

Tips for

Making Sense of Financial Reports - What a Manager/Business Owner Needs to Know

Canadian Farm Builders Association
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Tips for Effective Financial Management

1. Understand your financial statements
2. Assess your profitability
3. Manage your cash flow
4. Set targets and budgets
5. Keep good records
6. Consider incorporation for lower tax rates
7. How can a CPA in public practice help?

1. Understand your Financial Statements

Before you can use your Financial Statements in managing your business, you need to understand:

1. Accrual Basis of Accounting
2. The Matching Principle
3. Basic Financial Statements
 - Balance Sheet
 - Income Statement
 - Statement of Cash Flow

Which Method of Accounting?

- **Cash Basis of Accounting**
 - Revenues and Expenses are recorded when cash is actually paid or received. A simple method of accounting that allows for more flexibility in tax planning.
- **Accrual Basis of Accounting**
 - Revenues and Expenses are recorded in the period they are earned or incurred - called The Matching Principle. More complex than Cash Basis but more accurate.
- The method you choose can affect the decisions you make

Basic Financial Statements

The Balance Sheet

- Contains a summary of what the business owns and owes at a specific point in time.
- Shows Book Value (historical cost) of Assets and Liabilities
- Shows Owner's Equity - what you are worth

The Balance Sheet

Values at a
specific point
in time

What the
business owns

What the
business owes

The net worth of
the business

ASSETS	
Current Assets	\$ 335,797
Capital Assets	3,247,481
Other Assets	55,700
TOTAL ASSETS	\$3,638,978
LIABILITIES	
Current Liabilities	265,755
Mortgages Payable	929,705
Due to Owners	734,462
TOTAL LIABILITIES	1,929,922
OWNER'S EQUITY	1,709,056
TOTAL LIABILITIES & OWNER'S EQUITY	\$3,638,978

Basic Financial Statements

The Income Statement

- A statement of the operating activity of the business
- Shows Revenues and Expenses and the resulting Net Income (profit or loss) for a specific period of time
- Captures the changes to the Owner's Equity on the Balance Sheet during that same period of time
- Cash versus Accrual system can have a significant impact

The Income Statement

Values at the end of a specific period

What the business earned	TOTAL REVENUE	1,963,055
	TOTAL EXPENSES	1,910,229
What the business spent	NET INCOME (before adj)	52,826
	<i>Add Adj on Capital Assets</i>	116,241
What the business made in profit	NET INCOME (LOSS)	<u>\$ 169,067</u>

2. Profitability

- The ability of a business to generate profit from using its resources

Understand your Operating Expenses

- Fixed Expenses
- Variable Expenses
- Mixed Expenses

	Focus On
1. Liquidity	Balance Sheet
2. Solvency	Balance Sheet
3. Profitability	Income Statement

Understand your Operating Expenses

There are different types of expenses:

Fixed Expenses

- You incur the expense whether or not you make any sales

Variable Expenses

- You don't incur the expense unless you make a sale

Mixed Expenses

- Expenses that have both a fixed component and a variable component

Fixed Expenses

- You incur the expense whether or not you make any sales
- The expense is independent of your volume of sales or revenues
- Examples of fixed expenses:
 - Equipment maintenance
 - Property taxes
 - Loan interest
 - Family member wages

Variable Expenses

- You wouldn't incur the expense if you weren't trying to make a sale
- The expense varies in relation to the volume of revenues
- Examples of variable expenses:
 - Purchase of fuel to run delivery trucks
 - Purchase of labour (You might bring on additional staff to service extra sales volume)

Mixed Expenses

- There are some expenses that have both a fixed component and a variable component:
- Examples of mixed expenses:
 - Utilities (A fixed price to use the service and incremental usage fees)

3. Plan Your Cash Flow

Generate a monthly Cash Flow Report

- How/when will you collect cash from sales?
- How/when will you pay for your purchases?

Sample Cash Flow Report

Enterprise = <u> All </u>	Jan	Feb	Mar
Cash inflow			
Received from Sales	130,000	145,000	175,000
From Other Sources	<u> </u>	<u> </u>	<u> </u>
Total	130,000	145,000	175,000
Cash outflow			
For Cost of Sales & Overhead Expenses	127,000	149,000	170,000
For Loan Payments	7,000	7,000	7,000
For other capital expenditures	<u> 0</u>	<u> 0</u>	<u> 20,000</u>
Total	134,000	156,000	197,000
Net Cash	<u>- 4,000</u>	<u>-11,000</u>	<u>-22,000</u>
Opening Cash	58,500	54,500	43,500
Closing Cash	54,500	43,500	21,500

4. Setting Targets and Budgets

1. Develop a plan for the future:
 - What do you want for the future?
 - Where do you want to be?
 - What do you need to do to get there?
2. Share your plan with your family/management team
3. What can you do to increase your Gross Margin %
4. How much are you willing to pay for certain expenses?
5. How can you reduce these expenses?

Budget for Revenues and Expenses

- A month-by-month budget for one Operating Cycle
 - What sales will you make?
 - What expenses will you incur?

Monthly Budget Report

- Shows Revenue and Expenses
- Uses Accrual Basis of Accounting
- Puts transactions in the month they are expected to occur

5. Keep Good Records

- **Avoid issues with CRA**
 - **Issues arise not because you don't have legitimate deductions**
 - **More often because you cannot adequately support these deductions**
- **Shows the less obvious opportunities for deductions**
 - **Even your accountant needs good records to find these opportunities**
 - **Especially important for business use of home and some automobile deductions**

6. Consider Incorporation

- To take advantage of the low business tax rate for active business income
 - Ontario tax rate for the first \$500,000 of incorporated business income is around 15.5%
 - The top marginal rate for personal income is close to 47%
 - Can still defer taxes or split income among family members
 - There is a cost to incorporating:
 - *Legal fees*
 - *Accounting fees to file corporate tax returns*

7. Consider hiring a CPA

WHAT CAN A CHARTERED PROFESSIONAL ACCOUNTANT DO TO HELP?

- Start-up consulting
- Purchase and sale of a business
- Business valuations
- Business planning and financial projections
- Process development and improvement
- Developing strategies for securing financing
- Corporate and personal tax planning
- Information technology need analysis
- Assurance (audit, review and compilation)
- Preparing and analyzing financial information
- Acting as a trustee for receivership, insolvency, or bankruptcy
- Developing managerial controls
- Management and consulting
- Forensic accounting and litigation support