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4.2. Analytical Accounting

Main Accounting Principles

It is necessary to have a basic understanding of the fundamental accounting principles in order to write accurately and then monitor the financial planning.
It's critical to note predicted revenues, direct and indirect spending, and fixed and variable costs for at least the next three years in the budget forecast. The gross profit or loss is the difference between sales and the costs incurred to produce the goods sold. Aside from the costs of producing the commodities supplied, the company must also deal with additional charges, such as expenses and expenditures. The difference between these two is that expenditures are intended to generate revenue, whilst expenditures are not (they are also defined operational costs). Sales revenue minus Costs of Goods Sold minus Expenses and Expenditures is the difference. It's the EBITDA (Earnings Before Interests, Taxes, Depreciation, and Amortization), which is not to be confused with the annual profit. When a company is first starting out, it's common to have to spend money on assets, which are goods that can't be measured in money but that the company will use for several years (such as furniture, computers, and so on); at the end of each financial year, all of the assets will generate costs, which is depreciation. The annual profit will be reduced as a result.
The income statement or profit/loss statement summarizes sales revenue, costs, expenses, and expenditures, and is used by management to show investors if the company made a profit or lost money during the fiscal year. The revenue, also known as the top line, is the amount of money received from sales before taxes and expenses, while the net income, often known as the bottom line, is the amount received after taxes and expenses.
The cash flow statement is also useful for monitoring cash flows (that is, cash flows into and out of the business) in financial planning. It aids in the examination of cash flows generated by or utilised in operating, investing, and financing operations.
A company's balance sheet must be edited at the end of the financial year, with current assets (those expected to be used within one year) and fixed assets (those that cannot be converted into cash) on the left side and liabilities (obligations arising from past events and transactions with, for example, suppliers) on the right side. The most crucial thing is that the left and right sides must be identical.

It is conceivable to state categorically that being an accounting specialist is unimportant. The most important thing is to have a basic understanding in order to plan and track the business trend.

Calculating the StartUp capital

Starting a business is difficult, and for most entrepreneurs, raising starting cash is the most difficult element. The first beginning cost covers one-time company expenses such as refurbishment of premises, equipment sourcing, layout alteration, and electrical work, among others. Apart from these, every firm has operating costs such as rent, office supplies, phone service, electricity / power bill, and so on.

TIP:

When making substantial investments, it is advised that the company objectively examine its ability to cover the investment and evaluate its short and long-term financial standing. Performing alternative computations will assist the company in making finance decisions. It is beneficial to develop a written report on the connection between the investment and the firm's business idea and strategy in order to persuade funders.

	Type of expense
1	Expected salary of the business owner
2	Staff salaries
3	Rent
4	Rent / Lease of machinery
5	Advertising
6	Business supplies
7	Delivery Expense/Transportation
8	Telephone, Fax, Internet Service
9	Electricity / power bill
10	Other Utilities
11	Insurance
12	Taxes Including Employment Insurance
13	Interest
14	Legal and Other Professional Fees
15	Maintenance costs
16	Miscellaneous
Expenses only for the startup of the business	
1	Fixtures and Equipment
2	Decorating and Remodeling
3	Installation of Fixtures and Equipment
4	Starting Inventory
5	Legal and Other Professional Fees
6	Deposits with Public Utilities
7	Licenses and Permits
8	Advertising and Promotion for Opening
9	Initial capital of the company
10	Miscellaneous

Setting price for services – Methodology

- FACTORS THAT AFFECT THE PRICING
- CALCULATE YOUR COSTS
- DETERMINING THE PRICING MODEL
- MONITORING AND CHANGING YOUR PRICE

- **Setting price for services**

- **STEP 1 – FACTORS THAT AFFECT THE PRICING METHODOLOGY**

- **Cost-plus pricing.** This strategy attempts to determine the cost of producing a product or, in this case, providing a service, before adding an additional number to indicate the targeted profit. To calculate the cost, you must first estimate the direct, indirect, and fixed costs.
- **Competitors' pricing.** You must be informed of what competitors in the market charge for identical services. This data could come from competitor websites, phone calls, conversations with friends and associates who have utilized a competitor's services, publicly available data, and so on.
- **Perceived value to the customer.** When deciding on a pricing for a service, here is where a lot of subjectivity comes into play. When you have a product, you can use keystone pricing, which doubles the wholesale price to arrive at a price to charge and account for your profit. You can't always do that with a service.

STEP 2 – CALCULATE YOUR COSTS

You must first determine the costs of providing these services to patients before you can set a price for them. The following three components make up the cost of producing any service:

Materials cost. These are the costs of the materials you utilize to provide the service. Paper towels, cleaning chemicals, rubber gloves, and other supplies would be included in the charges of a cleaning company.
Labor cost. This is the cost of hiring direct labor to do a service. This would be your cleaning crew's or accountant's hourly wage.
Overhead costs. Your monthly rent, taxes, insurance, depreciation, advertising, office supplies, utilities, mileage, and other overhead expenditures are all included in your overhead costs. Each service should be billed for an appropriate portion of these overhead costs, whether in an hourly rate or a percentage.

STEP 3 – DETERMINING THE PRICING MODEL

After you've determined your costs, you'll need to mark up your services/products to make a profit for your company. It's a delicate balancing act. You want to make sure that you attain a desirable profit margin, but you also don't want your company to gain a reputation for overcharging for services/products, especially in a bad economy.

STEP 4 – MONITORING AND CHANGING YOUR PRICE

Every month, you must be aware of your company's profitability. In addition to knowing your monthly profitability, you should know the profitability (or lack thereof) of each service or product you sell. Make certain you understand the extent to which each person you sell contributes to your monthly profit objective.

The income statement

"The income statement's goal is to present the profit or loss for the financial period."

The Income Statement, commonly known as the Profit and Loss Statement (P&L), is a financial statement that shows how a company fared over a period of time. It may be used to figure out how profitable a company is, how creditworthy it is, and generate projections about future financial performance based on historical data.

The nature of the firm is one factor that will alter the appearance of the revenue statement. A manufacturing business's income statement will differ slightly from that of a service company. Service businesses do not have accounts like "cost of products sold," hence they are not included on the income statement.

Great Brushers, Inc.
Income Statement
for the Year Ended December 31, 2013

	2013	2012
Patient revenue	1,276,433.98	1,098,339.24
Salaries expense	(307,884.29)	(299,554.33)
Payroll tax expense	(108,443.77)	(97,324.93)
Benefits expense	(13,226.00)	(11,554.22)
Professional supplies expense	(44,834.04)	(50,112.27)
Laboratory fees expense	(76,935.21)	(81,265.07)
Marketing expense	(41,263.66)	(40,112.40)
Rent expense	(48,000.00)	(48,000.00)
General & adminstrative expense	(100,433.99)	(94,001.49)
Depreciation expense	(17,883.02)	(16,443.98)
Interest expense	(4,463.09)	(3,785.84)
Income before income taxes	513,066.91	356,184.71
Income tax expense	(205,226.76)	(142,473.88)
Net Income from Operations	307,840.15	213,710.83

Balance sheet

"A balance sheet is a statement of a company's financial situation at a specific point in time, such as the end of a financial period. The balance sheet shows the assets of a company in comparison to its equity and liabilities."

A balance sheet, also known as a statement of financial position, is a report that summarizes an organization's assets, liabilities, and equity as of a certain date. It's based on the basic accounting formula "Assets = Liabilities + Owners" Equity. This equation must be balanced at all times.

Assets are the things that a company owns. They are listed on the balance sheet according to their liquidity, or their ability to be converted into cash rapidly. ***Liabilities*** are the amounts owed by an entity to third parties, such as vendors and banks. The most recent liabilities are listed first, followed by the ones that are due soonest.

The amount that would remain if all liabilities were paid using the organization's assets is known as ***stockholders' equity***, sometimes known as owners' equity.

Mo-Lar Dental
Balance Sheet
12/31/2013 and 12/31/2012

	2013	2012		2013	2012
Assets			Liabilities and Stockholders' Equity		
Current Assets			*Current Liabilities*		
Cash and cash equivalents	14,000	12,000	Current portion of long-term debt	7,000	5,000
Accounts receivable	30,000	18,000	Accounts payable	15,000	11,000
Inventory	5,000	3,000	Notes payable	12,000	9,000
Prepaid expenses	1,000	2,000	Total Current Liabilities	34,000	25,000
Total Current Assets	50,000	35,000			
			Long-Term Liabilities		
Property, plant and equipment			Long-term debt	200,000	150,000
Land	150,000	100,000			
Buildings	120,000	100,000	Total Liabilities	234,000	175,000
Equipment	50,000	20,000			
Less: Accumulated depreciation	(25,000)	(20,000)	*Stockholders' Equity*		
Total PP&E	295,000	200,000	Common stock	40,000	25,000
			Paid in capital in excess of par	22,000	5,000
Total Assets	345,000	235,000	Retained earnings	49,000	30,000
			Total Stockholders' Equity	111,000	60,000
			Total Liabilities and Stockholders' Equity	345,000	235,000

Financial ratios

Financial ratios are one method for analyzing the information on the balance sheet and income statement. Liquidity ratios, activity ratios, profitability ratios, and long-term debt-paying ability (or coverage) ratios are the four types of financial ratios.

- Liquidity Ratios

Liquidity ratios assess a company's ability to repay short-term loans. When a debt is due within the next twelve months, it is considered short-term debt. Current ratio = Current assets/Current liabilities

Acid-test ratio = (Cash equivalents + Marketable securities + Net receivables)/Current liabilities

- Activity Ratios

Activity ratios are used to assess how effectively a company utilises its resources. They show how well management converts assets like inventory and accounts receivable into cash. Accounts receivable turnover = Net credit sales/Average net receivables

- Profitability Ratios

Profitability ratios use data from both the income statement and the balance sheet to determine whether an organization's efforts to be profitable over time were successful.

Return on total assets = Net Income/Average total assets

- Long-Term Debt-Paying Ability Ratios

Long-term debt-paying ability ratios measure an organization's ability to meet its long-term debt obligations. They're also known as solvency ratios, and they're the long-term counterparts to liquidity ratios, which evaluate a company's capacity to pay down short-term debt.

Debt ratio = Total liabilities/Total assets

Cost categories

Variable and fixed costs

According to how they are used in relation to the quantity of goods or services produced, costs can be split into variable and fixed costs.

Direct and indirect costs

Depending on how the costs are incurred, they can be classified into direct and indirect costs.

The concept of marginal revenue

The idea of marginal revenue can be used to track a company's profitability as well as the impact of cost-cutting strategies. The concept of marginal income is based on dividing costs into two categories: variable and fixed costs. The following formula is used determine marginal revenues:

Turnover
- Variable costs

= Marginal earnings
- Fixed costs

= Operating margin

Basic Accounting

Revenues and expenses, financial transactions, as well as corrections and adjustments, are all recorded in basic accounting. When a product is passed to a client, revenue is considered realized. In the same accounting period, the company must also report the expenses it incurred in generating the profit. Double entry accounting or bookkeeping is required, which means that the company must not only declare where its money came from but also how it was spent.

Accounting principles

Principle of continuity. Accounting is based on the idea that the business exists for the time being and that its operations would, in theory, continue indefinitely.

Principle of prudence. Only the actual revenues and expenses are recorded. To put it another way, they have already happened or are soon to happen.

Principle of Full Disclosure / Materiality. When compiling the financial statement, financial management must have the goal of disclosing all expenses and income for the fiscal period.

Financial Planning

Financial planning is to determine how a company can deal with financial challenges utilizing its resources while also serving as a monitoring tool to see if the company is on track to meet its objectives while maintaining financial stability. A financial plan is developed right after the management sets the objectives, and it's a vital tool for managing the firm's trend in the short term, rather than imagining what will happen to the company in the future.

Important issues regarding finance

One of the most essential goals of a sensible business manager is to build value for his company; proper financial planning can assist him in accomplishing this goal. However, financial planning must have its own objectives, which might be summarized as follows:

1. To accelerate the company's growth in order to gain a strong market position and grow into a large corporation.
2. Reduce the cost of capital to reach a high degree of profitability.
3. Maintaining financial equilibrium through assessing self-financing potential and consolidating the current financial framework.
4. Maintaining and pursuing a previously established financial plan.
5. The capital opportunity cost is used to shift financial resources to shareholders.

Each of these objectives can be utilized according to the firm's life cycle; during the start of business activities, it is necessary to accelerate the firm's development in order to achieve a high level of profitability while maintaining financial equilibrium; during growth, the firm must face the same problems but with a different emphasis; and, during maturity, it is often possible to transfer f Applying the approaches to attain the previously stated aims necessitates a great deal of attention on the part of a business management in order to avoid costly financial mistakes.

Sources of finance/ funding acquisition

A company's ability to afford critical investments may be hampered at times during its life, requiring it to use a variety of financing methods:

- **Internal financing**: Operational revenue derived from product sales, as well as profits retained by the company and not distributed at the conclusion of the fiscal year (self-financing).
- **External financing**: This funding source is made up of the following components:

i. own capital, such as shareholder financing with no time limit on the reimbursement or a non-interest loan from shareholders (in addition to social capital and reserves).
ii. debt capital, such as debts negotiated with a financier (e.g., banks or institutional investors) that have an expiration date for the shareholder refund and a low business risk.

The business manager can use own capital or medium-long term debt capital (i.e., for assets), or he can use own capital or short-term debt capital (i.e., for the purchase of circulating assets) depending on the sort of investment that needs to be made.

Financial Statement/ Preparation for the meeting with the financer

The financial statement is an accounting record that provides all positive and/or negative changes in the liquidity and financial streams over the course of a year, allowing the manager to track the firm's financial trend. As a result, when a company needs to raise money, it must submit a financial statement that authorizes the lender to approve the loan. The so-called Elevator Pitch and Business Plan are two more key documents that might aid the financier in comprehending the business idea.
The first is a document in which the entrepreneur must present the business idea to a business angel (a financier who invests their own money in your project in exchange for bonds, i.e.) according to the rule of 10/10/30, which means 10 slides must be explained in 10 minutes in a type size of at least 30 points, and the entrepreneur must concentrate all the important aspects in a short amount of time. The following are the important points: presentation of the idea and the team behind the project's practical application; background of the project, such as other investors' interest, securing public money,

potential job experiences in the same field as the project, and so on; presentation of the business model that underpins the product/competitive service's advantage in comparison to others already on the market (competitive advantage= the product/outcomes service's must be greater than the costs paid); Presentation of the company's future prospects using the SWOT Analysis, which is a strategic planning tool that evaluates a project's Strengths, Weaknesses, Opportunities, and Threats. The entrepreneur must give financial statistics at the end of the text to assist the financier in understanding the project's profitability.

The Business Plan, the second document, is a management tool in which the entrepreneur directs the attention of the financier to the areas of production, financing, and marketing. The business plan must clearly express the business concept, and it must be utilized as a tool for evaluating the results accomplished as well as a benchmark for potentiality as the company grows.

Aside from these two important documents, the entrepreneur must consider his attitude: he must present his idea in a decisive manner and be prepared to answer the financer's questions. It is, without a doubt, preferable if the entrepreneur presents the slides to his friends for feedback prior to the meeting with the financer.

Profitability preview

In economics, profitability refers to a company's ability to create value and profit, or, to put it another way, the profit earned by shareholders who put their own money into the company. Different indices are used to measure it in economic terms:

- ***The Return on Equity (ROE) index*** is the ratio of a period's profit to the capital invested to achieve it. It shows the company's ability to pay all of the investors who put their money into the company.
- The ***ROI (Return on Investment) index*** measures the relationship between operating income and invested capital. It indicates the company's ability to profit from its investments.
- The ***ROS (Return on Sales) index*** measures the relationship between operational income and sales revenue. It's useful to compare the sales' economic convenience to that of other companies on the market.

When applying for funding and drafting a financial report or a business plan, it's critical that all entered data is accurate and based on official information to avoid calculating erroneous indexes and risking a financer's incorrect assessment of the business idea. When a financier invests his funds, he must be certain of his future earnings!

Liquidity planning

Liquidity planning is important in financial planning because it symbolizes an organization's ability to be solvent in the medium to long term. A corporation must always be liquid in order to meet its operating expenditures yet maintaining the appropriate degree of liquidity can be difficult at times. In reality, having a high level of it is not recommended because it is money that does not earn interest, but having a low level of it could present challenges in continuing to handle normal business activities. However, if the level of liquidity is too low during a crisis, there are various solutions that can be implemented:

- to allow creditors/clients to pay on a short-term basis.
- to send out invoices
- to take advantage of credit limits to the fullest extent possible

It is also possible to keep cash money by requesting longer payment terms, lowering shares, deferring non-essential expenditures, selling plants, and requesting shareholder capital, among other things.

In light of this, it's critical to create a detailed liquidity plan in order to foresee which liquid tools might be used. Injunctions, executions, and even bankruptcies are all possibilities if the corporation is not solvent.

Pricing

The price is one of the tools that a business management can use to attain his goals. It can be described as the monetary value of goods or services that are valued by the seller based on what he believes they are worth to the buyer. Price policy is important for a variety of reasons:

1. It assists a country in maintaining a high level of living for its citizens.
2. It aids in the monitoring of the planning process.
3. It aids in the management of monetary volatility.
4. It enables for the regulation of supply and demand.
5. It aids in the adjustment of distribution management.
6. It contributes to the growth of national resources.

A price policy assists a business management to achieve his aims, but it also has a variety of objectives that can be summarized as follows:

1. When a financier puts capital in a business, he expects a return, hence the price is set to reflect this.
2. Establishing high pricing to gain market share will reduce market share, however setting low rates would grow market share and the business will undoubtedly attract new clients.
3. Pricing policy in the face of competition: setting low pricing, for example, will entice customers while also discouraging competitors.
4. Pricing policy aimed at maximizing profits by setting high prices, but it operates in monopolistic competitions, because buyers are aware of the high price, and thus attracts new competitors who offer identical items at a cheaper price. There will be price control at this point.
5. Pricing policy with the goal of long-term price stability. In fact, prices cannot fall below a certain level during a recession, and they cannot rise above a certain level during a boom.
6. Pricing policy to encourage resource mobilization, i.e., items are priced in a way that demonstrates that businesses have the resources to invest in their growth. Marketers want to see a quick return on their investment so that management may set high prices, which will entice competitors with low prices and similar items.
7. A pricing policy that permits the company to survive and flourish, rather than maximize profits, is a more essential goal.
8. Pricing policy to uphold the company's reputation.

In any case, monitoring price policy is difficult for a business management because it is influenced by both internal and external forces.
The following are examples of the first type:

- Factors influenced by the company's internal structure.
- The most essential component of the marketing mix that can influence manufacturing, promotion, and distribution is price.
- Product characteristics based on which a company may set a price in consideration of competition in the same market category.
- Prices are viewed as a tool for achieving business objectives such as increasing profits or market share, among others.

The external factors, or the second category, are as follows:

- Demand, for example, might be useful to analyse the market, the type of the consumers, and so on before collocating a product. When a product's demand is inelastic, it's preferable to set a high price, whereas when demand is elastic, it's better to set a low price.

- Customers will buy the rivals' product if the price is set higher than the competitors', but if the price is set lower than the competitors', the consumer will consider the product is of poorer quality. A corporation may use product differentiation to avoid a pricing war.
- Distribution routes are particularly significant since there is usually a middleman operating in the distribution channel who charges a profit on the price, and the final price for the consumer is often so expensive that he rejects the product.
- The pricing is also influenced by the economic environment. During a recession, prices fall to maintain a minimum level of turnover, whereas during a boom, prices rise to allow the company to cover its production and distribution costs.
- When a company sets its price, it must also consider government rules and taxes.
- Finally, a company must consider consumer reactions to prices, because if the price is too high, the buyer may decide to boycott the product.

How can prices be fixed?

Cost- based policies:

1. The most frequent is cost plus pricing, which involves setting the price on the basis of the costs incurred in producing the product and then adding a proportion of profit.
2. Target pricing is a method through which a corporation establishes a target rate of return on invested capital by estimating future rates and costs.
3. The price is derived using marginal cost pricing, which is based on variable costs.
4. Break-even pricing is when a company predicts the break-even point (when total sales equal total costs) and the price has to cover variable and fixed costs even if profit isn't taken into account.

Demand-based policies:

1. Differential pricing (telephone utilities), in which the same product is supplied at various prices to different buyers in different locations.
2. Modified break-even analysis, in which a company determines the price-quantity mix that maximizes profit and sets prices accordingly.
3. Premium pricing refers to how a product can be placed at the top of the market because it offers more value than similar products.
4. Pricing that is neutral and allows for added value or benefits while maintaining a competitive price.

Competition-based policies:

1. Going rate pricing is a method of determining a company's rates based on the industry's average price level.
2. Prices are determined from the customers under customary pricing. It will only alter if the cost of production rises.
3. Sealed bid pricing, in which a corporation sets its price based on the price of its competitors.

Value-based pricing:

1. Perceived-value pricing is a type of pricing in which the price is set based on the consumer's perception of value.
2. Value for money pricing establishes a price based on the value that the consumer receives when purchasing a product.

The estimation of the demand curve is challenging in the case of new items that must be co-located on the market without regard to historical trends or information to be analyzed, so it is recommended to set the price based on the following factors:

- The product's commercial acceptability based on the consumer's taste and psychology.
- To investigate a variety of pricing points by seeing how consumers react to various price points.
- To forecast a sale volume.
- To determine the marketing approach that the rivals will use based on their reaction to price.

Finally, it's fair to say that determining the price of a product is a difficult and time-consuming process. It's critical to keep a pricing that permits the product to be collocate on the market, neither too expensive nor too low. Because a company's success is determined by its price!

References