



Income Statements for Small Businesses

We just returned from a national conference on writeup accounting and tax preparation, and here is a really good idea that I learned.

Most of the many lines that you see on an Income Statement for a Small Business you *really don't need* to make informed decisions about the performance of your business.

For most of us—I'm talking about businesses whose gross annual revenues are less than \$1,500,000—can get a feel for their overall business health by looking at just a few numbers.

But which numbers?

The Cost of Materials—whatever it is that you make or sell—is one number. It answers an important question: "Can you buy at a price favorable to you?"

The Cost of People—including the obvious expenses of payroll, payroll taxes, and fringe benefits—is another number. You might also include the expense of training, the payroll service fees, the expense of your company's retirement plan, etc.

The speaker—Pat Barnes, CPA, of Roanoke, VA—was suggesting that for most of us only a third category would be necessary—one he would call General and Administrative.

He's assuming, of course, that all the components of the "traditional" Income Statement are incorporated into one of the three categories.

He wants to get all the numbers in—the bottom line wouldn't change a penny—he just wants to focus attention on the really important Key Economic Variables.

His idea, though unusual, makes perfect sense. All of us who own small businesses must concentrate our attention and energies on the relatively few crucial Key Economic Variables that must be attended to if the business is to flourish and grow.

And for most of us, focusing on three things will do the job much of the time.

So what are these three things? The Cost of Materials. The Cost of People. And The Cost of Everything Else.

And if you take care of the first two—the Materials and the People—the third will usually fall into line.

That third category—the one Pat calls General and Administrative, but which I call Everything Else—tends to have a lot of relatively small and relatively stable amounts that can't be changed significantly, particularly in the short run.

Examples would include the various insurance premiums you must pay,

the monthly security monitoring fees, and of course your monthly accounting fees! (Wouldn't want to forget them!)

Small Business Owners don't have nearly enough time to do the things they want to do, and should do. All too often, they end up focusing on the C tasks at the expense of the A tasks, and thereby jeopardize or at least penalize the vitality of the business.

So here's a quick way to address this most important of all A tasks: Pay close attention to the sudden fluctuations in the Cost of Materials and the Cost of People, and monitor the overall level of Everything Else.

I can think of a quick way to break out key components of the Everything Else if you wish.

For instance, you may want to create a Cost of Occupancy category. Cost of Occupancy could include your rent or lease payment, CAM expense, utilities, property insurance, cleaning, security monitoring, and so on.

Another good one might be The Cost of Communications—telephone, fax, internet, cellular phones, etc. Make your own decisions—you're in charge.

Either way, you're likely to find that Everything Else, Occupancy, and Communications are all relatively stable and are not likely to change much in the short term no matter what you do.

So keep in touch with how those costs are behaving, but focus your energies and your efforts on the Materials and the People.

The underlying principle in all of this is that the Management Control System—which is what the Accounting System should be—works best when it conforms to the needs of the Business Owner.

All too often we find things set up the other way round—the Business Reporting system conforms to the needs of the Accounting System.

This stuff isn't rocket science, and it can make all the difference in the world.

Try this idea out on your business accountant and advisor—and if you don't have one, why don't you? (After all, she or he will be in Everything Else...)

In the final analysis, this type of Income Statement is more of a Management Report than it is a formal financial record that you would take to the Bank.

But it could be an important tool that gives you the focus and direction that we all need.

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