



Understanding Financial Statements



TODAY'S AGENDA

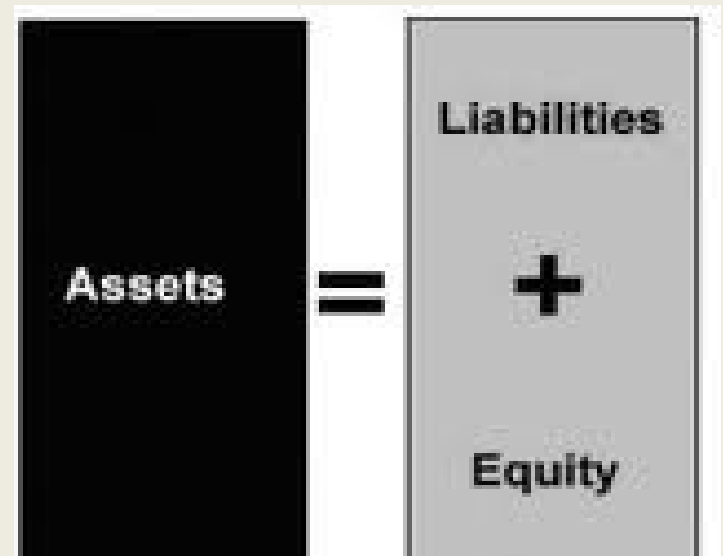
Understanding the following financial statements:

- **Business Financial Statements**
 - Balance Sheet
 - Income Statements
 - Cash Flow Statements
 - Ratios
 - Notes to the Financial Statements
- **Personal Financial Statements**
 - Statement of Financial Condition
 - Personal Earning Statement
- **The Basics of Budgeting**

WHAT'S THE BIG IDEA?

BALANCE SHEET:

- The Balance Sheet is like a snapshot of your business, frozen in time.
- It's called a balance sheet because it shows the basic accounting equation...(Assets=Liabilities + Equity)
- It shows the balance of your:
 - Assets
 - Liabilities
 - Equity
- It must balance!



YOUR BALANCE SHEET INCLUDES THE FOLLOWING:

ASSETS:

Things you have in your possession, therefore they can be repossessed is not totally paid for...

These are categorized as:

- Current Assets:
 - *Can be converted into cash in one year*
 - Example:
 - Cash
 - Accounts receivable
- Fixed Assets
 - *Can be converted into cash in one year*
 - *Example:*
 - This includes Furniture, property, plant, and equipment
- Total Non-Current Assets
 - *(intangible) Assets*
 - *Example:*
 - Start-up cost (intangible assets)

YOUR BALANCE SHEET INCLUDES THE FOLLOWING:

LIABILITIES:

How much the company owes...

These are categorized as:

- Current Liabilities
 - *Liabilities due within one year*
 - *Example:*
 - Current Portion of Long-Term Debt
 - Notes Payable
 - Long-Term Liabilities
 - *Due for more than one year*
 - *Example:*
 - Loan Payable
- Total Non-Current Liabilities
 - *(Intangible) Liabilities*
 - *Example:*
 - Unearned Revenue

YOUR BALANCE SHEET INCLUDES THE FOLLOWING:

EQUITY /CAPITAL:

The business equity (things you have ownership in)...or the difference between your assets and your liabilities

These are categorized as:

- Initial Capital
- *Amount of money owners have invested*
 - *Example:*
 - Owners Investment
- Additional Capital
- *Amount of money others have invested*
 - *Example:*
 - Proceeds from sale of Stock
- Retained Earnings
- Income earned and kept in the business
 - *Example:*
 - Savings from net profit

BALANCE SHEET

BALANCE SHEET

Your Company Name
BALANCE SHEET
date of statement

ASSETS

Current Assets

Cash	\$ _____
Accounts Receivable	\$ _____
Inventory (ending)	\$ _____
Other Current Assets	\$ _____
Total Current Assets	\$ _____

Non-Current Assets

Fixed Assets	\$ _____
Less Depreciation	\$ _____
Fixed Assets (net)	\$ _____
Advances to Owners	\$ _____
Other Non-Current Assets	\$ _____
Total Non-Current Assets	\$ _____

Total Assets	\$ _____
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LIABILITIES

Current Liabilities

Current Portion of Long-Term Debt	\$ _____
Note Payable	\$ _____
Accrued Taxes	\$ _____
Accounts Payable(A/P)	\$ _____
Total Current Liabilities	\$ _____

Long-Term Liabilities

Loan & Notes Payable	\$ _____
Total Long-Term Liabilities	\$ _____
Total Liabilities	\$ _____

CAPITAL

Owners Investment	\$ _____
Retained Earnings	\$ _____
Total Capital	\$ _____

TOTAL LIABILITIES & CAPITAL	\$ _____
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These numbers should be the same.

Questions Bankers will ask about your Balance Sheet:

- What did you buy with the proceeds from each of the listed loans?
- How long has it been since you last paid your Payroll Tax Liability?
- If your Retained Earnings account is zero, then you have taken all of the profits from your business? Why should the Bank Loan you money when you are not willing to invest in your own company?
- If your Retained Earnings account is negative, you have lost money over the life of your business? Why should the Bank Loan you money when you are not profitable over the long-term?

WHAT'S THE BIG IDEA?

USE RATIOS TO MAKE DECISIONS:

- Ratios are your business scores. Even though ratios are not included in your business plan, they will be calculated by lenders to make decisions.
 - Lenders and investors compare your ratios to:
 - acceptable bank ranges
 - a company's prior years
 - your business' history
 - other companies in your industry

LIQUIDITY RATIOS :

Working Capital

Number Source:

- Balance Sheet:
 - Shows if a company has enough cash to pay bills. This example shows an excess amount after paying all current liabilities. The answer must be positive.
 - More money is needed to meet expenses if the answer is negative.

Current Assets	\$170,000	
Less: Current Liabilities	<u>\$150,000</u>	
Equal Working Capital	= \$20,000	← Amounts use for operations

LIQUIDITY RATIOS :

Current

Number Source:

- Balance Sheet:
 - Tests a company's short-term debt paying ability.
 - This means there is \$1.13 in cash and current assets available to pay every \$1 of current liabilities

$$\begin{array}{l} \text{Total Current Assets} \longrightarrow \underline{\$170,000} \\ \text{Total Current Liabilities} \longrightarrow \underline{\$150,000} \end{array} = 1.13 \longleftarrow \text{Number of times you can pay current liabilities}$$

LEVERAGE RATIOS :

Debt-to-Worth

Number Source:

- Balance Sheet:
 - Determines if a company has enough equity. Lower answers are better.
 - Lenders prefer this ratio to be 3 or lower.

$$\begin{array}{l} \text{Total Liabilities} \longrightarrow \underline{\$204,000} \\ \text{Equity} \longrightarrow \$87,000 \end{array} = 2.34 \longleftarrow \text{The number of times a company is leverage}$$

LEVERAGE RATIOS :

Accounts Payable Turnover

Number Source:

- Balance Sheet & Income Statement:
 - Shows how quickly a company pays its suppliers.
 - Lower numbers are better

$$\begin{array}{l} \text{Accounts Payable} \longrightarrow \underline{\$14,965,000} \\ \text{Purchases} \longrightarrow \$350,000 \end{array} = 42.75 \longleftarrow \text{Accounts Payable are paid every 43 days}$$

WHAT'S THE BIG IDEA?

INCOME STATEMENT:

- The Income Statement is your company's report card..
- Expenses are subtracted from income, which gives you the business financial performance or net profit (or loss) over a period of time...
(Income–Cost of goods Sold=Gross Profit–General Expenses= Net Profit)
- It shows if you made a profit or loss over a given period and is also called:
 - Operating Statement
 - Earnings Statement
 - Profit and Loss Statement

YOUR INCOME STATEMENT INCLUDES THE FOLLOWING:

SALES:

Revenue from sales of goods or services

These are categorized as:

- *Gross revenue or income is before returns and allowances.*
- *Net sales is after returns and allowances.*

Less Cost of Goods Sold (variable cost)

- *Sales less cost of goods sold.*
- *Cost to make products including materials and labor*

Equal Gross Profit

- *This is your gross profit margin*

YOUR INCOME STATEMENT INCLUDES THE FOLLOWING:

Gross Profit :

Revenues minus the cost of selling the goods or services

These are categorized as:

- *Shipping cost*
- *Packaging cost*

Less Fixed Expenses:

- *Salaries and expenses related to sales only*
 - *General and Administrative*
 - *All other expenses used to run the company*

Equal Net Profit:

- *Profit left after all expenses (including taxes) have been paid*

Less Dividends Declared:

- *Drawings*

Equal Retained Earnings

INCOME STATEMENT

INCOME STATEMENT

Your Company Name

INCOME STATEMENT

Date of Statement _____

SALES

Net Sales\$ _____

Less Cost of Goods Sold:

Beginning Inventory\$ _____

Purchases\$ _____

Labor\$ _____

Total\$ _____

Less: Ending Inventory-\$ _____

Cost of Goods Sold\$ _____

Gross Profit (sales less cost of goods sold)\$ _____

EXPENSES

Operating Expenses:

Selling Expenses\$ _____

General and Administrative\$ _____

Total Expenses\$ _____

Operating Income\$ _____

Interest Expense\$ _____

PROFIT

Net Profit before taxes\$ _____

Less: All Income Taxes\$ _____

Net Profit\$ _____

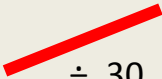
WHAT'S THE BIG IDEA?

KNOW YOUR BREAKEVEN POINT:

- When a company has neither a profit nor a loss, it is the breakeven point.
- It is important to determine your breakeven point so you know the sales needed for your business to be profitable.
- The numbers for this formula come from your Income Statement:
 1. Determine your **Net Sales**
 2. Total your **Variable Expenses and divide them by the**
 3. Net Sales to calculate the percentages they represent
 4. Subtract your Total Variable Expenses from your
 5. Net Sales to calculate the **Margin**
 6. Divide your Fixed Expenses by the Margin
 7. and the answer is your **Breakeven Point**

BREAKEVEN POINT

USE YOUR INCOME STATEMENT TO CALCULATE BREAKEVEN:

1.	Determine Net Sales	\$900,000	100%
2.	Find total Cost Of Goods Sold	\$540,000	
3.	Add: Selling Expenses	<u>+\$90,000</u>	
4.	Calculate Total Variable Expenses	<u>\$630,000</u> (As a % of variable exp) (\$630K/\$900K)	70%
5.	Net Sales	\$900,000	100%
6.	Subtract: Total Variable Expenses	<u>\$630,000</u>	<u>-70%</u>
7.	Equal: Gross Margin	<u>\$270,000</u>	<u>=30%</u>
8.	Then, Identify Fixed Expenses	\$170,000	
9.	Divide: Fixed Expenses by Gross Margin	 ÷ .30	
10.	The Result is your BREAKEVEN AMOUNT	\$566,667	

Questions Bankers will ask about your Income Statement:

- How do you plan to increase the profits of the company in order to repay the loan?
- Is your Gross Profit increasing or decreasing?
- Which product produces the greatest amount of profit?
- Why are your Overhead Costs increasing?
- Why are you able to generate revenue? That is, what is your competitive advantage in the market?

PROFITABILITY RATIOS :

Profit Margin on Sales

Number Source:

- Income Statement:
 - Shows the percentage of net profit for every dollar of sales.
 - If the profit margin is too low: the prices are too low, the cost of goods is too high, or expenses are too high.

$$\begin{array}{l} \text{Net Profit} \longrightarrow \underline{\$53,000} \\ \text{Net Sales} \longrightarrow \$900,000 \end{array} = .0588 \longleftarrow \text{The number profit margin 5.9\%}$$

PROFITABILITY RATIOS :

Cash Flow to Current Maturities (Debt Service Coverage)

Number Source:

- Balance Sheet & Income Statement:
 - Shows your ability to pay term debts after owners' withdrawals.
 - Lenders prefer 2 or better.

Net Profit & Depreciation \longrightarrow 63,000 = 10.5 \longleftarrow 10.5 is available to pay for each \$1. for debt

Current Portion of Long-Term Debt \longrightarrow \$6,000

SO WHAT IS YOUR BUSINESS RATIO ANALYSIS :

Assets	1	<i>Accounts Receivable Turnover</i>	ANSWERS:
		<i>Inventory Turnover</i>	
Liquidity	2	<i>Working Capital</i>	
		<i>Current</i>	
Leverage	3	Leverage (or Debt-to-Worth)	
		Accounts Payable Turnover	
Profit	4	<i>Profit Margin on Sales</i>	
		<i>Cash Flow to Current Maturities (Debt Service)</i>	

WHAT'S THE BIG IDEA?

CASH FLOW STATEMENT:

- The Cash Flow Statement is your cash “register.”
 - It shows money that comes into the business and what goes out.
 - Profits do not guarantee positive cash flow because of the difference between the two ways of handling your accounting:
 - **Cash basis** versus the **Accrual basis** of accounting
 1. The cash method means you don't record a sale until you collect money, and you don't record an expense until you pay for it.
 2. The accrual method, the one lenders want, means:
 - Sales are made but payments are not immediately collected.
Your customers pay later, which creates “accounts receivable.”
 - Business purchases are made, but paid for later, creating “accounts payable.”

YOUR CASH FLOW STATEMENT INCLUDES THE FOLLOWING:

INVESTING ACTIVITIES:

Changes in long-term assets

These are categorized as:

- *Receipts from sales of equity or debt*
- *Sale of fixed assets*
- *Purchase of fixed assets*

FINANCING ACTIVITIES:

Changes in long-term liabilities and equity

These are categorized as:

- *Funds from the sale of stock*
- *Funds from debt*
- *Paying off debt*

OPERATING ACTIVITIES:

Changes related to the manufacturing or selling of goods and services

These are categorized as:

- *Cash sales or collection of receivables*
- *Cash receipts from returns or interest income*
- *Cash paid for raw materials*

Notes to the Financial Statements

The Notes to the Financial Statements are used to describe, in detail, the issues facing a company that are not readily apparent from reading the other financial statements.

Depreciation Method Used

Depreciation is a measure of the amount of value of an asset that you have used during a specific accounting period.

Typically, the accounting period is either one month or one year.

Depreciation Method (Example)

Book value at beginning of year	Depreciation expense	Accumulated depreciation	Book value at end of year
\$17,000 (original cost)	\$3,000	\$3,000	\$14,000
\$14,000	\$3,000	\$6,000	\$11,000
\$11,000	\$3,000	\$9,000	\$8,000
\$8,000	\$3,000	\$12,000	\$5,000
\$5,000	\$3,000	\$15,000	\$2,000 (scrap value)

WHAT'S THE BIG IDEA?

PERSONAL STATEMENT OF FINANCIAL CONDITION:

- Personal financial health is carefully examined by the lender or investor.
- Complete a Personal Financial Statement for each person listed in the business plan who will be guaranteeing the loan (partners, officers, stockholders)
- Most lenders will supply you with their own Personal Financial Statement form, but the information they usually request is shown in this equation...(Assets-Liabilities=Net Worth)
- It shows the balance of your personal:
 - Assets
 - Liabilities
 - Net worth
- It must balance!

YOUR STATEMENT OF FINANCIAL CONDITION INCLUDES THE FOLLOWING:

ASSETS:

Things you have in your possession, therefore they can be repossessed is not totally paid for...

Personal assets have only one category:

- Assets:
 - *Life insurance statements*
 - In the **APPENDIX**, provide face amount and cash surrender value of policies, name of insurance companies
 - *IRA*
 - *Stocks and bonds*
 - The total is included here. In the **APPENDIX**, include the number of shares, name of securities, cost, market value
 - *Real estate*
 - *Total here. In the APPENDIX, list each and include: type of property, date purchased, original cost, and the present market value. Also include the mortgage account number, balance, and monthly payment.*
 - *Automobiles*
 - *Personal property*
 - *Describe in the APPENDIX. If any pledged as security/collateral, include name and address of lien holder, lien amount, and payment term*

YOUR STATEMENT OF FINANCIAL CONDITION INCLUDES THE FOLLOWING:

LIABILITIES:

How much you owe...

Personal Liabilities have only one category:

- Current Liabilities
 - Notes payable
 - In the APPENDIX, include the name and address of the note holder, original loan balance, current balance, payment amount, and what collateral is used for security.
 - Residential Mortgages on real estate
 - Investment Mortgages on real estate
 - Loan balance on automobiles
 - Credit card balances
 - Unpaid taxes
 - Describe in the APPENDIX the type of tax, who taxes are owed to, the amount, when it is due and whether there is a lien on any property.

YOUR STATEMENT OF FINANCIAL CONDITION INCLUDES THE FOLLOWING:

NET WORTH:

The things you have ownership in...

Personal Net Worth does not have a category:

- Net Worth
 - It is just the difference between your total assets and your total liabilities
 - Total all your Personal Assets
 - Total all your Personal Liabilities
 - Subtract the total Personal Liabilities from your total Personal Assets
 - The results is your **Net Worth**

STATEMENT OF FINANCIAL CONDITION



1 PERSONAL FINANCIAL STATEMENT

WHAT'S THE BIG IDEA?

Personal financial health is carefully examined by the lender or investor.

Complete a Personal Financial Statement for each person listed in the business plan who will be guaranteeing the loan (partners, officers, stockholders). It's a good idea to order your credit report from the three credit bureaus and review it because lenders will scrutinize it. Be prepared to explain any negative reports.

Most lenders will supply you with their own Personal Financial Statement form, but the information they usually request is shown in this sample.

Life Insurance: In the **APPENDIX**, provide face amount and cash surrender value of policies, name of insurance companies and beneficiaries.

Other Property: Describe in the **APPENDIX**. If any pledged as security/collateral, include name and address of lien holder, lien amount, and payment terms.

Notes Payable: In the **APPENDIX**, include the name and address of the noteholder, original loan balance, current balance, payment amount, and what collateral is used for security.

PERSONAL FINANCIAL STATEMENT

Date _____
 Your Name and Address _____
 Business Name and Address _____
 Social Security _____ Date of Birth: _____
 Phone: _____ Fax: _____ E-mail: _____

ASSETS & LIABILITIES

ASSETS (what you own)

Cash	\$	_____
Savings Accounts	\$	_____
Retirement Accounts	\$	_____
Accounts & Notes Receivable	\$	_____
Life Insurance, cash surrender value	\$	_____
Stocks & Bonds (market value)	\$	_____
Real Estate (market value)	\$	_____
Automobiles (market value)	\$	_____
Other Property	\$	_____
Other Assets	\$	_____
TOTAL ASSETS	\$	_____

LIABILITIES (what you owe)

Accounts Payable	\$	_____
Notes Payable	\$	_____
Residential Mortgage, balance	\$	_____
Investment Mortgage, balance	\$	_____
Installment Loan Balance, auto	\$	_____
Installment Loan Balance, other	\$	_____
Unpaid taxes	\$	_____
Other liabilities	\$	_____
TOTAL LIABILITIES	\$	_____

NET WORTH (assets less liabilities) \$ _____
TOTAL LIABILITIES + NET WORTH \$ _____

Stocks & Bonds: The total is included here. In the **APPENDIX**, include the number of shares, name of securities, cost, market value with date.

Real Estate: Total included here. In the **APPENDIX**, list each and include: type of property, date purchased, original cost, and the present market value. Also include the mortgage account number, balance, and monthly payment.

Unpaid taxes: Describe in the **APPENDIX** the type of tax, who taxes are owed to, the amount, when it is due and whether there is a lien on any property.

STATEMENT OF FINANCIAL CONDITION



U.S. SMALL BUSINESS ADMINISTRATION

EXPIRATION DATE: 3/31/2008

PERSONAL FINANCIAL STATEMENT

As of _____, _____

Complete this form for: (1) each proprietor, or (2) each limited partner who owns 20% or more interest and each general partner, or (3) each stockholder owning 20% or more of voting stock, or (4) any person or entity providing a guaranty on the loan.

Name _____ Business Phone _____

Residence Address _____ Residence Phone _____

City, State, & Zip Code _____

Business Name of Applicant/Borrower _____

ASSETS		(Omit Cents)	LIABILITIES		(Omit Cents)
Cash on hand & in Banks	\$	_____	Accounts Payable	\$	_____
Savings Accounts	\$	_____	Notes Payable to Banks and Others	\$	_____
IRA or Other Retirement Account	\$	_____	(Describe in Section 2)		
Accounts & Notes Receivable	\$	_____	Installment Account (Auto)	\$	_____
Life Insurance-Cash Surrender Value Only	\$	_____	Mo. Payments \$ _____		
(Complete Section 8)			Installment Account (Other)	\$	_____
Stocks and Bonds	\$	_____	Mo. Payments \$ _____		
(Describe in Section 3)			Loan on Life Insurance	\$	_____
Real Estate	\$	_____	Mortgages on Real Estate	\$	_____
(Describe in Section 4)			(Describe in Section 4)		
Automobile-Present Value	\$	_____	Unpaid Taxes	\$	_____
Other Personal Property	\$	_____	(Describe in Section 6)		
(Describe in Section 5)			Other Liabilities	\$	_____
Other Assets	\$	_____	(Describe in Section 7)		
(Describe in Section 5)			Total Liabilities	\$	_____
Total	\$	_____	Net Worth	\$	_____
			Total	\$	_____

Section 1. Source of Income

Salary	\$	_____
Net Investment Income	\$	_____
Real Estate Income	\$	_____
Other Income (Describe below)*	\$	_____

Contingent Liabilities

As Endorser or Co-Maker	\$	_____
Legal Claims & Judgments	\$	_____
Provision for Federal Income Tax	\$	_____
Other Special Debt	\$	_____

Description of Other Income in Section 1.

*Alimony or child support payments need not be disclosed in "Other income" unless it is desired to have such payments counted toward total income.

Section 2. Notes Payable to Banks and Others. (Use attachments if necessary. Each attachment must be identified as a part of this statement and signed.)

BANKERS BOX:

QUESTIONS:

- How much are you investing in the business?
- Why is your credit score....?
 - It's a good idea to order your credit report from the three credit bureaus and review it because lenders will scrutinize it.
 - Be prepared to explain any negative reports.

WHAT'S THE BIG IDEA?

PERSONAL EARNING STATEMENT:

- The Personal Income Statement is your financial report card..
- Cost of Living Expenses are subtracted from Personal Income, to calculate your net-discretionary funds for a period of time
- It shows how much money is left after you have paid all your bills
- Also called:
 - Operating Statement
 - Income Statement
 - Profit and Loss Statement

YOUR PERSONAL EARNING STATEMENT INCLUDES THE FOLLOWING:

ANNUAL INCOME (multiply your monthly income by 12):

Income from working

These are categorized as:

- Salary, Bonuses, and Commissions
- Dividends, Interest, Investment income
- Real Estate Income
- Other Income

YOUR PERSONAL EARNING STATEMENT INCLUDES THE FOLLOWING:

ANNUAL EXPENSES (multiply your monthly expenses by 12):

Cost of Living

These are categorized as:

- Mortgage/Rental payments
- Loans and notes payable
- Taxes: Federal, State, Local, Property
- Insurance premiums
- Alimony and child support
- Tuition
- Medical Exp./Insurance
- Contingent liabilities
 - Are you an endorser, co-maker or guarantor of other loans? If so, are there any legal actions or contested taxes?
- Other Debt or Liabilities

Equal Net Profit:

- *Revenues minus the cost of living*
- *Profit left after all expenses (including taxes) have been paid*

PERSONAL EARNING STATEMENT

PERSONAL FINANCIAL STATEMENT

INCOME & EXPENSES

ANNUAL INCOME:

Salary, Bonuses, and Commissions	\$	_____
Dividends, Interest, Investment income	\$	_____
Real Estate Income	\$	_____
Other Income	\$	_____
TOTAL ANNUAL INCOME	\$	_____

Annual Expenses:
Multiply your monthly expenses by 12.

ANNUAL EXPENSES:

Mortgage/Rental payments	\$	_____
Loans and notes payable	\$	_____
Taxes: Federal, State, Local, Property	\$	_____
Insurance premiums	\$	_____
Alimony and child support	\$	_____
Tuition	\$	_____
Medical Exp./Insurance	\$	_____
Contingent liabilities	\$	_____
Other Debt or Liabilities	\$	_____
TOTAL ANNUAL EXPENSES	\$	_____

Contingent liabilities:
Are you an endorser, co-maker or guarantor of other loans? If so, are there any legal actions or contested taxes?

This statement is true and accurate.
I authorize any inquiries necessary to verify its accuracy.

(your signature and date) _____

BANKERS BOX:

QUESTIONS:

- How much money do you want?
- How will the loan be used?
- How long do you need to repay the loan?
- How will the loan be repaid?
- What collateral do you have to offer?

WHAT'S THE BIG IDEA?

THE BASICS OF BUDGETING:

A business budget is simply a **forecast** of all of your business cash sources and business cash expenditures:

- Typically, a business budget covers a one-year timeframe, delineating expected revenues and expenses on a month-by-month basis.
- Let's start with the basics of business budgeting:
(Income = Costs + Profits)
- This simple mathematical equation shows that the dollars you make from sales must cover your costs and your profits.

WHY CREATE A BUSINESS BUDGET?

REASONS:

- The biggest benefit of business budgeting is that reduce the number of business surprises that will come your way, especially unpleasant ones like not having enough money to pay a vendor or make payroll.
- Because budgets are forward-looking documents, they force you to think strategically about the future of your business. By examining how much cash you have to spend, your expenses and how much you need to earn, you tend to solve problems long before they occur.
- The bottom-line? A business budget is the tool you need if you want to translate your business plans into a **successful business** reality.

USE OF BUDGETS:

- Budgets are statements setting out the planned performance of a business typically over time in a table made up of numbers.
- Usually these plans deal with money units but they can also consist of other measurable units e.g. units of output.
- Creating a budget enables an organization to plan ahead and then to check on its performance against budgeted figures.
- The difference between budgeted figures and actual figures is called a variance.

THE STAGES OF BUDGETING:

- Budgets need to be regularly monitored (i.e. checked) to see if action needs to be taken. There are thus three main stages in budgeting:

1. Create the budget

⇒

2. Monitor the budget

⇒

3. Take action

E.g. estimate sales
revenues and costs

Compare actual figures
with budgeted ones

If there is a
variance take
action.

THE BENEFIT OF VARIANCE ANALYSIS:

- Variance is an important management tool because it enables businesses to manage their business
- A variance is a difference between what actually happens and what is budgeted to happen.
 - Actual performance compares with budgeted performance...either favorable or unfavorable.
 - A favorable variance is one where actual business performance proves to be better than what was budgeted for.

HOW TO CREATE A BUSINESS BUDGET?

- In order to [prepare a cash budget](#) you need to know what receipts and payments are likely to take place in the future and the dates when they will happen.
- It is important find the length of lead time between incurring an expense and paying for it as well as the time lag between making a sale and collecting from debtors.
- The art of successful cash budgeting is to be able to plan and calculate accurately receipts and expenditures.
- The budget is a planning tool.

HOW TO CREATE A BUSINESS BUDGET?

=profit_before_interest_and_taxes+net_other_income-interest_expense-taxes_incurred						
A	L	M	N	O	P	Q
Pro Forma Profit and Loss						
	Oct	Nov	Dec	2003	2004	2005
Sales	\$36,167	\$39,885	\$39,920	\$279,415	\$707,301	\$770,608
Direct Costs of Goods	\$16,275	\$17,948	\$17,964	\$125,737	\$318,286	\$346,773
Other Costs of Goods	\$100	\$100	\$100	\$1,200	\$1,320	\$1,452
	-----	-----	-----	-----	-----	-----
Cost of Goods Sold	\$16,375	\$18,048	\$18,064	\$126,937	\$319,606	\$348,225
Gross Margin	\$19,792	\$21,837	\$21,856	\$152,478	\$387,696	\$422,382
Gross Margin %	54.72%	54.75%	54.75%	54.57%	54.81%	54.81%
Operating Expenses:						
Payroll	\$16,480	\$16,480	\$16,480	\$188,912	\$241,680	\$250,164
Depreciation	\$1,250	\$1,250	\$1,250	\$15,000	\$35,000	\$35,000
Advertising	\$100	\$100	\$100	\$1,200	\$1,200	\$1,200
Rent	\$1,500	\$1,500	\$1,500	\$18,000	\$36,000	\$36,000
Insurance	\$200	\$200	\$200	\$2,400	\$3,600	\$3,600
Payroll taxes	\$2,472	\$2,472	\$2,472	\$28,337	\$36,252	\$37,525
Other	\$175	\$175	\$175	\$2,025	\$2,228	\$2,450
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Total Operating Expenses	\$22,177	\$22,177	\$22,177	\$255,874	\$355,960	\$365,939
Profit Before Interest and Taxes	(\$2,385)	(\$340)	(\$321)	(\$103,395)	\$31,736	\$56,443
Interest Expense	\$167	\$167	\$167	\$2,000	\$2,000	\$2,000
Taxes Incurred	\$0	\$0	\$0	\$0	\$1,487	\$2,722
Net Profit	(\$2,552)	(\$507)	(\$488)	(\$105,395)	\$28,249	\$51,721
Net Profit/Sales	-7.06%	-1.27%	-1.22%	-37.72%	3.99%	6.71%

CASH BUDGET vs STATEMENT OF CASH FLOW:

TWO DIFFERENT DOCUMENTS USE FOR DIFFERENT REASONS:

Cash Budget:

- The business owner prepares the cash budget on a monthly basis and looks at the cash the firm takes in versus the cash the firm takes out

The Statement of Cash Flows:

- The Statement of Cash Flows looks at changes in cash:
 - in operating
 - Investing
 - financing cash
- Over a longer period of time such as a quarter or a year.

WHAT'S THE BIG IDEA?

Cash Flow Management :

- **Cash flow management** is the process of monitoring, analyzing, and adjusting your business' cash flows.
- For small businesses, the most important aspect of cash flow management is avoiding extended cash shortages, caused by having too great a gap between cash inflows and outflows.
- You won't be able to stay in business if you can't pay your bills for any extended length of time!

USING THE BUDGETS TO MANAGE CASHFLOW:

Cash Flow Management :

- Determine your total average income...
 - Invoice promptly.
 - Ask for partial payment up front.
 - Give a reward for quick payment.
 - Go after receivables.
 - Calculate your regular and repeated income on a monthly basic
 - Stress that amount by 10 %

USING THE BUDGETS TO MANAGE CASHFLOW:

Cash Flow Management :

- Determine your total average Expense...
 - Calculate your regular and repeated expenses on a monthly basic
 - Increase that amount by 10 %
- Pay bills twice monthly on the 1st and 15th
- Set aside money for large and irregular bills
- Make payments on past bills (escrow savings account)
- Keep your bank accounts balanced and reconciled
- Resist the credit card and line of credit
- Live beneath your means
- Maintain a retain earnings/savings account

Together we soar.



ASA
Axiom Strategy Advisors, LLC