Small Business Report Cards

In the last column of this series on “knowing your business numbers”, I discussed a balance sheet and stated that it is a snapshot in the life of your business at just one financial moment. It is one of several financial report cards that a business should prepare and is sometimes referred to as a "Statement of Financial Condition." Now let us look at a couple other report cards that are very important for a CEO to understand and monitor. The first is the income statement.

In order to avoid the mistake of looking at a payment and guessing at your profit, you should use an income statement. An income statement provides a line by line breakdown of revenue and the various sums that are subtracted from the revenue to determine profit. As I related in the last column, most accounting software programs will generate similar statements of profitability for you.

The top line in an income statement is the total sales revenue (or "gross income"). That is followed by the sales costs which are the direct costs involved in producing the items that are sold (also known as cost of goods sold, COGS). For example, if you are a book publisher, these costs might be the costs of paper and printing or the costs to pay a writer to create the book. When you deduct the cost of goods from total sales revenue you get the "gross profit."

The next lines are a series of operating expenses. For example: expenses associated with running your company, known as the general and administration costs (or "G&A"), and expenses associated with sales, marketing, and product development. When you subtract these operating expenses from your gross profit, you get your "operating income."

A company next subtracts interest on debt and arrives at an amount referred to as its "income before taxes." After taxes are subtracted, the income statement shows "net income from continuing operations," and then finally, after subtracting all its expenses listed above, one should consider any one-time losses (for example, a legal judgment) from its total sales revenue. The final number is considered the "net income."

Another good report card to look at each month is the cash flow statement, to report your cash on hand and enable you to forecast your cash in the future.
A cash flow statement summarizes all the cash coming in and going out of a business during a specific period by analyzing cash in three classes: operations (sales and operating expenses), financing activities (loans and equity), and investing activities (ownership of real estate, securities and non-operating assets).

I often get the question, is a cash flow statement really as helpful as it sounds? Cash flow statements can be difficult to understand at first, but once you have studied them, they become clearer. I know of several business people that have a hard time, but explanations from their accountant, each time, at least for a couple of accounting periods, really helps.

I recommend that the CEO reviews the company’s report cards every month (this includes the balance sheet, income statement, and cash flow statement) to help make sound business decisions and help to plan and forecast for the future.

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