

**UNDERSTANDING  
WHERE YOU STAND**

*A Simple Guide to  
Your Company's  
Financial Statements*

COMPLIMENTS OF



**MasterCard**  
Worldwide

## MasterCard Solutions For Small Business

MasterCard® Solutions for Small Business encompasses MasterCard's ongoing commitment to better serve the needs of small businesses. Small business owners need greater control over every aspect of their business. They want solutions to help them run their company better. MasterCard is focused on providing small business owners with "what it takes" to be successful small business entrepreneurs. With access to innovative card programs, value-added services, productivity tools, web-based reporting solutions, rewards and savings on products and services, MasterCard delivers powerful, flexible, and creative payment solutions built specifically with the needs of small business owners in mind. Every solution is backed by advanced technology, unsurpassed global merchant acceptance and the anytime, anywhere reliability of the MasterCard brand. MasterCard is proud to support small business owners and ready to start working for you.

To find out more, visit [www.mastercardbusiness.com](http://www.mastercardbusiness.com) and click on "Small Business."

Notwithstanding any provision in any documents available here, you are permitted to download a copy to a computer and make a print copy for internal use.

This material is intended to provide a general overview and does not purport to provide all specific requirements for any person. MasterCard provides this material AS IS for the convenience of its members and cardholders.



## INTRODUCTION

One statement cannot diagnose your company's financial health. Put several statements together and you can make smart financial, investment and management decisions.

Many business owners don't know how to read their statements and rely on advisors (such as accountants) to tell them the results. Their input is valuable but you need to educate yourself. You must be able to understand your statements so you can:

- realize the vital role money plays in every business decision
- determine if you are making a profit or losing money
- calculate your current and future financial needs:
  - › make sure you have positive cash flow for short-term needs
  - › make sure your business is growing and will continue to grow

For lending purposes, statements will help you determine:

- if you can afford to pay a loan
- the loan amount
- the loan term (number of years)
- which assets you should buy vs. which assets should be financed
- what collateral is available to secure a loan

## WHAT ARE THESE STATEMENTS?

Financial statements are meaningful, written records which allow you to diagnose your financial strengths and weaknesses and increase the life and profitability of your company. Statements are usually prepared annually although the income statement should be developed on a monthly or, at least, a quarterly basis.

## WHAT DO THESE STATEMENTS SHOW?

### Balance Sheet

What a company owns, what it owes, and what is left over

### Income Statement

A firm's sales and expenses plus its profit (or loss)

### Ratios

Analyze a company's financial condition. Ratio answers can be compared to others in the same industry.

### Cash Flow Statement

The sources, uses, and balance of cash, shown on a monthly basis

NewGround Publications. (Phone: 800 207-3550) All rights reserved. Photocopying any part of this book is against the law. This book may not be reproduced in any form, including xerography, or by any electronic or mechanical means, including information storage and retrieval systems, without prior permission in writing from the publisher. 021907

## Contents

4

### BALANCE SHEET



6

### INCOME STATEMENT



8

### CASH FLOW STATEMENT



10

### RATIOS



## Balance Sheet



The Balance Sheet is a picture of your business, frozen for a second in time.

### WHAT DOES A BALANCE SHEET TELL YOU?

This statement shows what you own (assets), what you owe (liabilities), and what's left over (net value or equity in the business). The numbers change every time you receive money or give credit to a client as well as when you pay for or charge an expense.

#### Liabilities + Net Worth = Assets

Think of the Balance Sheet like a scale. Assets and liabilities alone are out of balance until you add capital, the last weight put on the scale, to makes it balance.

#### Assets

Assets are divided into two categories: current and non-current. They are listed according to how liquid they are (how quickly they can be turned into cash).

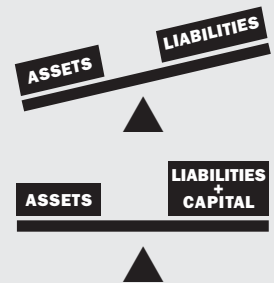
Examples of current assets are cash and inventory. Examples of non-current assets are furniture, fixtures, property and equipment. Money owed to your company (accounts receivable) is considered an asset.

#### Liabilities

Liabilities (debts you owe) are divided into two categories: current and non-current (or long-term). They are listed in the order they need to be repaid.

#### Capital or Net Worth

The business' equity includes money the owners have invested and income kept in the business from the company's profits.



### BALANCE SHEETS: BEFORE AND AFTER FINANCING

#### Established

**companies** should develop two Balance Sheets — one before, and one the day after the loan closes.

#### New companies

should include an opening Balance Sheet in the projections to reflect what the balance sheet will look like the day after the loan closes.

### WHAT IT SHOWS YOU

- The net value of the business
- How much of your loan debt is current, and how much is long-term
- Percentages and ratios (which are extracted from the numbers) necessary to analyze your business (see Ratios section)
- Compare two of the same time periods to see changes in:
  - › cash      › accounts payable      › accounts receivable
  - › equity      › inventory      › retained earnings

### WHAT IT WON'T SHOW YOU:

- Income or expenses over a period of time. *Remember, the Balance Sheet reflects one moment in time.*
- Market value of assets, although it will reflect purchase costs and depreciation according to industry standards
- Quality of assets
- Contingent Liabilities (money you agreed to repay by signing notes, or by being a co-maker or guarantor of loans).
- *Operating Lease* obligations (which allow you to buy the item at the end of the lease, for a set price, do not appear on the Balance Sheet). However, *Capital Leases* (with buyout price of \$1) are shown on the Balance Sheet.

**Max Computer Company, Balance Sheet  
December 31, 2007**

**ASSETS (WHAT YOU OWN)**

**Current Assets** (converts to cash in one year)

Cash .....	10,000	
Accounts Receivable .....	75,000	←
Inventory .....	85,000	
<b>Total Current Assets</b> (10K+75K+85K) .....	<u>170,000</u>	

**Non-Current Assets** (more than one year to convert to cash)

Fixed Assets (furniture, fixtures, property, equipment) .....	140,000	←
Less Accumulated Depreciation .....	- 25,000	←
Fixed Assets (net, 140K - 25K) .....	<u>115,000</u>	
Advances to Owners .....	6,000	
<b>Total Non-Current Assets</b> (115K + 6K) .....	<u>121,000</u>	

**Total Assets** (170K + 121K) ..... 291,000

**LIABILITIES (WHAT YOU OWE)**

**Current Liabilities** (due within one year)

Accounts Payable .....	41,000	←
Accrued Taxes .....	3,000	
Current Portion of Long-Term Debt .....	6,000	
Note Payable (due within one year) .....	<u>100,000</u>	
<b>Total Current Liabilities</b> .....	<u>150,000</u>	

**Long-Term Liabilities** (due for more than one year)

Loan Payable .....	<u>54,000</u>	
<b>Total Long Term Liabilities</b> .....	<u>54,000</u>	
<b>Total Liabilities</b> (150K + 54K) .....	<u>204,000</u>	

**CAPITAL OR NET WORTH (THE COMPANY'S EQUITY)**

Owners Investment .....	20,000	
Retained Earnings (income kept in the business) .....	<u>67,000</u>	←
<b>Total Capital or Net Worth</b> (67K + 20K) .....	<u>87,000</u>	
<b>Total Liabilities &amp; Capital</b> (204K + 87K) .....	<u><u>291,000</u></u>	

**Accounts Receivable**  
Sales made but money still owed to the company

**Fixed Assets**  
Original Cost

**Depreciation**  
Assets lose their value. Deductions are made according to tax rules

**Accounts Payable**  
Purchases not paid for

**Retained Earnings**  
Money left in the business from the company's profits, accumulated over the life of the business.

**Non-Current Assets**  
Takes more than one year to turn into cash

**Advances to Owners**  
Money owners take, in the form of a loan, to be repaid

**Current Portion of Long-Term Debt**  
One year's worth of loan payments

**Loan Payable**  
Loan balance after one year's worth of payments

**Owners Investment**  
Money owners invest in business

**WHICH ACCOUNTING METHOD IS RIGHT FOR YOU**

**THE CASH METHOD**

- Records a sale when money is collected
- Records an expense when it is paid

**THE ACCRUAL METHOD**

- Sales are made on credit, and not immediately paid for. The amount customers owe is called Accounts Receivable
- Buy items or incur expenses for the business, but pay later. The amount owed is called Accounts Payable.
- Net worth does not always translate to cash, since money can be tied up in Accounts Receivable, expenses and inventory. To get a better idea of how much cash there is at the end of the month, learn about the Cash Flow Statement.
- Lenders prefer the accrual method.

# Income Statement



**Think of the Income Statement as a report card for your business. It is issued from time to time and gives an overview of how you are doing.**

## OTHER NAMES FOR THIS STATEMENT

- Operating Statement • Earnings Statement • Profit & Loss Statement (P&L)

## WHAT DOES AN INCOME STATEMENT TELL YOU?

In the day-to-day running of your business, numbers fly around at a dizzying pace. Bills are paid, money is taken in, and sometimes, in this whirlwind of activity, it's hard to know how much you're actually making. The Income Statement answers that question.

Think of the Income Statement as a kind of report card for your business. Like a report card, it is issued from time to time and gives an overview of how you are doing (for that period of time).

Since this statement reflects your business activity over time (not like the Balance Sheet which is a snapshot of your business for one moment in time), it is usually developed monthly, quarterly and annually. Creating a projected statement for the next 12 months, based on your predictions, is also a good idea.

## WHAT IT SHOWS YOU

- If sales are going up or down
- Your gross profit — how much money is left for the rest of the business after deducting what it costs to produce or purchase the product
- All expenses for the time period it covers
- Increases and decreases in net income
- How much money is left to grow the business
- How much money is left for the owner(s)
- How much money is left to pay debt (principal only)

## WHAT IT WON'T SHOW YOU

- If your overall financial condition is weak or strong (see the Balance Sheet).
- What's tied up in Accounts Receivable (money owed to you) and Accounts Payable (money you owe).
- What you own (assets) and what you owe (liabilities)

**Max Computer Company, Income Statement  
December 31, 2007**

**Net Sales**  
Revenue or income.  
Gross sales is *before* returns and allowances.  
Net sales is *after* returns and allowances.

<b>Net Sales</b> .....	.900,000	<b>100%</b>
Less Cost of Goods Sold (cost to make products):		
Beginning Inventory .....	75,000	<b>8%</b>
Purchases (to make product) .....	350,000	<b>39%</b>
Labor (to make product only) .....	200,000	<b>22%</b>
Total (75K+350K+200K) .....	625,000	<b>69%</b>
Less: Ending Inventory .....	- 85,000	<b>9%</b>
Cost of Goods Sold (625K less 85K) .....	540,000	<b>60%</b>
<b>Gross Profit</b> (900K less 540K) .....	360,000	<b>40%</b>

**Gross Profit**  
This is your profit margin

**Selling Expenses**  
Salaries and expenses related to sales only

Operating Expenses:		
→ Selling Expenses .....	90,000	<b>10%</b>
General and Administrative .....	+ 170,000	<b>19%</b>
Total Expenses (90K + 170K) .....	260,000	<b>29%</b>

**General & Administrative**  
All other expenses used to run the company

**Operating Income (or Loss)**  
Shows how the business performed

Operating Income (360K less 260K) .....	100,000	<b>11%</b>
Less: Interest Expense (on loans) .....	- 20,000	<b>2%</b>
Net Profit before taxes (100K less 20K) .....	80,000	<b>9%</b>
Less: All Income Taxes .....	- 27,000	<b>3%</b>
<b>Net Profit</b> (80K less 27K) .....	53,000	<b>6%</b>

**Net Profit**  
Profit left after all expenses have been paid

**To get a more accurate picture of your financial performance, compare percentages instead of numbers.**

- First, convert numbers from the Income Statement into percentages
- Next, compare these percentages from this period to those from the previous period
- Are the percentages increasing or decreasing?

**FOR EXAMPLE**

$$\frac{\text{Gross Profit of } \$360,000}{\text{Total Sales of } \$900,000} = 40\%$$

If gross profit was 35% last year, it has increased by 5%

## Cash Flow Statement



**What money comes in, what goes out, and what stays**

### WHAT DOES A CASH FLOW STATEMENT TELL YOU?

Cash is the fuel that runs your business. Running out of it would be disastrous, so you must have a “cash flow” or money on hand to pay bills and meet day-to-day expenses. Keep in mind that companies can produce a profit, but still not have a positive cash flow.

The Cash Flow Statement shows money that comes into the business, money that goes out and money that is kept on hand to meet daily expenses and emergencies.

### WHAT IT SHOWS YOU

- If the business has enough money to:
  - cover day-to-day activities
  - pay debts on time
  - maintain and grow the business without a negative cash flow
- The need for additional working capital (cash) when sales increase since increased sales mean increased purchases of material or labor. You should know how much you need. Show where the additional working capital will come from.
- The maximum loan payment the business can afford
- The breakdown of principal and interest on your loan payments. Note that the Income Statement only shows interest - not principal.
- Your weaknesses (an inability to keep and generate cash). For lending purposes, explain how you’ll handle these weaknesses (via increased sales, cost reductions, or owner’s investments).

### WHAT IT WON'T SHOW YOU

- How much you have in Accounts Receivable and Accounts Payable (shown in the Balance Sheet)
- Your balances in assets, liabilities and net worth
- Depreciation of equipment, which is a non-cash expense. This is dealt with in the Balance Sheet.

#### **Of Special Interest to New Companies**

Losses - also called “pull down balances” - are common in the first year of a start-up. Lenders want to see the business break-even during the year. To produce positive balances, you’ll have to cover months (that show negative balances) with loans, increased revenue, additional owner’s investments, or by reducing expenses.

**Loan Principal**

Loan principal appears here but not in the Income Statement. If the loan was used for real estate, furniture, fixtures and equipment or machinery, that portion will be depreciated over time (as allowed by the IRS) on the Income Statement.

**Loan Payment**

Loan received a month before these projections. Purchases are paid, up to date. They are now taking advantage of 30-day payment terms. The Income Statement will record the purchases as an Accounts Payable but it won't be recorded here until paid.

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
<b>A. Cash On Hand</b> (Beginning of month)	10,000	5,627	13,741	10,470	13,830	15,190	11,498	15,202	22,157	30,997	39,372	48,601	
<b>B. Cash Receipts</b>													
1. Cash Sales													
2. Collections from Credit Accounts	32,813	75,000	76,250	81,250	85,000	85,750	88,500	90,000	88,750	84,250	81,500	78,750	
3. Loan or Other Cash injection (specify)													
<b>C. Total Cash Receipts</b> (B1+B2+B3)	32,813	75,000	76,250	81,250	85,000	85,750	88,500	90,000	88,750	84,250	81,500	78,750	
<b>D. Total Cash Available</b> (A+C, before cash paid)	42,813	80,627	89,991	91,720	98,830	100,940	99,998	105,202	110,907	115,247	120,872	127,351	
<b>E. Cash Paid Out:</b>													
1. Purchases (Merchandise)	0	30,000	42,500	42,500	44,000	45,000	45,000	42,500	41,000	40,000	37,500	37,500	447,500
2. Gross Wages (excludes withdrawals)	10,758	10,758	11,364	11,970	11,970	12,334	12,576	12,576	11,970	11,606	11,364	10,758	140,004
3. Payroll Expenses (Taxes, etc.)	1,076	1,076	1,136	1,197	1,197	1,233	1,258	1,258	1,197	1,161	1,136	1,076	14,001
4. Outside Services	758	758	808	859	859	889	909	909	859	828	808	758	10,002
5. Supplies (Office and operating)	383	383	408	434	434	449	459	459	434	418	408	303	4,972
6. Repairs and maintenance	390	390	416	422	422	458	468	468	442	426	416	390	5,108
7. Advertising	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	50,400
8. Car, Delivery and Travel	2,700	2,700	2,800	2,900	2,900	2,960	3,000	3,000	2,900	2,840	2,800	2,700	34,200
9. Professional Services (Accounting, legal, etc.)	1,500	0	0	1,500	0	0	0	0	0	1,500	0	0	4,500
10. Rent	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	23,400
11. Telephone	278	278	296	315	315	326	333	333	315	303	296	278	3,666
12. Utilities	400	400	400	400	400	400	400	400	400	400	400	400	4,800
13. Insurance	0	450	450	450	450	450	450	450	450	450	450	0	4,500
14. Taxes (real estate, etc.)	0	750	0	0	750	0	0	750	0	0	750	0	3,000
15. Interest (on loans)	500	498	495	493	490	488	485	482	480	477	475	472	5,835
16. Other/Miscellaneous Expenses (specify)	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>17. Subtotal</b>	24,893	54,591	67,223	69,590	70,337	71,137	71,488	69,735	66,597	66,559	62,953	60,785	755,888
<b>F. Other Operating Costs:</b>													
1. Loan Principal Payment	293	295	298	300	303	305	308	310	313	316	318	321	3,359
2. Capital Purchases (ex., Buy a computer)	0	0	0	0	0	5,000	0	0	0	0	0	0	5,000
3. Other Start-up Costs	0	0	0	0	0	0	0	0	0	0	0	0	0
4. Reserve and/or Escrow (ex., Pay \$100K loan)	10,000	10,000	10,000	5,000	10,000	10,000	10,000	10,000	10,000	5,000	5,000	5,000	100,000
5. Owner's Withdrawal	2,000	2,000	2,000	3,000	3,000	3,000	3,000	3,000	3,000	4,000	4,000	4,000	36,000
<b>G. Total Cash Paid Out</b> (E17 + F1 through F5)	<b>37,186</b>	<b>66,886</b>	<b>79,521</b>	<b>77,890</b>	<b>83,640</b>	<b>89,442</b>	<b>84,796</b>	<b>83,045</b>	<b>79,910</b>	<b>75,875</b>	<b>72,271</b>	<b>70,106</b>	
<b>H. Cash Position (End of month, D minus G)</b>	<b>5,627</b>	<b>13,741</b>	<b>10,470</b>	<b>13,830</b>	<b>15,190</b>	<b>11,498</b>	<b>15,202</b>	<b>22,157</b>	<b>30,997</b>	<b>39,372</b>	<b>48,601</b>	<b>57,245</b>	
<b>I. Essential Operating Data</b> (Non-cash flow info)													
1. Accounts Receivable (End of month)	117,188	117,188	120,938	124,688	124,688	126,938	128,438	128,438	124,688	122,438	120,938	117,188	
2. Bad Debt (End of month, if applicable)	0	0	0	0	0	0	0	0	0	0	0	0	
3. Inventory on Hand (End of month)	77,500	82,500	85,000	86,500	89,000	90,000	87,500	83,500	81,000	77,500	75,000	75,000	
4. Accounts Payable (End of month)	71,000	83,500	83,500	85,000	86,000	86,000	83,500	82,000	81,000	78,500	78,500	78,500	

**Cash Position**

This company has a positive cash flow.

**Summary**

Good information to calculate

# Ratios



Think of ratios as your business' financial scores

## WHAT RATIOS SHOW YOU?

Ratios help you identify your strengths and weaknesses. Use them to compare your business to standards in your industry. Lenders look very carefully at ratios.

The numbers for ratios are taken from the Income Statement and the Balance Sheet, but not the Cash Flow Statement.

## ASSET MANAGEMENT RATIOS

How effectively are you managing your assets?

### ACCOUNTS RECEIVABLE TURNOVER

Number Source: Balance Sheet & Income Statement

#### FORMULA

Accounts Receivable  
(\$75,000 x 365 days)

$$\frac{\$27,375,000}{\$900,000} = 30.4$$

Net Sales Figure

It takes 30 days to collect bills

**NOTE:** This shows how many days it takes to collect money owed to you. **Lower answer is better.**

### INVENTORY TURNOVER

Number Source: Balance Sheet & Income Statement

#### FORMULA

Inventory Figure  
(\$85,000 x 365 days)

$$\frac{\$31,025,000}{\$540,000} = 57.4$$

Cost of Goods Sold

57 days to turnover or sell the inventory

**NOTE:** This formula shows how many days it takes you to turnover (or sell) your inventory. **Lower answer is better.**

## LIQUIDITY RATIOS

How "cash rich" is a company? Liquidity ratios show a company's ability to turn an asset into cash.

### WORKING CAPITAL

Number Source: Balance Sheet

#### FORMULA

Current Assets

$$\$170,000 - \$150,000 = \$20,000$$

Subtract Current Liabilities

Shows if a company has enough cash to pay bills. Answer must be positive

**NOTE:** 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 a negative number. **Higher number is better.**

### QUICK OR ACID TEST RATIO

Number Source: Balance Sheet

#### FORMULA

Total Current Assets of \$170,000 less Inventory of \$85,000

$$\frac{\$85,000}{\$150,000} = .56$$

Total Current Liabilities

Eliminates inventory from current assets and cash. "Quick" means items can be turned into cash.

**NOTE:** Inventory may become no longer useful. This ratio eliminates inventory from current assets and cash. It's called "quick" because it includes items that can be turned into cash. **Answer should be 1 or higher.**

### CURRENT RATIO

Number Source: Balance Sheet

#### FORMULA

Total Current Assets

$$\frac{\$170,000}{\$150,000} = 1.13$$

Total Current Liabilities

A company's short-term debt paying ability.

**NOTE:** 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. **The higher the number, the better. Answer should be 2 or more**

## DEBT MANAGEMENT RATIOS

Shows how much money owners have invested in the business versus lenders.

### LEVERAGE (OR DEBT TO WORTH) RATIO

Number Source: Balance Sheet

**FORMULA**

$$\frac{\text{Total Liabilities}}{\text{Total Capital}} = 2.34$$

The company is leveraged 2.34 times. For every \$1 owners have invested, lenders and creditors have invested \$2.34

**NOTE:** Determines if a company has enough equity. **Lower answers are better. Answer of 3 or lower is preferred.**

### ACCOUNTS PAYABLE TURNOVER

Number Source: Balance Sheet & Income Statement

**FORMULA**

$$\frac{\text{Accounts Payable at } \$41,000 \times 365 \text{ days}}{\text{Purchases}} = 42.75$$

Accounts Payable are paid every 43 days

**NOTE:** Shows how quickly a company pays its suppliers. **Lower numbers (30 days or less) are better.**

## PROFITABILITY RATIOS

Shows company's ability to make a profit

### PROFIT MARGIN ON SALES

Number Source: Income Statement

**FORMULA**

$$\frac{\text{Net Profit}}{\text{Net Sales}} = .0588$$

The profit margin is 5.9%

**NOTE:** Shows the percentage of net profit for every dollar of sales. **The higher the number, the better.**

If the profit margin is too low:

1. the prices are too low
2. the cost of goods is too high
3. expenses are too high

### CASH FLOW TO CURRENT MATURITIES (DEBT SERVICE) RATIO

Number Source: Balance Sheet & Income Statement

**FORMULA**

$$\frac{\text{Net Profit of } \$53,000 + \text{Depreciation of } \$13,000 \text{ (amount created for this example)}}{\text{Current Portion of Long Term Debt.}} = \$11$$

For every dollar of payments \$11 is available to pay it

**Note:** Shows your ability to pay term debts after owner(s) withdrawals. New businesses, use one year's worth of loan payments. **Answer of 2 or more is preferred.**

### Ratio Comparisons

Ratios should be compared to prior years, acceptable lending ranges, and industry averages.

- Industry ratios are averages. Some firms are above and some firms are below these numbers. Differences are due to the age of the company, locations, managers, and operations, to name a few.
- A ratio of 38% compared to an industry average of 39% seems like a small 1% difference. If sales are \$4 million, 1% is \$40,000. If net profits are \$100,000, then the \$40,000 is very important.

These reference books include industry information:

- RMA Annual Statement Studies
- Almanac of Business and Industrial Financial Ratios (gathered from U.S. Treasury and IRS information)
- Dunn and Bradstreet

Other good industry sources (especially when your company is smaller than those used in the reference books):

- Trade Associations
- Magazines and newspapers for your industry
- Small Business Administration/SBA

## RATIOS AT A GLANCE

RATIO

GET NUMBERS FROM:

### ASSET MANAGEMENT

- Accounts Receivable Turnover . . . . .Balance Sheet & Income Statement
- Inventory Turnover . . . . .Balance Sheet & Income Statement

### LIQUIDITY RATIOS

- Working Capital . . . . .Balance Sheet
- Quick or Acid Test . . . . .Balance Sheet
- Current . . . . .Balance Sheet

### DEBT MANAGEMENT RATIOS

- Leverage (or Debt to Worth) . . . . .Balance Sheet
- Accounts Payable Turnover . . . . .Balance Sheet & Income Statement

### PROFITABILITY

- Profit Margin on Sales . . . . .Income Statement
- Cash Flow to Current Maturities (Debt Service) . . . . .Balance Sheet

## Glossary

**Ability to Pay.** Ability to pay loans from future business' profits.

**Accounts Payable (A/P).** Expenses incurred from purchases made on credit.

**Accounts Receivable (A/R).** Sales made but money not collected. Credit is granted.

**Assets.** What a company owns.

**Asset-based Lending.** Financing secured by pledging assets (inventory, receivables, or other collateral).

**Available Credit.** The unused portion of a line of credit.

**Balloon.** A stop point or early maturity of a loan.

**Business Credit.** Loans made to businesses in the form of a term loan or a line of credit.

**Business Plan.** An overview of a new or existing company which is used to obtain financing.

**Capacity.** Borrower's ability to handle a certain level of debt.

**Capital Leases.** Leases with a buyout price of \$1 which are shown on the Balance Sheet.

**Commercial Mortgage.** A loan on business' real estate. Rates and terms are negotiated and the interest rate is usually related to the prime rate.

**Cost of Goods Sold.** Cost to make a product, including materials, labor, and related overhead.

**Credit Rating.** Credit rating as determined by a credit reporting agency.

**Credit Scoring.** A process used to approve or reject commercial loan applications, based on ratios and other factors.

**Current Assets.** Assets that can be converted into cash in one year.

**Current Liabilities.** Liabilities due within one year.

**Depreciation.** Except for land, assets wear out. They are devalued or depreciated every year.

**Draw Down.** Taking an advance on a line of credit.

**Equity.** The book value of a business. Assets minus liabilities.

**Fair Market Value (FMV).** The price of an asset, product or service in a current, competitive market.

**Fixed Assets.** Assets including furniture, fixtures, equipment, machinery, and real estate.

**Gross Profit.** Gross sales less cost of goods sold. Also called gross margin.

**Gross Sales.** Revenue or income from sales before returns and allowances.

**Intangible Asset.** Have no physical properties but represent something of value (for example, patents and trademarks).

**Inventory.** Assets held for resale. May be in the form of raw materials, work in progress, or finished goods.

**Liquid Collateral.** Collateral that can be converted to cash quickly.

**Line of Credit (LOC).** A short-term loan (usually used to finance accounts receivable and/or inventory)

**Liquid Asset.** Asset that can be turned into cash quickly, within one year

**Long-Term Liabilities.** Expenses, loans, and payables due after one year

**Net Profit.** Money left after all expenses have been paid. Used to pay loan principal and to grow the company.

**Net Sales.** Revenue or income from sales after returns and allowances are deducted.

**Net Worth.** Assets less liabilities. Show equity value.

**Non-Current Assets.** Assets that take one year or more to turn into cash.

**Operating Lease.** Leases which allow you to buy the item at the end of the lease, for a set price. These leases do not appear on the Balance Sheet.

**Owners' Investment.** The money owners have invested in a business.

**Prime Rate.** The rate of interest lenders give to its prime customers from time to time. Most business owners are charged the prime rate plus a percentage.

**Pro Forma.** Projecting or forecasting future income, expenses, and cash flow.

**Retained Earnings.** Net profits accumulated through the company's life and reported in the net worth or equity section of the balance sheet. Note: Can be negative if losses occur.

**Secured Loan.** Loan secured by collateral (which will be liquidated if the borrower defaults on the loan).

**Tangible Asset.** Real property (machinery, equipment, furniture and fixtures).

**Term.** A loan's maturity, stated in months or years.

**Term Loan.** Loan, usually given in one lump sum at the closing. Repayment is monthly over a stated term.

**Trend Analysis.** Analysis of financial statements and ratios to determine the financial strength over time.

**Working Capital.** Difference between current assets and current liabilities. An indication of liquidity and the ability to meet current obligations.