



Presented to:
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Basic Financials 101

1. Profit-and-Loss Statement (Income Statement)

2. Revenues vs. Expenses

Revenues

Expenses

3. Cost of Goods Sold vs. Cost of Doing Business

Cost of Goods Sold

Cost of Doing Business

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4. Gross Margin vs. Gross Profit

Gross Margin

Gross Profit

5. Maintained Gross Margin

6. Gross Profit vs. Net Profit

Gross Profit

Net Profit

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7. Balance Sheet

8. Assets vs. Liabilities

Assets

Liabilities

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9. Accounts Receivable

10. Accounts payable

11. Current vs. Long-Term

Current term

Long-term

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12. Current Income vs. Retained Earnings

Current Income

Retained Earnings

13. Net Worth

14. Equity

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15. Book Value

16. Depreciation

17. Fair Market Value

18. Budget

19. Cashflow

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20. Sales per Square Foot

21. Average Ticket

22. Other Financial questions, terms, and ratios

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Take control of your cashflow

By Tom Shay

SOUND ADVICE FOR BUSINESS

Sometime during the middle of the month, the owner of a business performs a monthly ritual: a file folder begins to fill with various sheets of information, all of which are delivered to the accountant for the appropriate processing. Within the next couple of weeks, the accountant calls the business owner or manager. "I have the numbers ready," is the traditional beginning of the conversation.

At the meeting, the accountant will review the monthly financial sheets with the client. The meeting lasts approximately an hour; and during this time, the gross sales, gross margin, maybe a couple of expense items, and the bottom line are reviewed. The businessperson then takes the financial sheets back to the office, files them in the appropriate cabinet and returns to work, often with a facial expression that is indicative of how the financial sheet looked.

Is this an exaggeration of the monthly ritual? In many businesses, the answer is "no"—even though many businesses own computers and are able to generate preliminary financial sheets. At larger businesses, an office manager might perform this exercise. Regardless of the size, the scenario can apply to any type of business.

For too many businesses, the sequence is exactly as described, which prompts me to ask, "If you are not making decisions in a timely manner from the financial sheets you receive or create each month, why not create them only once a year for the necessary tax purposes?"

The answer will probably be that in observing the sheets for several months, the business may see a trend that can be avoided or promoted as the situation dictates. While the logic does make sense, it can also be likened to deciding which direction to drive a car by looking in the rear-view mirror to see where you have been. Fortunately, for all businesses, there is an alternative.

Stepping back to observe the available material, businesses have long depended on the two traditional sheets: the income statement (also known as the profit-and-loss statement), and the balance sheet. The income statement is the story of what the business has done for the last month. The story begins with the first day of the month and ends with the last day. It reflects the incomes and all of the expenses charged to that month.

A business utilizes one of two styles of income statements. The first is a cash-basis income statement, and the second is an accrual-basis income statement. To explain the difference, we can look at one of the many items that appear on the statement. The federal income tax due on March 15 can be entered into the books for the month of March—an action that will likely greatly affect that month's statement. Because the taxes are both paid and entered into the books in March, this type of accounting is referred to as cash-basis accounting. However, if an estimate of the federal income tax due is divided by 12, with this lesser amount being entered on each of the 12 income statements, the business is utilizing an accrual-basis accounting system.

With accrual, each of the 12 months will now have a financial sheet that is more reflective of the true income and expenses of the month. The example of federal income tax can be extended to include wages, insurance, and rent, as well as many other expenses (or income) created by the events of more than one month.



Take control of your cashflow

(continued)

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SOUND ADVICE FOR BUSINESS

The balance sheet is the financial strength of the business; items from the business's entire existence are included. As the income statement is created at the end of the month, select items (cash on hand, inventory, accounts receivable, accounts payable, net income, and a few others) are updated as a result of the last 30 days of business.

With this backdrop of information, let's look forward as we decide where the business is going. The tool necessary to turn our heads from looking exclusively at the history to looking primarily forward is a cashflow sheet.

The cashflow sheet allows a business to anticipate the opportunities and pitfalls that present themselves to the decisionmakers within the business. So how do you create the cashflow sheet, and what can you use it for?

While earlier versions of cashflow sheets were created using multi-column ledger sheets and an adding machine, today's versions utilize computer spreadsheet programs and provide answers within a few moments once the format is created with the software.

For those who have not experienced a cashflow sheet, visualize 12 columns of information that are a hybrid of the income statement. The first row of information is the cash on hand on the first day of the month, followed by sales information and the types of sales. Obviously a sale on a 30-day credit basis affects the cashflow sheet over two months as compared with the cash sale, which affects only one month of cashflow.

Follow this section with rows of information about the expenses, payments toward accounts payable and collection of accounts receivable, as well as purchases and sales of fixtures, and inventory. All of these rows of entries share a commonality in that they affect the checking account of the business; and when this calculation is completed, the last line of information is the cash-on-hand balance on the last day of the month.

Again, imagine a column for each of the next 12 months, and you have created a cashflow sheet. To make the columns tie together, you will notice the last line on one column (cash on hand, end of month) becomes the first line of the next column (cash on hand, beginning of month).

To enter the correct information for each of the cells (the intersection of a row and column), you would examine your past 12 financial statements for the appropriate numbers. Between your income statement and balance sheet, all the necessary figures are at hand.

After creating this cashflow sheet, which is reflective of the past 12 months, you can begin to ask yourself questions about where you believe your business is going. You can start by anticipating the sales for each month as well as the expenses. As you change each cell to indicate what you expect is going to happen from what did happen last year, you will notice the last line (cash on hand) changes to reflect how the new entry will affect your cash on hand for not only the current month but each of the succeeding months.



Take control of your cashflow (continued)

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SOUND ADVICE FOR BUSINESS

With this new tool in hand, what can you do to utilize it? After all, if you are not going to make decisions from the information you receive, there is not a strong case to be made in defense of creating the tool. There is, however, an abundant supply of possible decisions to be made. Let's look at several examples.

Do you think you need an extra employee? Once you add this expense to your current wages, insurances and payroll taxes, you will see if you have the necessary cash on hand. And if you believe the new employee will increase your sales, you can make this entry as well and see if you are now a more profitable business or one that is just trading dollars.

Another opportunity for use applies to businesses that utilize an outside person. If you have had the experience of the salesperson that habitually brings in orders with lower margins, the cashflow sheet can be used as a motivational tool. Utilizing your cashflow sheet, calculate the total sales this person would produce each year if he or she had an acceptable margin, and you will see the increase in your profits.

Knowing that dollar amount, you can create an incentive program that could be a powerful tool in training this salesperson to stress the quality and services of your business. You may find that giving a \$1,000 bonus to this salesperson can create an additional \$5,000 through increased sales.

Finally, from the experiences of several businesses that have had cashflow deficiencies, a cashflow sheet provides an opportunity to foresee the problem and take corrective actions. It allows businesses to see well in advance any and all months in which their businesses would experience a cash shortage.

Although this problem usually leads to concern, worry and sleepless nights, the situation would instead be taken in stride if a cashflow sheet were present. The cashflow sheet would show the depth and duration of the cash shortage. Using your cashflow sheet, you would be equipped to visit your banker with a plan of action stating how much money you would need, for how long and what type of interest rate and payment plan would work with the needs of your business.

Needless to say, you can eliminate sleepless nights while you impress your financial advisors and creditors with your ability to manage money.

Perhaps there is truth in the idea that a little information can be a dangerous thing, but in addition to having too little information, the failure to utilize information can be not only dangerous, it can also prelude the failure to take advantage of opportunities or even the failure of the business. The cashflow sheet is more than just a piece of paper; it can be the best tool in your management arsenal.