



**Littleton  
Advisory  
Group**

Navigating Your  
Business Journey  
Together

# HOW TO READ YOUR FINANCIAL STATEMENTS

## A SMALL BUSINESS GUIDE



### Income Statement

Shows income, expenses, and profit over a period



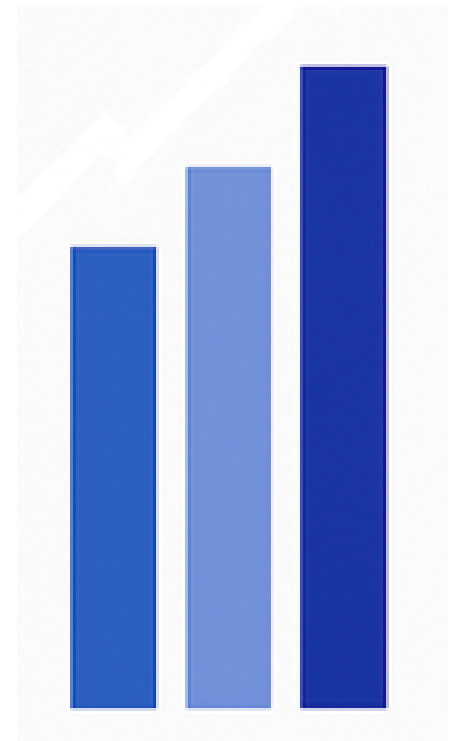
### Balance Sheet

Gives a snapshot of what you own, owe, and how much you have invested in your company



### Cash Flow

Tracks the flow of incoming and outgoing cash



# INCOME STATEMENT / PROFIT & LOSS

Net Sales \$100,000

Total revenue earned after subtracting returns, discounts, & allowances from gross sales.

Cost of Goods Sold -\$45,000.00

Direct costs like materials or labor necessary to provide what you sell

Gross Profit \$55,000.00

This shows how profitable you are after paying for the goods/services you sold

Operating Expenses -\$30,000.00

Day-to-day costs of running your business: software, rent, etc.

Net Operating Income \$25,000.00

Shows how much money you have earned after paying for main expenses

Taxes -\$5,250.00

If your company is NOT a pass-through entity, it pays taxes

Net Income \$19,750.00

What is remaining after subtracting expenses from net sales.

# INCOME STATEMENT / PROFIT & LOSS



The P/L Statement comes in several different formats.



This report can be ran for any time period.



Cash basis records when money changes hands



Accrual basis records when transactions are earned or incurred, not when paid.



A business can earn money but have no cash inflow



P/L does NOT list liability payments (loans, credit card payments, etc)



Owner's draws do NOT appear on the P/L



Profitable businesses can have a negative cash flow.



Pass-through entities don't pay income taxes. The owner's pay it.



Nonoperating income/expenses will appear in separate section.

# BALANCE SHEET

## ASSETS

### Current Assets

Checking	\$15,000.00
Accounts Receivable	<u>\$13,000.00</u>
Total Current Assets	\$28,000.00

### Fixed Assets

Computers	\$4,000.00
Building	<u>175,000.00</u>
Total Fixed Assets	\$179,000.00

### Total Assets

\$207,000.00

Assets are what you own, divided into current and long-term (fixed)

Must equal L+E

## LIABILITIES & EQUITY

### Current Liabilities

Accounts Payable	\$3,000.00
Payroll Tax	<u>\$2,200.00</u>
Total Current Liabilities	\$5,200.00

### Long-term Liabilities

Mortgage	<u>\$155,000.00</u>
Total Liabilities	\$160,200.00

Liabilities are what you owe, divided into current and long-term

### Equity

Owner's Contribution	\$27,050.00
Retain Earnings	<u>\$19,750.00</u>
Total Equity	\$46,800.00

Equity represents a combo of what money you have in the company and the accumulated net earnings

### TOTAL LIABILITIES & EQUITY

\$207,000.00

Must equal Assets

# BALANCE SHEET



Assets are listed in order of liquidity.



High cash balances do not always mean things are healthy.



Loan principal repayments reduce liabilities. The interest appears on P/L



Depreciation reduces the value of assets over time.



Prepaid expenses are assets as they have future value.



Payments received for services/goods yet provided are liabilities.



Equity shows what owners truly own once things are paid.



Retained earnings shows the accumulated net profits



Negative equity may indicate the owner has taken out too much money



Financial ratios are the key to understanding the balance sheet.

# Cash Statement

This sample report uses the Indirect Method which starts with Net Income and backs out or adds info from the balance sheet to allow us to arrive at the ending cashing balance.

## Cash Flows From Operating Activities

Net Income	\$19,750.00
Adjustments	
Increase in A/R	-\$3,000.00
Increase in A/P	\$1,000.00
Decrease in Payroll Tax Payable	<u>-\$300.00</u>
Net Cash from Operating Activities	\$17,450.00

The Operating Section makes adjustment for noncash activities related to the day-to-day operations. An increase in A/R means that money was included as part of the net income but was never received. An increase in A/P means that credit was used instead of cash to cover expenses that reduced the income.

## Cash Flows from Investing Activities

Purchase of Fixed Assets	<u>-\$29,500.00</u>
Net Cash Used in Investing Activities	-\$29,500.00

The Investing Activities covers cash used for buying or selling fixed assets.

## Cash Flows from Financing Activities

Owner's Capital Contribution	\$17,050.00
Mortgage repayment	<u>-\$9,750.00</u>
Net Cash Used in Financing Activities	\$7,300.00
Total Net Increase/Decrease	-\$4,750.00

The Financing Activities covers cash used for cash from loans, owner contributions, or distributions

The Net Cash shows how much increase or decrease to cash occurred.

Beginning Cash	\$0.00
Ending Cash	\$15,000.00

The Ending Cash will match the cash balance on the Balance Sheet.

# Cash Statement



The direct method of cash flow shows actual cash collected and paid — it's clearer but harder to prepare without detailed transaction records.



Positive net income with negative cash flow could signal major cash traps — like unpaid invoices or high inventory.



Cash flow from operations should be consistently positive — it's the best sign of a healthy business.



Loan payments show up in two places: interest in operating cash flow, principal in financing activities.



Cash flow helps determine how many months of expenses you can cover — a key survival metric.



Comparing cash flow to profit helps you catch timing issues in billing or collections.



You can be profitable and still run out of cash — that's why investors and lenders often ask for cash flow projections, not just income statements.



Inventory purchases don't show up on the income statement until sold — but they immediately reduce cash on the cash flow statement



A growing accounts receivable balance means your customers owe you more — which can hurt your cash flow even if sales look strong.



Depreciation is a non-cash expense — it reduces your profit but doesn't affect your cash flow directly.