FREE GUIDE

How to Read Your Financial Statements

P&L, balance sheet, and cash flow: what each one tells you, and the questions to ask.

Your financial statements are a scorecard, an X-ray, and a bank statement rolled into one. You don't need to prepare them to read them — you need to know where to look. Here's a practical walk-through.

The Profit & Loss Statement

Also called the income statement. It covers a **period of time** — a month, quarter, or year — and answers: *did we make money?*

Line	What it means	Question to ask
Revenue	Sales earned in the period	Is it growing? Which customers or products drive it?
Cost of sales (COGS)	Direct costs of delivering what you sold	Are direct costs growing faster than revenue?
Gross profit / margin	Revenue - COGS; margin = GP ÷ revenue	Is margin stable? Are we pricing correctly?
Operating expenses	Overhead: rent, salaries, software, marketing	Which expenses grew, and did they produce results?
EBITDA / operating income	Profit from operations before financing and taxes	Is the core business profitable?
Net income	The bottom line after everything	Is it enough to fund growth, debt, and owner pay?

Read it like a CFO

- Look at **percentages**, not just dollars. A rising expense may be fine if it's a stable % of revenue.
- Compare to **last month, last year, and budget**. One number alone tells you very little.
- Watch **gross margin** first. It's usually the earliest warning of pricing or cost problems.
- Find the **one or two lines** that changed most — that's where the story is.

The Balance Sheet

A snapshot at a **single point in time**. It always balances: **Assets = Liabilities + Equity**. It answers: *are we financially healthy, and can we pay our bills?*

Section	Includes	Question to ask
Current assets	Cash, accounts receivable, inventory, prepaids	Is AR growing faster than sales? (slow collections)
Fixed assets	Equipment, vehicles, improvements, less depreciation	Are we investing enough to stay competitive?
Current liabilities	Accounts payable, credit cards, accrued expenses, current debt	Can current assets cover these?

Section	Includes	Question to ask
Long-term liabilities	Loans due beyond 12 months	Is debt manageable relative to earnings?
Equity	Owner investment + retained profits - distributions	Is equity growing year over year?

Three ratios worth knowing

Ratio	Formula	Rule of thumb
Current ratio	Current assets ÷ current liabilities	Above 1.5x is comfortable; below 1.0x is a warning
Debt-to-equity	Total debt ÷ total equity	Below 2.0x for most small businesses
Days sales outstanding	AR ÷ revenue × days in period	Close to your payment terms (e.g., under 45 days)

The Cash Flow Statement

This bridges the P&L and the balance sheet by showing why cash changed. It has three sections:

- **Operating** — cash from running the business. Should be positive over time.
- **Investing** — buying or selling equipment and other long-term assets.
- **Financing** — borrowing, repaying debt, owner contributions and distributions.

WATCH FOR If net income is positive but operating cash flow is negative, look at accounts receivable and inventory first. Profit tied up in unpaid invoices isn't spendable.

Ten questions to ask every month

1. Did revenue meet the plan? Why or why not?
2. Did gross margin hold?
3. Which expense lines moved the most?
4. Are we profitable after paying owners a fair wage?
5. How many weeks of expenses does our cash cover?
6. Is AR aging getting older?
7. Are we paying vendors on time without paying too early?
8. Did we take on or pay down debt?
9. Is equity growing?
10. What will next month look like — and what can we change now?

NEXT STEP Pair this guide with our P&L Template, Balance Sheet Template, and KPI Tracker to see these numbers update automatically.

This guide is general information for small business owners and is not tax, legal, or accounting advice. Rules, rates, and deadlines change — confirm specifics with your CPA or the relevant agency.