This lesson on competent financial management, the 16th in a series of 18 units, is part of the first level of a comprehensive entrepreneurship curriculum entitled: A Program for Acquiring Competence in Entrepreneurship (PACE). (Designed for use with secondary students, the first level of PACE introduces students to the concepts involved in entrepreneurship and helps them become aware of entrepreneurship as a career option.) The following topics are covered in the unit: the importance of financial management, the components of a balance sheet, the differences between current and fixed assets and current and fixed liabilities, the components of a profit and loss statement, methods for calculating selected financial ratios, sources of financial ratio data, and the activities associated with electronic data processing and financial analysis. Included in the lesson are instructional text organized in a question-and-answer format, individual and group learning activities, a case study, and assessment questions. (MN)
Managing the Finances

Developed by M. Catherine Ashmore and Sandra G. Pritz

You will be able to:

• Explain the importance of financial management.
• Describe the components of a balance sheet.
• Differentiate between current and fixed assets—current and fixed liabilities.
• Describe the components of a profit and loss statement.
• Identify methods for calculating selected financial ratios.
• Identify sources of financial ratio data.
• Identify the activities associated with electronic data processing and financial analysis.
BEFORE YOU BEGIN...

1. Consult the Resource Guide for instructions if this is your first PACE unit.

2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.

3. Look for these business terms as you read this unit. If you need help with their meanings, turn to the Glossary in the Resource Guide:

   assets
   balance sheets
   classifying
   cost of goods sold
   current liabilities
   data reproduction
   fixed assets
   fixed liabilities
   gross margin
   input activities
   inventory turnover

   liabilities
   management by exception
   manipulation activities
   net profit
   net worth
   output activities
   ratio analysis
   retrieving
   return on investment
   sorting
   source documents
MANAGING THE FINANCES

WHAT IS THIS UNIT ABOUT?
Competent financial management is essential for a business to grow and earn profits. Too often, the small business owner asks an accountant to prepare statements and files them away after merely glancing at them. This attitude toward financial management often indicates a lack of knowledge about the value of financial statements.

This unit provides information about both income statements and balance sheets. The unit also shows how to interpret the information in these financial statements through the use of ratio analysis. Ratio analysis is simply a study of the relationships between different business factors. The study of the amount of advertising dollars a business spends in relation to sales realized would be one example of a ratio analysis. The future of the business depends on the owner's ability to handle financial management. Financial management tasks include—

- reading and analyzing financial statements;
- determining the financial strengths and weaknesses of the firm;
- planning and taking necessary corrective action.

WHAT IS A BALANCE SHEET?
A balance sheet is a statement that tells what you own and what you owe at any one time. It is like a photograph of your business on one day. Most likely, balance sheets prepared for three days in a row will have different figures. Financial information about a business—or about you—changes every day. You receive income periodically and you pay bills periodically. In effect, you manage a flow of cash.

If your cash is always in motion, why is the balance sheet so important? The balance sheet helps you control this cash flow. This control enables you to manage both your financial resources (what you own) and your debts (what you owe) effectively. The balance sheet is a tool used to keep the business profitable.

WHAT ARE THE COMPONENTS OF A BALANCE SHEET?
The balance sheet has three main parts or components. These are (1) assets, (2) liabilities, and (3) net worth (also called equity).

All balance sheets are based on the following formula:

Assets = Liabilities + Net Worth.
Assets must equal liabilities plus net worth. In other words, the total of those items on the left side of the balance sheet (under assets) must exactly equal the total of the right side of the balance sheet (under liabilities) plus net worth. All the main sections of this type of financial statement must balance.

Assets are anything that the business owns, including cash on hand, equipment, real estate, and inventory. Current assets include cash and anything that can be changed into cash within twelve months. Current assets include cash on hand or in the bank, accounts receivable (what people owe you), and inventory.

Fixed assets are those items that usually cannot be changed into cash within twelve months. They are items that the business acquired for long-term use. Fixed assets include land, buildings, machinery, equipment, and company vehicles.

Liabilities are anything that the business owes. Liabilities might include loans, credit notes, income taxes, and mortgages. A current liability is anything you owe that can be paid by using a current asset. Current liabilities are usually due within twelve months. Current liabilities include income taxes, loans, and bills due to creditors. A long-term liability includes any debts that will not be paid within twelve months. A mortgage is an example of a long-term liability.

Net worth is the owned portion of the business. It is the owner's investment in a single proprietorship, the partners' investment in a partnership, or an individual's investment in corporate stocks.

An example of a balance sheet for Bill's Craft Shop is as follows.
# BILLS CRAFT SHOP

## Balance Sheet

**December 31, 19**

### Assets

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$13,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$7,000</td>
</tr>
<tr>
<td>Less allowance for doubtful accounts</td>
<td>$1,000</td>
</tr>
<tr>
<td><strong>Inventory</strong></td>
<td></td>
</tr>
<tr>
<td>Less allowance for inventory loss</td>
<td>$1,000</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>$27,000</td>
</tr>
<tr>
<td><strong>Fixed Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$40,000</td>
</tr>
<tr>
<td>Building</td>
<td>$10,000</td>
</tr>
<tr>
<td>Less allowance for depreciation</td>
<td>$4,000</td>
</tr>
<tr>
<td><strong>Equipment</strong></td>
<td></td>
</tr>
<tr>
<td>Less allowance for depreciation</td>
<td>$1,000</td>
</tr>
<tr>
<td><strong>Total Fixed Assets</strong></td>
<td>$52,000</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td></td>
</tr>
</tbody>
</table>

### Liabilities and Net Worth (Equity)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$7,000</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>$2,000</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong></td>
<td>$9,000</td>
</tr>
<tr>
<td><strong>Long-Term Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Mortgage</td>
<td>$30,000</td>
</tr>
<tr>
<td><strong>Total Long-Term Liabilities</strong></td>
<td>$30,000</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Equity (Net Worth)</strong></td>
<td></td>
</tr>
<tr>
<td>Owner's equity</td>
<td>$38,000</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES AND NET WORTH</strong></td>
<td>$79,000</td>
</tr>
</tbody>
</table>
WHAT IS A PROFIT AND LOSS STATEMENT?
The profit and loss statement is a record of the activities of the business during a period of time. Profit and loss statements are usually developed at the end of an accounting period; that is, at the end of the month or at the end of the fiscal year.

WHAT ARE THE COMPONENTS OF A PROFIT AND LOSS STATEMENT?
Profit and loss statements have five major components. These are (1) total sales, (2) cost of goods sold, (3) gross profit, (4) expenses, and (5) net profit. Each of these components provides important financial data about the firm.

Total sales includes both cash and credit sales. It does not include sales tax collected or the sales figures for products returned.

The cost of goods sold is the amount that it costs you to buy or produce the goods that you sold. If you are a manufacturer, you will also inventory raw materials and products in process and include this information. The cost of goods sold is calculated by:

- taking a beginning inventory;
- adding materials or products purchased during the accounting period; and
- subtracting inventory remaining at the end of the accounting period.

Gross margin is the amount of profit made from sales before operating expenses are deducted. Gross margin is calculated by subtracting the cost of goods sold from the total sales.

Expenses include all costs involved in running the business.

Net profit is your profit or loss at the end of the accounting period. This does not include taxes you must pay on the business. An example of a Profit and Loss Statement for Bill's Craft Shop is illustrated next.
BILL'S CRAFT SHOP
Profit and Loss Statement
For Period Ending December 31, 19

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Sales</strong></td>
<td></td>
</tr>
<tr>
<td>Cash sales</td>
<td>$32,000</td>
</tr>
<tr>
<td>Credit sales</td>
<td>$48,000</td>
</tr>
<tr>
<td><strong>Total Sales</strong></td>
<td>$80,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td></td>
</tr>
<tr>
<td>Beginning inventory</td>
<td>$18,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Cost of goods available for sale</strong></td>
<td>$68,000</td>
</tr>
<tr>
<td>Less ending inventory</td>
<td>$8,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>$60,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>$10,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>$1,000</td>
</tr>
<tr>
<td>Advertising</td>
<td>$1,500</td>
</tr>
<tr>
<td>Depreciation on Equipment</td>
<td>$3,500</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$15,000</td>
</tr>
<tr>
<td>Net Profit before Taxes</td>
<td>$7,000</td>
</tr>
<tr>
<td>Estimated Income Tax</td>
<td>$2,000</td>
</tr>
<tr>
<td><strong>NET PROFIT</strong></td>
<td>$5,000</td>
</tr>
</tbody>
</table>
Ratio analysis is a means of analyzing the figures that appear on financial statements. This analysis enables the manager to compare the past and present performance of the business. It can also help a manager compare the performance of the business to the performance of another firm or to the industry as a whole. Such comparisons are essential to future planning as they reveal the strengths and weaknesses of the business operation. A ratio is computed by taking two selected figures from the financial statements and expressing one figure as a percentage of the other.

The following ratios compare figures from the profit and loss statement and the balance sheet for Bill's Craft Shop. As you work through each of these ratios, however, remember that today many small business owners use microcomputers to help them manage finances. A section on microcomputers in business is included at the end of this unit. When reading this section, think of ways the computer could be used to help calculate financial ratios for Bill's Craft Shop, or for your own small business.

- **Return on investment.** This ratio shows the return obtained on the owner's investment in the business. Compute by dividing the net profit figure by owner's equity figure and express the result as a percentage.

\[
\frac{\text{NET PROFIT}}{\text{EQUITY}} = \frac{\$5,000}{\$38,000} = 13.1\%
\]

This figure should be a great deal larger than the return the owner could get by investing the money elsewhere. Business owners should receive a better return on their investment because of the time, effort, and risks involved in owning and operating a business.
Net profit to sales. This ratio shows the net profit margin on sales. Compute by dividing the net profit figure by the sales figure.

\[
\frac{\text{NET PROFIT}}{\text{SALES}} = \frac{\$5,000}{\$80,000} = 6.2\% 
\]

A reduced net profit on sales can be caused by (1) poor pricing policies, (2) high operating costs, or (3) a combination of both factors. To determine which of these factors is causing a low net profit, the business owner should look at further ratio data.

Sales to equity (net worth). This figure is often referred to as the investment turnover. It is not expressed as a percentage. A firm's net profit on sales may be high, but if the rate of asset turnover is low, the rate of return on investment may be low. The value of annual sales should be greater than the amount of investment in assets. Compute this figure by dividing sales by equity (net worth).

\[
\frac{\text{SALES}}{\text{EQUITY}} = \frac{\$80,000}{\$38,000} = 2.1 \text{ to } 1 
\]
- **Inventory turnover.** The inventory turnover figure shows how rapidly the merchandise is being sold. It determines whether the business has too much or too little money tied up in inventory. Compute this from the income statement by dividing total revenue for a certain period by average inventory. Determine the average inventory by computing the average of the beginning and ending inventory. In the case of Bill's Craft Shop, compute this by dividing \(18,000 + 8,000 = 13,000\).

\[
\text{TOTAL REVENUE} = \frac{\$80,000}{1/2 (18,000 + 8,000)} = \frac{\$80,000}{13,000} \approx 6.2 \text{ times}
\]

Usually, the higher the turnover rate, the better. Turnover rates vary depending upon the type of business and its merchandise. This rate of 6.2 would suggest that the merchandise in the inventory is current and salable. A low rate, say 1, would suggest that all the revenue is tied up in inventory that isn't being sold quickly.

- **Average collection period.** The average collection period indicates how quickly the credit sales are being collected. It will tell the owner how many days' sales are tied up in accounts receivable. Compute it from the balance sheet and the income statement. First divide sales by 360 (the rounded number of days in the year) to find the average sales per day. Then divide the accounts receivable figure by the average sales per day.

\[
\frac{\text{SALES}}{360} = \text{AVERAGE SALES PER DAY} = \frac{\$80,000}{360} = \$222
\]

\[
\frac{\text{ACCOUNTS RECEIVABLE}}{\text{AVERAGE SALES PER DAY}} = \frac{\$7,000}{\$222} = 31 \text{ days}
\]

The average collection period should not be more than one and one-half times the credit terms extended by the business (thirty, sixty, ninety days, and so on). In this case, assume that Bill's Craft Shop offers thirty-day credit. Customers must pay their bills within thirty days. The average collection period of thirty-one days shows that his customers do pay close to the credit period allowed.

- **Current ratio.** The current ratio shows whether the business has enough current assets to meet its current debts. Compute the current ratio from the balance sheet by dividing current assets by current liabilities. A current ratio of 2 to 1 is generally considered good.

\[
\frac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}} = \frac{\$27,000}{\$11,000} = 2.5 \text{ to 1}
\]
Acid-test ratio. The acid-test ratio shows whether the business could meet its current obligations with funds readily available if all sales revenue should stop. Compute it by dividing cash plus accounts receivable by current liabilities. An acid-test ratio of 1 to 1 is considered satisfactory.

\[
\frac{\text{CASH + ACCOUNTS RECEIVABLE}}{\text{CURRENT LIABILITIES}} = \frac{$13,000 + $6,000}{\$11,000} = 1.7\text{ to } 1
\]

WHERE CAN RATIO DATA BE OBTAINED?

The following are sources of ratio data for comparing the performance of a business with the average performance of similar businesses.

- **Key Business Ratios.** Published annually by Dun and Bradstreet, Inc., 99 Church Street, New York, New York, 10007. Attention: Public Relations Department. Covers 125 lines of retailing, wholesaling, manufacturing, and construction industries.

- **Mail-Me-Monday Barometer of Small Business.** Published semiannually by the Accounting Corporation of America, 1929 First Avenue, San Diego, California, 92101.


- Various trade associations publish ratio data which is useful to different types of businesses. (See the Resource Guide.)

Additional business ratios are discussed in Levels 2 and 3 of the unit.

HOW CAN MICROCOMPUTERS AID FINANCIAL MANAGEMENT?

The use of microcomputers can assist in financial control and analysis for a business. A microcomputer has been described as a complete information processing system that includes an information processor, an information memory, a program ("software" or a set of directions), and a power supply.

WHAT ELECTRONIC INFORMATION PROCESSING ACTIVITIES ARE RELATED TO FINANCIAL MANAGEMENT?

In preparing and analyzing balance sheets, profit and loss statements, and selected financial ratios, it is necessary to perform information processing activities. All information processing, whether done by hand or by the latest electronic methods, consists of input, manipulation, and output activities.
WHAT INPUT ACTIVITIES ARE ASSOCIATED WITH ELECTRONIC INFORMATION PROCESSING?

Input activities involve information originated or captured in some form for electronic information processing. Such information may be first recorded on paper source documents. These documents could be sales tickets, checks, deposit slips, and so on. Information from these documents is converted into a machine-readable form for processing. A magnetically read, alphanumerical code on the bottom of a check is an example of a source document read by an electronic information processing machine.

WHAT MANIPULATIVE OPERATIONS ARE PERFORMED BY ELECTRONIC INFORMATION PROCESSING?

One or more of the following operations may be performed to process financial data.

- **Classifying.** Identifying and arranging items with like characteristics into groups or classes is called classifying. Financial data taken from an accounts receivable statement and used to group items may include the name of the customer, address, original amount owed, interest rate, payments to date, and any late payment charges.

  Classifying is usually done by a shortened, predetermined method of abbreviation known as coding. The three types of code used are numeric (e.g., Social Security number), alphabetic (grades A, B, and C), and alphanumerical (an automobile license plate stamped CSN-1772).

- **Sorting.** After the data are classified, it is usually necessary to arrange or rearrange them in a certain sequence. This arranging process is called sorting. Sorting is done by letter as well as by number. Accounts receivable may be sorted by account number or by customer name. Numeric sorting is often used because it requires less time than alphabetic sorting in electronic data processing.

- **Calculating and Summarizing.** Computers are capable of rapid and accurate calculations. To be of value to the financial manager, however, such calculations must be condensed and summarized. One technique of calling the attention of a manager/owner of a business to important data is a Management by Exception financial analysis system.

  The Management by Exception System identifies the ratios, overdue accounts receivable, expended expense budgets, low profit departments, and so on, that are either above or below desired predetermined limits, goals, ranges, and so on. People reading computer printout reports do not have to study a lot of data, as these "exceptional" data items are either highlighted in colored ink or printed on a separate, supplementary report.

WHAT OUTPUT ACTIVITIES ARE ASSOCIATED WITH ELECTRONIC INFORMATION PROCESSING?

Once the information has been transformed into electronically read information, and is stored in the computer, one or more of the following activities may be required.
Retrieving. Recovering stored information when needed is the retrieving step. Retrieval methods range from searches made by file clerks to the use of quick-responding computer terminals that are connected on-line (i.e., directly) to a computer. The computer, in turn, may be connected directly to a mass-storage device that contains the information.

Data Reproduction. It is sometimes necessary to copy or duplicate information. This operation is known as data reproduction. It may be done by a large printer or a small auxiliary printer attached to a desk top microcomputer. Often the user may just view the information on the microcomputer television screen.

These, then, are the basic steps in electronic information processing. A financial manager should consider these steps when planning and using electronic information processing systems and equipment. Many businesses find the best solution to their information processing and financial analysis requirements to be a combination of manual and electronic methods. With the increasing availability of low-cost, efficient microcomputers, however, manager/owners are converting from manual information processing to computerized operations. Any tedious, repetitive, and costly financial information recording task that involves processing of information in a predetermined way is a candidate for computerization.
ACTIVITIES
Do you feel knowledgeable enough about what it takes to become an entrepreneur? Will you be able to put some of the skills into practice? The following activities will help you experience some of the real-life situations of entrepreneurs.

INDIVIDUAL ACTIVITY
Prepare a balance sheet of your personal belongings, including any investments such as stock, savings bonds, and so on. List all your debts. To make the statement balance, enter any excess of assets over liabilities in the net worth portion of the balance sheet.

GROUP ACTIVITY
If groups of two or three, arrange an appointment with at least two small business owners in your community. Ask them what financial statements they use and why. Find out if they prepare their own statements or use an accountant. Ask them for examples of how they use information from these statements. Find out if they use computerized information records and reporting systems. Ask if they are using a computer service or a microcomputer. If they are using a microcomputer, find out what kind of hardware they have. Ask what software they have found to be most effective. If possible, get copies of blank forms or records. Prepare an oral and written report of your interviews for presentation to the entire group.
CASE STUDY

THE LAWN AND GARDEN SHOP

Ann Jenkins has just received her end-of-the-year balance sheet and income statement from her accountant. These financial statements may be found on the following pages. Although she has never used ratio analysis before, she has decided that this year she will compare her business's performance with the lawn and garden industry averages.

From her trade association she has obtained the following ratio data showing the industry average for each of the following ratios:

- **Return on Investment**
  \[
  \text{net profit} \div \text{equity} = 14.9\%
  \]

- **Net Profit to Sales**
  \[
  \text{net profit} \div \text{sales} = 5.0\%
  \]

- **Sales to Equity**
  \[
  \text{sales} \div \text{equity} = 3.4\%
  \]

- **Inventory Turnover**
  \[
  \text{total revenue} \div \text{average inventory} = 9.7 \text{ times}
  \]

- **Average Collection Period** = forty-five days

- **Current Ratio**
  \[
  \frac{\text{current assets}}{\text{current liabilities}} = 2.2
  \]

Suggested Questions for Discussion:

1. Compute the ratios for the Lawn and Garden Shop. Compare the business performance with the industry averages.

2. Determine the strengths and weaknesses of the Lawn and Garden Shop business based on the ratios calculated.
# The Lawn and Garden Shop

**Balance Sheet**

**December 31, 19__**

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
<th>Liabilities and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td><strong>Current Liabilities</strong></td>
</tr>
<tr>
<td>Cash</td>
<td>$4,000</td>
<td>Accounts Payable</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$3,600</td>
<td>Notes Payable</td>
</tr>
<tr>
<td>Less allowance for doubtful accounts</td>
<td>400</td>
<td><strong>Total Current Liabilities</strong></td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td>$7,600</td>
<td></td>
</tr>
<tr>
<td><strong>Fixed Assets</strong></td>
<td></td>
<td><strong>Long-Term Liabilities</strong></td>
</tr>
<tr>
<td>Land</td>
<td>$30,000</td>
<td>Mortgage</td>
</tr>
<tr>
<td>Building</td>
<td></td>
<td><strong>Total Long-Term Liabilities</strong></td>
</tr>
<tr>
<td>Less allowance for depreciation</td>
<td>5,000</td>
<td><strong>TOTAL LIABILITIES</strong></td>
</tr>
<tr>
<td><strong>Total Fixed Assets</strong></td>
<td>$25,000</td>
<td><strong>Equity (Net worth)</strong></td>
</tr>
<tr>
<td>Equipment</td>
<td>6,000</td>
<td>Owner's equity</td>
</tr>
<tr>
<td>Less allowance for depreciation</td>
<td>1,000</td>
<td><strong>TOTAL LIABILITIES AND EQUITY</strong></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$35,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities and Equity</strong></td>
<td>$42,600</td>
<td></td>
</tr>
</tbody>
</table>
THE LAWN AND GARDEN SHOP
Profit and Loss Statement
For Period Ending December 31, 19\text{---}

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Sales</strong></td>
<td></td>
</tr>
<tr>
<td>Cash sales</td>
<td>$15,000</td>
</tr>
<tr>
<td>Credit sales</td>
<td>$20,000</td>
</tr>
<tr>
<td><strong>Total Sales</strong></td>
<td>$35,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td></td>
</tr>
<tr>
<td>Beginning inventory</td>
<td>$4,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>$25,000</td>
</tr>
<tr>
<td><strong>Cost of goods available for sale</strong></td>
<td>$29,000</td>
</tr>
<tr>
<td>Less ending inventory</td>
<td>$3,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>$26,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>$9,000</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
</tr>
<tr>
<td>Salaries and wages</td>
<td>$3,500</td>
</tr>
<tr>
<td>Utilities</td>
<td>$700</td>
</tr>
<tr>
<td>Advertising</td>
<td>$600</td>
</tr>
<tr>
<td>Depreciation on equipment</td>
<td>$200</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$5,000</td>
</tr>
<tr>
<td><strong>Net Profit before Taxes</strong></td>
<td>$4,000</td>
</tr>
<tr>
<td>Estimated Income Tax</td>
<td>$1,100</td>
</tr>
<tr>
<td><strong>NET PROFIT</strong></td>
<td>$2,900</td>
</tr>
</tbody>
</table>
ASSESSMENT

Directions: Read the following assessment questions. When you feel prepared to respond to them, ask your instructor to assess your competency.

1. Discuss three advantages to a business manager/owner of preparing a balance sheet.

2. Explain the formula used to prepare a balance sheet.

3. Identify three examples of current assets and three examples of fixed assets.

4. Give three examples of a current liability and three examples of a fixed liability.

5. Give a definition of net worth for a single proprietorship, for a partnership, and for a corporation.


7. Tell how to calculate the cost of goods sold for a retail business.

8. Explain how the gross margin differs from the net profit.

9. Give formula for calculating each of the following financial ratios.
   a. Return on investment
   b. Net profit on sales
   c. Sales to equity
   d. Inventory turnover
   e. Current ratio

10. List three sources for locating financial ratio data.

11. Identify the three electronic information processing activities related to financial management.
SOURCES USED TO DEVELOP THIS UNIT


For further information, consult the lists of additional sources in the Resource Guide.
Unit 1. Understanding the Nature of Small Business
Unit 2. Determining Your Potential as an Entrepreneur
Unit 3. Developing the Business Plan
Unit 4. Obtaining Technical Assistance
Unit 5. Choosing the Type of Ownership
Unit 6. Planning the Marketing Strategy
Unit 7. Locating the Business
Unit 8. Financing the Business
Unit 9. Dealing with Legal Issues
Unit 10. Complying with Government Regulations
Unit 11. Managing the Business
Unit 12. Managing Human Resources
Unit 13. Promoting the Business
Unit 14. Managing Sales Efforts
Unit 15. Keeping the Business Records
Unit 16. Managing the Finances
Unit 17. Managing Customer Credit and Collections
Unit 18. Protecting the Business

Resource Guide
Instructors' Guide

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business

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