

# MICRO BUSINESS

## LEADER'S GUIDE

# MONEY WISE

A CONSUMER ACTION AND CAPITAL ONE PARTNERSHIP



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## About this Leader's Guide

The MoneyWi\$e “Micro Business Leader’s Guide” is designed to prepare community advocates to lead trainings for colleagues, clients and community members. “Micro Business Basics,” a companion brochure designed for adult learners of all skill levels, is available in Chinese, English, Korean, Spanish and Vietnamese. An adult learning curriculum with classroom activities and a PowerPoint presentation round out this MoneyWi\$e program.

Consumer Action, a national non-profit organization, and Capital One joined forces in 2001 to create the MoneyWi\$e national financial literacy partnership to educate consumers about how to manage their finances. The free multilingual education program centers on money management, personal finance and credit topics.

MoneyWi\$e materials are on the Internet at [www.money-wise.org](http://www.money-wise.org). For more information about Consumer Action call 800-999-7981, visit our web site ([www.consumer-action.org](http://www.consumer-action.org)) or e-mail us ([info@consumer-action.org](mailto:info@consumer-action.org)).

## Micro businesses

### *What are micro businesses?*

Micro businesses are very small companies run by their owners with few or no employees. They are often home-based, with annual sales under \$250,000, but they can qualify for loans to help them grow into large regional, national or franchise businesses.

### *What kind of pursuits have led to successful micro businesses?*

Many micro businesses start with a hobby or a great idea. Some examples of pursuits that might turn into businesses are cooking, child care, housecleaning, sewing, photography, errand-running, computer services, bicycle repair and medical records transcription.

### *What are the key attributes I need to make a business survive?*

You need the background and expertise to help your business thrive, the money to make your company succeed and an honest evaluation of your business skills. In addition, you must choose your business activity and market carefully.

### *Is it financially risky to start a business?*

Yes, it can be. You could lose your money as well as borrowed funds. You remain responsible for your loans until they are fully paid off, even if your business closes. Even success has its challenges—it takes long hours and hard work to ensure a thriving business.

### *How many small businesses fail?*

The U.S. Small Business Administration says that more than half of small businesses fail in their first year. Many businesses fail because they lack adequate funding.

### *Can I get a small business loan?*

If you have money or property (collateral) and good credit, you may qualify for a loan. Lenders want to be assured that you can pay the loan back. Before even seeking a loan, determine how much of your own money you can use for your business and how much money you might be able to attract from partners or investors. It is often recommended that start-up business owners prepare by saving money in advance or by keeping their jobs while launching a business.

## Anticipating your business needs

### *How can I make sure that my business succeeds?*

Sound financial planning is key to a successful business. By closely estimating what it will cost to run your company, you can prepare a realistic budget to see you through the start-up phase.

### *Is it okay to combine personal and business funds?*

Many small business owners mix personal finances with business finances—it is best to keep them separate. The Internal Revenue Service (IRS) recommends that you do not mix business and personal accounts. “Co-mingling” personal and business transactions makes it hard to track business activity and might raise questions about whether your deductions are allowable.

### *How can I best separate my personal finances from those of my business?*

Set up a business checking account and apply for credit cards in the name of your business. (Start-ups without steady cash flow might have to wait to qualify for a business credit card.) You can compare rates on business credit cards and business checking accounts online. Bankrate.com and Cardweb.com are frequently updated sources.

### *Should I have a credit card for my business?*

Many micro business owners rely on personal or business credit cards to pay for some purchases and track expenditures. Paying for business purchases on a credit card can help manage cash flow by giving you extra time to pay. Some cards give you “perks” such as discounts and rebates. Manage the use of your credit card carefully. For example, using credit card cash advances to pay for business expenses can result in large balances that are difficult to repay.

### *What issues should I consider before starting a business?*

People who are thinking about starting a business must consider many issues. These are some basic questions to ask yourself:

- Do I have the discipline necessary to be my own boss?
- Do I have the experience to make my business flourish?
- Are there too many companies in the line of business I have chosen?

- Is there demand for my product or service?
- How will I let people know I am in business?

## Business planning and bookkeeping

### *What is a business plan?*

Your business plan is like a resume for your business, an essential written document that describes your concept, outlines your objectives, forecasts costs and details the strategies you will take to achieve your goals. Writing your business plan gives you an opportunity to “succeed or fail” on paper and allows you to become comfortable with your place in the market before moving forward. When your business plan is complete, you can use it to approach lenders and potential partners about your idea. Community groups offer free or low-cost classes on writing a business plan and many web sites offer free business plan templates.

A well-rounded business plan includes an overview of your business purpose plus information about your products or services. It outlines your company’s structure and organization—a sole proprietorship or partnership, for example—and includes short biographies of key personnel. In it, you provide figures to support the need for your business, outline strategies for reaching customers and detail the costs of running your business now and in the future.

### *What are the financial documents I need for my business plan?*

A well-prepared business plan includes a profit and loss statement, a balance sheet and a cash flow forecast. A profit and loss (or income) statement is a financial report that summarizes revenues and expenses every three months (quarterly) and annually (each year). It shows your net income—the amount you have left after all expenses are subtracted from revenues. A balance sheet is a financial report that shows what you own and what you owe—the difference is the value of your company. A cash flow forecast is a report to help you calculate future expenses to make sure you will have money to pay your bills. (*Examples of these documents can be found on pages 17-20.*)

### *How do I write a business plan?*

Start with research—gather information about the industry, market and competition. Discuss your business plans with other people to get feedback. Once you have all the information you need, prepare an outline and start

writing your business plan. Examples of business plans can be obtained from the Small Business Administration (SBA) and SCORE. It may help you to write your plan in a straightforward manner if you imagine you are chatting with friends about your idea. Use simple words and keep the plan as short as possible—try not to exceed 20 pages. Use your outline to guide you in preparing a one-page “executive summary” for your cover page.

Don't stretch facts or figures in your business plan—exaggerations can come back to haunt you if your business becomes successful. Disclose the problems that might arise in starting your business, so that potential investors, lenders or partners, as well as your customers, won't get any negative surprises. Provide a detailed plan for dealing with any problems you foresee.

***What are assets and liabilities?***

Assets are things that your business owns, such as cash, stocks, real estate, equipment, etc. “Intangible” assets are non-material things that add to the value of your business such as copyrights, patents and the reputation of your business. Liabilities are obligations that you owe, usually to lenders.

***What is equity?***

In the context of small business, equity is what a company owns. You can figure your company's equity by subtracting its liabilities from its assets. For example, if your company's assets are \$500,000 and its liabilities are \$400,000, its equity is \$100,000. On a business balance sheet, assets should always equal liabilities plus equity.

***What is a balance sheet?***

A balance sheet is a financial report that shows your company's financial condition, usually at the end of each quarter: March 31, June 30, Sept. 30 and Dec. 31. Companies with sales of \$200,000 or more annually are advised to prepare balance sheets on a quarterly basis. Your balance sheet lists your company's assets, liabilities and equity. (*A sample balance sheet can be found on page 18.*)

***What is a profit and loss statement?***

Your profit and loss statement, also called an income statement, is a document that shows how profitable your business is by providing a historical record of income and expenses for your business. This key financial report summarizes revenues and expenses quarterly and annually,

allowing lenders, investors and other interested people to see how much money your business is making. The report's bottom line shows your company's net income—the amount left after all expenses are subtracted from revenues. (*A sample profit and loss statement can be found on page 20.*)

***What is cash flow?***

Cash flow is a term used to track the money that comes in from your customers and goes out to pay your bills. Without adequate cash flow, a business can fail because it does not have enough money to pay its suppliers.

***What is cash flow forecasting?***

Forecasting estimates the amount of cash that will move in and out of your business over time, including sales, supplies, payroll and taxes. A successful business must have a good “cash flow,” money that comes in from customers and goes out to pay bills. If your customers pay late, you will not have the money to pay your bills, which can jeopardize the health of your business. Cash flow forecasting is a tool to help you calculate your future expenses to make sure you will have money to pay your bills. (*A sample projected cash flow forecast can be found on page 17.*)

***What should my business's books contain?***

Your books should include receipts and records of every sale, payment and expenditure. By keeping accurate books you can closely monitor your profits and the value of your business. On a daily or weekly basis, transfer sales and receipts to a ledger—a book or computer program used to track money taken in and paid out by your business.

***What does it mean for a business to be solvent?***

A solvent company is able to pay all its debts if it sells all its assets. If a company's assets are greater than its liabilities, it is solvent. If not, it faces the risk of bankruptcy.

***What is factoring?***

Factoring is a way to turn your accounts receivable into cash by selling them, for a fee, to a finance company known as a factor. Factoring costs money but it may help your company grow by improving your cash flow or letting you take advantage of supplier discounts for bulk orders or

timely payment. Before entering into an agreement with a factor, check the company's references. You can find a list of factors online at the Commercial Finance Association ([www.cfa.com](http://www.cfa.com)) and the International Factoring Association ([www.factoring.org](http://www.factoring.org)).

## **Business structure**

### ***What are sole proprietorships and partnerships?***

Sole proprietorships are one-person businesses and partnerships are businesses owned by two or more persons. Both are easier and less costly ways to organize a business. In both sole proprietorships and partnerships, the owners have authority over all business decisions. However, owners report business income and losses on their personal tax returns and are personally liable for all business-related debts. If your business fails, you, or you and your partners, may have to file personal bankruptcy. If you abandon debts or file bankruptcy, your personal credit histories may be damaged.

### ***What is a corporation?***

A corporation is an entity organized under state or federal laws, that is legally separate from the people who own it. Corporations—like people—can own property, incur debt and sue or be sued. In most cases, business owners who incorporate are protected from personal liability arising from their business dealings or lawsuits against the company.

### ***What is a limited liability company?***

A limited liability company (LLC) is a business structure designed to combine features of a corporation and a sole proprietorship or partnership.

### ***Under what circumstances should I consider forming a limited liability company (LLC)?***

You might want to form an LLC if your business puts you at risk of being sued by customers or if you have substantial personal assets to protect should your business fail. Lawyers charge about \$1,500-\$2,000 to create LLCs.

***What are the chief benefits of LLCs?***

LLCs allow you to have multiple owners or one owner and have fewer legal requirements than incorporation. LLCs offer protection of personal assets and protection from personal liability and favorable tax treatment of profits.

***Are there any drawbacks to forming an LLC?***

Yes. LLCs require more legal preparation and result in more ongoing legal responsibilities than a sole proprietorship or partnership. Most businesses require legal or tax counsel to prepare LLC documents. LLC status must be renewed annually. If an LLC's legal preparations are faulty, your personal assets may not be protected.

**Start-up costs*****How much money do I need to start my own business?***

Many fast-growing companies are started with the founder's personal savings, in some cases no more than \$10,000. However, start-up funding should cover operating expenses for at least one year. For help with estimates of business costs, consult the SBA or SCORE. (See "Resources.")

***What should I consider in estimating start-up costs?***

Make sure you include your salary needs. If you are leaving a salaried job to start a business, you will need money to live on.

Other start-up costs include equipment, installations, remodeling, utility deposits, licenses and professional and legal fees. In addition, include direct costs, overhead and recurring costs in your estimates. Direct costs include raw materials or inventory. Overhead costs include rent, maintenance, supplies and utilities. Recurring costs include salaries, insurance, interest payments, payroll taxes and advertising and promotion.

**Finding funds for your business*****Should I use my own money to start a business?***

You are the only one who can answer this question. It is possible to lose any money you invest if your business fails. However, many people use their own money to start successful businesses and are able to expand the business out of revenues. Even if you are going to seek a loan, you will need some cash because lenders want to see that you are risking your own money

before asking for a loan. If you don't have cash to invest, consider selling possessions to raise money.

***I want to start a business but I feel that I do not have all the skills that are required to be successful. How can I find a partner?***

Start by asking friends and acquaintances. Seek a partner who has the skills you require as well as money to invest in your business. Your local chamber of commerce, SCORE chapter or industry trade group may have networking events at which you can search for a business partner. While somewhat more risky, many partners now meet online through Internet forums and chat rooms. If you go this route, make sure the site is sponsored by a reputable industry trade group and never mention how much money you have to invest until you have checked the backgrounds of potential partners.

***What is a business line of credit?***

A business line of credit is a loan that helps you meet temporary, short-term cash flow needs. To find such a loan, consider your own bank as well as credit unions and other banks. If your application is turned down, don't give up. Whenever you apply for a loan, be prepared to answer tough questions about your business. You may have to create a "loan package" with several funding sources—your local SCORE chapter can help you assess your needs before you shop for a line of credit.

***Are business credit cards useful to small business owners?***

If used carefully, a business credit card can help you manage cash flow and keep your business obligations separate from your personal obligations. Business cardholders can earn discounts on supplies, rental cars and other services. You do not escape personal liability because you have a business credit card. Payments and balances on your business credit card show up on your personal credit reports, so late payments or large balances can hurt your credit score. Business cards may come with unlimited spending limits, but may also lack interest-free grace periods, which means that you pay interest on all purchases even if you pay your bill in full each month.

***How can I build a credit history for my business?***

To build a business credit history, register with major business credit bureaus such as Dun & Bradstreet, the Small Business Financial Exchange (SBFE) or Business Credit USA.

***I saw an ad by a commercial finance company offering small business loans. Should I call them?***

Be cautious about borrowing money from a commercial finance company. In most cases, rates on finance company loans will be much higher than bank loans. In addition, commercial finance companies may be more aggressive in levying late fees or beginning foreclosure proceedings.

***My brother-in-law wants to finance our business partnership by borrowing on his life insurance policy. Is this a good idea?***

It might be, because holders of whole life insurance policies with substantial cash value can ask for a policy loan, and many companies lend up to 90% of the cash value. To be sure this is the right avenue for your business, you and your brother-in-law should seek counseling from your local SCORE chapter or from a private financial planner. On a personal level, it is important to assess whether the loan will leave your brother-in-law's survivors vulnerable to a reduced death benefit if he dies.

***What are the advantages to leasing equipment instead of buying it?***

When you lease equipment you don't tie up large amounts of cash. Equipment leases also may cover maintenance and repairs.

***I've heard about bartering for business services. How can I find out more about this?***

Bartering is an exchange of equally valued property or services between two parties. For instance, if you are a painting contractor, you could paint the local newspaper's office in exchange for advertising space. Business owners are required to report the fair market value received from bartering as taxable income. If few opportunities to barter with other businesses exist in your area, you can contract with a barter exchange organization that matches small businesses. Barter exchanges are usually profit-making businesses—before signing on, compare the benefits and membership costs, obtain references from members and check with the Better Business Bureau. Trade publications such as “Barter News” ([www.barternews.com](http://www.barternews.com)) provide information about the bartering industry.

***How can I find out about local economic development opportunities to help my business?***

Call your city, county and state governments and ask if they have economic development offices. Contact them and ask about small business funding and assistance programs. Some economic development programs require

that you raise matching funds or create jobs in order to qualify. Ask about in-kind credits (goods, commodities, or services rather than money) that can substitute as matching funds.

***What are revolving loan fund programs?***

Revolving loan funds (RLFs) are economic development programs often run by local governments that offer financial assistance to businesses with the ability to meet the cash or collateral requirements of bank financing. Often RLFs are used for rehabilitation of existing buildings, property acquisition and improvements, fixed equipment or machinery, new construction, including related soft costs, working capital and inventory—areas often excluded by business loans. (Soft costs include fees paid for business plans, consultants, studies, appraisals, permits and other planning costs.)

***I've heard about "angel investors" and venture capitalists who are willing to invest in small businesses. How do I find such people or companies?***

You may be able to best find opportunities like this through word of mouth. Ask business people that you know or your accountant, banker or lawyer for recommendations. Subscribe to newsletters from local business colleges, SCORE and the SBA, as they often carry news of venture capital forums or fairs. The National Venture Capital Association web site ([www.nvca.org](http://www.nvca.org)) and similar Internet sites might provide leads in your search. Check with your local library for books that provide information on financing sources.

***What is "vendor financing" and how can it help my business grow?***

Vendors sometimes play a role in business development by extending favorable terms and financing on supplies, equipment and business vehicles. Ask your suppliers about such services or inquire about opportunities at SCORE, the SBA or through industry or trade associations you belong to.

## **SBA loans**

***How can the Small Business Administration (SBA) help me with a loan?***

Although the SBA is primarily a guarantor of loans made by banks and other institutions, it supports small business people in other ways. The SBA helps streamline the lending process with lower down payments, longer

terms and lower interest rates than conventional loans. The agency can help you prepare loan documents for submission to banks that offer SBA loans. You pay for these services through fees when your loan is approved.

***What are the criteria for SBA loan approvals?***

SBA loan approvals are based on whether the business generates enough cash flow to repay the loan, on the character and background of the borrowers and on the borrowers' down payment or collateral.

***Is my business eligible for an SBA loan?***

The only way to answer this question is to apply for a loan. However, it is reported that 90% of for-profit businesses are eligible to qualify for SBA loans as long as they are owner-operated and organized as sole proprietorships, partnerships, LLCs or corporations.

***Are the interest rates on SBA loans set by the SBA or the banks?***

The SBA sets the maximum rate banks may charge, allowing you to negotiate the actual rate with the bank.

***Can you provide an overview of the SBA's activities?***

The SBA sponsors several lending programs, including a loan guaranty program for start-ups and small businesses; building and renovation loans; loan preapproval services, and small-scale financing and technical assistance for start-ups through SBA-funded non-profit business development programs. The SBA also helps minority and economically disadvantaged owners contract with the federal government.

***What is the SBA Micro Loan Program?***

The SBA Micro Loan Program provides small loans to start-up, newly established or growing micro businesses. The maximum loan amount is \$35,000; the average loan is about \$10,500. The funds are made available through third-party non-profit community-based lenders. In most cases, micro borrowers must undergo training and fulfill planning requirements. If your business fails, you will still be responsible for the loan.

***What are the steps to getting an SBA loan?***

The basic steps are to ask the SBA for a list of banks in your area and compare your choices by arranging an initial interview with a bank's SBA lending officer. Then decide which lender you will apply to and compile the forms and records required by the bank and submit your application.

### *How can I determine if I can get an SBA loan?*

If you can answer yes to the following questions, you may be a good candidate for an SBA loan:

- Can your business repay the loan out of its cash flow?
- Can you repay the loan using collateral if your business fails?
- Do you collect money from people who owe you in a timely manner?
- Do you pay your bills on time?
- Do you have a profitable history?
- Are your sales growing?
- Is the future of your industry bright?
- Are you positioned well against competition?

### **Legal and professional services**

#### *Are there any sources of free professional advice to fledgling business owners?*

There are many free resources available through the SBA, SCORE and other organizations, but you may need professional advice that is specific to your situation. (Always compare fees and check references before hiring a professional.) If you are in the start-up phase, you may find professional help for less money by joining a business “incubator.” (See “Resources.”) Business incubators are organizations that help new businesses in various ways—they may offer mentoring services, small business assistance programs and management training programs, or provide office space and economic development funding.

#### *How can I make sure I am complying with local, state and federal regulations?*

Requirements vary by business and by state. The SBA, SCORE or your local chamber of commerce or office of economic development can help you learn about requirements. Check with your city or county business development office, tax collector and zoning authority about business licenses, building permits and requirements for your industry. On the state level, you will need a sales permit, sales and income tax documentation and any licenses required by your state, as well as workers’ compensation insurance for your employees. On the federal level, you are responsible for

verifying your employees' right to work in the U.S., withholding employee income taxes and complying with minimum wage, overtime and child labor laws. You will be required to make estimated income tax payments for yourself and pay Social Security and Medicare taxes for yourself and your employees.

***How can I find out about business income tax requirements?***

The Internal Revenue Service (IRS) offers free tax publications and planning guides for small businesses on its web site ([www.irs.gov](http://www.irs.gov)). To obtain information specific to your situation, consider consulting a tax advisor. In many cases, consulting a professional can save you money and time and keep you from making mistakes. Your tax advisor can help determine your estimated federal and state taxes and advise you on tax deductions, such as health insurance, long-term care insurance or self-employment tax. Keep scrupulous records and meet with your tax professional at least twice a year. Review IRS materials before you consult an advisor so that you will be prepared.

***What sorts of insurance do I need as a micro business owner?***

Insurance coverage is an important cost of doing business—without protection, you might be ruined by a catastrophe. Business people should be adequately covered by property, fire, liability, auto and workmen's compensation insurance. Business liability insurance can protect you and your business from a personal injury or property damage lawsuit. Before you open your doors to customers, consult an insurance broker who specializes in small business needs.

There are several key types of specialty coverage available to business owners, including general business liability and product liability, as well as insurance that protects you from business interruption or loss of a key employee or partner. The Insurance Information Institute web site ([www.iii.org](http://www.iii.org)) provides detailed information about the various types of business insurance.

***How do I find a good insurance agent?***

Contact trade associations for a list of insurers who specialize in your field and with the company that provides your personal insurance. To make sure you are getting the best price and the best advice, talk to two or more agents and compare the results.

## Government contracting

### ***What opportunities does my business have to sell to or contract with the federal government?***

The U.S. government is the world's largest buyer of products and services. By law, a generous percentage of all government purchases is earmarked for small businesses, businesses owned by women and veterans who were disabled during their service and economically disadvantaged businesses.

### ***I'd like to do business with the federal government. How do I get started?***

Register with PRO-Net (the Procurement Marketing and Access Network), a free listing of small business contractors and subcontractors. The SBA web site ([www.sba.gov](http://www.sba.gov)) has information on how to register for PRO-Net.

### ***Where can I find out more about government contracting?***

The SBA offers programs and initiatives to help small businesses obtain government contracts ([www.sba.gov/businessop/index.html](http://www.sba.gov/businessop/index.html)). The Federal Acquisition Regulations (FAR) ([www.arnet.gov/far](http://www.arnet.gov/far)) provides details for doing business with the government. The Federal Procurement Data System (FPDS) ([www.fpds.gov](http://www.fpds.gov)) keeps statistics on government contracting.

## Resources

**The American Management Association** ([www.amanet.org](http://www.amanet.org)) is a non-profit, membership-based association providing management development and educational services to individuals, companies and government agencies worldwide.

**The Association for Enterprise Opportunity** ([www.microenterpriseworks.org](http://www.microenterpriseworks.org)) lists its member micro enterprise development programs.

**The Better Business Bureau’s “BBB Tips”** ([www.bbbtips.org](http://www.bbbtips.org)) is a web site with information about ethical business conduct, standards for advertising and ways to protect your business against fraud.

**Entrepreneur.com** ([www.entrepreneur.com](http://www.entrepreneur.com)) offers tips and how-to guides on all aspects of going into business.

**The National Business Incubation Association** ([www.nbia.org](http://www.nbia.org)) promotes business incubation and entrepreneurship organizations and opportunities.

**The National Minority Supplier Development Council** ([www.nmsdcus.org](http://www.nmsdcus.org)) brings corporate purchasing people together with minority businesses.

**The National Organization of Women Business Owners** ([www.nawbo.org](http://www.nawbo.org)) is a dues-based national organization representing the interests of women entrepreneurs in all industries.

**SCORE** ([www.score.org](http://www.score.org)) is a national organization offering free and confidential small business advice. Reach SCORE by phone at 800-634-0245. SCORE’s 60-second guides give you practical tips on business success.

**The U.S. Chamber of Commerce** ([www.uschamber.com](http://www.uschamber.com)) offers an online directory of nationwide Chambers of Commerce and a “small business toolkit.”

**The U.S. Small Business Administration** ([www.sba.gov](http://www.sba.gov)) provides many free resources and services for micro business owners. You can reach the SBA at 800-827-5722.

**The Wall Street Journal “Startup Journal”** ([www.startupjournal.com](http://www.startupjournal.com)) features articles, tips and success stories about new businesses.

## Sample Projected Cash Flow Statement

	2005	2006	2007
<b>① Cash Received</b>			
Cash Sales	\$75,000	\$105,750	\$150,000
Cash from Receivables	\$13,500	\$21,465	\$33,000
Subtotal Cash	\$88,500	\$127,215	\$183,000
<b>② Expenditures</b>			
Cash Spending	\$2,000	\$2,500	\$4,000
Payment of Accounts Payable	\$20,000	\$28,400	\$65,000
Subtotal Cash Spent	\$22,000	\$30,900	\$69,000
<b>③ Net Cash Flow</b>	<b>\$66,500</b>	<b>\$96,315</b>	<b>\$114,000</b>
<b>④ Cash Balance</b>	\$13,500	—	—

**How to read the Sample Projected Cash Flow Statement:**

- ① Cash Received:** This section predicts the amount of cash that will be received by the business during the year shown.
- ② Expenditures:** This section shows outflows of cash, as in cash that is spent or paid to suppliers for “accounts payable.”
- ③ Net Cash Flow:** This line equals the difference between Subtotal Cash and Subtotal Cash Spent.
- ④ Cash Balance:** This line is the cash that the business has on hand. To find a company’s actual cash balance, refer to its most recent balance sheet. It is not possible to predict the cash balance for future years. *(The Cash Balance shown cannot be deduced using the figures shown on this Sample Projected Cash Flow Statement.)*

# B

## BALANCE SHEET

### Sample Balance Sheet

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<b>1</b>	<b>Current Assets</b>	
	Cash	\$13,500
<b>2</b>	Accounts receivable	\$19,000
	Less allowance for doubtful accounts	-\$5,500
	Inventory	\$29,000
<b>3</b>	<b>Total Current Assets</b>	<b>\$56,000</b>
<b>4</b>	<b>Fixed Assets</b>	
	Machines	\$23,000
<b>5</b>	Less depreciation	-\$6,000
	Land	\$2,500
	Intangible assets	\$4,000
	<b>Total Assets</b>	<b>\$79,500</b>
<b>6</b>		
<b>7</b>	<b>Liabilities and Owner's Equity</b>	
	<b>Liabilities</b>	
	Accounts payable	\$20,000
	Taxes payable	\$3,500
	Loans	\$10,000
<b>8</b>	<b>Total liabilities</b>	<b>\$33,500</b>
<b>9</b>	<b>Owner's equity</b>	
	Capital contribution	\$38,000
	Retained earnings	\$8,000
	<b>Total Owner's Equity</b>	<b>\$46,000</b>
	<b>Liabilities and Owner's Equity</b>	<b>\$79,500</b>

## How to read the Sample Balance Sheet

A balance sheet is a snapshot of your business's assets, liabilities and equity. It provides information on what your business owns (its assets) and what it owes (its liabilities), and the value of the business (owner's equity). To balance, assets must equal the sum of liabilities and owner's equity.

To acquire assets, you must pay for them with either borrowed money (liabilities) or your own money (owners' capital contributions).

- ① Accounts receivable are amounts owed to your business by its customers. If you think it possible that certain customers will not pay what they owe to you, you can prepare for that possibility by making an allowance for "doubtful" accounts.
- ② Inventory is merchandise or other goods that you buy or produce for resale.
- ③ Fixed assets are things your business owns that have a useful life of greater than one year.
- ④ Depreciation is the loss of value of assets over time. If your business buys a car for \$20,000 it might be worth only \$15,000 a year later. The government allows you each year to take a paper loss on the car's reduced value, which provides you with a tax savings.
- ⑤ Intangible assets are non-material things that add to the value of your business such as copyrights, patents and the reputation of your business.
- ⑥ Liabilities are obligations that you owe, such as to lenders.
- ⑦ Accounts payable are any unpaid (outstanding) debts you owe for goods or services used by your business.
- ⑧ Owner's equity is the amount of capital you invested in the business.
- ⑨ Profits that you reinvest in your business are called "retained earnings."

A balance sheet should help answer these questions about a business:

***How much money has the owner invested in this business?***

***— \$38,000***

***How much debt does the business have?***

***— \$10,000***

# P

## PROFIT AND LOSS STATEMENT

### Sample Projected Profit and Loss Statement - Beach House Lodging

This sample projected profit and loss (or income) statement covers three years of operations for a small motel in a seasonal beach community.

	2004	2005	2006
① Sales	\$125,000	\$132,000	\$150,000
<hr/>			
② Operating Expenses:			
Payroll	\$12,000	\$33,000	\$35,000
Marketing	\$2,000	\$3,000	\$4,000
Depreciation	\$3,440	\$2,700	\$550
Insurance	\$2,500	\$2,550	\$2,600
Telephone	\$2,100	\$2,500	\$3,500
Dues & Subscriptions	\$200	\$200	\$1,500
Rent	\$12,000	\$12,000	\$12,000
Housecleaning	\$400	\$550	\$1,500
Groceries	\$1,500	\$2,000	\$2,400
Payroll Taxes	\$2,500	\$5,000	\$5,750
<b>Total Operating Expenses</b>	<b>\$38,640</b>	<b>\$63,500</b>	<b>\$68,800</b>
<hr/>			
Profit Before Interest and Taxes	\$86,360	\$68,500	\$81,200
③ Interest Expense	\$50,000	\$49,000	\$48,000
Taxes	\$5,454	\$3,330	\$4,980
<hr/>			
④ <b>Net Profit</b>	<b>\$30,906</b>	<b>\$16,170</b>	<b>\$28,220</b>
<hr/>			
⑤ Net Profit as a Percentage of Sales	24.72%	12.25%	18.81%

## How to read the Sample Projected Profit and Loss Statement

A profit and loss statement is a financial statement that shows a historical record of a business' income (revenue), expenses and operating activities for a year or more. A projected profit and loss statement estimates how a well-run company will be situated in upcoming years. Start-up companies, which have no track record, must attempt to predict how they will grow. Here is an explanation of some of the items on the projected profit and loss statement shown on the left.

- 1 **Sales:** Total annual customer revenues from the business.
- 2 **Operating Expenses:** The costs of running your business.
- 3 **Interest Expense:** Interest you pay on your business loans.
- 4 **Net Profit:** Your profit after operating expenses, interest expense and taxes are subtracted from the amount you earned from sales.
- 5 **Net Profit as a Percentage of Sales:** This figure shows how much profit a company makes. In 2004, Beach House Lodging put about 25¢ profit in the bank for every dollar of sales—an excellent net profit margin. In future years, Beach House Lodging's expenses are projected to be higher, resulting in a lower profit margin despite an increase in revenues from sales.

*Can you give an explanation of why Beach House Lodging's net profit is projected to fall in 2005?*

*— The company's payroll is more than doubling in 2005, which is not unusual for a growing business. The increase in employee wages will also cause the company's payroll taxes to rise.*

*What does the company predict that its net profit margin will be in 2006?*

*— The company expects to earn 18.81¢ in profit for every dollar of sales.*

## **Consumer Action**

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