



aronson LLC
ASSURANCE | TAX | CONSULTING

Expanding What's Possible

ACCOUNTING 101

What Startups & Small Businesses Need to Know

INTRODUCTION

*“As an entrepreneur or small business owner, why do I need to care about ~~bean-counting~~ **accounting**?”*

As an entrepreneur or a small business owner, it's probably safe to say that you have a lot on your plate—from marketing your brand to hiring the right people to building relationships with your customers. At the end of the day, however, your primary job is to drive your business forward. And to do this, you must understand how the money flows in and out of your business.

Every entrepreneur and small business owner should care about accounting because ultimately, this business function provides accurate financial information about your company that is required by investors, financiers, customers, and Uncle Sam.

In this eBook, we provide key information that entrepreneurs and small business owners need to know to make confident, well-informed decisions and achieve your ultimate goal, a sustainable and successful business.

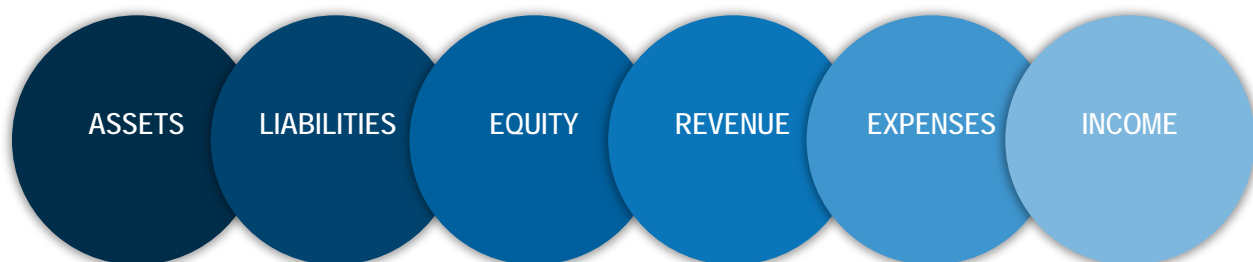
FOUR BASIC FINANCIAL STATEMENTS

Financial accounting information is conveyed through a standardized set of four reports. In a sense, financial statements are the dashboard of your company's financial health. These reports disclose your company's historical financial story and provide information that can help readers gauge your projected future performance. You'll also find lenders and investors will only take your business seriously if these documents are in order.



SIX BASIC ACCOUNTING CONCEPTS

In order to make strategic business decisions using your financial statements, it's important to understand six basic accounting concepts. On the surface, these concepts seem pretty straightforward and intuitive. However, as you can imagine, there are nuances within each that require careful consideration. We'll explore what these words mean and how they fit together on the following pages.



BALANCE SHEET 101

A summary of your company's financial position

The balance sheet provides a snapshot of your business's financial position, as well as displaying what your business owns and owes.

BALANCE SHEET



Resources owned by the company

- Cash
- Inventory
- Accounts receivable
- Equipment

Obligations of the company

- Accounts Payable
- Bank Loans
- Notes Payable
- Salaries Payable
- Taxes Payable

What's left after all the debt has been paid

- Stock
- Retained Earnings

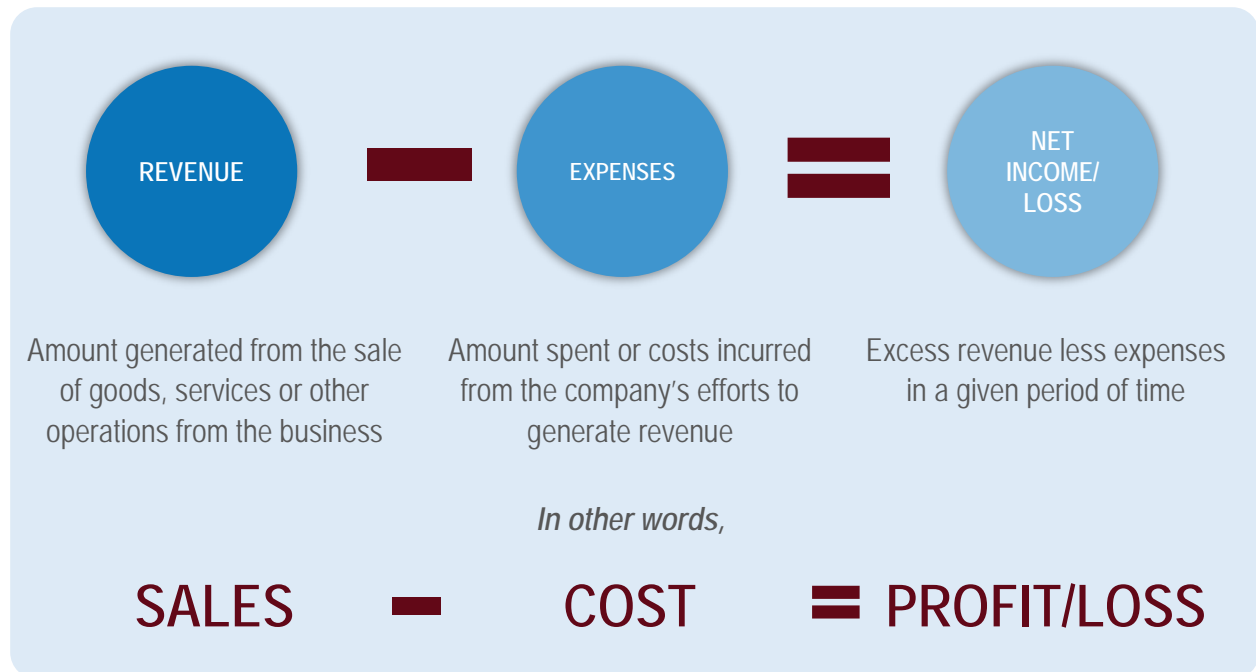
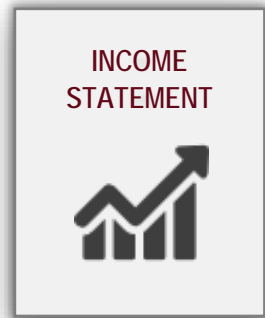
Most balance sheets classify a company's assets and liabilities into distinctive groupings such as current assets, non-current assets, current liabilities, and non-current liabilities. These classifications make the balance sheet more useful.

Company A			
Balance Sheet (in thousands)			
As of December 31, 2018			
ASSETS		LIABILITIES AND EQUITY	
Current Assets:		Current Liabilities:	
Cash	\$20,430	Accounts Payable	\$9,164
Accounts Receivable	5,900	Deferred Revenue	1,000
Prepaid Expenses	28,320	Interest Payable	150
Total Current Assets	54,650	Notes Payable	4,000
		Total Current Liabilities	14,314
Non-Current Assets:		Non-Current Liabilities:	
Equipment	80,000	Notes Payable	16,000
Accumulated Depreciation	-1,100	Total Liabilities	30,314
Net Non-Current Assets	78,900		
		Common Stock	100,000
		Retained Earnings	3,236
		Total Equity	103,236
Total Assets	\$133,550	Total Liabilities and Equity	\$133,550

INCOME STATEMENT 101

A summary of your company's financial performance as reflected in the profitability

The income statement shows a company's "bottom line" over a specific time period such as a year, quarter, or month.



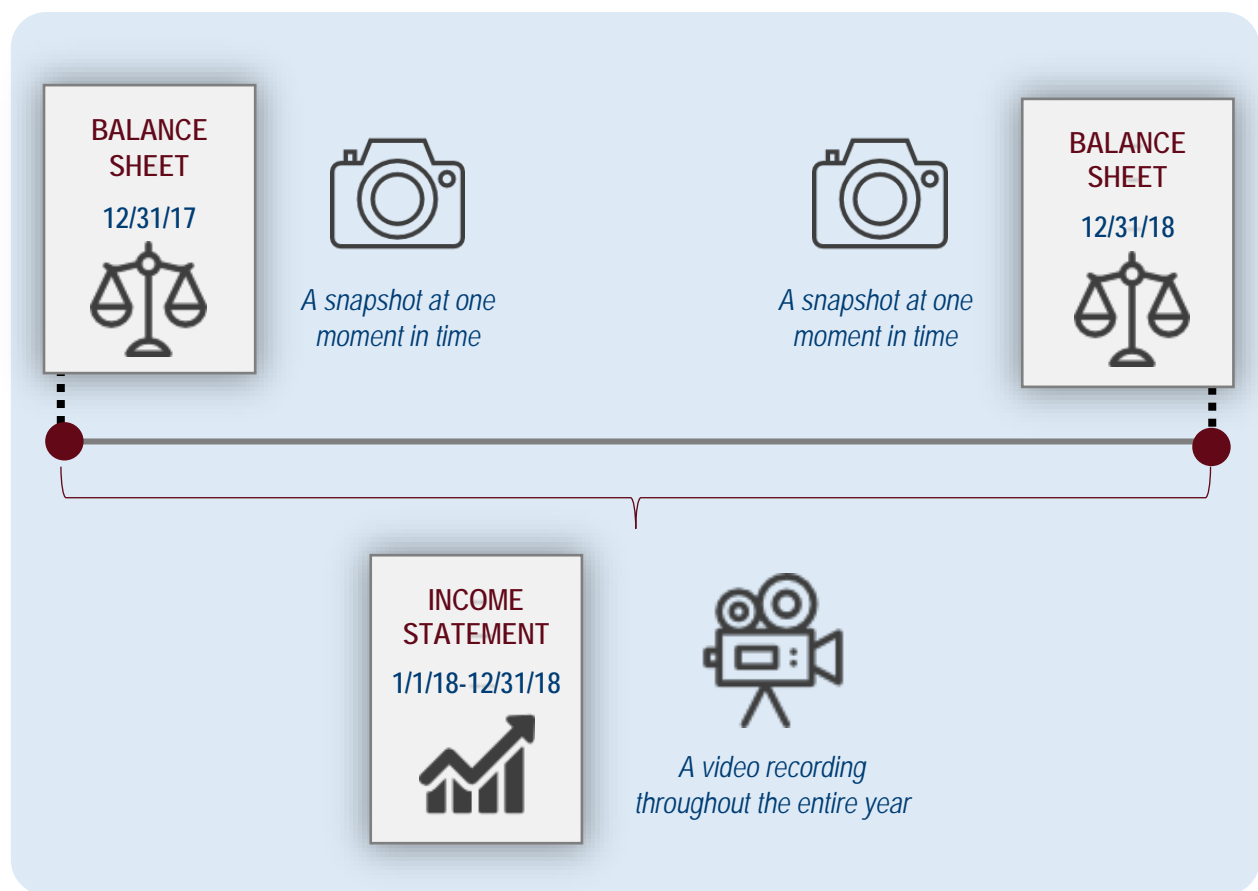
The format of the income statement, also commonly referred to as the "profit and loss statement," will vary according to the complexity of the business activities. If the net amount of revenues and gains minus expenses and losses is positive, the bottom line of the profit and loss statement is labeled as net income. If the net amount (or bottom line) is negative, there is a net loss.

Company A	
Income Statement (in thousands)	
For the year ended December 31, 2018	
Sales	\$85,600
Less: Expenses	
Wages Expense	\$38,200
Supplies Expense	18,480
Rent Expense	12,000
Miscellaneous Expense	3,470
Electricity Expense	2,470
Telephone Expense	1,494
Depreciation Expense	1,100
Interest Expense	150
Total Expenses	<u>-77,364</u>
Net Income	<u>\$8,236</u>

BALANCE SHEET VS. INCOME STATEMENT

Wait... what's the difference between a balance sheet and income statement?

While the balance sheet is a snapshot of your company's financial position at a single point in time, the income statement is like a video camera. It captures all the actions that occurred during a specific time period.



EQUITY STATEMENT 101

A summary of your company's equity activity

An equity statement provides a detail of your company's equity transactions, during a period of time, such as issuance of stock, payment of dividends, and the profit/loss for the reporting period. The equity statement deals with the some of the same concepts as introduced in **Income Statement 101**.

EQUITY STATEMENT



$$\text{CONTRIBUTIONS} - \text{WITHDRAWALS} \pm \text{NET INCOME/LOSS} = \text{EQUITY}$$

- Common Stock
- Preferred Stock
- Conversion of Convertible Notes

- Dividends
- Distributions
- Stock Buybacks

NET
INCOME/
LOSS

The equity statement is primarily useful and prepared for third-party users of the financial statements, such as investors and bankers. Unlike the balance sheet and income statement, it is typically *not* used by management to operate and monitor the business.

Company A
Equity Statement (in thousands)
For the year ended December 31, 2018

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total
	Shares	Amount			
Balance, January 1, 2017	1,000	\$ 1,000	\$ 500,000	\$ 432,600	\$ 933,600
Issuance of common stock	2,000	\$ 2,000	\$ 3,000,000	-	\$ 3,002,000
Net income	-	-	-	\$ 86,732	\$ 86,732
Balance, December 31, 2018	3,000	\$ 3,000	\$ 3,500,000	\$ 519,332	\$ 4,022,332

CASH FLOW STATEMENT 101

A summary of your company's actual inflows and outflows of cash

A cash flow statement tracks the inflow and outflow of cash and cash equivalents over a specific time period such as a year, quarter, or month. Cash flow is determined by looking at three components.

CASH FLOW STATEMENT



$$\begin{array}{l} \text{BEGINNING CASH} \\ \text{BALANCE} \end{array} + \begin{array}{l} \text{OPERATING ACTIVITY} \\ \text{INVESTING ACTIVITY} \\ \text{FINANCING ACTIVITY} \end{array} = \begin{array}{l} \text{ENDING CASH} \\ \text{BALANCE} \end{array}$$

OPERATING ACTIVITY

An activity where the cash effects of transactions generally determine net income.

INVESTING ACTIVITY

An activity such as (1) making or collecting loans or (2) acquiring and disposing of debt or equity investments and property, plant, and equipment, or other productive assets.

FINANCING ACTIVITY

An activity such as (1) obtaining resources from owners and providing them with a return of/on their investment or (2) obtaining resources from creditors and repaying the amounts borrowed.

The cash flow statement format is generally divided into three main sections. In addition to the cash amounts being reported as operating, investing, and financing activities, the cash flow statement must disclose other information, including the amount of interest paid, the amount of income taxes paid, and any significant investing and financing activities which did not require the use of cash.

Company A	
Cash Flow Statement (in thousands)	
For the year ended December 31, 2018	
Cash Flows from Operating Activities:	
Net Income	\$489,000
Depreciation Expense	112,400
Loss on Sale of Equipment	7,300
Gain on Sale of Land	-51,000
Increase in Accounts Receivable	-84,664
Decrease in Prepaid Expenses	8,000
Decrease in Accounts Payable	-97,370
Decrease in Accrued Expenses	-113,860
Net Cash Flow from Operating Activities	\$269,806
Cash Flows from Investing Activities:	
Sale of Equipment	\$89,000
Sale of Land	247,000
Purchase of Equipment	-100,000
Net Cash Flow from Investing Activities	136,000
Cash Flows from Financing Activities:	
Payment of Dividends	-\$90,000
Payment of Bond Payable	-200,000
Net Cash Flow from Financing Activities	-290,000
Net Change in Cash	\$115,806
Beginning Cash Balance	319,730
Ending Cash Balance	\$435,536

FINAL INSIGHTS

Your financial statements tell the story of your business. These four reports can help you spot what is going right and what is going wrong early on. They can help you make more informed and confident decisions on the future of your business. They can even give you a leg up when pitching to lenders and investors.



For these reasons and more, it's critical that you're telling the right story. You can't make good business decisions with bad data, and you won't make a positive impression of your business if your financial statements aren't in good shape.

Since we know you're busy, we'll dive into just a few of the key areas you should focus on a day-to-day basis to help ensure your financial statements are accurate. This list is by no means exhaustive, but touches on some common problem areas.

- It's critically important to understand the differences between a signed contract, backlog, and when revenue is actually earned on the signed contract. Don't make this mistake.
- Ensure all expenses have proper supporting documentation and are for valid business purposes.
- Make sure you maintain proper supporting documentation for all transactions and that these transactions are recorded timely, accurately, and in a level of detail that is meaningful to assist in managing your business.
- Don't forget to prepare and retain executed agreements for all debt and equity transactions, including equity grants to employees.
- Avoid comingling personal and business expenses. It's a bad idea and can have serious business implications.



INTERESTED IN LEARNING MORE?

For more information on the information contained in this eBook or to discuss your business' unique accounting needs, please contact the author, Alan Langelli, CPA, at alangelli@aronsonllc.com or 301.231.6210.



[Alan Langelli](#) is the lead partner of Aronson LLC's Technology Industry Services Group. He provides comprehensive audit, accounting, and consulting services to a diverse group of companies operating in the technology, life sciences, e-commerce, and software industries. Alan is known for his ability to simplify complex business and accounting concepts and help companies achieve their growth objectives through his strategic guidance.

ABOUT ARONSON LLC

Aronson LLC provides a comprehensive platform of assurance, tax, and consulting solutions to today's most active industry sectors and successful individuals. For more than 55 years, we have purposefully expanded our service offerings and deepened our industry specialties to better serve the needs of our clients, people, and community. From startup to exit, we help our clients maximize opportunity, minimize risk, and unlock their full potential. For more information about Aronson LLC, please visit www.aronsonllc.com or call 301.231.6200.