

Video Transcript: "Understanding Financial Statements and Accounting"

[https://youtu.be/ HK5ggg39pY](https://youtu.be/HK5ggg39pY)

Anna Akana: [00:00:00] You know what conversation starter will make you the life of the party? Spreadsheets. Maybe not unless it's a wild accounting party or if everyone really loves math. Even then. Honestly, spreadsheets are the vegetables of the business world. The very idea of them makes some people queasy, but that is okay. Yes, they can be intimidating, but they're not impossible to understand. Today, we're going to learn to love them because basic accounting can make or break a business. If we lose track of expenses or overestimate a revenue stream, we might end up questioning where all the money has gone. The key is using organized systems and knowing the right vocabulary. By the end of this episode we will be bookkeeping pros or at least able to talk about balance sheets and profitability with an accountant. I'm Anna Akana and this is Crash Course Business Entrepreneurship.

[00:01:00] Every entrepreneur has to seriously think about how we're going to take in money and where we're going to put it. The place and it could be a digital place where customers hand over money in exchange for a product or service is called the point of sale. Cash registers, credit card machines, the checkout page on a website. These are all points of sale. Now we want to make the buying process as painless as possible, so customers will feel good about doing business with us. Having a seamless point of sale system is a big part of that. Here are a few options. Some of the most popular electronic systems are created by Shopify, Square, and Paypal. Both Shopify and Square help you set up e-commerce sites and have hardware to use in physical stores to register sales. Paypal is an online checkout system that makes it really easy for customers to make purchases. These are great options for entrepreneurs with a lot of transactions or who are selling a product.

If your business isn't set up for immediate [00:02:00] transactions, you can send customers invoices, basically itemized records to get paid. Many freelancers do this. Customers may want to pay by credit cards so you might still look into one of those systems that we mentioned. If you're using a system that can process credit cards, there will probably be a 2-4 percent processing fee. You'll want to take that extra cost into account when pricing your products.

Then of course, we're going to need somewhere to put all the revenue like a business bank account. This is just like a personal account, except it has a business name on it. Unless your personal account is just under your mattress, in which case it's very different. This move is all about organization. Imagine scrolling through your transaction history. If you only had one account for both you and your business, it is just a swamp of latte receipts, supply runs, grocery bills, production costs, cat litter and more. Some of those were personal lattes and some were business lattes. When tax season rolls around in a few months, are you really going to be able to remember the difference? No.

Most importantly, we [00:03:00] want to be able to tell at a glance the financial health of our business. If calculating profit becomes a guess and check, walk through of every purchase we've made this year, that simple revenue minus expenses equation is suddenly much more complicated. To get set up in the United States you'll need your tax identification number, the official name your company is operating as, and most likely proof from your secretary of state as to what business entity you're running. Depending on whether you've decided to be an LLC, a corporation, a co-op, or something else, you may need additional forms. Start with your current bank and see what they offer for business accounts, but do not be afraid to shop around. Can you find free checking, free savings, better loyalty rewards?

After getting money from customers and storing it safely, we want to keep track of how much we have and how much we've spent and some idea of how well we're doing would also be nice. We can track almost anything and make tons of beautiful graphs, but there are three essential reports to measure our businesses [00:04:00] financial success. These three reports are also well understood by other business people who might be trying to help us out in the future.

An income statement, sometimes called a Profit and Loss Statement, or PNL, is a report that shows how much money we've spent and how much we've made during some period of time, usually a month or a year. Basically, it tracks the total revenue, total cost of goods sold, the total expenses, and comes up with our net income at the bottom. Which is total revenue minus cost of goods sold, minus selling general and administrative expenses, minus all our other expenses like depreciation of equipment or taxes. It is important to write down every revenue stream and every expense, so we are getting a complete picture of what our net income is.

The second report is a balance sheet. This is a snapshot of our businesses financial health at any point in time. On the income statement, we looked at just December or just 2019. But here we're looking at [00:05:00] all of our money for all time. There are three sections. The balance sheet will show our assets, not just our cash, but anything we could convert into cash within one year, like property, equipment investments or intellectual property. Assets are broken up into two categories. Current assets or anything we could convert into cash within one year, like cash or inventory. Fixed assets are purchased for long term use, so we probably can't convert them quickly into cash, like land or buildings. It also shows our liabilities, all our financial obligations and debts like loans, mortgages, revenue we're waiting on, and expenses. Like with assets, liabilities are broken up into two categories. Current liabilities are debts that must be satisfied within one year from the balance sheet date. Long term liabilities are debts that aren't due within one year of the date of the balance sheet like mortgages. It shows our equity or the amount of money that would be returned to our shareholders if all [00:06:00] of our assets were turned into cash and all of our debt was paid off. Many of us may not have shareholders yet, but we may have a friend or family member lying around that we just got to pay back. These three things balance, hence the name balance sheet. Equity is really just assets minus liabilities, which we rearrange to make the business equation assets equals equity plus liability.

Finally, the third statement we should be familiar with is a cash flow statement. Which tells us how much money has moved in and out of our business in a specific time period. Again, like a month or a year. There are three sections to this statement too. The operations cash flow shows how much cash was spent or earned from running the business. This includes revenue, expenses, and taxes. The investment cash flow shows how much our business sold or spent on property, plant and equipment, or PP&E. This is stuff like selling old equipment or purchasing a new building. The financial cash flow shows the amount of [00:07:00] money our business got in loans or paid in dividends to shareholders. Now we can remember these three sections with a made up word OIF. All three are added up to show the net cash flow for our business. Since we're looking at a specific snapshot and time, we can add in whatever cash we had from before to see the total amount of cash our business is sitting on.

Let's look at an example in the thought bubble. Ronnie has his own event planning business, and this year he's planning some weddings, insignias, bar mitzvahs, and fancy pool parties. But is his business doing well? On his income statement for January through April, we see he paid for SG&A costs like his website and his monthly accounting software subscription, but he had revenue from planning three events. His net income is positive, meaning he made a profit for these months. Nice. On his balance sheet, we can see that he received a bank loan, which is a liability. This loan is considered a current

liability if it will be paid off within a year of the balance sheet date, otherwise [00:08:00] it would be a long term liability. He spent almost all of this cash from the loan on event decor and a tech set up, a computer and tablet, and one of those headset things all the official event planners seem to have. All of this stuff, plus any cash he has from his net income are his assets. Now to calculate Ronnie's equity, we subtract the total liabilities from the total assets and there's how much he actually owns. Boom, balance. Finally, on his cash flow statement, we see three categories. The operations cash flow includes revenue from his customers and any cash left over from the loan. His operations cash flow is positive. The investment cash flow includes the money he spent purchasing new decorations and upgrading his tech setup. Since he didn't earn any money here his investment cash flow is negative. The financial cash flow has the bank loan that funded all of his upgrades. His financial cash flow is positive because that money came into his business. Overall Ronnie's making money though he does still need to pay off that bank loan. [00:09:00] Hopefully that new decor and tech will get him even more business. Thanks, thought bubble.

To create these statements, we can make our own spreadsheet for free, but that might require a lot of data [LAUGHTER] entry. Spreadsheet fun. I actually really like spreadsheets, so it is fun. Accounting software can be really efficient and depending on our price range, many accounting software systems have options for generating invoices and can play nice with our point of sale system. Since many people are intimidated by anything accounting related, not me, of course. There are tons of great choices. HubSpot has collected a list with a quick analysis and cost breakdown, and we can put a link in the description for you. Some of the most common choices are quickbooks, FreshBooks, and Xero. Quickbooks is buy into it. The same company that creates turbotax and is probably the most well known software for businesses. It can invoice people and interacts with many point of sale systems. FreshBooks is also popular and offers very similar options to Quickbooks, but it's usually recommended for subscription based businesses. [00:10:00] Xero is what Square recommends. If you're using Square as your point of sale system, you might try xero because they work really well together and pricing can be a bit friendlier. Do your research to make sure whatever you pick works well with the systems you already have. But ultimately you'll get very similar results with any of these.

As we make more money, we might want to bring on a key partner, like a bookkeeper to handle the data, or an accountant to manage projects and taxes. There are even services like Bench or SLC, book keeping, that will act as virtual accountants, but a local firm will also be glad to help you. If this is the path you want to take, you should still review your income statements, balance sheets and cash flow statements regularly, and know what they say. This is all the behind the scenes action of your business and you don't want to miss out or get taken advantage of. Remember, you are in charge. Consult everyone you need to understand reports and strategize, but make sure that you are still the one making the final call. We have these three reports as printouts or PDFs, but how exactly do we read them?

[00:11:00]

Speaker 1: Go ahead.

[00:11:01]

Anna Akana: This is my gross margin is half my dividend payout ratio. That can't be right. There are hundreds of different metrics we can use to see how efficient and profitable our company is called accounting ratios. Because there are so many of these, we suggest pulling up our old friend Investopedia to research on what could matter to your business. This is where finding a key partner who knows their

stuff can really help. Finally, we'll say it again, do not forget to file your taxes. You'll probably have to submit one or more of your financial reports along with the tax forms, but good thing you're prepared.

Depending on the country and type of business, there will probably be different requirements. In the US, you can find most of what you need online. For federal taxes, visit [irs.gov](https://www.irs.gov). For state taxes, look on your Secretary of State's website or visit your State Department of Revenue. For city or municipal taxes, drop a penny in the town fountain and whistle She'll be [00:12:00] coming around the mountain when she comes. No seriously, you should also check your city's website. The bottom line is on your income statement. [LAUGHTER]

No, but really bookkeeping can be fun. At the very least understandable. Set up systems to manage your revenue and invest in software or people to keep your business organized and profitable. Next time, we'll keep talking about money and look at the funding options for when you're just starting out. Thank you so much for watching Crash Course Business, which is sponsored by Google. Thank you to Thought Cafe for the beautiful graphics.