

Carnegie Mellon University
Swartz Center for Entrepreneurship

**Internal Accounting for
Start-Ups – A Beginners Guide**

Resources Required for Business

- To make a product or deliver a service **resources** are needed:
 - Labor
 - Materials
 - Energy
 - Property, Plant, and Equipment
 - **MONEY a.k.a. Capital**

Sources of Capital

- Friends and Family
- Angel Investors
- Venture Capitalists
- Crowd Funding
- Banks and other financial institutions

How to obtain Capital?

- **Requirements** to obtain financing:
 - **Business Plan**
 - Demonstrate viability of current business through financial reporting, e.g. **financial statements for the prior 2 years at minimum**
 - Demonstrate cash flow potential of business in future through **projected (*proforma*) financial statements for 3 years into the future**

Skill Needed to Obtain Capital

The ability to
speak the languages of business

What are the Languages of Business?

Three main languages of business:

- Accounting
- Finance
- Economics

Accounting

- Provides **historical information**
- A way to **track** overall financial position, including **revenues, expenses, capital**, and other items
- The **rules-based system** of accounting enables companies to track these items and **communicate the results** to a wide range of interested parties

Finance

- Finance is **forward-looking** and therefore critical to decision-making processes at companies
- The accounting numbers need to be analyzed and interpreted to create forward-looking **projections about what might happen in the future**

Finance

When you think of the **language of finance**, think of:

- Assessing value
- Looking into the future
- Rates of return
- Allocating capital

Economics

- Economics looks externally outside the organization and at the “laws” of behavior in markets, governments (regulation), and individuals
- Provides a sound understanding of supply and demand, consumer preferences, price sensitivity, etc.

The Financial Statements

- Companies produce three main financial statements:
 - Balance Sheet
 - Income Statement
 - Cashflow Statement

The Balance Sheet

- The balance sheet displays the company's total assets and how the assets are financed, either through either debt or equity
- The balance sheet is based on the fundamental equation:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Balance Sheet

Total Assets

Current Assets
+
Non-Current Assets

Total Liabilities

Current Liabilities
+
Non-Current Liabilities

Total Equity

Share Capital
+
Retained Earnings

Sample Balance Sheet

**Example Company
Balance Sheet
December 31, 2017**

ASSETS

Current assets

Cash	\$ 2,100
Petty cash	100
Temporary investments	10,000
Accounts receivable - net	40,500
Inventory	31,000
Supplies	3,800
Prepaid insurance	1,500
Total current assets	<u>89,000</u>

Investments	<u>36,000</u>
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Property, plant & equipment

Land	5,500
Land improvements	6,500
Buildings	180,000
Equipment	201,000
Less: accum depreciation	(56,000)
Prop, plant & equip - net	<u>337,000</u>

Intangible assets

Goodwill	105,000
Trade names	200,000
Total intangible assets	<u>305,000</u>

Other assets	<u>3,000</u>
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Total assets	<u>\$ 770,000</u>
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LIABILITIES

Current liabilities

Notes payable	\$ 5,000
Accounts payable	35,900
Wages payable	8,500
Interest payable	2,900
Taxes payable	6,100
Warranty liability	1,100
Unearned revenues	1,500
Total current liabilities	<u>61,000</u>

Long-term liabilities

Notes payable	20,000
Bonds payable	400,000
Total long-term liabilities	<u>420,000</u>

Total liabilities	<u>481,000</u>
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STOCKHOLDERS' EQUITY

Common stock	110,000
Retained earnings	220,000
Accum other comprehensive income	9,000
Less: Treasury stock	(50,000)
Total stockholders' equity	<u>289,000</u>

Total liabilities & stockholders' equity	<u>\$ 770,000</u>
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The notes to the sample balance sheet have been omitted.

The Income Statement

Revenues

Expenses

Profit or Loss

Sample Income Statement

Income statement example

TEDDY FAB INC. STATEMENT OF INCOME Year Ended December 31, 2100	
Revenues	\$ 1,000,000
<u>Cost of goods sold</u>	<u>200,000</u>
Gross profit	<u>800,000</u>
Operating expenses	
Selling, general, and administrative expense	357,700
Interest expense	20,000
<u>Depreciation and amortization expense</u>	<u>5,200</u>
Operating income	<u>417,100</u>
Interest income	20,000
Net earnings before taxes	<u>437,100</u>
Income tax expense	<u>240,000</u>
Net income	<u>\$ 197,100</u>

Cashflow Statement

Operating: Sale of Goods and Providing of Services

Investing: Buying or selling of a building or other asset

Financing: Obtaining a loan or grant or equity investment

Sample Statement of Cash Flows

Cash Flow Statement	
For the Year Ended December 31, 2016	
Cash Flow from Operations	
Net income	79,000
Adjustments for depreciation	2,000
Adjustments for increase in inventories	(22,000)
Adjustments for decrease in accounts receivable	12,000
Net Cash Flow from Operations	71,000
Cash Flow from Investing	
Cash receipts from sale of property and equipment	10,000
Cash paid for purchase of equipment	(12,000)
Net Cash Flow from Investing	(2,000)
Cash Flow from Financing	
Cash paid for loan repayment	(5,500)
Net Cash Flow from Financing	(5,500)
Net Increase in Cash	63,500

Accurate Financial Statements

Building **accurate financial statements** is **essential** to understand your company's financial performance and being able to **convey** that performance to those that can provide **capital**

Where to build Financial Statements?

- Every company has a ledger
- Ledgers used to be paper based
- Today ledgers are electronic -
Quickbooks

Quickbooks

- **Quickbooks (QB)** is the industry standard for small business
- Links to **Quickbooks** from most banks allow for **automatic downloading of transactions** into **QB software**

How do you keep track?

Discussion: *How* do you keep track of
your business transactions today?

How Financial Statements are Created

The Chart of Accounts (COA)

- Think about **the COA** as **the foundation** of a building
- In the COA you decide **how your transactions are categorized and reported in your financial statements.**
- **Companies use a COA to organize their finances and give** interested parties, such as investors and shareholders, a clearer **insight into their financial health.**

COA Organization

Numeric Range	Account Type	Financial Report
100 – 199	Assets	Balance Sheet
200 – 299	Liabilities	Balance Sheet
300 – 399	Equity	Balance Sheet
400 – 499	Revenue	Profit & Loss
500 – 599	Cost of Goods Sold	Profit & Loss
600 – 699	Operating Expenses	Profit & Loss
700 – 799	Taxes Paid	Profit & Loss
800 – 899	Other Expenses	Profit & Loss

Sample COA: Balance Sheet Accounts

*Code	*Name	*Type
101	Checking Account	Bank – Current Asset
120	Accounts Receivable	Accounts Receivable – Current Asset
140	Inventory	Inventory
160	Computer Equipment	Fixed Asset
161	Less Accumulated Depreciation on Computer Equipment	Fixed Asset
200	Accounts Payable	Accounts Payable
216	Wages Payable – Payroll	Current Liability
230	Employee Tax Payable	Current Liability
240	Income Tax Payable	Current Liability
290	Loan	Non-current Liability
300	Owners Contribution	Equity
320	Retained Earnings	Retained Earnings
330	Common Stock	Equity

Sample COA: Income Statement Accounts

*Code	*Name	*Type
400	Sales	Revenue
500	Cost of Goods Sold	Direct Costs
600	Advertising	Expense
604	Bank Service Charges	Expense
612	Consulting & Accounting	Expense
624	Postage & Delivery	Expense
632	Insurance	Expense
640	Legal Expenses	Expense
644	Utilities	Expense
648	Automobile Expenses	Expense
652	Office Expenses	Expense
660	Rent	Expense
664	Repairs and Maintenance	Expense
668	Wages and Salaries	Expense
672	Payroll Tax Expense	Expense
676	Dues & Subscriptions	Expense
680	Telephone & Internet	Expense
684	Travel	Expense
700	Depreciation	Expense
710	Income Tax Expense	Expense
720	Federal Tax expense	Expense
721	State Tax expense	Expense
800	Interest Expense	Expense

Financial Statements and the COA

Financial Statements *organize* and *display* the **information** that is **contained in the Chart of Accounts** in a standard way

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