

Understanding Financial Statements

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Who are the users of Financial Statements?

- Owners – Yes, REALLY!!!
- Lenders – Like to see year to year (comparative) statements
- Investors
- Tax Preparers

**A+ Tutors Inc.
Profit & Loss Statement
For the year ending
August 31, 2012**

REVENUE

Sales

EXPENSES

Advertising
Amortization
Bank fees and interest
Computer Repair
Payroll
Rent
Supplies
Utilities & Telephone

NET INCOME (LOSS)

- Shows income (revenue)
- Shows expenses
- P&L Statement covers a period (month, quarter or year). Think video!
- Hopefully more revenues than expenses = net income



**A+ Tutors Inc.
Balance Sheet
As at August 31, 2012**

ASSETS

Bank (Cash)
Accounts Receivable
Deposits
Fixed Assets

LIABILITIES

Accounts Payable
Loans
Gift Cards
Shareholder Loan

EQUITY

Shares
Retained Earnings

- A Balance Sheet shows values at a point (day) in time and NOT over a period. Think Camera!



- A Balance Sheet Balances!
- $\text{Assets} = \text{Liabilities} + \text{Equity}$

**A+ Tutor's Inc.
Balance Sheet
As at August 31, 2012**

ASSETS

Cash	1,000
Accounts Receivable	1,500
Inventory	400
Fixed Assets	<u>4,100</u>
TOTAL ASSETS	7,000

LIABILITIES

Accounts Payable	700
Wages Payable	1,300
GST Payable	225
Loan Payable	<u>3,275</u>
TOTAL LIABILITIES	5,500

EQUITY

Shares	200
Retained Earnings	<u>1,300</u>
TOTAL EQUITY	1,500

Assets = Liabilities + Equity

$$7,000 = 5,500 + 1,500$$

It Balances!!!



What are Retained Earnings (R/E)?

- The accumulation of previous years' net incomes or net losses.
- Each year, the income or loss is added to the R/E beginning balance.
- Negative R/E tells us the company has not been profitable.

The P&L and Balance Sheet “Hold Hands!”



**A+ Tutors Inc.
Profit and Loss Statement
For the year ending Aug 31, 2012**

Revenue
Sales

Expenses

Advertising
Amortization
Bank fees and interest
Computer Repair
Payroll
Rent
Supplies
Utilities & Telephone

Net Income (loss) \$1,300

**A+ Tutors Inc.
Balance Sheet
As at Aug 31, 2012**

ASSETS

Cash
Accounts Receivable
Inventory
Fixed Assets

TOTAL ASSETS

LIABILITIES

Accounts Payable
Wages Payable
GST Payable
Loan Payable

TOTAL LIABILITIES

EQUITY

Shares
Retained Earnings \$1,300

What If Revenue Increases by \$200? (Remember: Assets = Liabilities + Equity)

A+ Tutors Inc. Profit and Loss Statement For the year ending Aug 31, 2012

Revenue
Sales

 **\$200**

Expenses

Advertising
Amortization
Bank fees and interest
Computer Repair
Payroll
Rent
Supplies
Utilities & Telephone

Net Income (loss) **\$1,300+\$200**

A+ Tutors Inc. Balance Sheet As at Aug 31, 2012

ASSETS

Cash  **\$200**

Accounts Receivable

Inventory

Fixed Assets

TOTAL ASSETS

LIABILITIES

Accounts Payable

Wages Payable

GST Payable

Loan Payable

TOTAL LIABILITIES

EQUITY

Shares

Retained Earnings **\$1,300 + \$200**



What if Expenses Increase by \$1000?

(Remember: Assets = Liabilities + Equity)

A+ Tutors Inc. Profit and Loss Statement For the year ending Aug 31, 2012

Revenue
Sales

Expenses

Advertising
Amortization
Bank fees and interest
Computer Repair
Payroll
Rent
Supplies
Utilities & Telephone

 +\$1,000

Net Income (loss) \$1,300  \$1,000

A+ Tutors Inc. Balance Sheet As at Aug 31, 2012

ASSETS

Cash
Accounts Receivable
Inventory
Fixed Assets

 \$1,000

TOTAL ASSETS


LIABILITIES

Accounts Payable
Wages Payable
GST Payable
Loan Payable



TOTAL LIABILITIES

EQUITY

Shares
Retained Earnings \$1,300  \$1,000

★ NEW OFFICE FURNITURE COST \$4000

● Yearly amortization is \$400

A+ Tutors Inc. Profit and Loss Statement For the year ending Aug 31, 2012

Revenue
Sales

Expenses

Advertising
Amortization +\$400 ●
Bank fees and interest
Computer Repair
Payroll
Rent
Supplies
Utilities & Telephone

Net Income (loss) \$1,300 - \$400

A+ Tutors Inc. Balance Sheet As at Aug 31, 2012

ASSETS

Cash
Accounts Receivable
Inventory
Fixed Assets + \$4000 ★
- \$400 ●

TOTAL ASSETS

LIABILITIES

Accounts Payable
Wages Payable
GST Payable
Loan Payable + \$4000 ★

TOTAL LIABILITIES

EQUITY

Shares
Retained Earnings \$1,300 - \$400

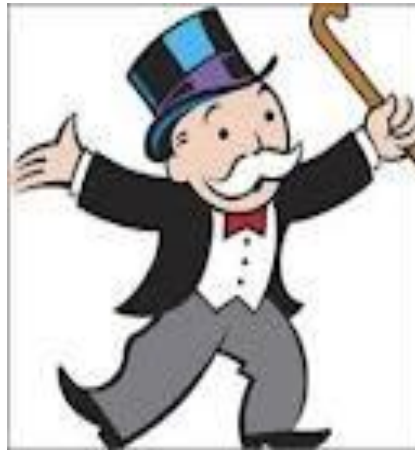
Points to remember about revenue and expenses – Accrual Accounting!!

- Revenues are recorded when **EARNED** and **NOT** when \$\$ is received!
– Called the Revenue Recognition Principle!

- Expenses are to be matched to the period when **INCURRED** and **NOT** when **PAID**
– Called the Matching Principle! Also to be matched to the revenue it helped generate!!

What do Banks look at?

- ?
- ?
- ?
- ?
- ?



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5 Key Areas ...

- Industry
- Company
- Management
- Financial Performance
- Access to Capital



Industry

- Is it growing? (coffee / fast foods)
- Is it stagnant or flat? (car/gas services)
- Is it in decline? (bagel shops/video stores)

- Are there big players who pose a threat?
- Is there new technology that poses an opportunity or a threat?



Company

- Where is the company within the industry?
- Is this Mom + Pop's Coffee House?
- Or ... a Tim Horton's franchise?
- Is there a niche that gives a competitive advantage?
 - McDiarmid Lumber vs. Home Depot
 - Rae & Jerry's vs. Earl's, Joey's or Moxie's



Management

- What business experience do they have?
- What industry experience do they have?
- Is there 1 key player or more?
- Have they ever managed through a downturn?
- Do they have an advisory group?



Financial Statements

- Are revenues trending up or down?
- Are margins trending up or down?
- Assets vs. Liabilities?
- Equity vs. Liabilities?
- Are earnings sufficient to pay obligations?
- Are they prepared to reduce taxes or to increase the value of the company?



Access to Capital

- If tough times are encountered where will needed funds come from?
 - The owner?
 - The Bank?
 - Suppliers?
 - Family / Friends



Thank You!

