BAS ASSOCIATES

making it all add up

OUR GUIDE TO YOUR TRADING ACCOUNT

Introduction

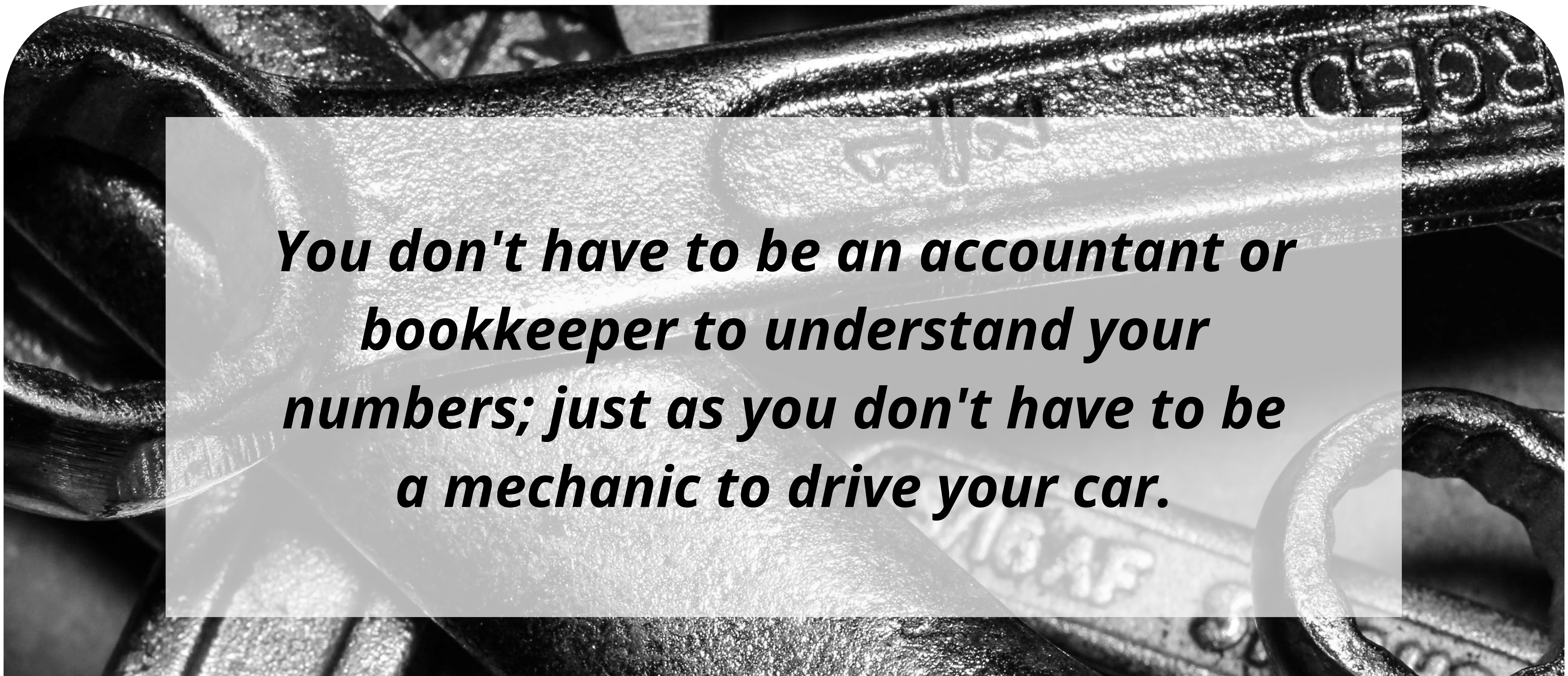
Your financial reports tell you the story of your business; allowing you to interpret the results of your business activity. The better you understand your financial reports, the better your decision-making and results will be.

We want to share the benefits of understanding your numbers, give you an overview of the standard reports and provide helpful tips on using them to improve your business. Where possible, we've avoided jargon and 'Accountanese'.

However, this guide is no substitute for specific one on one advice. We are available to talk to you about your unique situation and how we can help you and your business.

The benefits of knowing your numbers:

- Understand if your business is growing or shrinking
- Identify and track trends
- Compare results to your expectations (as set in your budget)
- Compare results between years or different periods
- Identify areas of strengths and weakness
- Measure your business efficiency
- Measure the value of your business
- Identify symptoms of underlying problems
- Measure your cashflow
- Make better business decisons



Tips for beginners

No matter which report you're looking at, there are fundamentals to consider and understand:

1. Is the data 'clean'? Most software packages allow you to export your own reports. While this gives you flexibility, the data can be unreliable if transactions haven't been coded correctly or bank statements haven't been reconciled. Likewise, if monthly invoicing hasn't been completed, sales reports could be understated. Contact us for information on the monthly procedures you should follow to keep your data 'clean'.

2. Inspect what you expect. Your reports are a representation of what you planned for your business. For example, you may have set a sales or gross profit target in your Business Plan and Cashflow Forecast (what you expected). Your reports can then be used to inspect if you're on track to achieve those targets.

3. Know which reports to use. Profit & Loss Statements measure income and expenses; the Balance Sheet measures assets, liabilities and net worth. There are different versions of each report, e.g. for the Profit & Loss you can measure this year vs last year, this period vs the same period last year, or this period vs the budget you set. Talk to us about the most appropriate reports for your business.

Tips for beginners cont.

4. Go horizontal and vertical when analysing your financial reports. A horizontal analysis compares the results of previous periods, e.g. comparing your 2020 Gross Profit to your 2019 Gross Profit. This shows whether your results are improving over a specified period. A vertical analysis calculates each item in the statement as a percentage of a base item, e.g. calculating expenses as a percentage of sales in your Profit & Loss. Conducting both helps identify specific areas of potential improvement.

5. 'As at' or 'for the period ending'. An 'as at' report shows the balances at the end of a specific period, e.g. the Balance Sheet shows asset and liability balances at the end of the financial year. A 'for the period ending' report shows the results over a period of time, e.g. the Profit & Loss shows your Gross Profit or Net Profit over the specified period.

6. Choosing the date range. For a period ending report, ensure you correctly specify the start and end date for the period you want to measure. For example, reporting on the current month and the year to date (the period from the start of this current financial year to the date required). It's best practice to choose a date that is a month end date, e.g. if you want to print a report on 15 July, set the date range to end on 30 June, as you should have all income and expenses coded and reconciled for the period ending 30 June, but may not have coded and reconciled them for July yet. Not to mention reoccurring monthly expenses may not be included if using a mid-month date.

Your key financial reports

The rest of this guide provides an overview of your key financial reports, what each report tells you about your business, some key ratios to use to track your results, and some tips on how to make good use of the reports.

Key ratios:
By calculating key ratios, you can compare your results over a number of periods, compare the profitability of different product lines, divisions or locations, and compare your results to your industry benchmarks.

All of this provides information which should be used in your decision-making. It's important to only compare your ratios with companies in the same industry; what may be viewed as a 'good' ratio for one industry, may be 'poor' in another.

Below is an overview of Your Trading Account.

However, it is important that you also understand the following reports:
1. Statement of Profit & Loss.
2. Balance Sheet.
3. Statement of Changes in Equity.
4. Shareholder Current Account.

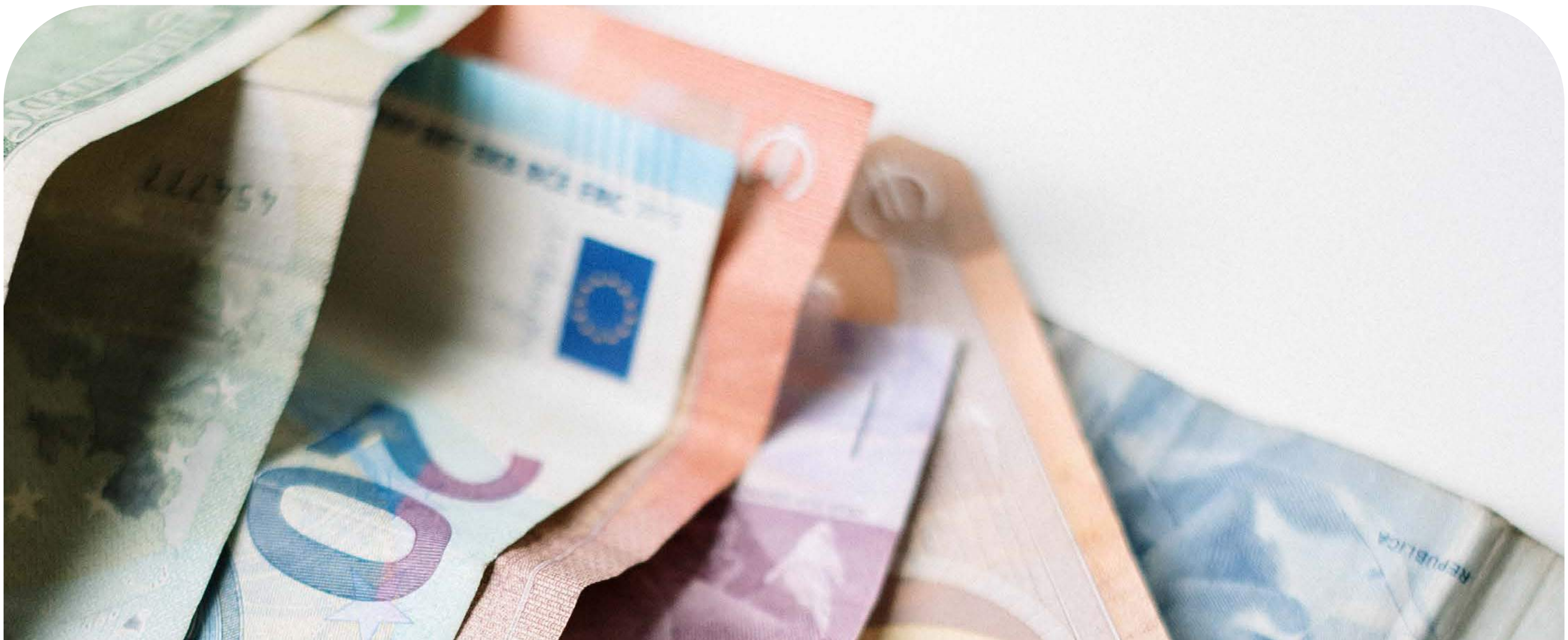
Your trading account

Your Trading Account can be prepared at any stage during the year and shows sales generated less any variable costs directly associated with those sales. It's used to calculate your Gross Profit (sometimes referred to as your Gross Margin) which is often also shown as a percentage.

The basic format for your Trading Account is
Sales - Cost of Sales = Gross Profit

If your business has multiple divisions, locations or product lines, a separate Trading Account should be used for each so you can monitor the performance and compare the profitability of each.

Cost of Sales
Cost of Sales is the total cost of producing the sales for the period being reported. In its simplest sense, if you sell ice cream, the cost of selling one ice cream is the cost of the ingredients plus other variable costs of producing that ice cream for sale, such as transport, packaging (the paper napkin or sleeve), and labour.



Your trading account cont.

A more comprehensive way to measure Cost of Sales is:

Cost of Sales = Opening Stock + Purchases + Direct Labour Costs - Closing Stock

Descriptions & calculations
Opening Stock: Stock at the start of the period - valued at cost price
Purchases: All variable costs to produce the product, e.g. ice cream, cones, refrigeration, packaging, transport costs, etc.
Direct Labour Costs: Wages for staff selling the product but not business administration wages, e.g. ice cream sales staff
Closing Stock: Stock at the end of the period - valued at cost price

Subtracting the Cost of Sales for any given period from the sales for that period gives you the Gross Profit.

Gross Profit
Your Gross Profit shows how much is left after costs directly relating to sales have been paid. Direct costs increase as your sales increase and include delivery expenses, direct wages, packing material, sales commission, etc.

Your trading account cont.

Key Ratios:
Gross Profit Percentage = (Gross Profit / Sales) * 100

Your Gross Profit Percentage shows the contribution of each pound (£) of Sales towards your overhead costs and profit. For example, if Sales are £1,000,000 and your Gross Profit is £250,000, your Gross Profit Percentage is 25%. This means that for each £1 of sales, 25p is available for overhead expenses and profit. To increase your Gross Profit Percentage, review cost of sales and direct costs to find potential savings. Increasing sales won't increase your Gross Profit Percentage as the costs will increase in line with the increase in sales.

Mark Up = ((Selling Price - Cost Price) / Cost Price) * 100

Mark Up is not the same as Gross Profit. The distinction between Gross Profit and Mark Up is very important. Mark Up is the amount you add onto your variable costs to arrive at a selling price. It's expressed as a percentage, so you know how to convert your costs to a selling price.

If we look at our ice cream example and determine that variable costs to produce one ice cream are £2 and we sell that ice cream for £4, our Mark Up is 100%: ((£4 - £2) /£2 * 100.

To calculate the Gross Profit Percentage for that single ice cream, divide the cost price by the selling price and multiply by 100. So the Gross Profit Percentage on that ice cream would be 50%: (£2 / £4) * 100.

Trading account tips

A. Increasing sales is not the only way to grow your overall profit. However, growing sales should always be part of your strategy.

There are five ways to grow sales:
1. Increase client retention - look after existing customers well so they keep coming back.
2. Generate more leads or enquiries - use your marketing effectively.
3. Convert more leads into customers - ensure you have an effective sales process and strong sales skills.
4. Increase transaction frequency - encourage people to buy from you more often.
5. Increase transaction value - encourage people to spend more each time they buy from you.

If you're looking to grow your business and are unsure where to start, speak to a member of our Business Development team on 01442 560050.

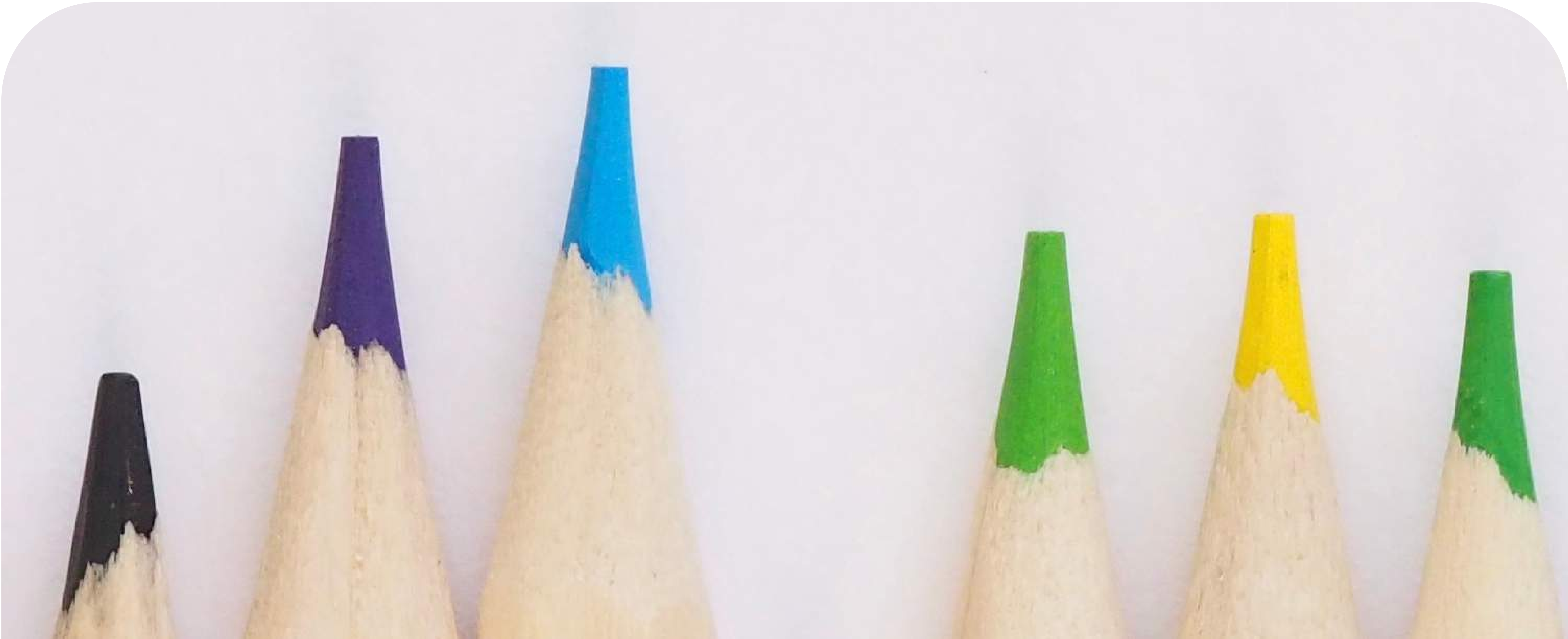
B. Lifting your Gross Profit Percentage by 1-2% can make a huge difference to your results. Calculate this impact by taking 1% of your total sales for the year; that is how much more will hit your overall profit if you lift your Gross Profit Percentage by 1%. We can help you employ strategies to increase your margin.

Trading account tips cont.

C. Compare your expected Gross Profit Percentage to your actual Gross Profit Percentage. You can do this by 'back costing' a job once you've finished it. Calculate all costs associated with a completed job, e.g. for a building job, the total material and labour costs for that job, then divide by the selling price to determine the Gross Profit for that job.

D. Ensure your pricing is up to date. If your Gross Profit is declining, review your costing to ensure you're using current costs when pricing a job, product or service. Many businesses use great pricing tools and standard Mark Up formulae but often have outdated costs in the model or calculation.

E. Consider all costs associated with creating a sale. Your margin could be slipping because there are costs hidden in overheads that should be measured as variable costs. For example, a mobile ice cream truck will have fuel as a variable cost, but the fuel costs might be lumped in as overhead costs with another business vehicle.



"If you'd like to learn more about your financial reports, the key financial ratios you should be measuring, and how to improve your results, get in touch to find out how we can help."

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