

INCOME STATEMENT

**CASH FLOW** 

BALANCE SHEET



# Why do you need Financial Statements?

- Decision Making
- Indicates What's Happened in the Past
- Look at What's Currently Happening
- Look at the Future
- Shows if you are Making a Profit?



## Legal Structure

- Impacts the Financial Statement Design
- Sole Proprietorship

Business venture in which the owner has full control and unlimited liability.

#### General Partnership

Business venture owned by two or more individuals.

#### Corporation

A Corporation is a legal entity that exists separately from the people who create it; owned by shareholders; and run by a board of directors elected by the shareholders who hire people to run the organization.



## Legal Structure (Continued)

#### S-Corporations

It is not a separate form of legal structure, but rather a special tax status granted by federal tax law to a corporation to tax the business' income like a partnership or a sole proprietorship. It must file forms both with the Secretary of State and the IRS.

#### Limited Liability Company

Combines the concepts of partnerships for tax purposes and corporations of liability purposes and must be created through the Office of the Secretary of State. It is <u>not</u> a corporation. Owners are referred to as members. There is also a form that has be filed with the IRS.



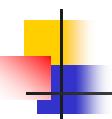
- ncome statement presents the revenues and expenses. The difference between the two will show if the business made a profit within a period of time.
- Balance sheet reports the assets, liabilities, and owner's equity at a specific date. The owner's equity section of that statement summarizes the changes in owner's equity.
- Statement of cash flows summarizes information about the cash inflows (money coming into the business) and outflows (money going out of the business). It is stated for a specific period of time.



### Income Statement



- Is like a motion picture of the day to day operating activities over a period of time.
- Includes all sales and expenditures.



#### **RHOADES SERVICES**

#### **Income Statement**

For Quarter Ending March 31, 2007

#### **Income**

\$ 38,000

Total Income \$ 38,000

#### **Expenses**

<u> LAPCHISCS</u>	
Advertising	\$ 1,200
Depreciation	1,761
Insurance	600
Interest	1,333
Repairs	1,500
Supplies	4,000

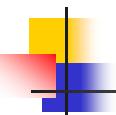
Taxes & Licenses 100

Utilities <u>1,000</u>

**Total Expense** \$ <u>11,494</u>

**Net Income** \$ 26,507

======



## RHOADES, INC. Income Statement For Quarter Ending March 31, 2007

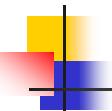
<u>Income</u>			
Sales	\$ <u>38,000</u>		
<b>Total Income</b>		\$	38,000
<b>Expenses</b>			
Advertising	\$ 1,200		
Depreciation	1,761		
Insurance	600		
Interest	1,333		
Repairs	1,500		
Supplies	4,000		
<b>Taxes &amp; Licenses</b>	100		
Utilities	1,000		
Wages	940		
Payroll	<u>60</u>		
Total Expense			12,494
Net Income		•	25,507

======



#### RHOADES RETAIL Income Statement For Quarter Ending March 31, 2007

<u>Income</u>				
Sales	\$	<u>38,000</u>		
Total Sales				\$ 38,000
<b>Cost of Goods Sold</b>				
Inventory January 1	\$	-0-		
Add Net Purchases		20,000		
<b>Total Inventory Availab</b>	le		\$20,000	
Less Inventory, March	31		<u>6,000</u>	\$ 14,000
<b>Gross Profit</b>				\$ 24,000
<b>Expenses</b>				
Advertising	9	1,200		
Depreciation		1,761		
Insurance		600		
Interest		1,333		
Repairs		1,500		
Supplies		4,000		
Taxes & Licenses		100		
Utilities		<u>1,000</u>		
Total Expense				11,494
Net Income				\$ 12,506



### **Balance Sheet**

- Is like snapshot of a company's financial health at a point in time.
- Includes the assets, debt, and equity of the business



## RHOADES SERVICES Balance Sheet March 31, 2007

Assets		
Cash	\$ 52,132	
Buildings \$ 100,000		
Less Acc. Depr. 761	99,240	
Equipment \$ 20,000		
Less Acc. Depr. <u>1,000</u>	19,000	
Land	<u>30,000</u>	
Total Assets		\$200,372
		======
<u>Liabilities</u>		
Notes Payable	\$ 99,865	
Owners Equity		
Rhoades, Capital 1/1/07	\$ 75,000	
+Net Income \$ 26,507		
-Withdrawal \$ 1,000		
Increase in Capital	\$ 25,507	
Rhoades, Capital 3/31/07		<u>\$100,507</u>
<b>Total Liabilities &amp; Owners Equity</b>		\$200,372
		======



# RHOADES, INC. Balance Sheet March 31, 2007

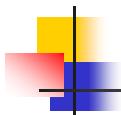
<u>Assets</u>			
Cash		\$ 52,132	
Buildings	\$100,000		
Less Acc. Depr.	<u>760</u>	99,240	
Equipment	20,000		
Less Acc. Depr.	<u>1,000</u>	19,000	
Land		30,000	
Total Assets			\$200,372
			======
<u>Liabilities</u>			
Notes Payable			\$ 99,865
Stockholders Equity			
Contributed Capital		\$ 75,000	
Retained Earnings		<u>25,507</u>	
Total Stockholder Equ	ity		100,507
Total Liabilities & Stoo	kholder Equity		\$200,372



### Cash Flow



- Video of all financial activities of the company during a period of time.
- The cash flow statement reflects all activity in the company that affects cash.



## Cash Flow Format (Formal)

## Used primarily by accountants and C Corporations

## RHOADES, INC. Cash Flow Statement For Quarter Ending M

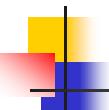
For Quarter Ending March 31, 2007

Cash Flow from Operating Activities			
Cash Receipts from Revenue	\$ 38,000		
Cash Payments from Expenses	12,494		
Net Cash Provided by Operating E	xpenses	\$	50,494
Cash Flow from Investing Activities	•		,
Cash Received from Lender	\$ 100,000		
Purchase of Fixed Assets	(150,000)		
Net Cash Provided by Investing A	ctivities	\$	(50,000)
Cash Flow from Financing Activities			,
Sale of Common Stock	\$ 75,000		
Payment of Cash Dividends	0		
Net Cash Provided by Financing	Activities	\$	75,000
Net Increase (Decrease) in Cash		\$	75,494
		==	=====
Cash Balance on 1/01/07		\$	-0-
Cash Balance on 1/31/07		\$	75,494

## Cash Flow Format (Informal)

Lenders Preferences

RHOADES SER	RVICES			[Needs to be	completed
CASH FLOW				For 4 Quarte	ers]
For Quarter En	ding Mar	ch 31, 20	007		
				1st Qtr.	
	<u>January</u>	<u>February</u>	March	TOTALS	
Beginning Cash	<del>-</del>	\$ 31,000	\$ 40,066		
Cash-In					
Sales	\$ 10,000	\$ 12,000	\$ 16,000	\$ 38,000	Income Statement
<b>Personal Investment</b>	\$ 75,000				Balance Sheet
<b>Proceeds from Note</b>	\$ 100,000			\$ 100,000	Balance Sheet
Total Cash-In	\$ 185,000	\$ 12,000	\$ 16,000	\$ 138,000	
Cash-Out					
Advertising	\$ 600	\$ 300	\$ 300	\$ 1,200	Income Statement
Buildings	\$ 100,000			\$ 100,000	Balance Sheet
Equipment	\$ 20,000			\$ 20,000	Balance Sheet
Land	\$ 30,000			\$ 30,000	Balance Sheet
Insurance	\$ 200	\$ 200	\$ 200	\$ 600	Income Statement
Interest		\$ 667	\$ 666	\$ 1,333	Income Statement
<b>Principle on Note</b>		\$ 67	\$ 68	\$ 135	Balance Sheet
Repairs	\$ 1,000	\$ 200	\$ 300	\$ 1,500	Income Statement
Supplies	\$ 2,000	\$ 1,000	\$ 1,000	\$ 4,000	Income Statement
<b>Taxes &amp; Licenses</b>	\$ 100			\$ 100	Income Statement
Utilities	\$ 100	\$ 500	\$ 400	\$ 1,000	Income Statement
Withdrawals	\$		\$ 1,000	\$ 1,000	Balance Sheet
Total Cash-Out	\$ 154,000	\$ 2,934	\$ 3,934	\$ 160,868	
Ending Cash	\$ 31,000	\$ 40,066	\$ 52,132		



### **Special Notation**

- If you are a sole proprietor, partnership, or LLC, what the owner takes out for personal use is called a withdraw and it goes into the equity section of the balance sheet and does not appear in the income statement.
- S Corporations can pay the owners and it is considered as salary and it does go into the income statement instead of the balance sheet. (Tax withholdings are taken out just like any other employee.)

## 4

## **Accounting Equation**

Assets = Liabilities + Owners Equity

ASSetS = Everything that the business owns including such items as cash, inventory, prepaid expenses, and vehicles.

Liabilities = Debts which is what the business owes to creditor (non-owners) who supply funds that must be repaid.

Owners Equity = is also known as Net Worth and is the amount the owners have invested in the company.



### **Financial Ratios**

- Analyze your financial statements by looking at basic ratios.
  - Break Even
  - Quick Ratio
  - Current Ratio
  - Debt to Worth Ratio
  - Return on Investment

### Break Even = FE ÷ CM%

- Determine Contribution Margin Percent
  - Contribution Margin (CM) equals Sales minus Variable Expenses. CM% equals CM dollars divided by Sales. (The largest variable expense is usually the Cost of Goods Sold which includes direct material and labor that is necessary to make an item ready for sale.)
- List and total all Fixed Expenses for a specific time period (usually one month.)
  - Expenses which do not rise or fall with sales volume such as rent, insurance, utilities, etc.
- Break Even Sales is Fixed Expenses divided by Contribution Margin percentage.
- Break Even =

Fixed Expenses + Contribution Margin Percentage

## 4

## Quick Ratio = CE + AR ÷ CL

Quick Ratio provides a simple reading of the company's liquidity. A higher value corresponds to a a higher level of liquidity, which in general is a positive indicator of a company's financial condition.

- CE is cash and cash equivalents
- AR is Accounts Receivable
- CL is Current Liabilities (Debts to be paid within 1 year.)
- Quick Ratio =

<u>Cash + Cash Equivalent + Accounts Receivable</u> Current Liabilities

## 4

### Current Ratio = CA ÷ CL

Current Ratio is the same as the Quick Ratio except that inventory is included as a current asset. Current Ratio is also an indication of liquidity, but is less precise because inventory often cannot be quickly converted to cash.

- CA = Current Assets (Cash & other assets that the business expects to use in the operation of the company within 1 year.)
- CL = Current Liabilities (Debts to be paid within 1 year.)
- Current Ratio =

<u>Current Assets</u> <u>Current Liabilities</u>



### Debt-to-Worth Ratio

## The Debt-to-Worth Ratio is used to measure the extent to which the company is leveraged.

A high Debt-to-Worth Ratio indicates that the company relies heavily on borrowed funds, which might affect its ability to repay a loan.

- Leverage = the process of incurring debt in order to continue or expand the scope of a business operation. An enterprise is said to be highly leveraged when it relies heavily on debt financing as opposed to owners financing.
- Debt = what is owed (total liabilities)
- Net Worth is what the business owes to the owners.
- Debt-to-Worth =

<u>Total Liabilities</u> Net Worth

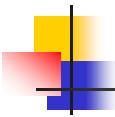


## Return on Investment (ROI) ROI = NP ÷ NW

Return on Investment measures the efficiency of Net Worth in generating Net Profit. It is the number of dollars in Net Profit produced for every \$1 invested in Net Worth. Example: 10% would mean for each dollar invested the owner is receiving 10¢.

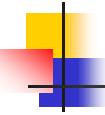
- NP = Net Profit (before corporate taxes) is the amount remaining after all expenses have been met. It is the difference between total sales and total cost of goods plus other expenses.
- NW = Net Worth (Owners Equity) is what the business owes to the owners. It is the investment that the owners have in the company.
- ROI (Return on Investment) =

<u>Net Profit</u> Net Worth



## Compare to Industry Standards

It is wise to compare your ratios with industry standards. For existing businesses, this will give you an idea of how "fiscally fit" your business is. For people who are seeking a loan, it will indicate how your numbers compare to other business in industry.



### Resources for Industry Standards

SBDC Centers or SCORE Offices

www.coloradosbdc.org will give you the location of the office nearest you. They offer free counseling services.

- Local & College Libraries
- Risk Management Association
- Trade Associations
- Internet