CEDA
CENTRAL ECONOMIC DEVELOPMENT AGENCY

BUSINESS TOOLS

UNDERSTANDING YOUR BALANCE SHEET

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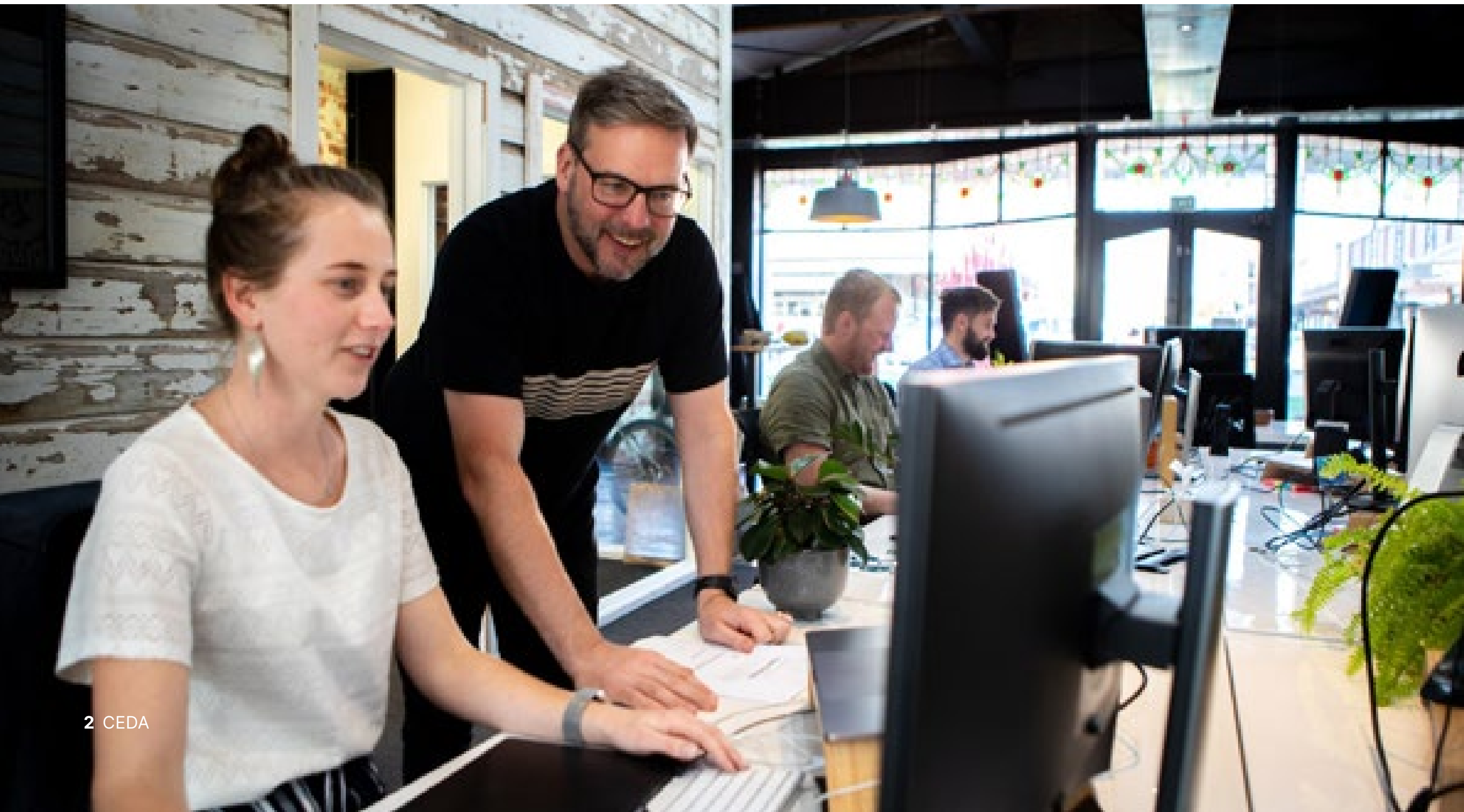
A balance sheet provides a snapshot of a business's assets, liabilities and equity at a point in time.

The core principle of a balance sheet is what your business owns is equal to what your business owes.

This is displayed as Assets (what the business owns) = Liabilities (what the business owes third parties) + (the owners value in the business).

For more information on balance sheets, tools and templates, visit Business.govt.nz



DEFINITIONS WITHIN THE BALANCE SHEET

The following are the main definitions used in a balance sheet

CURRENT ASSETS: An asset can be expected to be converted to cash or used up through normal business operations within 12 months. This can include cash on hand, or in the bank, short term investments, inventory and accounts receivable.

ACCOUNTS RECEIVABLE: Funds which are owed to the business by customer for products or services that have been invoiced.

NON-CURRENT OR FIXED ASSETS: Assets owned or purchased by a business for long term use in the business and have a useful life of more than a year. They are generally physical assets that are used to run the business and can include property, equipment and office furniture.

CURRENT LIABILITIES: Debts a business must repay within 12 months. This includes accounts payable, and short-term loans.

ACCOUNTS PAYABLE: Where a business owes money to its vendors/suppliers that have provided the business with goods and services on credit.

NON-CURRENT LIABILITIES: Debts owed by the business that are not due to be repaid within the next 12 months for example long term loans.

USE OF THE BALANCE SHEET

The following are the main uses and functions of the balance sheet

LIQUIDITY RATIOS

CURRENT RATIO: The comparison of current assets to current liabilities. This is used to calculate if a business is able to pay their debts as and when they are due.

Calculation: Current Assets ÷ Current liabilities = Current Ratio

CASH RATIO: This is a more conservative liquidity ratio to the curent ratio and compares only liquid assets to liabilities in order to ensure a business can meet its immediate obligations in the short term. A ratio higher than 1.0 shows you can afford your bills on time and in full, with cash or assets you can easily turn into cash.

EFFICIENCY RATIOS

INVENTORY TURNOVER: Determines how quickly a business is selling its inventory. A low turnover rate may indicate that a business has invest excessively in inventory.

Calculation: Annual cost of goods ÷ Ending inventory = Inventory turnover

ACCOUNTS RECEIVABLE TURNOVER: Comparison of net credit sales for the year to average receivables. This outlines how quickly receivables are collected. This can be useful in identifying causes of cashflow issues.

Calculation: Net annual sales ÷ ((Begining accounts receivable + ending accounts receivable) ÷ 2)

DEBT TO EQUITY RATIO: Comparison of a business's debt compared to equity. A high debt-to-equity ratio indicates a business is borrowing more to fund its operations, while a low debt-to-equity ratio means a business is utilising its assets to fund operations.

Calculation: (Long-term debt + Short-term debt + leases)

÷ Equity

For more resources, check out Tools and Resources

The Central Economic Development Agency (CEDA) exists to drive and facilitate the creation and growth of economic wealth in Manawatū and beyond.

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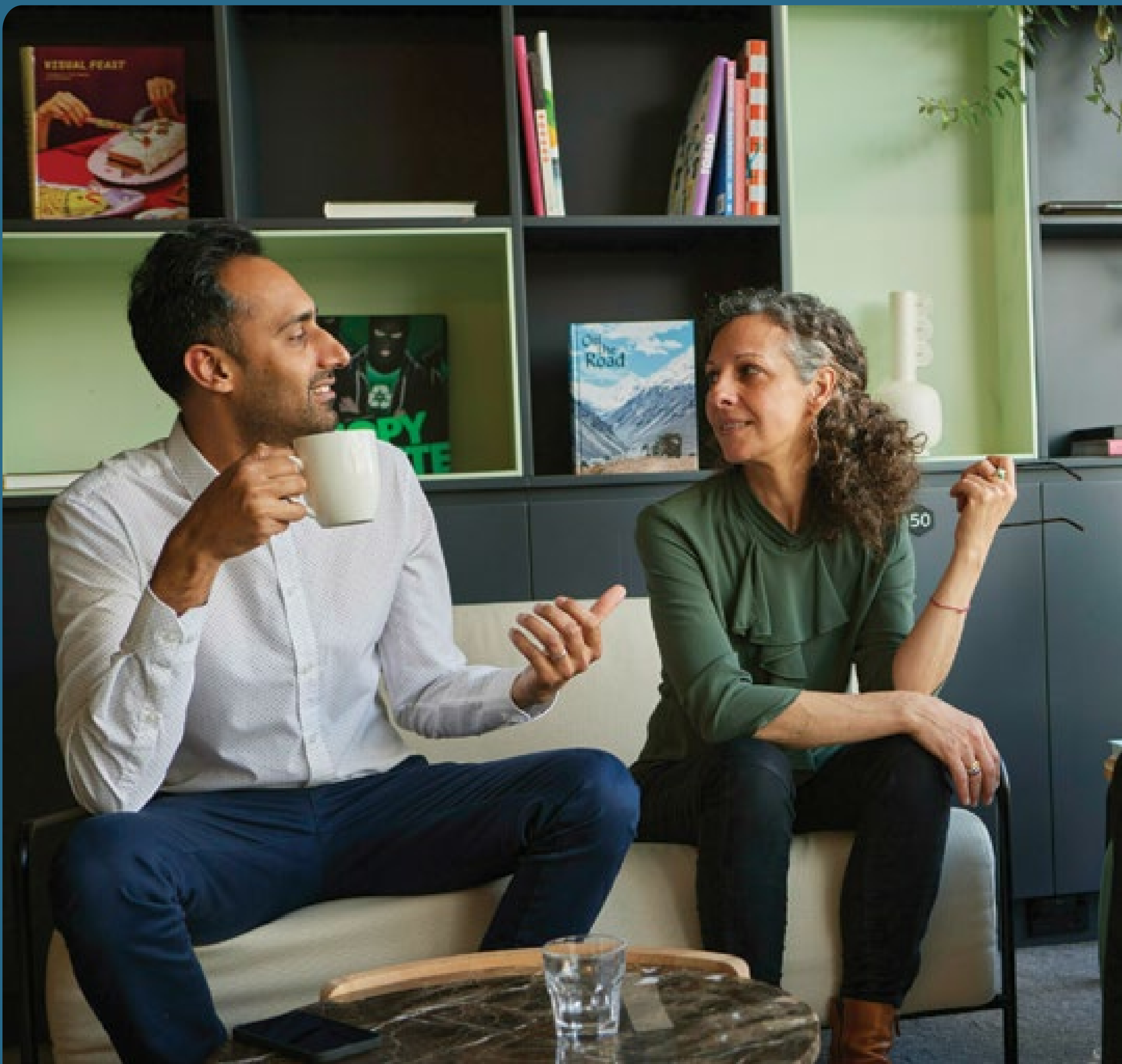
UNDERSTANDING YOUR PROFIT AND LOSS STATEMENT



UNDERSTANDING YOUR PROFIT AND LOSS STATEMENT

WHAT IS A PROFIT AND LOSS STATEMENT?

The Profit and Loss statement, also known as an Income statement, is a representation of your business over a period of time. This is required to be produced on a yearly basis along with a Balance Sheet for your annual tax returns.

PROFIT AND LOSS STATEMENT USES:

GROSS PROFIT:

If your gross profit is positive, then that's good. You are earning more from your products or services than they cost to produce.

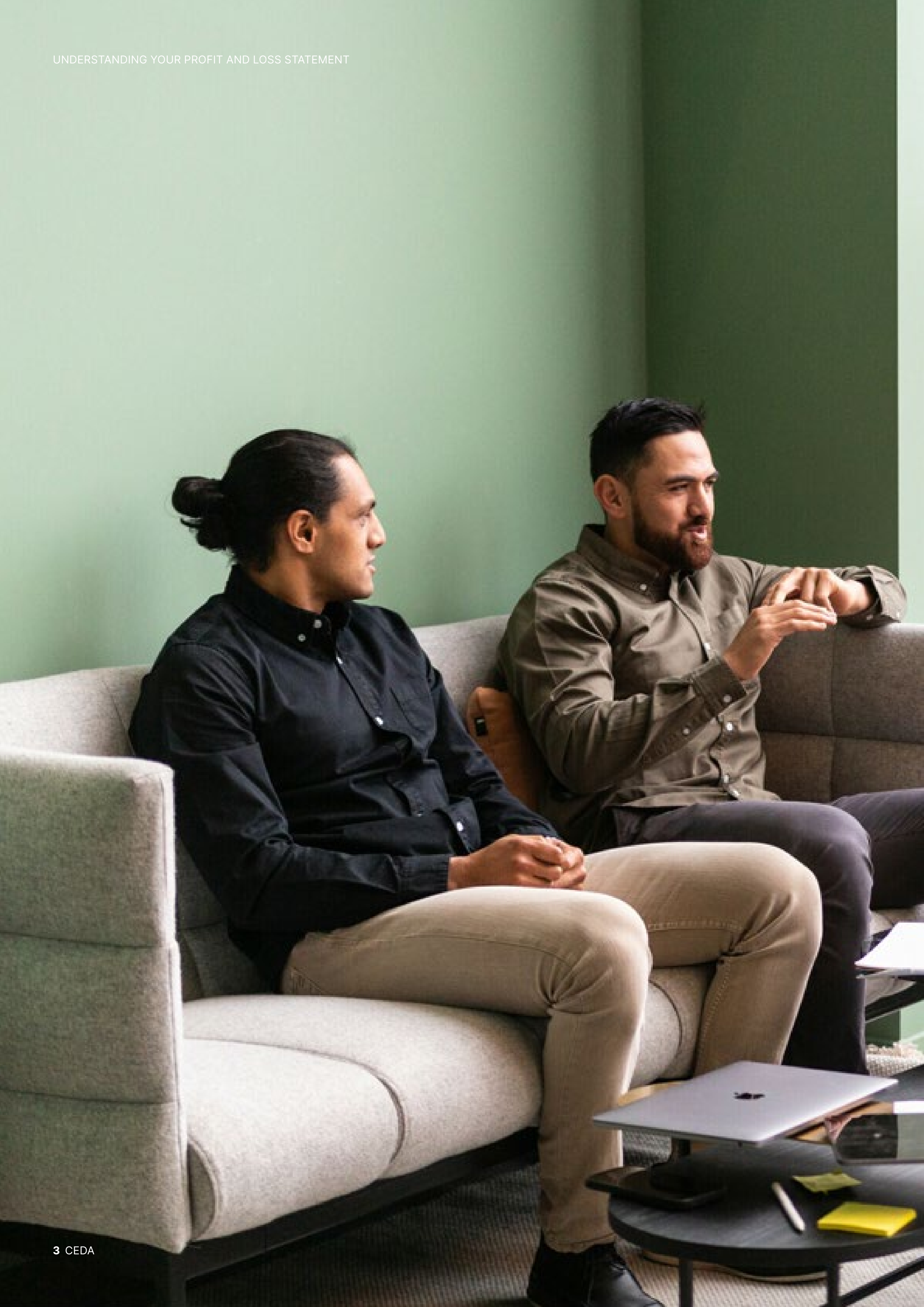
If it's negative, then it's a red flag. Your products or services cost more to make or do than you earn from selling them.

However, with good accounting software you are able to generate them as often as you would like. This can help you to identify trends and take action to address any concerns with your business early.

This means there will likely be no money left to cover operating costs, let alone earn profit.

Talk to your accountant or financial advisor as soon as possible.

With a good accounting system in place, it will be easier to see your profit and loss at any time. It is suggested that doing so at least every quarter is a good way to monitor and get a good sense of the pulse of your business.



GROSS PROFIT MARGIN:

This ratio shows whether your average mark-up is sufficient to cover all expenses and shows a profit

Formula: Gross Profit/Sales X 100 = Gross Profit Margin

A higher gross profit margin indicates a higher degree of profitability. This shows your business is operating efficiently and should remain at this level as long as operating expenses are kept in check.

In reverse, a lower gross profit margin can be a cause for concern and should highlight that there are areas that need improvement. Either in the pricing of your product or service or by looking at ways to improve your operating costs.

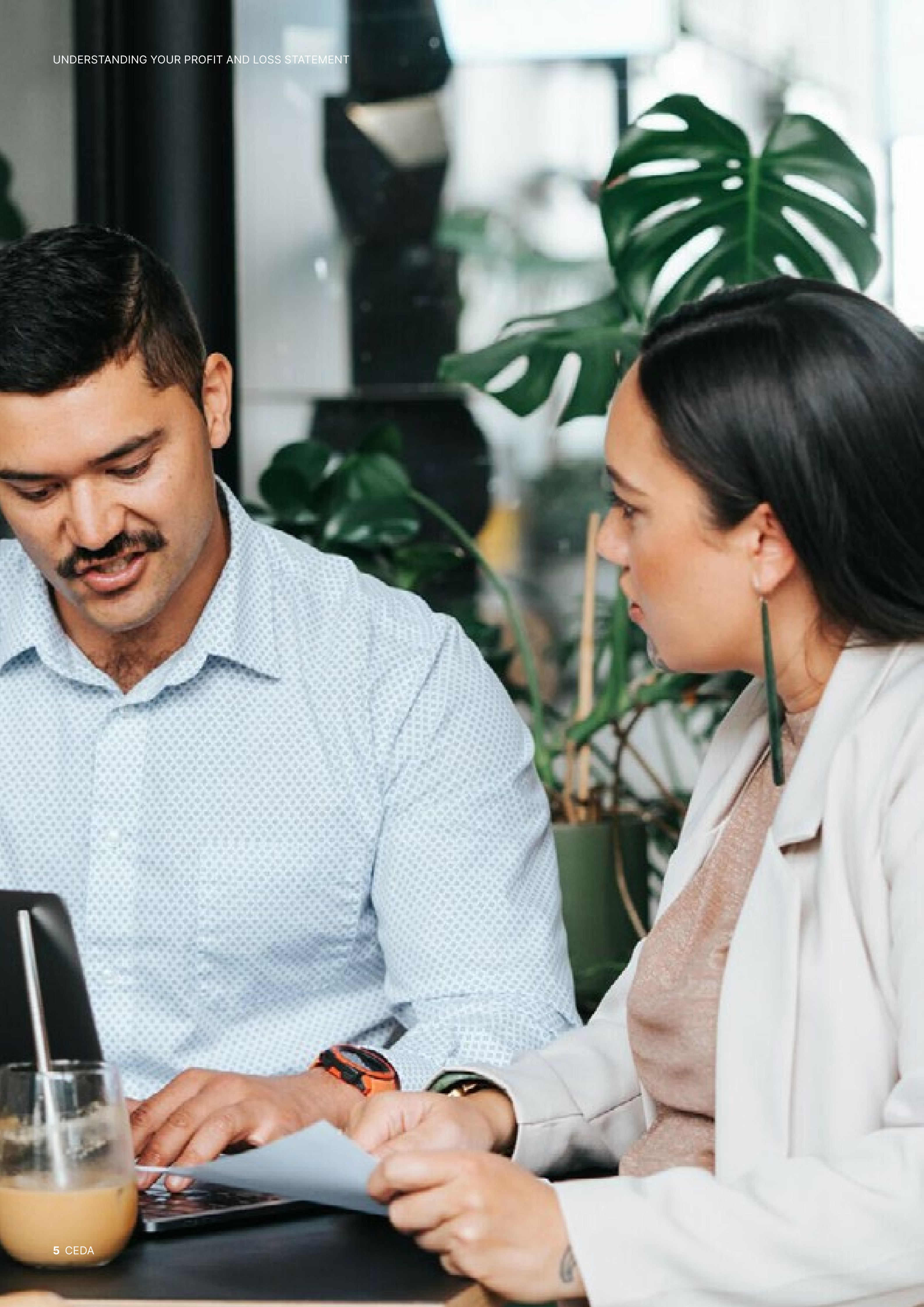
OPERATING PRODUCT

If operating profit is postive, then it’s a good sign.

If it is negative, then it isn’t always bad.
For example, you may have spent more on advertising to help boost sales. But if It’s negative and unexpected, double - check each item and compare these with previous statements to see if costs have increased.

For more information, tools and resources on profit and loss, visit business.govt.nz

For specific financial advice relating to your financials, we suggest you speak to you accountant or financial advisor



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