

# Understanding Financial Statements

## A starting point for Planning and Budgeting

Moderator: Alaina Capasso

[aecapasso@uri.edu](mailto:aecapasso@uri.edu)

RI Small Business Development Center

Training Coordinator

Presentation by:

Henry Schwarzbach, Financial Consultant

Former CPA, URI Professor and Consultant

Currently Part time Consultant

RISBDC

[henry@uri.edu](mailto:henry@uri.edu)



We exist to train, educate, and support entrepreneurs of both new (pre-venture) and established small businesses. Positioned within the nationwide network of SBDCs, we offer resources, key connections at the state and national level, workshops, and online and in-person support that equips us to help Ocean State entrepreneurs reach the next level of growth.



# UNDERSTANDING YOUR FINANCIAL STATEMENTS

## An Important step in Planning and Budgeting

**Intended Audience** – Small business owners, managers, bookkeepers, and entrepreneurs about to start a business. This will be especially valuable to those not using formal planning and budgeting as well as experienced financial managers.

**Goal of the webinar** – Improve everyone's understanding of financial statements, financial statement analysis, and the process and value of business planning and performance improvement

**Ask Questions** - At the end of each slide please ask questions or make comments. I would rather answer questions and get feedback than present more material and leave you with questions! LESS CAN BE MORE.

# THE THREE BASIC AREAS OF ACCOUNTING

## Financial Accounting and Auditing-

Systems and financial reports for external users, guided by US Generally Accepted Accounting Principles or International Financial Accounting Standards, and the standards and procedures for auditing the financial statements

## Management Accounting -

Owners or managers using accounting to help run the business is what we are discussing today. There are no set rules only guidance.

## Tax and Regulatory Accounting -

This is important because decisions made by a small business often have tax consequences that need to be considered and the same for regulations. Often a CPA or tax professional can provide guidance. It's not part of this webcast

# THE THREE BASIC FINANCIAL STATEMENTS

## Balance Sheet, Cash Flow Statement, Income Statement

### Balance Sheet-

Follows the accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Owners Equity}$

Least important for management planning & control. Important for assessing liquidity and solvency. We won't spend much time on this except to review the accounting equation

### Cash Flow Statement-

Businesses need to know they have enough cash to pay bills when due.

The Cash Flow Statement is not that important for owners, but the Forecasted or Budgeted Cash Flow Statement important for planning.

### Income Statement - aka Profit and Loss Statement-

Very important for management performance measurement, planning and budgetary control. We'll spend most of our time on the Income Statement

# Understanding & Analysing the Income Statement

## Revenues/Sales

Customers buy products (SALES ON THE INCOME STATEMENT) because of the value they receive. As you look at Sales on the Income statement think about this:

Value is a function of the **quality** of the product, the buying experience, and the **price**. **Quality** is how well the product meets the desire of the customer, how pleased the customer is with the product.

The higher the **quality**, the higher the **value** and vice versa. Normally the lower the price the higher the value. **The higher the value of a company's products the more customers will buy. Customers have to know that the products are good quality (perceived quality). Thus marketing and brand building are also important drivers of SALES.**

Revenues are recorded in the accounting system either when cash is received, or when the sale takes place even if the customer will pay later. The first is CASH accounting the second is ACCRUAL accounting

A credit card is considered cash  
Let's look at some sample Income Statements

Rule #1 - Check/analyze your revenues very often ter

## My Art Business (A Sole Proprietorship)

### Income Statement

For The Period January 1, 2009 to December 31, 2009

<b>Sales (Revenue)</b>		
Original Art	\$30,500.00	57.7%
Limited Edition Prints	\$20,000.00	37.8%
Frames	<u>\$2,400.00</u>	4.5%
<b>Total Revenue</b>	<b>\$52,900.00</b>	<b>100.0%</b>
<b>Cost of sales</b>		
Canvas - Original Art	\$1,000.00	8.6%
Paint & Supplies - Original Art	\$1,250.00	10.7%
Print Reproduction Services - Limited Edition Prints	\$1,000.00	8.6%
Frames & Framing Supplies - Original Art	\$1,200.00	10.3%
Studio Assistants Salaries (1)	\$6,000.00	51.5%
Payroll Taxes - Studio Assistants (1)	<u>\$1,200.00</u>	10.3%
<b>Total Cost of Sales</b>	<b>\$11,650.00</b>	<b>100.0%</b>
<b>Gross profit</b>	<b>\$41,250.00</b>	<b>78.0% - Gross Profit Margin</b>
<b>General, Selling and Administrative Expenses</b>		
Advertising	\$1,200.00	
Studio Rent	\$1,200.00	
Studio Utilities	\$600.00	
Phone & Internet Service	\$1,200.00	
Office Supplies	\$300.00	
Travel & Entertainment	\$400.00	
Insurance	\$500.00	
Dues & Subscriptions	\$300.00	
Interest Expense	\$250.00	
Depreciation on Equipment (2)	<u>\$200.00</u>	
<b>Total operating expenses</b>	<b>\$6,150.00</b>	
<b>Net Income before Income Tax</b>	<b>\$35,100.00</b>	<b>66.4% - Net Profit Margin</b>
<b>Income Tax</b>	<b>\$4,000.00</b>	
<b>Net Income After Taxes</b>	<b>\$31,100.00</b>	

Notes To Income Statement: (1) - Approximately 50% of the studio assistant's time was devoted to producing limited edition prints, 30% on general assistance and 20% on framing; (2) Depreciation expense was for a copy machine purchased 1/1/2009 for \$1000 and depreciated over a five year period.



## Business Name

Business Address

Suburb

## Profit & Loss Statement

for the period 1 January 2009 to 31 December 2009

### Income

Sales	\$120,200.00
Services	\$55,000.00
Other Income	<u>\$2,520.00</u>
<b>Total Income</b>	<b>\$177,720.00</b>

### Expenses

Accounting	\$2,500.00
Advertising	\$7,500.00
Assets - Small	\$100.00
Bank Charges	\$962.40
Cost of Good Sold	\$22,500.00
Depreciation	\$2,385.00
Electricity	\$2,994.90
Hire of Equipment	\$4,200.00
Insurance	\$1,221.00
Interest	\$2,401.66
Motor Vehicle	\$1,203.50
Office Supplies	\$962.11
Postage & Printing	\$725.00
Rent	\$15,610.00
Repairs & Maintenance	\$1,082.00
Stationery	\$660.00
Subscriptions	\$3,690.00
Telephone	\$2,165.00
Training / Seminars	\$2,200.00
Wages & Oncosts	<u>\$65,000.00</u>
<b>Total Expenses</b>	<b>\$140,062.57</b>

### **Profit / (Loss)**

**\$37,657.43**

Now let's go to an Excel Workbook where we can go over revenue in more detail

Then we'll come back to the slides and discuss Expenses before going back to the workbook a look at Expenses and, if time, at the Cash Flow Statement. Wow! If we get through it's the most I've covered in less than an hour.

# Expenses

Expenses are incurred in the process of earning revenues  
We could say they drive revenues or they are needed to generate revenue

A better way to look at Revenue generation is  
Business Processes/Activities -> Revenues  
Business Processes incur expenses to do so.

- The more effective the processes the more revenues they bring in.
- The more efficient the less it cost per \$ of revenue generated

# Expenses incurred for Business Processes

Businesses develop processes (aka Activities) that bring in customers, who buy products, which generates Revenue, and hopefully profit. **HAVING SOME GREAT PROCESSES LEADS TO SUCCESS.** It takes good founders/owners and other good people to design and operate the processes.

**Rule # 2 GREAT PEOPLE ARE KEY!!!!** They develop and run the processes that make the difference between success and failure  
**Good human resource management is critical for most businesses**

# Understanding the two Types of Activities

## 1. **Customer value adding activities are those activities that make customers want the business' products:**

- > A. Research & development - new technology, new concepts, new methods
- > B. Product design - manufacturability and customer pleasing
- > C. Production - quality, cost, and time
- > D. Marketing/Brand building loyalty/Customer Acquisition and Retention
- > E. Distribution - (Location, Location, Location, Amazon, LL Bean, App Stores)
- > F. Customer service (cell phone company example)

in the accounting/bookkeeping system, where feasible, we want to determine the cost of these activities. Yet very few if any accounting software packages do this.

Inputs>Process>Output    Want high quality output with least amount of inputs

# Understanding the two Types of Activities

**2. Business value adding and support activities are those activities that provide support to other activities and add value to the business**

**A. Strategic Management and Business Development**

B. Supply Chain/Logistics/Purchasing

C. Finance and Accounting

D. IT and Information Systems

E. Human Resource Management

F. Facilities Management

G. Legal services

H. Maintenance

**Rule #3 Benefits (increase revenue or decrease other expenses) should be greater than the Expense of the activity. If not and cost can't be lowered, consider outsourcing**

For each activity we should measure output quality, time/speed, and quantity metrics as well as determine the cost if not too difficult. We could also consider flexibility

# Learning from the Excel example

A couple more rules

Rule #4 Keep the Accounting System and Financial Reports as simple as possible but not simpler

Rule #5 Only add more capability to your accounting system and reports when the value of the additional information is greater than the extra cost. Always look for ways to lower the cost of accounting, without lowering quality, as you should do for all activities

We'll leave the slides and **go to back to the Excel worksheet** on my computer

We're back to for Wrap up.  
Thanks for attending  
Let us know what further webcasts  
you would like us to do

# Questions?

Type your question to the chat box

Contact Us:

401-874-7232

<https://bit.ly/regRISBDC>

aecapasso@uri.edu

