

Speaking the Language – Financial Jargon ***Learning Financial Jargon for the small business owner***

by Adam Chiffy, Business Consultant
with the Small Business Development Center

If you are like most small business owners, you do not really understand all the information in financial statements and how to use that information. For small business owners, balance sheets, income statements, and statements of cash flows from an accountant or produced by accounting software can seem confusing. Yet, these statements can provide crucial information if you know how to read them.

In its simplest form, an income statement shows sales less expenses and taxes to arrive at net income or profit. Everyone understands sales but not everyone really understands all the expenses. Companies purchase or make products (or services) for sale and the cost of these items make up “cost of goods sold (COGS).” When you subtract COGS from Sales, you are left with gross profit. From gross profit we deduct all other expenses, such as salaries, rent, or depreciation, which shows a company’s net income or profit.

An income statement ends with “net income” and that is where a statement of cash flows begins. A statement of cash flows will calculate the cash inflows and outflows from operating activities (sales and adjusted expenses), investing activities (purchases of new equipment or buildings), and financing activities (loans or debt and payment of dividends). These activities lead to a change in cash provided by or used during the year. For most small businesses, this is simply the change in your company checking account over the course of the year. When this change is added to your beginning balance of cash, you should arrive at your current level of cash. This amount of cash is reported on the balance sheet.

A balance sheet has two sides, assets on one side and liabilities plus owners equity on the other. As the name implies both sides must balance or be equal. The first side, Assets, is typically made up of the total value of cash, accounts receivable, inventory, prepaid expenses such as insurance or rent, and the depreciated value of property, plant and equipment.

The other side of a balance sheet is equal to liabilities plus owners equity. A liability in a small business is typically a loan or mortgage from a bank. However sometimes a supplier will extend credit to a small business and this will create an account payable. The owner’s equity portion of the balance sheet is the total value of money invested in a company plus any earnings retained by the company. Assets are only acquired by debt or the equity within the firm. This fact is what allows this statement to always remain balanced.

The important thing to remember about financial statements is that they are just a picture of a company at a specific point in time. Think of these statements like a trip to the doctor's office. Your doctor can only comment on your health based on what he can see when you are there.

###

The Small Business Development Center provides free and confidential Managerial and Technical Business Counseling from 16 offices throughout South Carolina. For more information, phone 803-777-5118 or email uscsbdc@moore.sc.edu.