startup foundations

FINANCE AT FIRST GLANCE: BASICS FOR ENTREPRENEURS

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WELCOME

Congratulations on embarking on this entrepreneurial journey.
Whether your business is in the planning stages or already in operation,
you should make firming up your financial literacy a priority.
Not to worry – this eBook will help you do just that.

PART ONE

HOW FIRM IS YOUR FOUNDATION?

Let's start with the basics: do you know how to read and understand your financial statements? Do you know what they include and why they matter?

A standard set of financial statements includes:

Income Statement (also known as Profit and Loss)

As the name implies, this is a record of your **income** (i.e. how much money your business has earned) and your **expenses** (i.e. how much operating money you have spent). Subtract your expenses from your income to arrive at **net profit** or **loss** or, in other words, your bottom line. Everything you buy or sell affects not only your income statement, but your balance sheet as well.

Balance Sheet

Here, you record all your **assets** (e.g. cash in the bank; inventory and equipment your business owns) and **liabilities** (e.g. money, taxes, or services that you owe). This also shows your **equity**; that is to say, the total of **retained earnings** (i.e. earnings from previous years) plus any investments into the company. Subtract what you owe from what you own to determine **net worth**.

Cash Flow Statement

This combines information from both your income statement and balance sheet, comprehensively showing your business's performance. Why not just look at your bottom line? Because it does not account for taxes or loan repayments. A **cash flow statement** will include your net income and your liabilities to give you a much clearer idea of how healthy your business finances are.

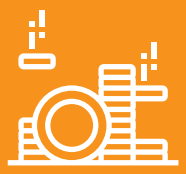
Why do your financial statements matter? Because they allow you to:

- **Track the health of your business**
- **Prove that you qualify for loans or credit**
- **Plan for the future**

PART TWO

CASH FLOW

Think of all the ways money will flow in and out of your business.
These could include:



INCOME FROM SALES OF GOODS OR SERVICES

PROCEEDS FROM A LOAN

MONEY INVESTED BY FAMILY OR FRIENDS

EQUIPMENT OR GOODS TO RESELL PURCHASED

WAGES PAID

RENT PAID

Every one of these transactions will affect one or more of your financial statements. Recording them is called bookkeeping. Keeping your records current is critical to your success. Reconciling your bank, credit card, and loan statements will ensure your records are accurate.

PART THREE

DAY-TO-DAY MANAGEMENT

Many business owners feel they do not need to start bookkeeping until they have income to report – this is not the case. Begin tracking all your transactions from the start. As soon as you pay for something like a website or business cards, you have a transaction that affects your financial statements.

Let's look at some sample daily transactions to see how they would affect your financial statements:

- You receive $25,000 from a loan to finance your business. As a result, your bank account assets on your balance sheet will increase by $25,000. At the same time though, your liability to the lender will also increase by $25,000. What does this mean? In effect, you're no further ahead at this point as you've neither earned money nor incurred an expense so your net worth has not changed.
- You buy a piece of equipment. The cost is $1,800. Your bank account on the balance sheet will decrease by $1,800 but your equipment asset value will increase by $1,800. This makes no difference to your net worth.
- You sell gift cards to your store for $150. Your bank account asset goes up by $150 because you received cash, but now you owe goods or services for that value. You have to track that new liability on the balance sheet.

Note that NONE of these transactions have affected your income statement.

Now, let's look at some transactions that would affect your income statement:

- You record sales of $2,000. The revenue line on your income statement will increase by $2,000 and the value of your bank account on the balance sheet will increase by $2,000. Yay, you made money!
- You pay rent of $750 for your workspace. Your rent expense account on your income statement increases by $750 and your bank account on the balance sheet decreases by $750.
- You hire an employee and pay her wages of $600. Your wages expense account on the income statement increases by $600 and your bank account on the balance sheet decreases by $600

Note that all of these income statement transactions affected the balance sheet.

It's vital to understand how day-to-day transactions affect your cash flow and your ability to pay your bills. Remember, your bottom line and your net worth typically change on a daily basis.

PART FOUR

PLANNING TO GROW

Businesses almost always grow or shrink. Planning and tracking key performance indicators will help yours thrive.

One area that requires close tracking is payables and receivables. Ensuring your customers pay invoices on time and paying your suppliers' bills promptly are two of the most important indicators of your success.

- If you own a retail store, you probably have no receivables. After all, customers normally pay for items before they leave, rather than taking an invoice to pay in 30 days.
- If you provide a service, you may issue customer invoices to be paid after the service has been completed. For example, a small restaurant won't have receivables for daily sales, though if the same restaurant does catering, it may issue an invoice that is due to be paid after the service has been provided. This is a **receivable**.
- Likewise, some of your expenses may be paid immediately (e.g. when you go to the office supply store to buy paper).
- Many other expenses will be **payables** (i.e. you receive a bill to be paid within a certain time). For example, utility companies and service providers often issue bills that need to be paid.

Tip: set payment terms with your customers so that you can be sure you receive the money to pay your own bills before they come due. Some businesses offer customers an early payment discount as encouragement.

PART FIVE

STAYING OUT OF TROUBLE

So far, we have covered income statements and balance sheets, but we also have to consider a dreaded word: "taxes." Every business owner has to pay income taxes, but most will also have to pay GST/HST and payroll taxes. These, of course, are a liability and will show on the balance sheet as money owed. Pay attention to these two taxes as they represent money you have collected from customers or employees and you are obligated to pass on a portion to the government. Never think of this as your money.

Sales Taxes

Familiarize yourself with the following questions and answers:

Q: Who has to charge and collect GST/HST?

A: Any business who taxable sales equal more than $30,000 in four consecutive quarters.

Q: How does charging GST/HST on sales, and paying GST/HST on expenses, affect your financial statements?

A: Here are a couple of examples of transactions with sales tax on them:

- You record a sale of $1,130, including GST/HST of $130. Your revenue on your income statement only increases by $1,000. At the same time, on the balance sheet your bank account asset increases by the $1,130, but your tax liability increases by $130. So, your net worth has increased by only $1,000

- You make a purchase of $226, including GST/HST. This will show on your income statement as an expense of $200, while at the same time your tax liability decreases by $26. This is because you can claim the GST/HST you paid out before you remit the GST/HST to the government.

Payroll Taxes

If your business pays employees, the government requires you to withhold income taxes, CPP and EI from them. In addition, you, as an employer, have to pay employers' contributions to CPP and EI. These payroll liabilities will show on the balance sheet and are due to be reported and remitted to the government by the 15th of the month following the month they were collected in.

QUIZ

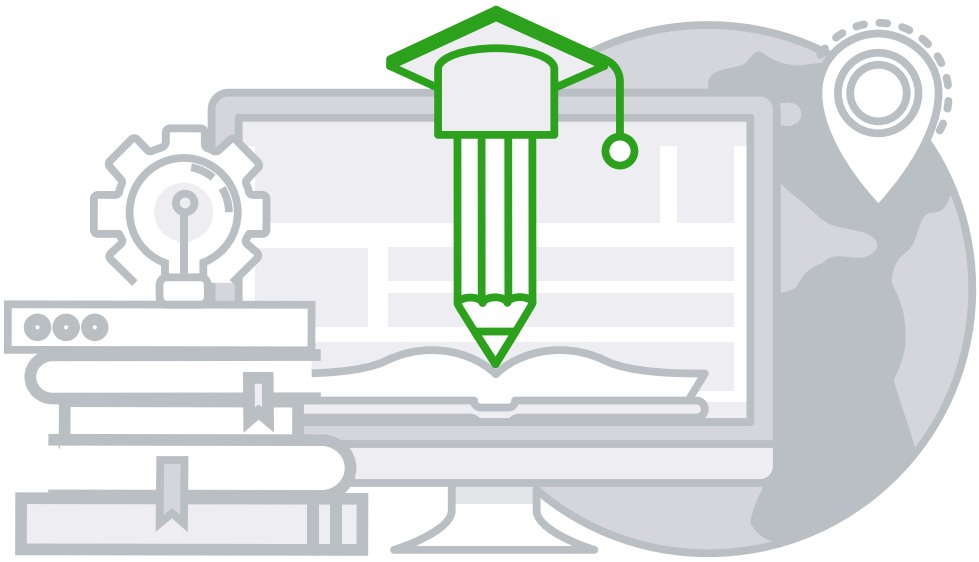
Now, put your new knowledge to the test. Ask yourself which accounts and which financial statements would be affected by the following transactions:

NOTE: Answers can be found on page 14

- You use your credit card to pay $65 at the office supply store.
- Your business records daily sales of $2260, including HST of $260.
- You sell a $150 gift certificate for use in your store.
- You make a payment of $275 against the principal of a loan you've taken out.
- You pay $1,000 towards your credit card balance.
- You pay $75 by automatic debit for gas for the company van.

CLOSING

While your finances may not seem like the most exciting part of your entrepreneurial journey, they will determine your success or failure. By applying what you have learned in this eBook and staying on top of your books, you will best position yourself for the future. Good luck!



QUIZ ANSWERS

How does your financial knowledge stack up? Refer to the answers below to see how you did on the quiz.

• You use your credit card to pay $65 at the office supply store.

The office expenses account on the income statement will increase by $65, AND the credit card liability account on the balance sheet will increase by $65.

• Your business records daily sales of $2260, including HST of $260.

The sales income account on the income statement will increase by $2000, the GST/HST liability account on the balance sheet will increase by $260, AND your bank asset account on the balance sheet will increase by $2260.

• You sell a $150 gift certificate for use in your store.

The gift card liability account on the balance sheet will increase by $150, AND your bank asset account on the balance sheet will increase by $150.

• You make a payment of $275 against the principal of a loan you've taken out.

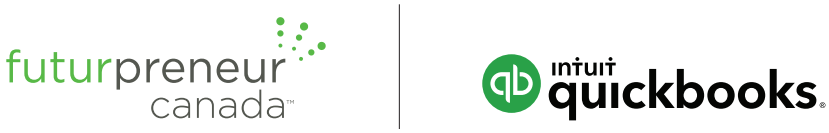
The bank asset account on the balance sheet will decrease by $275, AND the loan liability account on the balance sheet will also decrease by $275.

• You pay $1,000 towards your credit card balance.

The bank asset account on the balance sheet will decrease by $1000, AND the credit card liability account on the balance sheet will decrease by $1000.

• You pay $75 by automatic debit for gas for the company van.

The fuel expense account on the income statement increases by $75, AND the bank asset account on the balance sheet decreases by $75.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