

# **“Hiding In Plain Sight”**

## **Understanding and Communicating Business and Financial Performance**

Presented by:  
Elsie L. Rose, CPA, CGMA

# Business Structure

Sole Proprietorship

Partnership

LLC

C Corp

S Corp

# Business Structure

## Sole Proprietorship

### Advantages:

- Easy entry and exit
- No legal docs
- No tax return

### Disadvantages:

- Liability
- No tax deferral
- Limited fringe benefits
- Continuity

# Business Structure

## ► Partnership

### Advantages:

- Easy entry
- One layer of tax
- Flexibility

### Disadvantages:

- Liability
- No tax deferral
- Limited fringe benefits

# Business Structure

## ▶ LLC

### Advantages:

- Limited liability
- One layer tax
- Flexibility

### Disadvantages:

- No tax deferral
- Limited fringe benefits
- Inconsistent treatment by states

# Business Structure

## ► C-Corporation

### Advantages:

- Limited liability
- Perpetual life
- Ability to raise capital
- Ease of ownership transfer
- Fringe benefits

### Disadvantages:

- Double tax
- Corporate red tape
- State controls
- Complexity upon liquidation

# Business Structure

## ► S-Corporation

### Advantages:

- Limited liability
- Perpetual life
- Ability to raise capital
- No double tax
- No self employment tax on profit

### Disadvantages:

- Reasonable salary requirement
- Fringe benefits for owners
- Owners pay tax on undistributed earnings
- Less flexibility
- Retirement contribution based on wages not total earnings
- Limited number of shareholders

# Business Risk

## Challenging Environment

- ▶ Uncertainty
- ▶ Cash Flow
- ▶ Pressure to Perform
- ▶ Increased Appetite for Risk



# Strategic Risk

Competition

Government Spending Controls

Long term view

Understanding impact from each decision

- ▶ Profit Equation
- ▶ Include Everyone
- ▶ Scoreboards
- ▶ Recognizing Improvement
- ▶ 1000 little things

# Appetite for Risk

## Lower “Cost of Risk”

- ▶ Better, more focused, coverage
- ▶ Reduced claims
- ▶ Indirect Costs – Quantify and Project
- ▶ Risk Management Department – Cost/Benefits

## Profit Equation – Project Savings

## Risk Management

- ▶ Internal Controls
- ▶ IT Vulnerability
- ▶ Risk Management Systems

# Two Views on Profit

- ▶ Financial View is reflected in Financial Statements

Financial Outcomes

- ▶ The Business Performance View is a reflection of day-to-day activities

Business Drivers



Today we will look at how these are linked

# Financial View

If you want to measure outcomes  
the focus is on:

## Financial Statement Information

(Lagging Indicators)

# Business Performance View

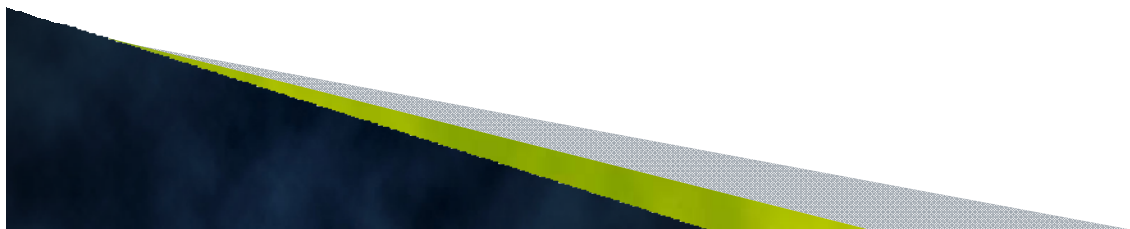
If you want to influence outcomes  
the focus needs to be on:

**People X Process = Profit**

(Leading/Predictive Indicators)

# The Financial View

## Financial Statement Basics



# Three Goals = Three Statements

1. To sell our services for more than it costs us to provide them.

Income Statement

2. To maintain a healthy cash flow to keep the business running

Cash Flows Statement

3. To get a return on our investment

Balance Sheet

# Basic Financial Definitions

## Income Statement

### Revenue –

- Sales/fees we generate; how much money we bring in

### Expenses =

- What it costs us to deliver products and services; how much we spend

### Profit \$

- How much money we have left over after all the bills are paid

## Balance Sheet

### Assets –

- The value of all the belongings and money in the business.

### Liabilities =

- How much money we owe to others

### Equity \$

- How much the business is worth on paper



# Basic Financial Equations

Profit =  
Revenue – Expenses  
Income Statement

Income Statement

Reflects activities  
over a period of  
time

1 month  
1 quarter  
1 year

Equity =  
Assets – Liabilities  
Balance Sheet

Balance Sheet

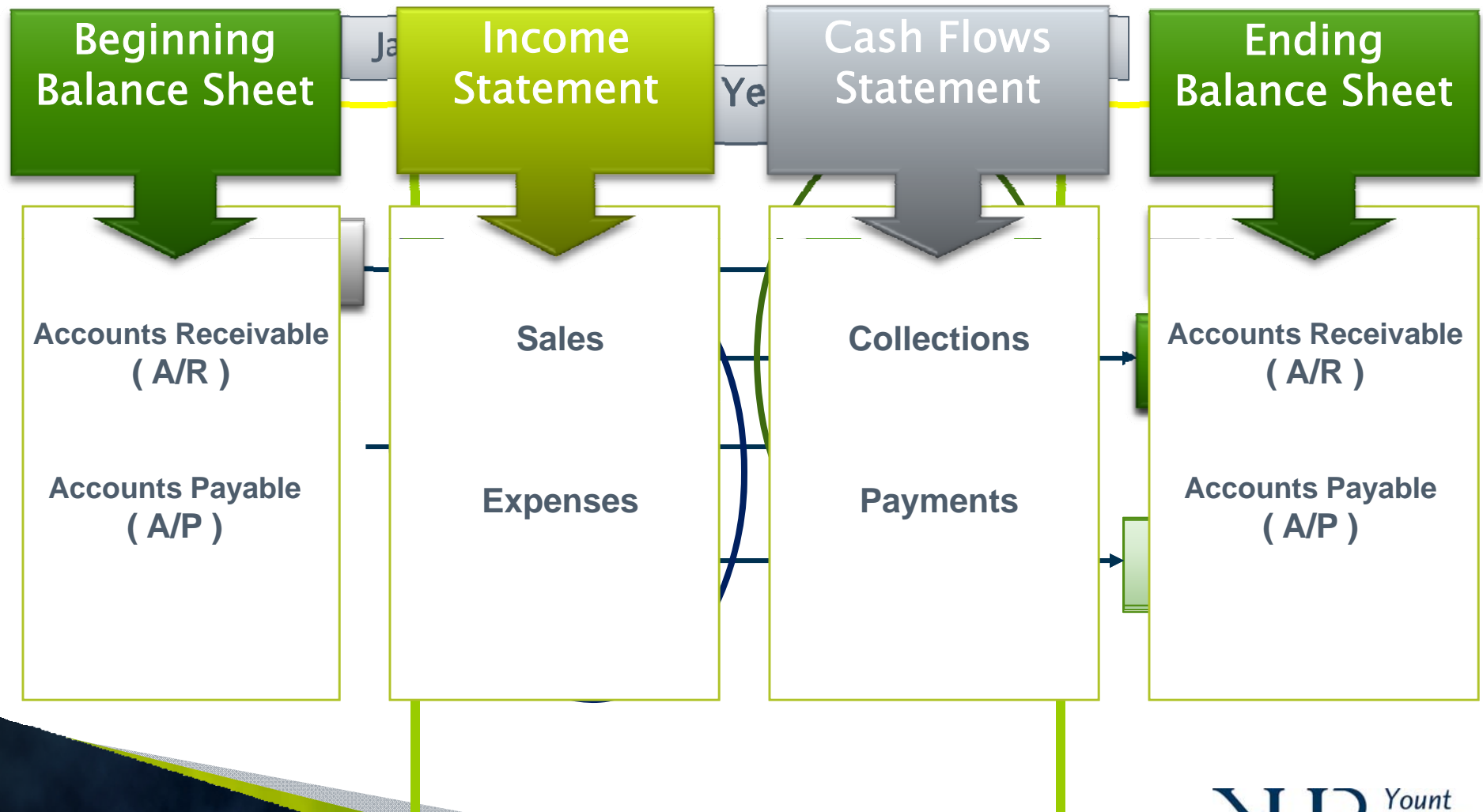
A snap shot of  
the financial  
position of the  
practice at a  
particular point  
in time

# Cash Flows Statement Link



The Cash Flows Statement provides the link between  
the Balance Sheet and Income Statement

# Information is broken into four statements



# Three Financial Statements yield Three Bottom Lines:

Income  
Statement =  
Net Profit

Cash Flows  
Statement =  
Operating  
Cash Flow

Balance  
Sheet =  
Return on  
Assets

**Balance Sheets**  
June 30, 2011 and 2010

<b>Assets</b>	<b>2011</b>	<b>2010</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 445,239	\$ 168,918
Trade receivables, less allowance for doubtful accounts 2011, \$3,000; 2010, \$3,000	41,141	35,370
Prepaid expenses	4,055	--
Deposits	34,468	--
Prepaid income taxes	--	7,183
Total current assets	<u>\$ 524,903</u>	<u>\$ 211,471</u>
 <b>Securities</b> , available for sale, at fair value	 <u>\$ 138,700</u>	 <u>\$ 130,899</u>
 <b>Property and Equipment</b> , at cost		
Land	\$ 665,923	\$ 675,512
Buildings	3,584,933	3,545,251
Machinery and equipment	845,354	1,276,366
Roadways	84,069	77,569
	<u>\$ 5,180,279</u>	<u>\$ 5,574,698</u>
Less accumulated depreciation	2,973,711	3,320,612
	<u>\$ 2,206,568</u>	<u>\$ 2,254,086</u>
	 <u>\$ 2,870,171</u>	 <u>\$ 2,596,456</u>

## Liabilities and Stockholders' Equity

### Current Liabilities

Current maturities of long-term debt	\$ 108,013	\$ 101,654
Accounts payable and accrued expenses	76,986	11,241
Income taxes payable	111,306	- -
Deferred income	- -	3,219
Total current liabilities	<u>\$ 296,305</u>	<u>\$ 116,114</u>

### Long-Term Liabilities

Long-term debt, less current maturities	\$ 467,843	\$ 575,908
Deferred taxes	67,307	61,904
Total long-term liabilities	<u>\$ 535,150</u>	<u>\$ 637,812</u>

### Stockholders' Equity

Common stock, par value \$100 per share; authorized 5,389 shares; issued and outstanding 5,389 shares	\$ 538,900	\$ 538,900
Retained earnings	1,420,477	1,229,361
Accumulated other comprehensive income	79,339	74,269
	<u>\$ 2,038,716</u>	<u>\$ 1,842,530</u>
	<u>\$ 2,870,171</u>	<u>\$ 2,596,456</u>

**Statements of Income**  
Years Ended June 30, 2009 and 2008

	<u>2011</u>	<u>2010</u>
<b>Sales</b>	\$ 1,635,722	\$ 1,313,836
<b>Cost of sales</b>	<u>852,651</u>	<u>845,892</u>
Gross profit	\$ 783,071	\$ 467,944
<b>Other operating revenue</b>	<u>2,284</u>	<u>1,322</u>
	\$ 785,355	\$ 469,266
<b>General and administrative expenses</b>	<u>442,394</u>	<u>442,814</u>
Operating income	<u>\$ 342,961</u>	<u>\$ 26,452</u>

**Non-operating income (expense):**

Interest income	\$ 1,453	\$ 932
Interest expense	(38,647)	(47,641)
(Loss) on sale of property and equipment	(3,556)	(4,820)
Finance charges	(1,157)	(4,760)
Residential rental income	<u>4,700</u>	<u>4,700</u>
	<u>\$ (37,207)</u>	<u>\$ (51,589)</u>
Income (loss) before income taxes	\$ 305,754	\$ (25,137)
Federal and state income tax (benefit)	<u>114,638</u>	<u>(7,497)</u>
Net income (loss)	<u>\$ 191,116</u>	<u>\$ (17,640)</u>
Income (loss) per common share, basic and diluted	<u>\$ 35.46</u>	<u>\$ (3.27)</u>



**Statements of Cash Flows**  
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
<b>Cash Flows from Operating Activities</b>		
Net income (loss)	\$ 191,116	\$ (17,640)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	112,789	111,345
Loss on sale of property and equipment	3,556	4,820
Deferred tax expense (benefit)	2,672	(8,561)
Changes in assets and liabilities:		
(Increase) decrease in trade receivables	(5,771)	63,869
(Increase) decrease in prepaid expenses	3,128	(7,183)
(Increase) in deposits	(34,468)	- -
Increase (decrease) in accounts payable and accrued expenses	65,744	(40,882)
Increase (decrease) in deferred income	(3,219)	3,219
Increase (decrease) in income taxes payable	<u>111,306</u>	<u>(11,618)</u>
Net cash provided by operating activities	<u>\$ 446,853</u>	<u>\$ 97,369</u>
 <b>Cash Flows from Investing Activities</b>		
Proceeds from sale of property and equipment	\$ 5,034	\$ - -
Purchase of property and equipment	<u>(73,860)</u>	<u>(216,617)</u>
Net cash (used in) investing activities	<u>\$ (68,826)</u>	<u>\$ (216,617)</u>
 <b>Cash Flows from Financing Activities</b>		
Principal payments on long-term debt	\$ (101,706)	\$ (92,242)
Proceeds from long-term financing	<u>- -</u>	<u>105,741</u>
Net cash (used in) provided by financing activities	<u>\$ (101,706)</u>	<u>\$ 13,499</u>
 Increase (decrease) in cash and cash equivalents	 \$ 276,321	 \$ (105,749)

**Cash and Cash Equivalents**

Beginning	<u>168,918</u>	<u>274,667</u>
Ending	<u>\$ 445,239</u>	<u>\$ 168,918</u>

**Supplemental Disclosures of Cash Flow Information**

Cash payments for:

Interest	<u>\$ 38,647</u>	<u>\$ 47,641</u>
----------	------------------	------------------

Income taxes	<u>\$ - -</u>	<u>\$ 19,576</u>
--------------	---------------	------------------

**Supplemental Schedule of Noncash Investing Activities,**

unrealized gain (loss) on securities available for sale	<u>\$ 7,801</u>	<u>\$ (86,079)</u>
---	-----------------	--------------------

# Question:

- Is it possible to make a profit and not have any cash?
- Is it possible to make a profit and not get a good return on investment?
- Is it possible to have cash without making a profit?

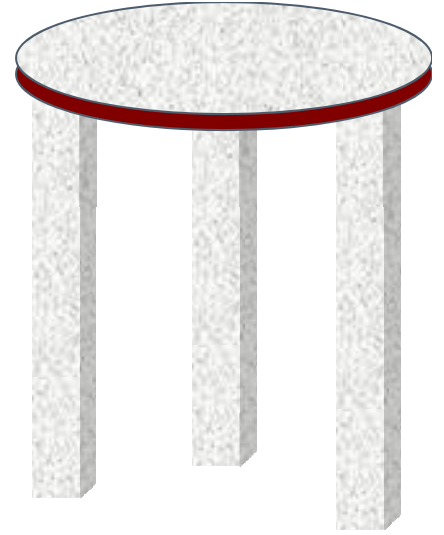
# Three Legged Stool



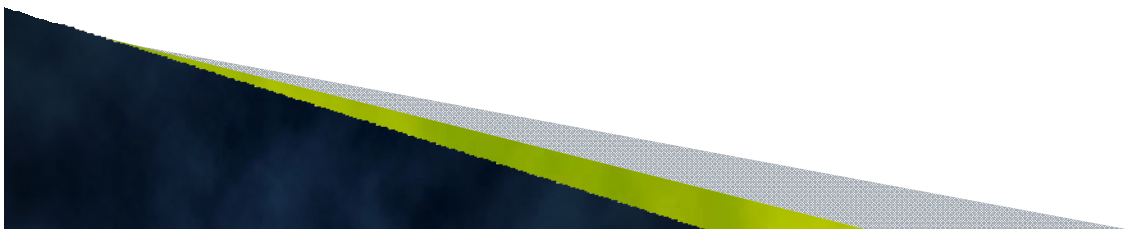
Answer:

- Yes to all three, but not for very long. It's like sitting on a stool with three legs of different lengths.
- The long-term health of the business requires that all three legs of the stool be equally balanced.

How can we make sure  
that all the legs are in  
balance?



We need to understand and manage  
the factors in the business that  
impact the three legs.



If you want to impact the future we focus on  
current and planned activities.

**People X Process**  
**drive financial outcomes**

(Leading Indicators)

# Sample Manufacturing Ratios

Current Ratio	2.16	1.60
Gross Profit Margin	13.3%	22.0%
Net Profit Margin	2.3%	4.0%
Inventory Days	46.4	75.0
A/R Days	36.1	55.0
A/P Days	27.7	45.0
Debt-to-Equity	10.04	1.70
Return on Equity	21%	14%
Fixed Asset Turnover	2.32	2.00

Ideally we want to measure both the business drivers and financial outcomes

## Activities

# of Customers  
X  
Frequency  
X  
Average Sale (\$)  
X  
Efficiency



?

## Outcomes

Revenues –

Cost of Services

Fixed Expenses

And

Variable Expenses

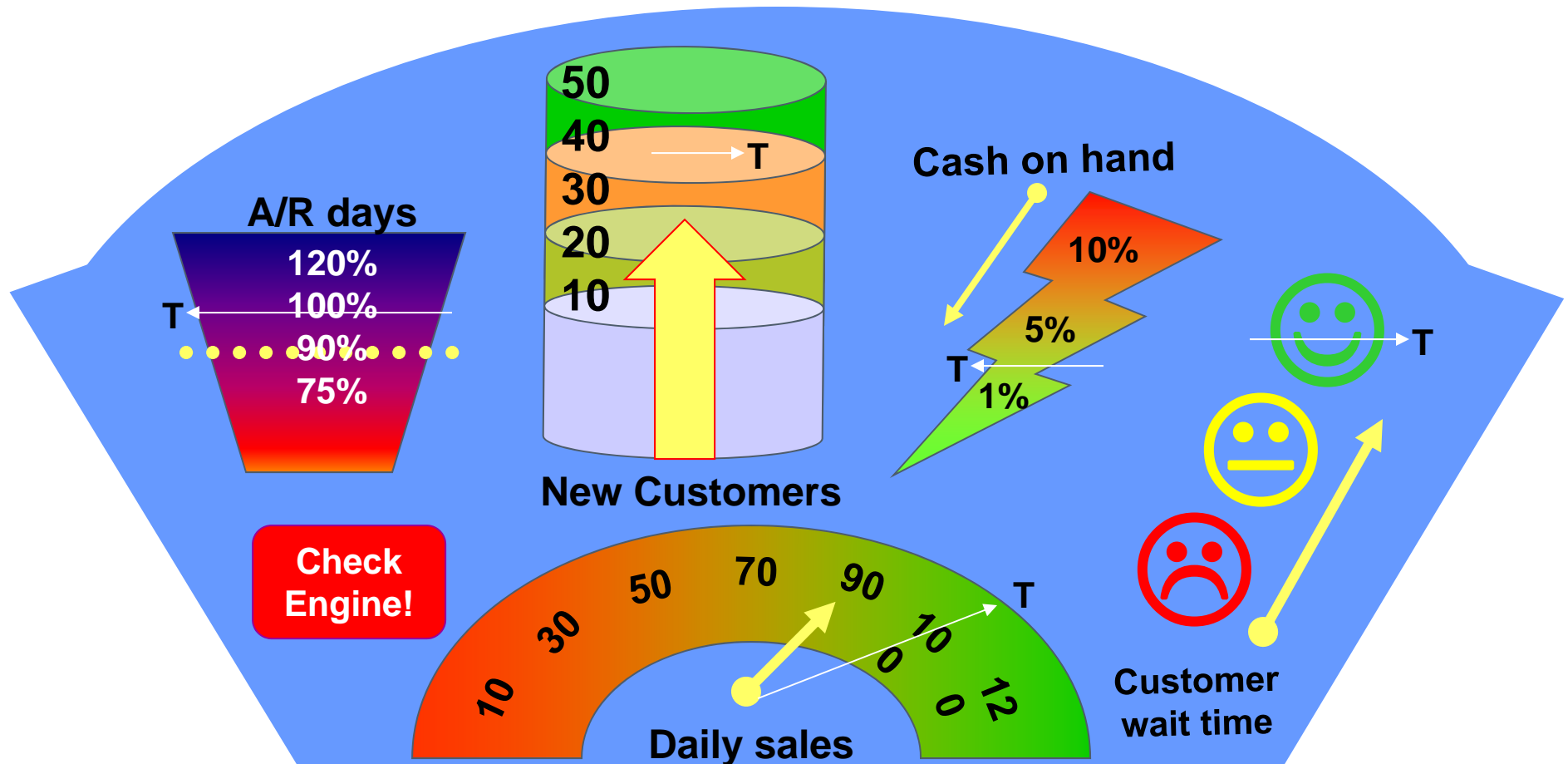
= Net Profit



# The 4<sup>th</sup> Statement

- ▶ Provides a “dashboard” like perspective
- ▶ Monitors important activities on a real-time basis
- ▶ Provides feedback to employees about their performance

# A Business Dashboard



## Today's Critical Numbers

# Financial VS. Performance Perspective

3 Financial Statements: Outcome Focused	4 <sup>th</sup> Statement: Activity Focused
Historical Reports	Real-time Reporting
Lagging Indicators	Leading Indicators
Capture Transactions	Measure the Activities that Drive Transactions
Financial View	Financial <u>and</u> non- Financial View
It's all about the \$\$\$\$	It's all about the #####

***Within each of these four areas there are Key Performance Indicators (KPIs) that should be measured and monitored.***

**Finance**

**Operations**

**People/Mgmt**

**Customers**

# Types of Performance Measures

## Monthly/Quarterly

- ▶ Key Result Indicators (KRIs) – Overview of past performance

## 24/7, Daily/Weekly/Monthly/Quarterly

- ▶ Result Indicators (RIs) – Summary of specific area
- ▶ Performance Indicators (PIs) – Targeted Measures

## 24/7, Daily/Weekly

- ▶ Key Performance Indicators (KPIs) – Communicate expectations to increase performance

# Sample Financial Performance Measures (PMs)

- ▶ Account Receivables
  - Collection days
  - Write-offs
  - % of A/R > 90 days
- ▶ Accounts Payable
  - Discounts taken
- ▶ Days cash on hand

# Sample Operational PMs

- ▶ % of scheduled patients preregistered prior to the date of service
- ▶ % of available self-pay dollars resolved at time of service
- ▶ Scheduled hours versus actual hours
- ▶ First available visit for new patients
- ▶ Patient no shows

# Sample Management PMs

- ▶ Employee satisfaction
- ▶ Employee suggestions for improvement
- ▶ Company I.Q. – Innovation Quotient
- ▶ Employee turnover
- ▶ Training costs/employee
- ▶ Cost of acquiring an employee
- ▶ Absenteeism
- ▶ Injuries



# Sample Customer Marketing/Services PMs

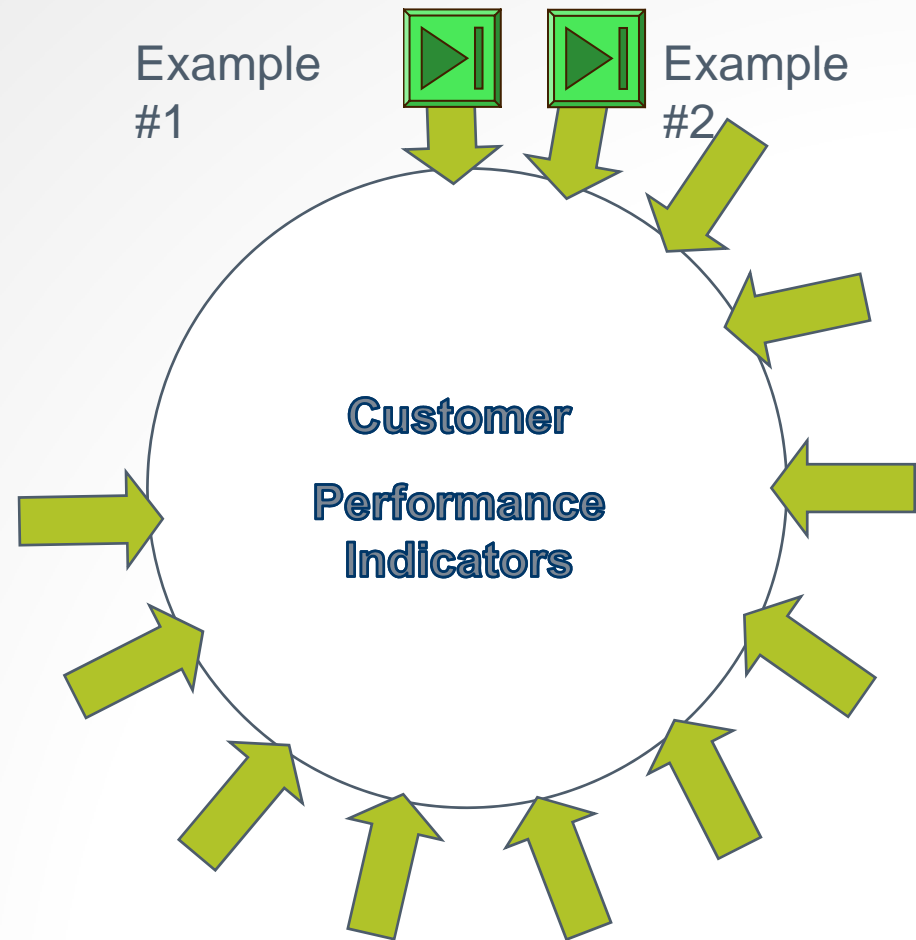
- ▶ Patient wait time
- ▶ Acquisition Rate
  - Number of new patients per week
- ▶ Attrition Rate
  - Reasons for leaving
- ▶ Patient Delight
  - Referrals/patient/source
- ▶ Repeat customers to one provider

There are literally hundreds of potential PMs to be monitored. Because each business is unique, the first step in this process is to identify KPIs specific to your activities.

We can do this by first looking at your business from the customer's perspective.

# Capturing Your Customer Cycle of Interaction

There are PIs associated with each point of contact you have with a Customer

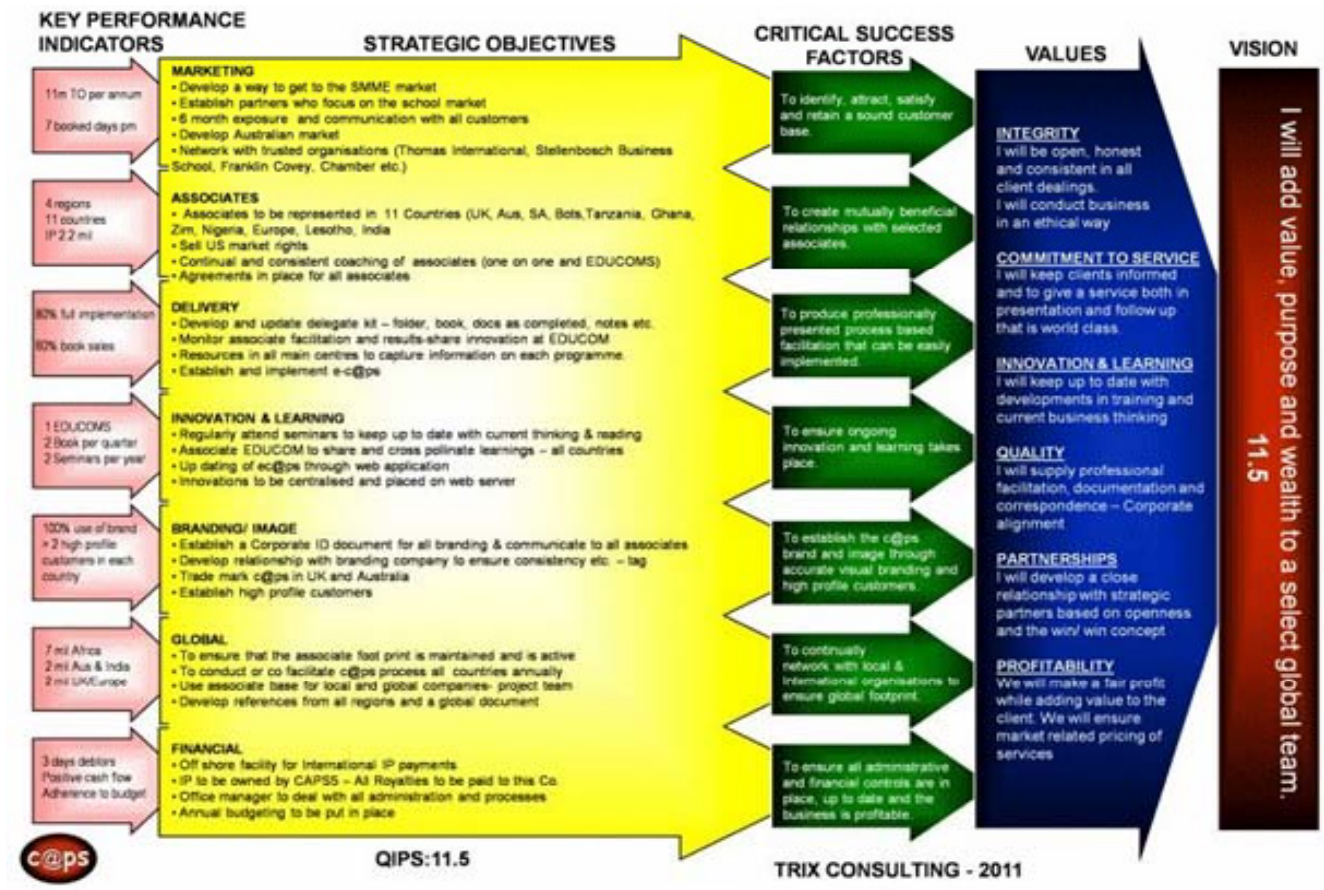


# Discussion:

How does this apply to your business?

- ▶ How will your business keep score?
- ▶ Will it be based on the performance of the business as a whole?
- ▶ Will it be based on the performance of specialty teams/product lines within the business?
- ▶ Will it be based on individual contributions?
- ▶ What performance measures will you track?
- ▶ How will you share them with the team?
- ▶ Will they be linked to compensation?

Source: news.caps.biz



# Contact Information

- ▶ Elsie L. Rose, CPA, Principal
- ▶ Yount, Hyde & Barbour, P.C.
- ▶ 4405 Cox Road, Suite 225
  - ▶ Glen Allen, VA 23060
- ▶ 804-553-1900
- ▶ [elsie.rose@yhbcpa.com](mailto:elsie.rose@yhbcpa.com)