Finance and Accounting Basics

Presented by Mark R. Allio
Senior Business Advisor
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
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...

- You
- Personal Finance
- Business Finance
- Your Family
# 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
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) - don’t hesitate to seek counsel
- Accountants/CPAs/bookkeepers - RI Society of Certified Public Accountants (ricpa.org) - know the difference between bookkeepers, accountants, and CPAs
- Insurance agents (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)
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 your financial situation 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

EXPENSES
   Mortgage Payment   $2,000
   Food             500
   Utilities        400
   Insurance        100
   Auto Payment     300
   Miscellaneous    300
TOTAL EXPENSES     $3,600

Profit (Loss)       $  400
# Financial Statements
## Linda’s Balance Sheet

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Bank Balance</td>
<td>$500</td>
</tr>
<tr>
<td>Car</td>
<td>6,000</td>
</tr>
<tr>
<td>House</td>
<td>300,000</td>
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<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th></th>
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<tbody>
<tr>
<td>Mortgage loan</td>
<td>$270,000</td>
</tr>
<tr>
<td>Car Loan</td>
<td>5,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>$275,000</td>
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</table>

<table>
<thead>
<tr>
<th>EQUITY (net worth)</th>
<th></th>
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<tbody>
<tr>
<td>Home Equity</td>
<td>$30,000</td>
</tr>
<tr>
<td>Car Equity</td>
<td>1,000</td>
</tr>
<tr>
<td>Equity- Other</td>
<td>500</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>EQUITY</th>
<th></th>
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<tbody>
<tr>
<td>EQUITY</td>
<td>$31,500</td>
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<table>
<thead>
<tr>
<th>Total Liabilities &amp; Equity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL Assets</td>
<td>$306,500</td>
</tr>
<tr>
<td></td>
<td>$306,500</td>
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</tbody>
</table>
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

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**Sample XYZ Retail Startup**

<table>
<thead>
<tr>
<th>Start-up Costs</th>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
<th>Month 4</th>
<th>Month 5</th>
<th>Month 6</th>
<th>Month 7</th>
<th>Month 8</th>
<th>Month 9</th>
<th>Month 10</th>
<th>Month 11</th>
<th>Month 12</th>
<th>Total</th>
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<tbody>
<tr>
<td>Sales</td>
<td>$1,000</td>
<td>$1,500</td>
<td>$2,000</td>
<td>$2,500</td>
<td>$3,000</td>
<td>$4,000</td>
<td>$6,000</td>
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<td>$6,000</td>
<td>$7,500</td>
<td>$7,500</td>
<td>$7,500</td>
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<tr>
<td>CGS @ 50%</td>
<td>$500</td>
<td>$750</td>
<td>$1,000</td>
<td>$1,250</td>
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<td>$2,000</td>
<td>$3,000</td>
<td>$3,000</td>
<td>$3,000</td>
<td>$3,750</td>
<td>$3,750</td>
<td>$3,750</td>
<td>$27,250</td>
</tr>
<tr>
<td>Gross Profit (Contribution)</td>
<td>$500</td>
<td>$750</td>
<td>$1,000</td>
<td>$1,250</td>
<td>$1,500</td>
<td>$2,000</td>
<td>$3,000</td>
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<td>$3,750</td>
<td>$3,750</td>
<td>$3,750</td>
<td>$27,250</td>
</tr>
<tr>
<td>Rent</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
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<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$12,000</td>
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<tr>
<td>Other overhead</td>
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<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
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<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$500</td>
<td>$6,000</td>
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<tr>
<td>Total Overhead</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
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<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$18,000</td>
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<tr>
<td>Net Profit</td>
<td>$(1,000)</td>
<td>$(750)</td>
<td>$(500)</td>
<td>$(250)</td>
<td>$-</td>
<td>$500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$2,250</td>
<td>$2,250</td>
<td>$2,250</td>
<td>$9,250</td>
</tr>
<tr>
<td>Cumulative cash</td>
<td>$(15,000)</td>
<td>$(16,000)</td>
<td>$(16,750)</td>
<td>$(17,250)</td>
<td>$(17,500)</td>
<td>$(17,500)</td>
<td>$(17,000)</td>
<td>$(15,500)</td>
<td>$(14,000)</td>
<td>$(12,500)</td>
<td>$(10,250)</td>
<td>$(8,000)</td>
<td>$(5,750)</td>
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</table>

<table>
<thead>
<tr>
<th></th>
<th>Profit divided by 2000 hours/year</th>
<th>$4.63</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Profit divided by 1000 hours/year</td>
<td>$9.25</td>
</tr>
</tbody>
</table>
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
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 15th 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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