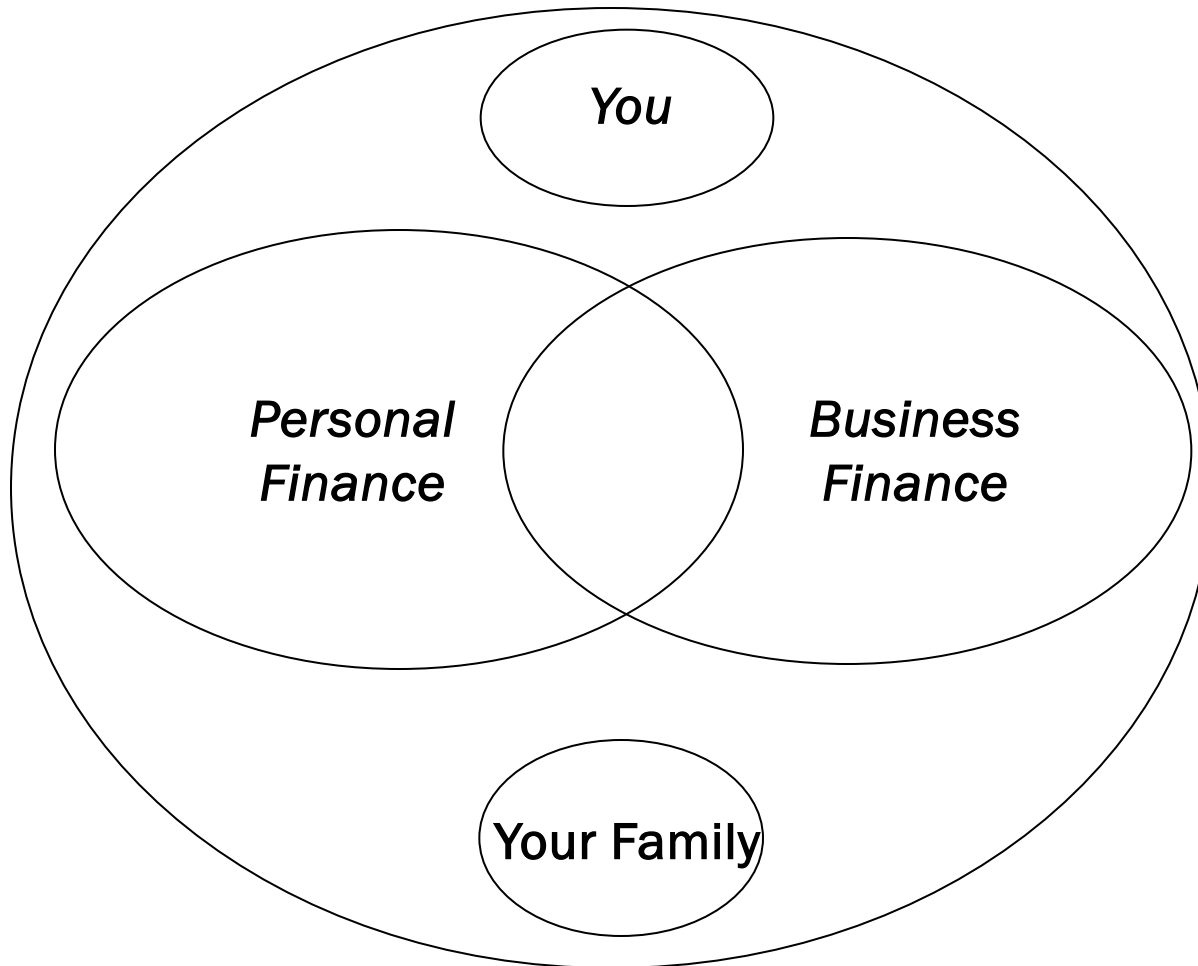
- Former Director of Massachusetts Small Business Development Center (MSBDC) & Minority Business Center at UMass Boston (2005-2015); currently P-T Senior Business Advisor at RI SBDC at URI
- Center assisted 10,000 entrepreneurs and business owners; helped establish more than 150 start-ups and facilitate \$27M in financing
- Recent history- Assistant Director of Planning & Economic Development for City of Central Falls, and Director of Workforce Training for CCRI's Center for Workforce and Community Education
- Former entrepreneur and CFO/finance director for two start-up ventures and three non-profits
- BA from York University in Canada, MBA from Babson College in Wellesley, MA
- Certified Global Business Professional, Certified Non-Profit Accounting Professional, and Certified Business Advisor
- Author of R is For RI Red- children's book on history and culture of Rhode Island

# *The Big Picture- Economy*

- We are still emerging from the pandemic downturn and highest inflation and interest rates since the 80s- although equity markets have recovered, Federal Reserve is managing interest rates to avoid a recession (soft landing)
- Global economies are volatile- serious geopolitical concerns linger; however dollar may be strengthening (good for imports)
- RI current unemployment at 3.9% (highest in New England)- rising slowly- good help can be hard to find
- Interest rates and inflation at highest level in decades- capital available but money is expensive; underwriting criteria has tightened; credit card debt reaching alarming levels
- Real estate values remain high- inventory tight; rents high and housing stock extremely limited- good for collateral
- Local flooding and bridge disasters affecting hundreds of RI businesses
- The economy is strong, but not everyone is winning yet!

# *The Big Picture*

*Important to maintain perspective on home and business...*



# *The Big Picture*

## *Why Do Businesses Fail?*

**General reasons-** lack of strategy, experience, resources

### *Internal*

- Focus on product or service rather than whole business
- Insufficient resources
- Poor location
- Failure to keep score
- Too much fixed assets
- Poor credit policies
- Owner taking too much \$\$
- Lack of management experience & knowledge

### *External*

- Adverse economic conditions
- Government regulations
- Taxes & insurance
- Bureaucratic inefficiencies
- High relative labor cost
- High interest rates
- Lack of available capital
- Crime

# *Legal and Tax Big Picture*

- **Forms of organization-** taxes and liability are the key dimensions; paper formalities do not “make” the business; always consult with advisors
- **Advisors-** attorneys, accountants, insurance advisor, other- establishing multiple resources is good practice (especially non-family members!)
- **Permits, EINs, DBAs-** required as needed;  
practicality rules
- **Taxes-** on both business and personal fronts, must be diligent in organization and record-keeping



# *Legal and Tax Forms of Organization*

- **Sole Proprietorship (or single member LLC):**
  - Default form of organization- easy to start and disband
  - Pay taxes as an individual owner- Schedule C
  - Full liability for business
- **General Partnership (and multiple member LLC):**
  - 2 or more partners
  - Similar to sole proprietorship but both partners have 100% liability
  - Partnership files information return Form 1065- each partner issued K-1 with pro-rata share of income- noted on Schedule E
- **Limited Liability Corporation (LLC) and Limited Liability Partnerships:**
  - Independent non-incorporated entities that are hybrid forms of organization
  - Affords members some protection against liability; profits/losses flow through to members

# *Legal and Tax Forms of Organization*

## **Corporation (three main types):**

- An independent entity by law. Taxed separately from owner's income.
- Protects owner/s against liability, but more expensive to organize.

### ***1) S Corporation (subchapter):***

- Small business corporation- 25 shareholders or less
- Income can be taxed & reported on owner's individual tax return- Schedule 1120S

### ***2) C Corporation (subchapter):***

- Taxed once at the corporate level, and again when distributed to owners as dividends. IRS Form 1120.

### ***3) Non-Profit 501c(3)***

- Generally non-taxable income primarily from grants and donations. Must have a charitable purpose and a board. IRS Form 990. Subject to state oversight.

## *Legal and Tax Other Considerations*

- Know your local permit requirements and zoning
- Employer Identification and Social Security Numbers (EINs and SSNs)
- Establishing separate Doing Business As (DBA) bank accounts
- Sales Tax- in-state, out-of-state, Internet- generally on retail/end user sales of goods
- Specialty licenses and certifications- check with state and city
- RI Secretary of State database

## *Legal and Tax Advisors*

- Attorneys- Rhode Island Bar Association ([ribar.org](http://ribar.org))- don't hesitate to seek counsel
- Accountants/CPAs/bookkeepers- RI Society of Certified Public Accountants ([ricpa.org](http://ricpa.org))- know the difference between bookkeepers, accountants, and CPAs
- Insurance agents ([iii.org](http://iii.org))- know what is mandatory, prudent, and desirable
- Specialty advisors- SBDC, SCORE, CWE, business, industry, and neighborhood associations, municipalities
- Vendors- office supply retailers e.g. Staples
- Software programs- Quicken, Quicken Home and Business, QuickBooks, Mint- see ([www.intuit.com](http://www.intuit.com))

## *Quick Break*

Checking Chat and Questions

## *Finance & Accounting In a Nutshell*

- Finance- managing money
- Accounting – measuring money

You can't manage

what you don't measure!



## *Personal Financial Statement*

- Know where you stand in order to determine the best way forward **before talking to lenders**
- Reflects your personal assets and liabilities (AND INCOME)
- Goes hand in hand with a credit check
- Required for any loan application- know the rules in advance
- If married, must include joint information
- Lenders will look at business AND personal cash flow

# *Financial Statements*

## ***BALANCE SHEET***

The Balance Sheet is a financial “snapshot” of  
at a given point in time.

It tells you, as of a specific date:

- What you own (Assets)
- What you owe (Liabilities)
- Your net financial worth (Equity)

*Note: Assets – Liabilities = Equity*



# *Financial Statements*

## **INCOME STATEMENT**

The Income Statement is a financial “movie” that covers a specific period of time. It tells you if your business operated at a profit or a loss during that time.

- Income (Revenue generated)
- Expenses (Cost of Operations)
- Profit or Loss (Difference between income and expenses)

## *Financial Statements*

### *Example- Linda's Financial Picture*

1. Linda's take-home pay is \$4,000/mo.
2. Her living expenses total \$3,600/mo.
3. The difference between her income and expenses is \$400.
4. Linda puts her monthly "profit" into a savings account.
5. She just bought a used car for \$6,000.

## *Financial Statements*

### *Example- Linda's Financial Picture (2)*

6. She put \$1,000 down to buy the car.
7. She has an auto loan with a balance of \$5,000
8. Linda is buying a house. The purchase price is \$300,000.
9. She put \$30,000 down on the house.
10. She has a mortgage balance of \$270,000.

# *Financial Statements*

## *Linda's Income Statement*

### INCOME

Salary	\$4,000
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### EXPENSES

Mortgage Payment	\$2,000
Food	500
Utilities	400
Insurance	100
Auto Payment	300
Miscellaneous	<u>300</u>
<b>TOTAL EXPENSES</b>	<b>\$3,600</b>

<b>Profit (Loss)</b>	<b>\$ 400</b>
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# *Financial Statements*

## *Linda's Balance Sheet*

### ASSETS

Bank Balance	\$	500
Car		6,000
House		<u>300,000</u>

### LIABILITIES

Mortgage loan	\$	<b>270,000</b>
Car Loan		<u>5,000</u>
Liabilities		\$275,000

### EQUITY (net worth)

Home Equity	\$	<b>30,000</b>
Car Equity		1,000
Equity- Other		<u>500</u>
<b>EQUITY</b>		<b>\$31,500</b>

**TOTAL Assets**                    \$306,500

### Total Liabilities & Equity

**\$ 306,500**

# *Finance & Accounting*

## *Business Core Statements (The Big 3)*

- **Profit & Loss (P&L) statement**
  - revenues less expense equals net profit
- **Balance sheet**
  - assets (what you have)
  - liabilities (what you owe)
  - equity (difference)
- **Statement of Cash Flow- cash sources and uses**
  - cash from operating activities e.g. net income and changes in receivables, payables, and inventories
  - cash from investing activities (purchase or sale of assets)
  - cash from financing (debt or equity)

# *Finance & Accounting*

## *Business Profit & Loss*

- Revenues- sales
- Cost of Goods Sold (CGS) or Cost of Sales- direct materials, labor, and overhead (variable)
- Gross Profit/Margin- contribution (towards fixed overhead)
- Expenses (operating)- indirect fixed costs (overhead)
- Net income (profit) before interest, taxes and depreciation (EBITDA)
- Net income (profit) after interest, taxes, and depreciation (NAT)

# *Finance & Accounting*

## *Business Cash Flow and Working Capital*

### **Cash flow**

- Receipts and disbursements
  - Not all sales generate immediate receipts
  - Not all expenditures require immediate disbursement
- Cash flow projections provide advance view of likely cash sources and uses and need for financing

### **Cash vs. accrual accounting**

- Cash- revenues recorded when deposited; expenses when paid
- Accrual- revenues recorded when invoiced (accounts receivable); expenses recorded when invoices received (accounts payable)
- Accrual basis reflects more accurate picture but is labor-intensive

### **Working capital**

- The snapshot view, generally current assets less current liabilities
- Funds needed to operate your business for a certain period of time
- Can change quickly and dramatically



# *Finance & Accounting*

## *Cost Structure & Pricing*

*Know your internal cost and what the market will bear...*

**Internal** cost structure (floor)

- Variable- directly related to sales (CGS- labor, materials)
- Fixed- unrelated to sales (rent, utilities, some wages)
- Semi-variable overhead- controllable, may be indirectly related to sales

**External** market – what will customers pay; competitive benchmarking (ceiling)

**Breakeven analysis-** helps you understand your cost structure and determine your pricing

## *Finance & Accounting*

### *Budgeting and Forecasting*

- Looking ahead is critical to managing your resources and business successfully
- Forecasts are made for multiple years- 3-5 year annual, quarterly- 1-3 years, monthly 12-24 months
- Budgets are typically established annually
- Lenders require financial statements and a 2 year forecast by month
- The quality of the assumptions are key- prepare optimistic, realistic, and pessimistic scenarios
- Revise frequently (quarterly) as internal and external conditions dictate
- [See retail start-up example](#)

# Simple 12 Month Projection

*Consider your cost structure and the value of your time*

Sample XYZ Retail Startup															
	Start-up	Month	Month	Month	Month	Month	Month	Month	Month	Month	Month	Month	Month	Total	
	Costs	1	2	3	4	5	6	7	8	9	10	11	12	Year	
Sales		\$ 1,000	\$ 1,500	\$ 2,000	\$ 2,500	\$ 3,000	\$ 4,000	\$ 6,000	\$ 6,000	\$ 6,000	\$ 7,500	\$ 7,500	\$ 7,500	\$ 54,500	
CGS @ 50%		\$ 500	\$ 750	\$ 1,000	\$ 1,250	\$ 1,500	\$ 2,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,750	\$ 3,750	\$ 3,750	\$ 27,250	
Gross Profit (Contribution)		\$ 500	\$ 750	\$ 1,000	\$ 1,250	\$ 1,500	\$ 2,000	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,750	\$ 3,750	\$ 3,750	\$ 27,250	
Rent		\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 12,000	
Other overhead		\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 6,000	
<b>Total Overhead</b>		<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 18,000</b>	
<b>Net Profit</b>		<b>\$ (1,000)</b>	<b>\$ (750)</b>	<b>\$ (500)</b>	<b>\$ (250)</b>	<b>\$ -</b>	<b>\$ 500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 1,500</b>	<b>\$ 2,250</b>	<b>\$ 2,250</b>	<b>\$ 2,250</b>	<b>\$ 9,250</b>	
<b>Cumulative cash</b>	<b>\$ (15,000)</b>	<b>\$ (16,000)</b>	<b>\$ (16,750)</b>	<b>\$ (17,250)</b>	<b>\$ (17,500)</b>	<b>\$ (17,500)</b>	<b>\$ (17,000)</b>	<b>\$ (15,500)</b>	<b>\$ (14,000)</b>	<b>\$ (12,500)</b>	<b>\$ (10,250)</b>	<b>\$ (8,000)</b>	<b>\$ (5,750)</b>		
														Profit divided by 2000 hours/year	\$ 4.63
														Profit divided by 1000 hours/year	\$ 9.25

# *Finance & Accounting*

## *Breakeven Analysis*

The Formula for Break Even is:

### **Breakeven Dollars (\$)**

- Gross Income – Cost of Goods Sold = Gross Profit
- *Example- \$10,000-\$6,000=\$4,000*
- Gross Profit ÷ by Sales = Gross Margin (%)
- *Example- \$4,000/\$10,000= 40%*
- Fixed Expense ÷ Gross Margin (%) = Breakeven (\$)
- *Example- \$2,500/40%- \$6,250*

### **Breakeven Units**

Calculate margin per unit and divide into Fixed Expense-

- Margin =  $\$4,000/1,500 = \$2.66$  and
- $\$2,500/\$2.66 = 940$  units

# *Finance & Accounting*

## *Accounting*

### **People**

- CPAs, accountants, bookkeepers, business managers
- Legal and business advisors

### **Systems (to keep score)**

- Non-computerized e.g. Safeguard One-Write, checkbook
- Computerized e.g. Quicken, Quickbooks, Mint, other

### **Key Needs**

- Bookkeeping and record-keeping
- Banking
- Accounts Receivable and Accounts Payable
- Financial statements (monthly)
- Budgets and forecasting
- Tax returns
- Insurance
- Payroll (if necessary) or Independent contractors
- Inventory management

## *Finance & Accounting Other Key Considerations*

- Business set-up and timing- fiscal year?
- Cash versus accrual accounting
- Financial and cost accounting
- Chart of accounts
- Bank reconciliations
- Customers and accounts receivable
- Vendors and accounts payable
- Credit cards
- Merchant accounts
- Online presence and e-commerce



# *Finance & Accounting Software Systems*

- Assess both your personal and business needs
- Consider online and desktop versions

## **Intuit Products**

### **Quicken Personal financial management software**

- Personal system can cover very basic business tracking

### **Quicken Home & Business**

- Accommodates personal and limited business
- Includes Invoicing and basic biz account management

### **QuickBooks- Online and Enterprise (Desktop)**

- Invoicing, payroll, inventory management, account mgt, also linkages with tax software
- Add-ons include merchant services, point of sale
- Simple Start
- QuickBooks Pro- full G/L accounting
- QuickBooks Premier Industry Editions- retail, manufacturing, contractor, professional services, non-profit
- QuickBooks Enterprise solutions- scalable from 5 to 20 users
- Consider Quickbooks Pro Advisor to help with set-up

# *Finance & Accounting Systems & Record-Keeping*

- Get organized- set up files and record-keeping systems- understand requirements- keep payroll and tax records 4 years minimum (7 years for some records), other keys docs like incorporation docs forever
- Make hard copies, file in organized way, and digitize- always back up your data
- Confirm your resources and the time available to manage your finance and accounting needs
- Understand what is required to set up systems- hire help if needed for initial set-up (e.g. QuickBooks-certified Advisor)
- Learn as much as you can- program help, self-study, videos, workshops and course, individualized program
- Do not delegate everything to independent contractors- it is **your** business!
- Impose the discipline to manage affairs on a regular basis; hire part-time or full-time resources when needed



# *Good Business Practice*

- Evaluate and re-evaluate your personal financial situation in relation to your business- two pockets on the same pair of pants!
- Perform a basic feasibility analysis, including assessment of resource and financial considerations; identify start-up and ongoing costs
- Formulate a business strategy (utilizing internal and external information and perspectives)
- Keep paper and digital records of everything!
- Implement finance & accounting systems consistent with your self-assessment and resources; obtain training and help if needed
- Set financial and non-financial goals, prepare annual forecasts, and review your situation frequently (at least monthly)
- Establish/maintain relationships with advisors and lenders now
- Understand the difference between profits and cash flow
- Know your Federal and state requirements for taxes- business and personal- file on time and pay what you owe (next Tues April 15<sup>th</sup> is tax day- file extension if need be)
- Don't place all of your eggs in one basket
- Maintain a long-term perspective and be willing to change direction as necessary

# *Questions and Answers*

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