

HOW TO UNDERSTAND MY BUSINESS FINANCIAL STATEMENT.

You didn't start a business to do accounting. You found that you had a gift that you wanted to use to serve other people, and to make a better life for yourself. You weren't trained in finance, so you have no idea how to make use of your financial statements, let alone read them.

However, there are some things on your financial statements that can give you some insight into your business. Let's look at a few things your financials can tell you about your business, and what you can do with that information.

- **THE INCOME STATEMENT**

This statement shows you how much you sold to your customers, and how much it cost to make those sales. The big number on this report is net income, which shows you if your sales exceeded the expenses for the period. However, there are a few other things you can find out by looking at this report.

- 1. If you are following your budget.**

If you have set up a budget for your company, you can compare your sales and expenses to that budget, you can see if you are on track with that plan. If not, you can see where you need to make adjustments in your strategy.

- 2. If your gross profit margin is sufficient**

The gross margin shows you how much your sales exceeded the cost to make the product or provide the service (not including administrative and marketing costs, which are included in net

income). If your costs exceed your sales, you need either to rethink your pricing, or see where you can cut back on costs.

3. Are you doing better than last month, or last year?

How are you doing as compared to last month or last year? You should see some improvement over time. If not, you need to see what has changed from one year to the next.

4. Are you doing as well as other companies in your industry?

Other companies provide an excellent benchmark to use to see how you are doing. If they are doing a great job at bringing in income, you want to see how your numbers compare and adjust your operations. However, don't just look at the numbers, but see if you can determine why you are getting different results, and make appropriate changes.

- **THE BALANCE SHEET**

The balance sheet gives you a snapshot at a moment in time on how much you have to finance operations, how much you owe vendors and creditors, and how much you could get if you closed the business today. There are a few things you could look at to give you an idea of how your business is doing.

1. Look at your working capital

Working capital shows the amount by which your cash, the amount your customers owe you, and the value of your inventory and other items you expect to turn into cash (current assets) exceed the amount you will have to pay out within the next year (current

liabilities). This should always be a positive number, or you could run into problems paying your bills.

2. Do some ratio analysis

There are a few calculations you can do to see how your company is doing. For instance, you can divide the current assets by the current liabilities, and get a ratio that tells you if you have enough money to cover the amount you owe other people. There are a myriad of other calculations you can make to see how well you are managing your company.

For instance, you can calculate the number of days it takes your customers to pay your bills using the following formula:

$$365 \text{ divided by } (\text{net revenue divided by average accounts receivable balance})$$

If the result you get is significantly more than your payment terms you offer your customers, you may need to start making those follow up calls to your customers a lot sooner.

- **THE CASH FLOW STATEMENT**

The cash flow statement shows you where the cash is coming in, and where it is going out. It is divided into the operating section, the investing section, and financing section.

The operating section tells you what you spent cash on to run the day-to-day operations of your business. This will tell you if you need to change your day to day spending to meet your goals.

The investing section tells you how much you spent on equipment and other machinery. This will let you know if you have made some upgrades, and you need to keep an eye on how well that equipment is performing.

The financing section tells you how much you brought in from the sale of stock and loans from the bank, and how much you spent to buy back stock or pay off loans.

Trying to understand your financials can be a complicated but rewarding process. We are available to help you understand your financial statements. We are committed to helping our clients build their businesses, and would love to help you with yours.

Need Help Making This Decision?

Contact Us;

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