Financials and Accounting terms ALL business owners should know and understand!

As a business owner, the foundation of your company is your finances. In order to run a profitable business, make money, and grow the company, a business starts with managing, understanding, and controlling the finances.

All business owners should understand what an income statement, cash flow and balance sheet is. You should not dread or avoid understanding these statements. You must also have an understanding of your profit margins, working capital and retained earnings.

This guide will simplify and help you understand these terms.

Understanding and controlling your finances always STARTS WITH THE UTILIZATION AND UNDERSTANDING OF YOUR OWN INTERNAL SYSTEMS AND CONTROLS

Internal financials and systems are pertinent to your business and growth and are reviewed by banks and sureties alike when lending and extending credit. It is important to understand these financial terms, which you should have at your fingertips via your internal systems and controls.

You provide this data to your accountants who present your data via a FINANCIAL STATEMENT with various **levels of assurance: Compilation, Review or Audit** along with a specific **financial reporting basis: Cash, Accrual, Percentage of Completion**

Let's start with the basics:

Income Statement (a.k.a. Profit & Loss Statement): This shows all sources of sales revenues and all operating expenses associated with the business. The difference between them (the revenue minus cost associated) is your **PROFIT**. An Income statement can be generated over a specific time period to give you a more accurate accounting of your profitability for that time. ie: A fiscal year.

Balance Sheet: The balance sheet is a listing of all assets vs. The liabilities of the company. The difference between the two is the company's Net Worth. The Total assets minus the total liabilities is the net value/worth of the company otherwise known as Equity or Retained Earnings. Think of this in terms of the equity in a home. The Home value minus the mortgage due is the equity of the home.

Profit Margins: Profit margins are expressed as percentages and are equated by dividing the profits by the amount of revenues in the specific period of time.

- **Gross Profit Margin:** measures how a business' revenues/sales cover the direct cost associated with operating their business. (example: $450,000 gross profit / $1,500,000 revenues = 30% gross profit)

- **Net Profit Margin** (a.k.a "bottom line"): measures how a company turns revenues/sales into profits than can be used to grow the balance sheet by increasing retained earnings. (example: $150,000 net profit /$1,500,000 revenues = 10% net profit)

Cash Flow Statement: Cash flow shows a picture of a company's cash health or cash flow. This statement takes into account the income, eliminates certain expenses that don't involve cash and adds in many other costs and sources of cash that are not included in the income statement, including cash from loans and cash paid for startup cost. The end result is what the company generated vs. spent in cash. Your cash flow.

Working Capital: is equated looking at your balance sheet and calculating the "total current assets" less your "total current liabilities". This working capital determines your business liquid reserve available to pay for the cost of ongoing operations while you wait on getting paid. Working capital (when analyzed by an underwriter) can be adjusted by lenders/sureties by eliminating slow accounts receivables, reduced inventory and eliminating prepaids. Cash is king!

LEVELS OF CPA ASSURANCE- Understanding different levels of assurance and accounting basis

Compilation Statement: A compilation report is the least level of assurance provided by a CPA firm and does not express an opinion or conclusion of the financial statement presented. The CPA does not obtain any assurance for a compilation because he/she is not required to verify the accuracy or completeness of the information provided or otherwise gather evidence for the purposes of expressing an audit opinion or a review conclusion. The CPA is literally just "compiling" the information for the reader.

A compilation is typically appropriate when initial or lower amounts of financing or credit are sought.

Review Statement: Intended to provide lenders and other outside parties with a **basic level of assurance** on the accuracy of financial statements. A review is the base level of CPA assurance services. The CPA will perform analytical procedures and inquiries to provide the user with a level of comfort of the accuracy of the financial statement.

A Review is typically appropriate as a business grows and is seeking larger and more complex levels of financing and credit.

Audit Statement: The highest level of assurance provided by a CPA firm. It is intended to provide creditors, investors and other outside parties with a high level of comfort on the accuracy of financial statements. The CPA issues a formal report that expresses an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework.

An Audit statement is typically appropriate and often required when seeking high levels of financing or outside investors, or when selling a business. This is generally needed when levels of bonding or lending exceed $50mm.

Basis of accounting: Cash vs. Accrual vs. Percentage of Completion

Cash: The cash method is the most simplistic method of financial accounting. This method is where income/revenue and expenses count when cash is received and made. Simple, cash comes in, it is recognized as revenue/sales on your P&L. Bills get paid, it counts as expense on your P&L. In construction accounting, this method does not provide a good financial picture of your company's financial health.

Accrual: Is a more advance method of accounting from cash. This method is where income/revenue and expenses are recorded when a transaction occurs rather than when the transaction payment is received or made. This method provides a better financial picture of your company's financial health as it will include accounts receivables due to you which is an ASSET.

Percentage of Completion: The percentage of completion method calculates the recognition of revenues, expenses and gross profits related to ongoing projects based on the proportion of work completed on a cos to cost basis. This method of construction accounting provides the best financial picture of your company's financial health when reviewed by creditors.