MBDI minority business development institute

Savvy Finance

Building a Budget & Understanding Financial Statements

MARCH, 2016

Budget Basics Topics Covered

Budget Usefulness

What Does A Budget Do?

How To Create A Budget

What Does a Budget Tell Me?

How A Budget Is Useful

You cannot drive a car without knowing where you are going – you will need to rely on a navigation system

The same is true for your company's financial health – without a roadmap or budget, you will not know or be aware of your company's finances

How A Budget Is Useful

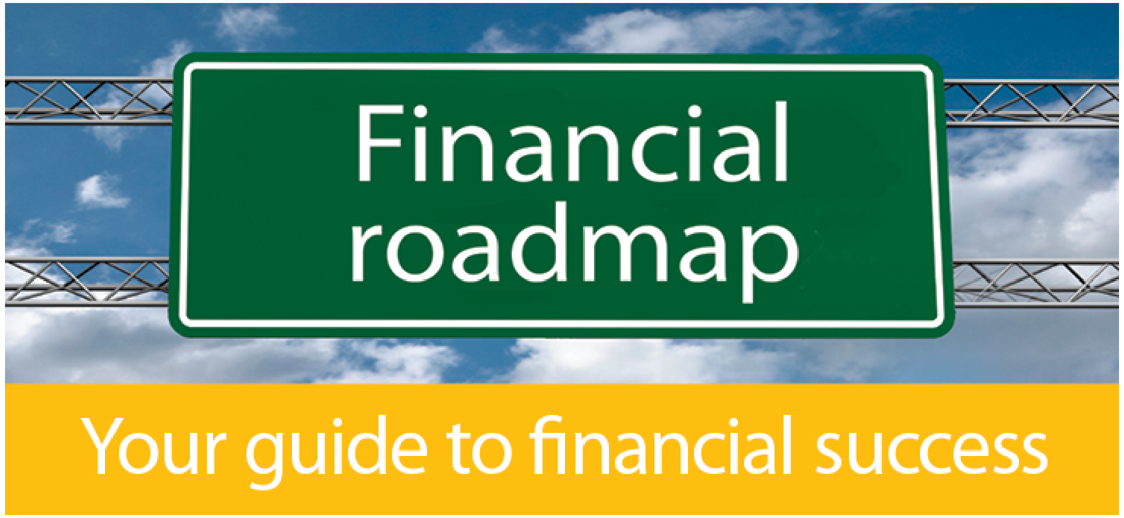
Predicts How a Company Will Spend Its Money

Creates A Financial Roadmap for a Period of Time

Helps Plan for Growth

Financial Presentation of Business Plan

Aids a company in determining its Cash Burn Rate



How A Budget Is Useful

Cash Burn Rate

- The Cash Burn Rate for a company is how much cash does the company spend daily, monthly, etc.
- The Cash Runway is how long your cash will last at the current spending (burn) rate

To calculate the burn rate, review a period of time and look at the beginning cash balance and the ending cash balance. Simple example: Opening cash balance at 3/1/XX is $1,000, and the ending balance at 6/1/XX is $400. That is a net decrease in cash of $600 for the 3 months. That is a burn rate of $200 per month.

If the company has only $600 left in cash, that is a runway of only 3 months.

If the company has an opening balance of $1,000 and an ending balance of $5,000, that is a negative cash burn rate. That means the company has increased its cash reserves or cash balances for the period.

How A Budget Is Useful

Cash Burn Rate

- It is important to know your company's Cash Burn Rate
- The Cash Burn Rate is a useful tool to manage the company's cash flow
- If the Burn Rate is too high, the company has a few strategies or options:

1. Increase revenue
2. Decrease expenses
3. Pay bills more slowly to maintain a larger cash balance
4. Bill sooner and collect faster (increase cash flow)
5. Develop terms with suppliers and/or vendors

Budget Preparation

Look Back at Prior Year(s)

Did Sales or Revenue Increase or Decrease?

Did Expenses Increase or Decrease?

Prediction for Next Year – Increase or Decrease

Budget Preparation

How Do You Obtain Prior Year(s) Information

- Tax Returns – look at 3 years of returns
- Financial Statements (CPA or QuickBooks or other accounting software) – 3 years of information to build a strong financial picture
- If no automated accounting software, checking account statements for 2-3 years – it will show the inflows and outflows of cash on a monthly basis
- Job Profitability Reports – review prior contract profitability to see if your company has strong profit margins or if they are declining over time

Budget Rough Draft

At this point, you will start to prepare a preliminary budget

The budget will be based on YOUR company's trends over the last 2-3 years

- Did Expenses Increase – ie Insurance is now 15% higher
- Price of Gas – dramatically decreased in last 2 years, helping to boost profitability
- Need to buy new equipment or machinery this year? Useful life of your equipment may be up this year and require replacement
- Union benefits or employee benefits have increased – affects bids and project costs
- Established a business relationship that is bringing in more work – could result in an increase in sales for next year

Budget Rough Draft

Total Expenses and Income/Sales by year from prior 2-3 years

Analyze Trends – increases or decreases over 24 to 36 month period

Prepare Your Budget for Next Year – full 12 months of income and expenses

Determine Fixed and Variable Costs – fixed costs are the same each month (i.e., rent and utilities) and variable costs are those that change depending upon certain factors (i.e., materials and supplies)

Include any increases or decreases to the numbers – if your company projection is an increase in sales/contracts by 10%, add 10% to your gross revenue (sales) number; if the company expects expenses to increase by 15%, add 15% to your annual number from the prior year

Then breakdown the budget by quarterly and monthly projections

- For Quarterly, divide the expenses and income by 4 (4 quarters in a year)
- For Monthly, divide the expenses and income by 12 (12 months in a year)

Budget Rough Draft

Quarterly and Monthly Expenses – Dividing Annual Number by 4 or 12 may not be the BEST strategy

Company may need to take into account the following:

- Current contracts – how many will carry over into the next year?
- Does your company work outside and its busier months are April through October? Then your company's budget may be more weighted towards expenses and revenue in those 6 months vs. June through December.
- Are your contracts front-loaded – meaning you have more expenses for mobilization – then that needs to be reflected in your budget forecast

Rough Draft to Refinement

Expenses prior year $100,000; company projects a 10% increase for next year; next year's budget for expenses is $110,000 ($100,000 x 10% = $10,000 increase)

Monthly budget for expenses = $9,167

Quarterly budget for expenses = $27,500

However if the company expects that the first 6 months of the year will have **more** contracts than the second half of the year, it would be wise to adjust the quarterly budget. Instead of $27,500 per quarter (3 months), the company adjusts the budget for the first two quarters to $35,000 and the last two quarters to be $20,000 each

Budget Comparisons – Revenue/Sales

ANNUAL PROJECTION $1,000,000

Monthly Budget – spread equally over 12 months

Monthly	Quarter
$83,333	
$83,333	$250,000
$83,334	
$83,333	
$83,333	$250,000
$83,334	
$83,333	
$83,333	$250,000
$83,334	
$83,333	
$83,333	$250,000
$83,334	

ANNUAL BUDGET $1,000,000

Monthly Budget adjusted to projected sales over the next 12 months

Monthly	Quarter
$100,000	
$85,000	$285,000
$100,000	
$200,000	
$75,000	$375,000
$100,000	
$80,000	
$80,000	$240,000
$80,000	
$40,000	
$40,000	$100,000
$20,000	

Budget Preparation
Sales Budget Estimate from Prior Year

Shows a 10% increase from prior year's sales

Month	Revenues in Current Year	Increase by 10%[b]	Estimated Revenue: New Operating Budget
January	$ 139,950	$ 14,000	$ 153,950
February	149,000	14,900	163,900
March	147,500	14,750	162,250
April	148,250	14,830	163,080
May	148,000	14,800	162,800
June	147,000	14,700	161,700
July	148,500	14,850	163,350
August	148,000	14,800	162,800
September	149,500	14,950	164,450
October	148,750[a]	14,880	163,630
November	148,000[a]	14,800	162,800
December	147,750[a]	14,780	162,530
Totals	$1,770,200	$177,040	$1,947,240

[a]The budget is being planned in late summer/early fall; these are estimates.
[b]Increase is to the nearest $10.

Budget Reality Check

Pie in the Sky Projections – What Does This Mean?

- Do not fall into the trap of making grand or bold predictions. Base your budget on your company's history of revenue and expenses.

Take into account Economic Trends, Government Policy and Agency Budgets; is the economy in a booming year or a lean year for your business sector.

- Example – decline in gas prices for 2015. Do you predict this trend will continue? If so, then the budget projection for fuel costs may decrease in 2016.

Contract Opportunities – how many projects are bid vs. contracts awarded – not wise to make projections that overstate history

Review bidding strategies to ensure expenses are accounted for and profit margins are accurate and not over-inflated

- It is easy to forget to include project expenses such as surety bond premium, insurance costs or other overhead expenses in a bid

Review, Review, Review

Roll Out the Budget

Prepare Your Spreadsheet or Ledger

Prepare a 12-month Budget – Revenue is First Line, Itemized Expenses are Below and Difference = Net Profit or Loss for Month. See example on slide 18.

Create a separate spreadsheet (monthly or for full year) to track Budget vs. Actual. The difference between the two numbers is called a Variance. See example on slide 19.

Track the variances – where did you over-spend or under-spend; why was the revenue less than the budget;

Sample Budget – Weekly

company budget

START DATE 1/1/2011 PERIOD LENGTH (IN DAYS)

	01-JAN	15-JAN	29-JAN	12-FEB	26-FEB	11-MAR	25-MA
NET INCOME	$ 1,750.00	$ 2,236.00	$ 1,442.00	$ 2,253.00	$ 1,533.00	$ 1,086.00	$ 1,594.
income							
INCOME ITEM 1	$ 3,000.00	$ 3,500.00	$ 2,978.00	$ 3,384.00	$ 2,858.00	$ 2,809.00	$ 3,220.
INCOME ITEM 2	1,150.00	1,200.00	1,144.00	1,400.00	1,358.00	1,154.00	1,245.
INCOME ITEM 3	300.00	350.00	392.00	326.00	381.00	364.00	315.
TOTAL INCOME	**$ 4,450.00**	**$ 5,050.00**	**$ 4,514.00**	**$ 5,110.00**	**$ 4,597.00**	**$ 4,327.00**	**$ 4,780.**
expenses							
WAGES	$ 1,500.00	$ 1,577.00	$ 1,823.00	$ 1,529.00	$ 1,759.00	$ 1,947.00	$ 1,875.
RENT	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00	1,000.
ELECTRICITY	40.00	43.00	40.00	42.00	45.00	40.00	42.
TELEPHONE	12.00	11.00	13.00	14.00	11.00	15.00	15.
INTERNET	15.00	15.00	15.00	15.00	15.00	15.00	15.
WATER	11.00	10.00	13.00	10.00	13.00	10.00	12.
GAS	23.00	27.00	26.00	27.00	22.00	29.00	21.
WASTE REMOVAL	4.00	4.00	4.00	4.00	4.00	4.00	4.
CABLE TV	10.00	10.00	10.00	10.00	10.00	10.00	10.
OFFICE SUPPLIES	25.00	57.00	68.00	146.00	125.00	111.00	132.
INSURANCE	60.00	60.00	60.00	60.00	60.00	60.00	60.
TOTAL EXPENSES	**$ 2,700.00**	**$ 2,814.00**	**$ 3,072.00**	**$ 2,857.00**	**$ 3,064.00**	**$ 3,241.00**	**$ 3,186.**

Full Year Budget – Revenue & Expense

[Company Name] **2014 Budget**

INCOME	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Operating Income													
Category 1													-
Category 2													-
Category 3													-
Category 4													-
Other													-
Total Operating Income	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-Operating Income													
Interest Income													-
Rental Income													-
Gifts Received													-
Donations													-
Other													-
Total Non-Operating Income	-	-	-	-	-	-	-	-	-	-	-	-	-
Total INCOME	-	-	-	-	-	-	-	-	-	-	-	-	-
EXPENSES													
Operating Expenses													
Accounting and Legal													-
Advertising													-
Depreciation													-
Dues and Subscriptions													-
Insurance													-
Interest Expense													-
Maintenance and Repairs													-
Office Supplies													-
Payroll Expenses													-
Postage													-
Rent													-
Research and Development													-
Salaries and Wages													-
Taxes and Licenses													-
Telephone													-
Travel													-
Utilities													-
Web Hosting and Domains													-
Other													-
Total Operating Expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-Recurring Expenses													
Furniture, Equipment and Software													-
Gifts Given													-
Other													-
Non-Recurring Expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Total EXPENSES	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income Before Taxes	-	-	-	-	-	-	-	-	-	-	-	-	-
Income Tax Expense													-
NET INCOME	-	-	-	-	-	-	-	-	-	-	-	-	-

Sample Monthly Report – Actual vs Budget

Expense Budget [Company Name] [Month and Year]

Personnel	Budget	Actual	Difference ($)	Difference (%)
Office			$ -	0.0%
Store			-	0.0%
Salespeople			-	0.0%
Others			-	0.0%
Operating	**Budget**	**Actual**	**Difference ($)**	**Difference (%)**
Advertising			$ -	0.0%
Bad debts			-	0.0%
Cash discounts			-	0.0%
Delivery costs			-	0.0%
Depreciation			-	0.0%
Dues and subscriptions			-	0.0%
Employee benefits			-	0.0%
Insurance			-	0.0%
Interest			-	0.0%
Legal and auditing			-	0.0%
Maintenance and repairs			-	0.0%
Office supplies			-	0.0%
Postage			-	0.0%
Rent or mortgage			-	0.0%
Sales expenses			-	0.0%
Shipping and storage			-	0.0%
Supplies			-	0.0%
Taxes			-	0.0%
Telephone			-	0.0%
Utilities			-	0.0%
Other			-	0.0%
Total Expenses	**Budget**	**Actual**	**Difference ($)**	**Difference (%)**
	$ -	$ -	$ -	0.0%

Take Action

It is GREAT to have a budget, but if you do not review it monthly, it is useless as a tool. Compare the budget you created to the actual sales and company expenses (prior slide)

Account for variances or differences in numbers

- Ask yourself or your staff, why was materials higher than anticipated?
- Why is the revenue projection or estimate so far off this month?
- Why are the profit margins decreasing each month?
- What accounts for the variances or differences in certain expenses?

Determine if the BUDGET needs to be revised

- If the budget was prepared expecting a large contract to be signed and the job is no longer viable, revenue and expenses may need to be adjusted or revised

TOP FOUR POINTS

Review prior 2-3 years revenue and expenses to develop a budget. Do not rely solely on one year (unless your business is less than 2 years old)

Understand what the budget reflects

- What do the numbers mean?

Budget Usefulness

- Track revenue and expenses on a monthly basis
- No need to wait for your accountant to tell you if you were profitable or not
- Track costs by month, quarter, semi-annual (6 months) and annual

Budget Review should occur Monthly

Understanding Financial Statements

Understanding Financial Statements

- Understand What the Numbers Tell You
- What Accounts on What Statements?
- Why is Equity Important?

Sample Financial Statement

Rock Castle Construction
Profit & Loss
January 1 through December 15, 2015

	Jan 1 - Dec 15, 15
Ordinary Income/Expense	
Income	
40100 · Construction Income	447,537.34
40500 · Reimbursement Income	2,119.80
Total Income	449,657.14
Cost of Goods Sold	
50100 · Cost of Goods Sold	14,766.19
54000 · Job Expenses	165,299.14
Total COGS	180,065.33
Gross Profit	269,591.81
Expense	
60100 · Automobile	6,844.94
60600 · Bank Service Charges	125.00
62100 · Insurance	20,125.09
62400 · Interest Expense	1,995.65
62700 · Payroll Expenses	120,347.21
63100 · Postage	104.20
63600 · Professional Fees	250.00
64200 · Repairs	1,525.00
64800 · Tools and Machinery	2,820.68
65100 · Utilities	2,269.31
Total Expense	156,407.08
Net Ordinary Income	113,184.73

Revenue for the period

Expenses related to contracts – materials, labor, subcontractors, permits, bonds, etc.

GROSS PROFIT for the period

Overhead Expenses or General & Administrative Expenses

Net Profit or Loss

Standard Profit & Loss Statement

What do the numbers tell us? Overall the company is profitable – does not tell us if any specific jobs are losing money or may have declining profit margins

Gross Profit is $269,591. Gross Profit % = 60% ($269,591/$447,537)

Net Profit is $113,184. Net Profit % = 25% ($113,184/$447,537)

Rock Castle Construction

Profit & Loss

January 1 through December 15, 2015

	Jan 1 - Dec 15, 15
Ordinary Income/Expense	
Income	
40100 · Construction Income	447,537.34
40500 · Reimbursement Income	2,119.80
Total Income	449,657.14
Cost of Goods Sold	
50100 · Cost of Goods Sold	14,766.19
54000 · Job Expenses	165,299.14
Total COGS	180,065.33
Gross Profit	269,591.81
Expense	
60100 · Automobile	6,844.94
60600 · Bank Service Charges	125.00
62100 · Insurance	20,125.09
62400 · Interest Expense	1,995.65
62700 · Payroll Expenses	120,347.21
63100 · Postage	104.20
63600 · Professional Fees	250.00
64200 · Repairs	1,525.00
64800 · Tools and Machinery	2,820.68
65100 · Utilities	2,269.31
Total Expense	156,407.08
Net Ordinary Income	113,184.73

Profit & Loss or Income Statements

Accounts Include:

Revenue accounts

Cost of Goods Sold (COGS) account(s) – considered project specific accounts for the company (not all companies have a Cost of Goods Sold Account – not used for service companies such as accountants or lawyers)

All Expense accounts – considered overhead for the company

Revenue – Cost of Goods Sold = GROSS PROFIT

GROSS PROFIT – Expenses/Overhead = NET PROFIT

Balance Sheet

Sample Balance Sheet – side by side view so everything fits on one page

Strong assets – cash is sizable, Accounts Receivable is low, fixed assets have value

Liabilities – Accounts Payable and other current liabilities are low; current liabilities is anything that is due and owing in the next 12 months

Current Assets of $302,184 compared to Current Liabilities of $54,690 shows a strong balance sheet (want to show more assets than liabilities)

Retained earnings and Net Income are both positive numbers

Total Assets = Total Liabilities + Equity

Quality-Built Construction
Balance Sheet
As of December 15, 2016

	Dec 15, 16
ASSETS	
Current Assets	
Checking/Savings	286,284.97
Accounts Receivable	
1210 · Accounts Receivable	14,700.00
Total Accounts Receivable	14,700.00
Other Current Assets	
1330 · Security Deposit	1,200.00
Total Other Current Assets	1,200.00
Total Current Assets	302,184.97
Fixed Assets	
1510 · Automobiles & Trucks	32,952.00
1520 · Computer & Office Equipment	19,862.00
1530 · Machinery & Equipment	25,643.00
1540 · Accumulated Depreciation	-6,500.00
Total Fixed Assets	71,957.00
TOTAL ASSETS	374,141.97

LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Accounts Payable	24,301.61
Credit Cards	
12374 · Home Depot	700.00
2050 · Mastercard Payable	-131.02
Total Credit Cards	568.98
Other Current Liabilities	
2100 · Payroll Liabilities	1,842.33
2200 · Customer Deposits	27,500.00
2240 · Worker's Comp Payable	477.49
Total Other Current Liabilities	29,819.82
Total Current Liabilities	54,690.41
Long Term Liabilities	
2460 · Truck Loan	13,985.00
Total Long Term Liabilities	13,985.00
Total Liabilities	68,675.41
Equity	
3910 · Retained Earnings	194,131.87
Net Income	111,334.69
Total Equity	305,466.56
TOTAL LIABILITIES & EQUITY	374,141.97

Balance Sheet Accounts

Accounts Include:

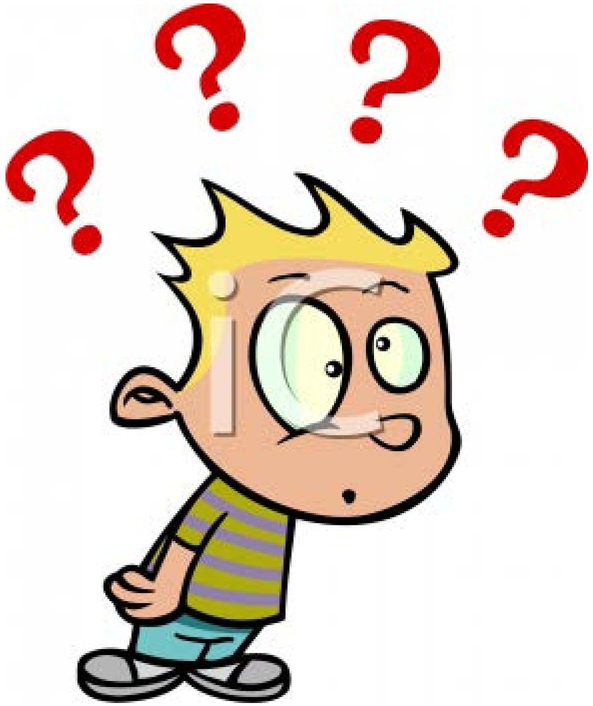
Asset Accounts – Cash, Retainage, Accounts Receivable, Fixed Assets such as equipment, vehicles, inventory, etc.

Liability Accounts – Payable accounts such as Notes Payable, Loans payable, Bank Line of Credit payable, credit cards, suppliers, subcontractors, taxes, insurance, utilities, etc. Do not confuse these with expense accounts.

Equity Accounts – Retained Earnings, Net Profit or Loss, Paid in Capital, stock/shareholder balances and/or Owner's Draw Account. This shows the stake in the company for the owners. A positive number means that some profits of the company are being retained in the business. It also signifies that the assets are greater than the company's liabilities. Negative equity usually signifies that the liabilities are greater than assets (and thus the company is owned by the creditors) and/or the company is taking the profits out of the company.

TOP 4 POINTS

- Understand the accounts used in creating an Income Statement & Balance Sheet
- Understand the Equity part of the Balance Sheet
- Know when the profit margins are declining and why by reviewing the Profit & Loss Statements often
- Know what the numbers represent – bankers and lenders like to see more assets than liabilities and positive equity



Contact:

Liz Duncan-Gilmour, Esq.

Executive Director
Minority Business Development Institute
535 Fifth Avenue
New York, NY
(609)-456-0818

Senior VP and Counsel
The Cayemitte Group
306 Farnsworth Avenue
Bordentown, NJ 08505
(609)-521-4200