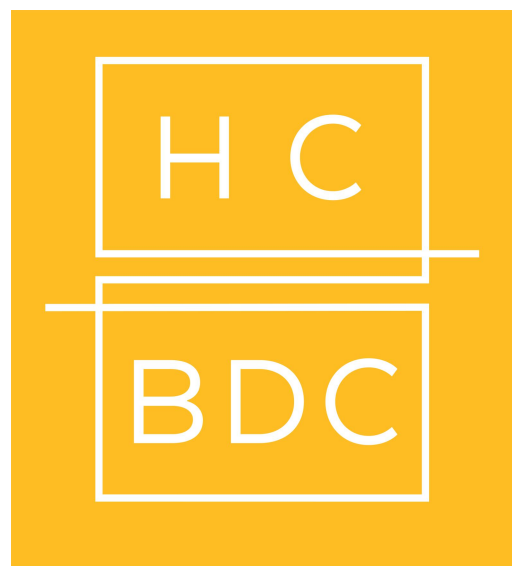




Sequoia Technical Services LLC



WORKFORCE TRAINING

August 2020

Understanding Financial Statements



Sequoia Technical Services LLC

1225 Stagecoach Rd.

Trinidad, Ca. 95570

(707) 845-7272

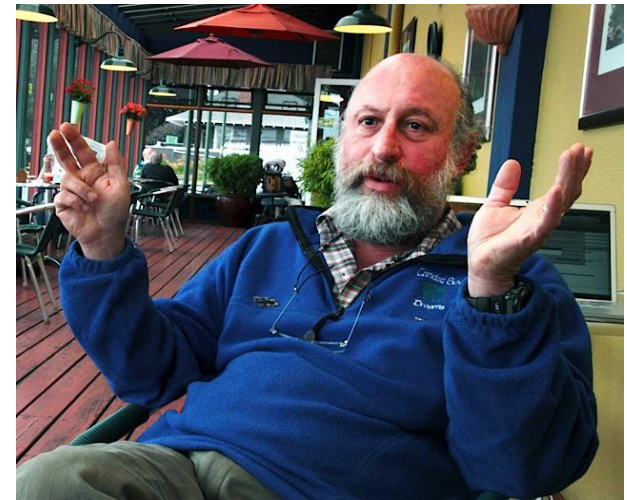
larry@northcoastca.org

Your presenter today:

- MBA from Humboldt State University Successfully built, managed and sold three IT businesses over the past twenty years.
- Originally from New York City, but has lived on the California Northcoast since 1978
- Began professional career working on energy management and renewable energy projects, pioneering the leasing and installation of residential and commercial solar water heaters on Northcoast in 1979.
- Worked for 11 years in community action (**Redwood Community Action Agency**) building energy retrofitting, financing and technical support programs for low-and-moderate income communities.
- Started Sequoia Technical Services in 1980 providing consulting services to small businesses, government & individuals.
- Developed the first Internet services on the California Northcoast (**Northcoast Internet**, 1994) and later founded a national outsource 24/7/365 Helpdesk technical support service business (**NetHelp International**, 1996 – 2001)



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Agenda



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- Review accounting basics to understand the information on your financial statements
- Understand how to read and analyze your:
 - Income statement
 - Balance sheet

“ No one can advise you on how to manage your business without first reviewing and understanding your financial statements. ”

What are financial statements?



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The summarized results of your business financial transactions over a designated period of time.

They will show total income, expenses, cash balances, level of debt, and much more.

But where does this information come from?

Accounts



Accounts are the categories into which the effects of transactions are recorded, and from which financial reports are created.

5 major account categories:

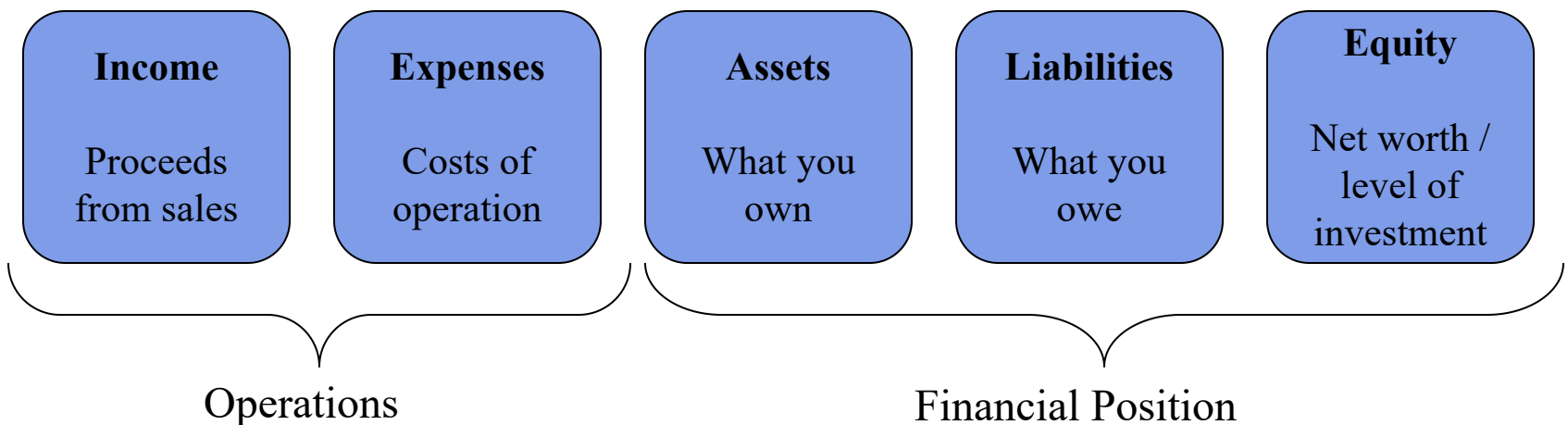


Chart of Accounts



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Sample Income accounts

- Sales revenue
- Other income

Sample Expense accounts

- Rent
- Cost of Goods Sold (COGS)
- Marketing
- Office supplies
- Payroll
- Professional fees

Sample Asset accounts

Current assets

- Cash
- Inventory
- Accounts receivable

Fixed assets

- Equipment
- Property

Sample Liability accounts

- Accounts payable
- Credit card payable
- Loan payable

Sample Equity accounts

- Owner's equity
- Retained earnings

Financial Statements Basics



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Income Statement*

Balance Sheet*

Statement of Cash Flow

* today's class will focus on the income statement and
balance sheet

Income Statement / Profit & Loss Statement (P&L)



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- Shows the performance of your business over a period of time
- Resets at the beginning of each new accounting period
- Summarizes all revenue generated by the business
- Summarizes all expenses incurred by the business (by category)
- Calculates the net profit or loss, or “bottom line” = Income – Expenses
- Tells you how well your business is operated

My company Income Statement For the month of August 2008

Income

Sales revenue	\$2,000
---------------	---------

Expenses

rent	\$ 850
------	--------

utilities	75
-----------	----

payroll	400
---------	-----

insurance	25
-----------	----

<u>marketing</u>	<u>250</u>
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Total expenses	1,600
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Profit/Loss	\$400
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Reviewing your income statement



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- How is your revenue trending?
 - Month-to-month
 - Against same period last year (considers seasonality)
- How are your expenses trending?
- What are your highest categories of expenses?
- Which expenses are fixed vs. variable?
- What is your cost of goods sold?
- How do your expenses (as a % of sales) compare to others in your industry?

Reviewing your income statement will tell you...



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- Are you profitable?
- What's your profit margin?
 - Profit / Sales
- What's your gross profit margin?
 - $(\text{Sales} - \text{COGS}) / \text{Sales}$

Balance sheet



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- Shows a snapshot of your business at a point in time
- Accumulates over the lifetime of your business
- Shows the net worth of your business
- The balance sheet always balances $ASSETS - LIABILITIES = EQUITY$

My company Balance Sheet As of August 31, 2020

<u>Assets:</u>		<u>Liabilities:</u>	
Cash	5,000	Accounts Payable	900
Accounts Receivable	600	Loan Payable	3,500
Inventory	900	Total Liabilities	4,400
Equipment	1,000	<u>Equity:</u>	
Total Assets	7,500	Owner's equity	2,700
		Retained earnings	400
		Total Equity	3,100

Link between balance sheet and income statement



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Profit or loss is taken from the bottom line of the income statement and recorded on the balance sheet in the Retained Earnings equity account. Retained earnings accumulate over the life of the business.

- When a business operates at a profit, it increases in equity (is worth more)

<i>My company Income Statement For the month of August 2008</i>	<i>My company Balance Sheet As of August 31, 2008</i>
Income	
Sales revenue \$2,000	
Expenses	
rent \$ 850	
utilities 75	
payroll 400	
insurance 25	
marketing 250	
Total expenses 1,600	
Profit/Loss \$400	
	<u>Assets:</u>
	Cash 5,000
	Accounts Receivable 600
	Inventory 900
	Equipment 1,000
	Total Assets 7,500
	<u>Liabilities:</u>
	Accounts Payable 900
	Loan Payable 3,500
	Total Liabilities 4,400
	<u>Equity:</u>
	Owner's equity 2,700
	Retained earnings 400
	Total Equity 3,100

Reviewing your balance sheet



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- Liquidity: Can your company meet its payment obligations?
 - Cash balance
 - Working capital: $\text{Current assets} - \text{Current liabilities}$
 - Current ratio: $\text{Current assets} / \text{Current liabilities}$
- Cash flow management
 - How much inventory do you have? How fast are you selling it?
Is your inventory on the shelf collecting dust and interest?
Are you doing physical inventories monthly, annually, never?
 - Inventory turns: $(\text{COGS} / \text{Inventory balance})$
 - How high is your accounts receivable balance?
How quickly are you collecting it?
 - Days sales outstanding: $(\text{AR} / \text{Sales}) * \# \text{ of days in period}$

Reviewing your balance sheet



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- Debt management
 - What are your total debt obligations?
 - What is your total equity in the business?
 - How leveraged is your company?
 - Debt-to-equity ratio: $\text{Total liabilities} / \text{Total equity}$

Double-entry accounting



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Every business transaction will affect at least two accounts. If only one side of the entry is done, the accounting system will become out-of-balance.

Example: You write a check to the newspaper for \$100 to place an advertisement.

- Your cash account is reduced by \$100
- Your marketing expense account is increased by \$100

Accounting methods



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Cash-based accounting

- You record transactions when payment is made or received (cash exchanges hands), not when the business event occurs

Accrual-based accounting

- You record transactions when the business event occurs, regardless of whether payment has yet been made or received
- Accounts payable and accounts receivable accounts are used

Analyzing financial statements



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To obtain optimal management information from the numbers on your financial statements, they should not just be looked at alone, but compared against other numbers.

To know if your numbers are “good,” you must compare them to:

- Your expectations and needs (budget-to-actual)
- Your competitors and industry norms (benchmarking)
- Historical performance (trending)
- Each other (ratios)

Other management reports



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There are many other management and financial reports you may find useful for managing your business that provide more detail for income statement and balance sheet accounts, such as:

- Sales revenue by customer
- Sales revenue by product
- Unpaid invoices
- Accounts receivable by customer
- Accounts receivable aging
- Expenses by vendor

Next Class: Finance 2

Developing a 5-year pro-forma



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Topics include:

- Developing a budget
- Sales forecasts by product
- Cashflow
- Financial trend analysis
- Financial graphics
- Tracking profitability



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Questions?

**Thank you for your participation
In this
HCBDC workshop**



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