

**Pam Bauer**

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**Sent:** Tuesday, April 14, 2009 3:08 PM  
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**Subject:** What Are Your Financials Telling You?

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## Abacus & Co. of NY, Inc.



### In This Issue

[Small Business Mastermind Group](#)

[Business Tips](#)

[QuickBooks Tips](#)

### Quick Links

[Our Website](#)

[Our Blog](#)

### Small Business Peer to Peer Group



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## April Newsletter

**Dear Pam,**

The flowers are beginning to bloom your taxes are hopefully done. Now you have some time to take a serious look at how your are doing and where you would like to be. Our Business & QuickBooks tips section this month deals with both those items. Learn how to read your financials in our **Business Tips** section and how to do a budget in our **QuickBooks Tips** section

*We Take The Work out of Paperwork!*

### **Business Tip - How to Read Your Financials and figure out how you measure up!**

Financial statements are accounting reports used to summarize and communicate financial information about a business. The major financial statements are the Profit & Loss statement and the Balance Sheet. These statements are used to report information about the business's primary objectives and are the end result of the accounting process.



**Balance Sheet:** A balance sheet summarizes a business's

## Forward to a Friend

financial position on a given date. It is sometimes called a statement of financial position. A balance sheet lists the business's assets, liabilities, and owner's equity.

- Assets are the economic resources of a business that are expected to provide future benefits to the business. A business may own many assets, some of which are physical in nature, such as land, buildings, supplies to be used in the business, and goods (inventory) that the business expects to sell to its customers. Other assets do not possess physical characteristics, but are economic resources because of the legal rights they convey to the business. These assets include amounts owed by customers to the business (accounts receivable), the right to insurance protection (prepaid insurance), and intangible items like good will.
- Liabilities are the economic obligations (debts) of a business. The external parties to whom the economic obligations are owed are referred to as the creditors of the business. Usually, although not exclusively, legal documents serve as evidence of liabilities. These documents establish a claim (equity) by the creditors (the creditors' equity) against the assets of the business. Liabilities include such items as amounts owed to suppliers (accounts payable), amounts owed to employees for wages (wages payable), taxes payable, and mortgages owed on the business's property. A business may also borrow money from a bank on a short or long-term basis by signing a legal document called a note, which specifies the terms of the loan. Amounts of such loans would be listed as notes payable.
- Owner's Equity of a business is the owner's current stake in the business. For a partnership, the owner's equity might be referred to as the partners' equity; for a corporation, stockholders' equity. The owner's equity is affected by the capital invested in the business by the owner, by the business's earnings from its operations, and by withdrawals of capital by the owner of the business.

**Profit & Loss Statement (or Income Statement):** Is a financial statement summarizing the results of a business's earnings activities for a specific period of time. It shows

the revenues, expenses, and net income (or net loss) of the business for this period. Revenues are the prices charged to the business's customers for goods and services provided. Expenses are the costs of providing the goods or services. The net income is the excess of revenues over expenses; a net loss arises when expenses are greater than revenues.

Let's take a look at a company I will call ABC, Inc.'s financials and see how we measure up!

**Quick ratio:** This measures ABC, Inc.'s ability to meet its obligations without selling off inventory; the higher the result, the better. It is expressed as current assets minus inventories, divided by current liabilities. In ABC, Inc.'s case, that is 14,706 minus 6,254, divided by 11,117, which equals 0.76. If this number declines over time or falls short of your benchmark, you may be investing too much capital in inventory or you may have taken on too much short-term debt.

**Current ratio:** This is another test of short-term liquidity, determined by dividing current assets by current liabilities. In ABC, Inc.'s case, that is equivalent to 14,706 divided by 11,117, which equals 1.32. This number should be above 1, and it's usually a sign of strength if it exceeds 2. If this number is below 1, that means your short-term liabilities exceed your short-term assets. A liability is considered current if it is due within a year. An asset is current if it can be converted into cash within a year.

**Debt-to-equity ratio:** In brief, divide total debt by total equity. In ABC, Inc.'s case, the denominator is termed a shareholder's investment because ABC, Inc. is a public company. Using ABC, Inc.'s data, that ratio is expressed as 8,675 divided by 15,633, which equals 0.555. Long-term creditors will view this number as a measure of how aggressive your firm is. If your business is already levered up with debt, they may be reluctant to offer additional financing.

**Working capital:** This refers to the cash available for daily operations. It is derived by subtracting current liabilities from current assets, which in this example is 14,706 minus 11,117, which equals 3,589. If this number is negative, that means your firm is unable to meet its current obligations. To improve this number, examine your inventory management practices; a backup of goods and the resulting loss in sales can take a toll on your

business's cash resources.

**Accounts receivable collection:** Many businesses experience a lag between the time they bill customers and when they see the revenue. This may be due to trade credit or because customers are not paying. While you can note this potential revenue in the balance sheet under accounts receivable, if you're not able to collect it, eventually your business will lack sufficient cash. To measure how many days it takes to collect all accounts receivable, use this formula: 365 (days) divided by accounts receivable turnover (total net sales divided by accounts receivable). In ABC, Inc.'s case, that equates to 365 divided by the sum of 59,490 divided by 6,194, which equals 38. This means that, on average, it takes ABC, Inc. 38 days to collect on its accounts. If you find your business has a healthy balance sheet but is short on cash, increase collection on outstanding accounts.

**Gross profit margin:** The money ABC, Inc. earns from selling a T-shirt, minus what it paid for that item -- known as cost of goods sold, or COGS -- is called gross profit. Sales minus COGS, divided by sales, yields the gross profit margin. According to ABC, Inc.'s income statement, that would be 59,490 minus 39,399, divided by 59,490, which equals 0.337, or 33.7 %.

**Operating profit margin:** Use the total Operating Expenses and divide it by total sales. In this case the equation is 5,069 divided by 59,490, which equals .085, or 8.5 %. This is an effective way to measure operational efficiency. If you find this number to be low, either raise revenues or cut costs. It may help to analyze which of your customers are the most profitable and concentrate your efforts there. You may also want to check the detailed industry standards for your industry and see how you measure up. An example of this is if your industry standard is 25% of every dollar is spent on payroll and you see your number is 40% then you are paying too much for payroll according to your industry and should see what you can do to reduce it.

**Net profit margin:** Net earnings divided by total revenue yields the net profit margin. In this case, 2,787 divided by 59,490, which equals .047, or 4.7 %.

Knowing these ratios will help you determine how you are doing in comparison to your competition. In addition, it is always helpful to know these ratios before you go to a creditor for funding.

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## QuickBooks Tip - Using the Budgeting feature

Most of the recent versions of QuickBooks have a budgeting feature that you can easily access. The 2009 version accesses the budgeting process starting with the company tab. Once you are there just click on



"Budgets & Planning" and click on "Set up Budgets".

You should have arrived on a screen that says "Create New Budget". I would just use the Profit & Loss for a budget and leave the Balance Sheet alone. In addition, if you have a complete years worth of information from the prior cycle I would choose the "Create budget from previous year's actual data". Click on "Finish" and you should see a screen that has all of your prior year's income and expenses broken down by account and month. The actual QuickBooks process is pretty intuitive so you should find it fairly easy to maneuver. If you have any problems feel free to email me and I will try and help you out.

The important thing is to budget for your success not your failure. If you don't improve your numbers you won't improve your results. Start with your sales numbers and work your way down. How much do you realistically think you can increase your sales? Take each month and think about the things that are going on that time of year. Are there trade shows that you plan on attending? Are you doing a mass mailing or eblast that time of year? Should you be? Does the weather make a difference to your sales? Does the season make a difference in your sales?

Once you feel that you are comfortable with your sales projections next you should walk through each of your expenses. I find that the industry standards for your industry help here a great deal. If the industry standard for a manufacturing companies COGS is 30% then that is the number I would try and hit. So I would take my projected sales each month and multiply that by 30% and book that as my COGS for that month. I would do that for every expense account where I had an industry standard. Then I would go ahead and look further into the

other accounts that don't have obvious industry standards and see if I can reduce them.

The most important part of budgeting is to be realistic. If you project to wildly one way or the other you will have muted the value of the budget and wasted your time. Once you have a good budget created you can begin to print reports on a monthly basis that show how you did as it relates to your budget.

Go ahead and plan your future! It's going to happen anyways so you might as well have a say in it.

Enjoy the spring everything old is new again!  
Keep an eye out for our next months newsletter.  
We are going to talk about what your businesses "Z Score" is!

**Sincerely,**

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