



HOW TO GET MORE FROM YOUR FINANCIAL STATEMENTS!

Preamble

Langbroek, Louwse, & Thiessen LLP present evening workshops for clients and others six or so times a year in order to "Assist Business Owners in Achieving Their Goals"!

On October 17, 2012, we held such a workshop entitled "How to Get More from Your Financial Statements".

This is a summary of what we shared with our clients in attendance.

Agenda

1. Strategic Thinking/Planning
2. Annual Operations Goals/Budgets
3. Terminology and Financial Statements
4. "Cash is King"
5. What is your bank looking for?
6. Summary

Strategic Thinking/Planning

Develop a strategic and forward thinking plan with your Partners and key shareholders, one that you can share with your banker, employees, and other stakeholders. This is to ensure that everyone, especially you, knows which direction you are going and what your aspirations are.

Recommended Reading

1. "Good to Great" by Jim Collins
2. "Mastering the Rockefeller Habits" by Verne Harnish
3. "Five Dysfunctions of a Team" by Patrick Lencioni

Four Decisions any Growth Company Must Master

1. *People* - Would you enthusiastically rehire anyone on your team?

2. *Strategy* - The Seven Strata of Strategy
3. *Execution* - Three disciplines to get right
 - Priorities (alignment)
 - Data/Metrics (for clarity and foresight)
 - Meeting rhythms (for better/faster decisions)
4. *Cash* - How can you increase your cash flow without outside financing?

"If there's one thing that every growth company must do to build and maintain a competitive edge in today's fast-paced global economy, it's making great decisions...". As Jim Collins suggests, it's the combination of thousands of decisions that lead to greatness. Yet there seems to be a handful of decisions that stand apart from the rest; a few "black swan moments" as Verne Harnish would say.

Assist business owners in achieving their **goals**



Annual Operations Goals/Budgets

- Develop goals and an annual budget with your Partners and key shareholders so that you can share it with your banker, employees, and other stakeholders so that everyone, especially you, knows as to what the annual yardstick is and what your aspirations are.
- Consider: Sales - variable costs, gross profit, gross profit percentages, fixed costs, profit and what you plan to pay yourself, budget with breakeven point, budget with realistic performance, budget with optimistic performance ie. Realistic plus 15%, budget with pessimistic performance ie. realistic minus 17%, zero based budgets.
- What are key performance indicators; things that must be measured every day to give an indication on how you are doing. Examples are gross profit, number of full-time equivalent (FTE) staff, revenue per FTE, levels of inventory, age of accounts receivable, cash in the bank, and others.
- Always, always compare your annual and prorated budget to your monthly results. This will make them more useful and will force you to pay attention to the results compared to your budget.

Terminology and Financial Statements

- What is a *Notice to Reader*? - financial statements with no assurance; usually prepared if there is no bank debt.
- What is a *Review Engagement*? - financial statements prepared with a review of records and statements but without an audit.
- What is an *Audit*? - financial statements with the assurance that they meet the relevant accounting standards based on records that have adequate levels of internal control.

Financial Statements

- Statement of income or loss
- Statement of retained earnings or deficit
- Statement of financial position
- Statement of cash position
- Notes to the financial statements
- Management discussions and reports

Ratios measure how a statement stands up to the acceptable standards of financial health...

Profitability Ratios

- *Return on sales* - net income divided by sales
- *Return on assets* - net income divided by average assets
- *Return on equity* - net income divided by shareholder's equity
- *EBITA* - earnings before interest, taxes, and amortization
- *Gross profit percentage* - gross profit (sales less cost of sales) divided by sales
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Liquidity Ratios

- *Current ratio* - current assets divided by current liabilities
- *Quick ratio* - quick assets (current assets minus inventory) divided by current liabilities

Leverage Ratios

- *Debt to equity ratio* - total liabilities divided by shareholders equity
- *Debt to tangible assets ratio* - debt divided by tangible assets (land, buildings, and other current assets)
- *Current portion of long term debt* - principal portion of long term debt to be retired in the next twelve months
- *Times interest earned ratio* - interest divided by EBIT (earnings before interest and taxes)

Asset Management Ratios

- *Accounts receivable turnover* - sales divided by average accounts receivable
- *Inventory turnover* - cost of goods sold divided by average inventories

Assist business owners in achieving their goals



Cash is King!

- An instructive review of sample financial statements to see how they fit together (please see attached)
- Pay attention to how you can, strategically, improve your cash conversion cycle

What is your bank looking for?

Profitability
Good working capital position
Sound liquidity ratios
Strong leverage ratios
Indicators of excellent asset management
Ability of cash to meet obligations and management salary
Next year's budgets
Planning (preferably strategic)
Proactive conduct
Long term relationships

Summary

Think strategically
Plan strategically
Consider your people
Set goals
Determine a budget

Track performance
Compare results
Analyze statements
Build relationships
Read

Casey Langbroek FCGA
Certified Business Coach, Gazelles International

Recommended Readings

7 Habits of Highly Effective People, by Stephen Covey - book summary available
The 8th Habit, by Stephen Covey - book summary available
Multipliers, by Liz Wiseman - book summary available
Financial Statements - A Step by Step Guide, by Thomas R. Ittelson

Assist business owners in achieving their **goals**

STATEMENT OF INCOME

REVENUES	\$ 210,000
COST OF SALES	
Cost of materials	65,000
Direct labour	55,000
TOTAL DIRECT COST	<u>120,000</u>
TOTAL STAFF, GENERAL AND ADMINISTRATIVE EXPENSES	58,000
DEPRECIATION	5,000
INCOME TAX	<u>7,000</u>
NET PROFIT	<u><u>\$ 20,000</u></u>



STATEMENT OF CASH FLOWS

OPERATING CASH FLOW

Profit	\$ 20,000
Depreciation	5,000
Change in current assets	(15,000)
Change in current liabilities	(7,000)
	<u>3,000</u>

INVESTING CASH FLOW

Fixed assets purchases	<u>(15,000)</u>
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FINANCING CASH FLOW

Change in debt	(5,000)
Dividends paid	(10,000)
	<u>(15,000)</u>

CHANGE IN CASH

(27,000)

BEGINNING, CASH BALANCE

50,000

ENDING, CASH BALANCE

\$ 23,000

BEGINNING, CASH BALANCE

50,000



STATEMENT OF FINANCIAL POSITION

ASSETS

CURRENT ASSETS

Cash	\$ 23,000
Accounts receivable	190,000
Inventory	<u>205,000</u>
	418,000

FIXED ASSETS

230,000

TOTAL ASSETS

\$ 648,000

LIABILITIES AND EQUITY

CURRENT LIABILITIES

Accounts payable	\$ 176,000
Taxes due	<u>-</u>
	176,000

LONG TERM DEBT

60,000

236,000

EQUITY

Retained earnings	<u>412,000</u>
	<u>412,000</u>

TOTAL LIABILITIES AND EQUITY

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Relationships Between Financial Statements

BEGINNING BALANCE SHEET	STATEMENT OF INCOME	STATEMENT OF CASH FLOW	ENDING BALANCE SHEET
ASSETS	ASSETS	ASSETS	ASSETS
CURRENT ASSETS	CURRENT ASSETS	CURRENT ASSETS	CURRENT ASSETS
Cash	Revenue	Change in cash	Cash
Accounts receivable	Cost of materials	Collections	Accounts receivable
Inventory	Direct labour	Materials payments	Inventory
		Direct labour payments	
FIXED ASSETS	DEPRECIATION	EQUIPMENT (PURCHASES)/SOLD	FIXED ASSETS
TOTAL ASSETS			TOTAL ASSETS
\$ 50,000	\$ 210,000	\$ 5,000	\$ 23,000
180,000	65,000		180,000
200,000	55,000		205,000
430,000			418,000
220,000	5,000		230,000
\$ 650,000			\$ 648,000
LIABILITIES AND EQUITY	LIABILITIES AND EQUITY	LIABILITIES AND EQUITY	LIABILITIES AND EQUITY
CURRENT LIABILITIES	CURRENT LIABILITIES	CURRENT LIABILITIES	CURRENT LIABILITIES
Accounts payable	Total staff, general, & administrative expenses	Staff, general, & administrative expense payments	Accounts payable
Taxes due	Income tax	Tax payments	Taxes due
LONG TERM DEBT	LONG TERM DEBT (PAY)/RECEIPT	LONG TERM DEBT (PAY)/RECEIPT	LONG TERM DEBT
TOTAL LIABILITIES			TOTAL LIABILITIES
EQUITY	Net profit	Dividends	EQUITY
Retained earnings			Retained earnings
TOTAL EQUITY			TOTAL EQUITY
TOTAL LIABILITIES AND EQUITY			TOTAL LIABILITIES AND EQUITY
\$ 180,000	\$ 58,000	\$ 5,000	\$ 176,000
3,000	7,000	(10,000)	176,000
183,000		(72,000)	60,000
65,000		5,000	236,000
248,000			412,000
402,000			412,000
650,000			648,000

