LAFAYETTE

Financial Projections And Other Lies Entrepreneurs Tell

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IPrize 2016 Education Series

What Kind of Financial Information is Important?

Sales (Both amount and rate of change)
Expenses (Both amount and rate of change)
How much do we owe others
How much do others owe us
What is the company worth (book v. market)
Can we continue? Are we “liquid”?
Do we have any cash?
Internal v. External Measurements
What happened v. What we project will happen

Critical Financial Statements

- Income Statement (aka P & L)
- Balance Sheet
- Cash Flow Statement

Generally Accepted Accounting Principles (GAAP) – SEC + FASB (1934)

Why create standards?

Critical Financial Statements

Accounting Reporting

- Compilation- *Preparing financial statements of private entities based on information provided by the entity's management.*
- *Review - Inquiry and analytical procedures applied to financial statements of private entities.*
- *Audit - Includes such procedures as confirmation with outside parties, observation of inventories, and testing selected transactions by examining supporting documents.*

Income Statement
(aka Profit & Loss Statement)
(aka P&L)

- Tells a story *over a period of time* (monthly, quarterly, yearly)
- Provides information on an *accrual* basis
  - Events are “recognized” as they happen, without regard to cash changing hands

- Income Statement (aka P & L) Major Terms
  - Sales
  - Revenues
  - Cost of Goods Sold
  - Gross Profit, Gross Margin
  - Sales, General, Administrative
  - EBITDA
  - Net Profit

Sales or Revenue?

- Sales is usually the main type of revenue
- Revenue is also known as the “top line”
- Sales Revenue is accounted for as sales transactions occur…aka “revenue recognition”
- Became tricky for software and other subscription services…revenue recognized as service delivered (software licenses).
- Net Revenue vs. Gross Revenue

Cost of Goods Sold

- aka “cost of revenue” or “cost of sales”
- Entire courses that focus on accounting for this…
- Often viewed as variable costs or direct costs
- Labor, material, overhead “allocated” directly to sales revenues.

Gross Profit, Gross Margin

Make a Sale:	$200,000 ($100k/yr--2yr)
Sales Revenue Yr. 1:	$100,000
Sales Commission:	- $10,000
Net Revenue:	=$90,000
Cost of Goods Sold:	
(Cost of Revenue):	- $50,000
Gross Profit:	**=$40,000**
Gross Margin:	*40% ($40,000/$100,000)*

* Sales minus Revenues can be viewed as “backlog”…in this case $100,000.

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Sales, General, Administrative (Expenses)

- “Indirect” costs of items like: marketing, Research and Development, facility expenses, administrative expenses, management expenses
- “Fixed costs”…in other words, not variable with the level of sales.
- Strategically, “lumpy”

EBITDA, Net Profit

Gross Profit:		$40,000
S,G,A expenses:	-	$50,000
EBITDA:	=	($10,000)
Depreciation/Amort.	-	$1,000
EBIT:	=	($11,000)
Interest, Taxes:	-	$1,000
Net Income (Loss)	**=**	**($12,000)**

http://finance.yahoo.com/q/is?s=TXN&annual

Balance Sheet

- Tells the story as of a moment in time (ie., March 31, Year End)
- Provides a picture of the liquidity and worth of the business
- Called “balance” sheet because:

Assets = Liabilities + Net Worth

aka

What I have = What I “borrowed” to buy + What I’ve already paid for.

Balance Sheet

- Assets
  - Short Term Assets
    - Cash and Equivalents
    - Accounts Receivable
    - Inventory
  - Long Term Assets
    - Building and Equipment (less depreciation)
    - IP costs
- Liabilities
  - Accounts Payable, Wages Payable
  - Short Term Debts

Balance Sheet

- Liabilities
  - Short Term Liabilities
    - Accounts Payable, Wages Payable, Taxes Payable
    - Short Term Debts
    - Current Portion of Long Term Debt
  - Long Term Liabilities
- Net Worth
  - Retained Earnings (Losses)
  - Capitalization (Equity)

Balance Sheet

January 1, 2010

Assets:	Cash $100,000
Liabilities:	None $0
Net Worth:	Capitalization $100,000

Balance Sheet
January 31, 2010

Assets:	$150,000	
Cash		$51,000
Accounts Rec.		$50,000
Inventory		$30,000
IP (net of amort.)		$19,000
Liabilities:	$62,000	
Wages Payable		$25,000
Accounts Payable		$30,000
Short Term Loan		$7,000
Net Worth:	$88,000	
Capitalization		$100,000
Retained Earnings (Loss)		($12,000)

Cash Flow Statement

- Cash is King – Only Cash Pays the Bills
- Cash flow statement tells a story over time
  - (Monthly, Quarterly, Annually)
- Reconciles accrued information between P&L and Balance Sheet with... Cash balance.

Cash Flow Statement

- Three Sections of Cash Flow Statements
  - – Cash flows from Operations
    - “*Churn of the Business*”
  - – Cash flows from Investing
  - – Cash flows from Financing

Cash Flow Statement

– Cash flows from Operations - confusing flow of CA$H.

– Increases and Decreases in accrued accounts may have a different effect on cash:

- Depreciation
- +/- in Inventory, Accounts Receivable
- +/- in Payables

SIMPLE EXAMPLE:
Accrual → Cash
Open for business on January 1

January 5, place an order for $30,000 in goods with a credit card (A/P up by $30k).

January 15, sell goods for $50,000, allowing 30 days for payment (A/R up by $50k).

January Income Statement thinks you spent $30,000 and earned $50,000 for Net Income of $20,000…but

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…Cash Flow Statement thinks nothing has changed.

Beginning Cash:	\$100,000
Cash from Operating Activities:	
Net Income	+\$20,000
Δ Accounts Receivable	-\$50,000
Δ Accounts Payable	+\$30,000
Cash Provided by Operations:	\$0
Ending Cash:	\$100,000

…BACK TO OUR STORY…

Cash Flow from Operations

Beginning Cash (Jan. 1)		$100,000
Net Income :	($12,000)	
Depreciation	$1000	
∆ Acct. Rec.	($50,000)	
∆ Inventory	($30,000)	
∆ Wages Payable	$25,000	
∆ Accts. Payable	$30,000	
∆ in Cash from Operations		($36,000)

Cash Flow from Investing Activities

Investment in Fixed Assets	$0
Investment in Land, Building	$0
Δ IP	($20,000)

Cash Flow from Financing Activities

Additional Equity Invested	\$0
Δ Short Term Borrowing	\$7,000

Operations and Finance

Beginning Cash (Jan. 1)		**$100,000**
Net Income:	($12,000)	
Depreciation	$1,000	
∆ Acct. Rec.	($50,000)	
∆ Inventory	($30,000)	
∆ Wages Payable	$25,000	
∆ Accts. Payable	$30,000	
Cash from Operations		**($36,000)**
Investment in Fixed Assets	$0	
Investment in Land, Building	$0	
∆ IP	($20,000)	
Cash Flow from Investing Activities		**($20,000)**
Additional Equity Invested	$0	
∆ Short Term Borrowing	$7,000	
Cash Flow from Financing Activities		**$7,000**
Ending Cash (Jan. 31)		**$51,000**

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