

Module 13 – Financial Statements Explained

When producing financial statements, and particularly the Income Statement, it is important to know the audience who will be using the document. For a business owner, in most cases the more detail the better. A detailed statement will allow the owner to analyze which products or services are creating the most revenue and profit, and where cost savings might be achieved.

Other individuals who are involved in the business may also want to see a certain level of detail but may not want the highly detailed review that would be desired by the owner. A moderate level of detail might make the most sense for these individuals (a Board member for example).

Lastly, although closely held for-profit companies do not typically share financials with the public, non-profits and publicly traded companies do. Members of the general public would typically be shown a document that is summarized into broad categories (Operating Expense, for example), and is not broken out into great detail. In most cases these summarized documents will be satisfactory. Sometimes providing too much detail where it is not necessary will only create additional questions and confusion.

We have included two versions of sample financial statements that have been prepared for a hypothetical rural grocery store. One is fairly detailed and the other is summarized into a format that might be used for the general public. Below is a short description of each of these statements, and a link to the statements can be found at the end of this document.

Income Statement

The income statement covers a range of time, which can be a month, a quarter, a year, or any period desired. Frequently, income statements will be produced showing year-to-date results. The income statement begins by showing sales and other revenues, then cost of goods is subtracted, as are operating expenses and any other expense. The remainder, after subtracting all expense from revenue, is the Net Income, which can be positive or negative.

Balance Sheet

The balance sheet provides an overview of a company's assets, liabilities, and shareholders' equity as of a point in time, as shown by the date at the top of the page. This report is generally viewed at the end of a reporting period (month, quarter, or year).

Assets are shown first on the balance sheet and include items such as current assets (cash and accounts receivable for example) and long-term assets such as equipment, buildings, and vehicles. Long-term assets are sometimes referred to as fixed assets and are assets that will last longer than a year. These assets are depreciated over their useful life.

Liabilities are amounts owed and are also divided into current and long-term accounts. Current liabilities are things like accounts payable and other short-term obligations. Long-term liabilities are often long-term debt. In a healthy business, assets will exceed liabilities.

Owners' equity is a company's total assets minus its total liabilities. Owners' equity represents the amount of money that would be returned to shareholders if all of the assets were liquidated and all of the company's debt was paid off.

An easy way to remember how a balance sheet functions is this: assets are what you own, liabilities are what you owe, and equity is the difference.

Cash Flows Statement

The purpose of a cash flow statement is to provide a detailed picture of what happened to a business's cash during a specified period, such as for a specific month or year-to-date for example. It demonstrates an organization's ability to operate in the short and long term, based on how much cash is flowing into and out of the business.

The cash flow statement is typically broken into three sections:

- Operating activities
- Investing activities
- Financing activities

Operating activities detail cash flow that's generated once the company delivers its regular goods or services and includes both revenue and expenses. Investing activities include cash flow from purchasing or selling assets, such as equipment or real estate that is purchased with cash not debt. Financing activities detail cash flow (in or out) as debt is incurred or repaid.

Sources and Uses of Funds

While not necessarily considered a core financial statement, this is often a key financial document for business start-ups. This document will show how a particular project is being paid for by listing all sources of funding, such as Acme Bank loan, State Grant, and Owner Contribution. Sources are typically listed on the left side of the page.

Then Uses of Funds will be listed on the right side of the page and will show all anticipated expenditures, including items such as Equipment, Vehicles, Lighting, and Working Capital. While it is not necessary to list every single item here, some level of detail is typically desired. As with most financial documents, the two columns are expected to balance (Sources = Uses).

Sources and Uses of Funds statements are often requested by entities funding the project. A well thought out Sources and Uses document will show that the potential business owner has carefully considered the amount of cash needed and how it will be used. Due to the nature of this document, we have only included one sample in this instance.

Sample Financial Documents

As mentioned above, we have included two samples of each of the basic financial statements. These are a summarized and a detailed version of an Income Statement, a Balance Sheet, and a Statement of Cash Flows. In addition, we have included a sample Sources and Uses of Funds document. A link to these documents can be found at the end of the AgMRC Rural Grocery webpage, located here:

<https://www.agmrc.org/business-development/rural-grocery>