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BEAN COUNTING FOR BEAN COUNTERS



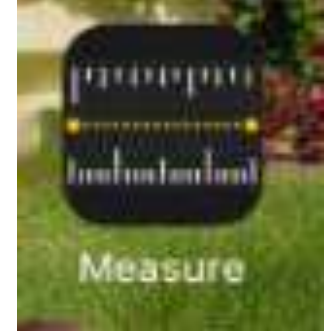
Bean counting – why?



- A joke of course
- I will ensure you can win next time you are asked to guess – I will give you the science behind bean counting
- Every few years I run into a bean-counting contest



Bean counting science



- Measure/estimate volume of container in cubic centimetres
- (Volume of a cylinder is $\pi r^2 h$)
- Multiply by 0.37 to get a very good estimate of the number of standard-size jelly beans



PRACTICAL TIPS TO IMPROVE YOUR INTERNAL FINANCIAL REPORTING

PRESENTED BY:

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PD**

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Introduction

- Welcome
- I use fill in the blanks, there is a reason for this... ..(but you will get completed slides after, email spriddle@bell.net)

All my live seminars/webinars have an opportunity to win prizes

- Stay awake and participate to get them...max one per person
- However, the top participant of the day, will win a special prize, and can have won a prize earlier





Type "55" in the chat if you...

- Plan to retire by 55
- For some of you, it is already too late....



Type “under” in the chat if
you...

- You believe you are underpaid

Where I am coming from



- Active CFO, 35 years of financial reporting experience (& other experience)
- I have created many practical courses that over 31,000 have signed up for
- An active case author



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Objectives

- To practice your financial reporting skills in a realistic case situations
- Although your industries are different, the tip logic can often be applied to different industries



Case #1

- 72 minute case
- Please write your response in a Word document, and email it me spriddle@bell.net
- A team of markers will grade them and return them to you, within 48 hours of receipt, with your national ranking in deciles...



Introduction

- Cases best simulate real life
- Have you ever marked professional accounting exams?
- Case Examination Bloopers

I have spent about 3 weeks of my life locked up in this hotel...marking exams (UFE)





How does one stay sane
working intensely 12 hours a
day at the marking centre?



We collect exam bloopers

- *"Golf is popular because of the Tiger Woods phenomenon. Like disco, it will pass.."*
- *(First year in business)*
- *"Since this is a first time audit, we must qualify because we will be unable to verify the opening numbers"*
- *"This could be a disastrous audit"*

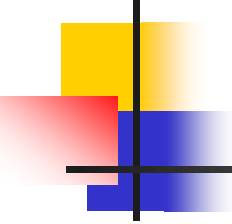


Exam bloopers

- *"We have two days to finish this audit, which is better than 84 minutes to finish this question"*
- *"I must assess whether I am competent to carry out this audit – I believe I am"*
- *The company has lost money for so many years, so it has become a Not-Profit-Organization"*
- *"As such, it does not need to follow the Handbook on income taxes..."*



I authored some of the cases..



A case purchaser, a professor from a major Montreal university once said...

- Your cases unfold like a Tarantino movie
- I had no idea what they were talking about - I had to google Tarantino...



Improved financial reporting

- Whose main focus is financial reporting?
- Does anyone report on other than a monthly basis? (An alternate reporting idea: date the balance sheet was strongest)
- Are users satisfied with your reports
- Are you?



Improved financial reporting

- Do users read them?
- Why or why not?
- How do you find out whether they are reading them...
- Can you improve them?



One attendee said they wrote

- “The VP Sales was beamed up to Mars” in the Board report, and only 2 of the 6 members seemed to notice this...



Improved financial reporting

- An auditor perspective on financials...
- The key is useful information for user decision-making
- Sugar coat/spin doctor or tell it like it is for internal financial reporting?
- Question: too much versus too little info



Improve financial reporting

- More than numbers: the importance of useful narrative analysis
- Make the numbers speak
- Should provide the users with financial and business wisdom about the results
- Consider comparable public company MD&As for ideas for your company



No crooked accounting!

- A woman wanted to know what $2 + 2$ was so she went and asked a _____

She asked

- An engineer
- A lawyer
- A statistician
- A humanities student
- An Arthur Anderson partner....



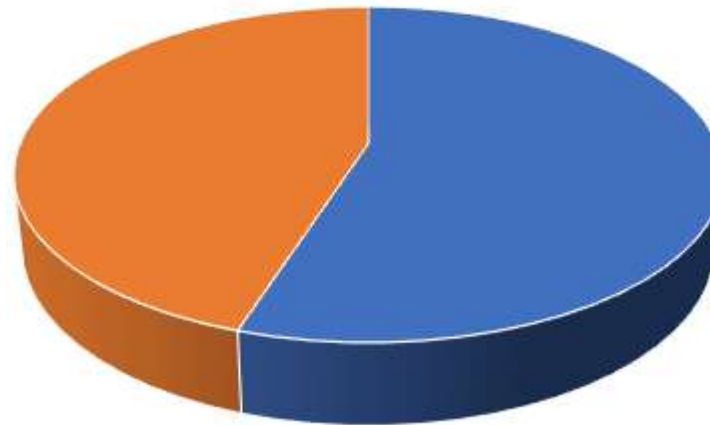


No crooked accounting!

- A woman wanted to know what $2 + 2$ was so she went and asked a _____
- Note: we don't do our financial reporting with a pre-determined result in mind, although someday, someone will say to you, "I don't like this result, can't it be _____"

Polling question – financial reporting ethics

Have you ever faced a financial reporting ethical dilemma?



■ Yes ■ No



Financial reporting case prep

- % completion accounting review
- Contract value x % complete
- % complete determined most appropriate way
- What is a holdback? a payment held back under certain conditions



Now time to read the case

- Scenario: improving the reporting for both Board and management
- Focus more on the reporting issues, than the business issues
- Don't criticize the reporting, suggest how to improve it!
- Think about a better monthly financial package, and also think KPIs! (30 plus)
- Put yourself in the Board's shoes



Note

- Remember to distinguish what actually was reported versus what is additional information in the case



What is the key to the case?

- Miscellaneous expense?
- Balance sheet out \$1?
- Suzie?
- Is Suzie a related party transaction?



Who is Suzie?



Who is Suzie?

- She is dating the President's son!



This Susie

- Was dating the case author's son, and now they are married!



Note

- My humour always get edited out of my published cases, but finally I am the editor....
- Names of auditors, were two Enron fraud villains



Once when I taught this case at a CPA conference...

- CPA Manitoba let a few college accounting students attend free, and sit together at a table
- Their comment after reading it... "the reporting package looks fine to us"
- You have learned a lot since you were in school!



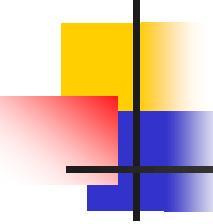
Opening comments

- Who works/has worked in construction?
- (You have more insight if you do, but everybody can learn from this case's principles for improvement)
- Don't just find problems with the reporting, suggest improvements
- Some people will say board members are superficial, they look at the f/s and say, "did we make money, are the covenants on side, that's it! I would hope they would do more!"



Business issues

- Some CPAs want to focus on the business issues in the case
- There are lots – the company is having some trouble
- But the main focus is financial reporting improvements



What important single sentence
needs to be included in the
covering note to the financials to
the Board?

You should always include this monthly, unless it is stated elsewhere



- “The company is up to date on all statutory remittances.”
- Board members will be happy to see this, since they are legally at risk for source deductions, unremitted taxes...
- (Only about 10% of my attendees do this)



Also

- Also good to put “unaudited”
- For safety you might to put “preliminary” allows you to change numbers if you have to without embarrassment



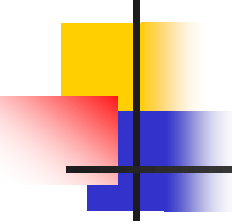
Other ideas

- The report would not lose anything if all numbers were in thousands
- It might be useful to report quarterly numbers as well

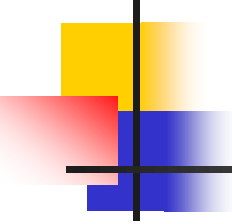


What are the major deficiencies?

- Lack of decision-oriented information
- An uninformative written analysis
- No useful schedules
- No looking ahead at all
- Poor comparatives



A big question that
participants don't usually deal
with up front



A big question that participants don't usually deal with up front

- What is the basis of reporting?
- Many are confused about this

GAAP

- Does GAAP need to be followed strictly in internal monthly financials? No!
- But bank covenants, probably have requirement
- GAAP will be required at year end
- So one might as well do GAAP monthly, or at least disclose material departures from GAAP
- Not that anybody does full GAAP notes monthly!





Are there any historic problems?

- Poor past financial reporting
- No CPA in charge!
- Uninformed senior management
- And possibly more....

Are there any historic problems?

- A detailed review of revenue recognition on contracts should be conducted since this is an area which might be prone to error & it is key
- Key tips about discovering historic inherited problems are found in my course **Practical Tips for Controllers & CFOs**



Let's discuss financial statement users

They include:

- Management
- The Board
- Presumably, the Bank



Idea



- Have a meeting with each of the organization's executives and the Board
- Find out if they are satisfied with the financial information they are getting
- This is especially important to do with the VP, Construction, probably the most important exec, who doesn't understand the financial reporting

A new board member

- What should you do?
- Consideration could be given to providing them a one or two page summary on the organization's finances: contracts and recognition, bank line and etc.
- Or an have in-person orientation



S,



Big picture

- Discuss the month's results versus the company's overall strategy
- Discuss the macro-economy versus the results
- Discuss the business environment and the results, tariffs and more
- Discuss competition in relation to results



Consider a risks and opportunities discussion

- Risks including project/technical, currency, credit, petroleum price, competitive
- Some call it upsides and downsides



Management estimates

- It is a good practice to disclose significant management estimates
- This de-risks management if they wrong, and means the Board is less likely to get surprised
- Specifically, the board should be told that management has estimated that the Philips Limited and Rio receivables are collectible, rather than the estimate being made but not disclosed



Currency risk

- There is currency risk in the company since the company's position is not to hedge currency risks
- The Board has no idea what the magnitude of the exchange risks faced is, at least this could be quantified
- The Board might want to revisit the no hedging position in due course

Position with respect to its bank covenants



- The current position and the actual covenants should be disclosed
- Currently at 1.53 for current ratio, versus minimum of 1.5, very tight and a concern
- 1.88 for the debt-to-equity covenant, versus 2.25 maximum, reasonable
- Does anyone know Canada's debt-to-equity ratio?
- It was 2.28 last time I checked, but before COVID-19, much worse now






Stress-test

- If an allowance for doubtful accounts is recorded for the \$67K Phillips A/R the current ratio bank covenant will go off-side, which likely means the bank can call all the loans...
- This will get worse if the \$164K Rio also must be written off
- We don't have enough information to finalize this

Future-Oriented-Financial Information



- The Board and management are likely very interested in projected results for October, November and December, toward year end 
- Some forward-looking information for these months should be provided, even if it is harder to develop and entails the risk of being shown wrong



Percentages

- Showing key percentages in the financials is useful
- Margin %
- Expenses as % of revenue
- Assets as a % of total assets
- And possibly more



Accounting note

- I was once a 38 year old CFO and designated accountant, but I had never booked an entry in an accounting system!
- I had verified, proposed, supervised, ordered hundreds and hundreds of them
- So I did one, one day, and I finally felt like a real accountant!
- If you have never done one....

Let's discuss the income statement





Break-even

- Disclosure of the organization's approximate monthly break-even revenue would be relevant to users
- Do you know what your break-even level is?



Good comparatives are important

- One day an accountant was walking in the downtown of a big city...

Good comparatives are important

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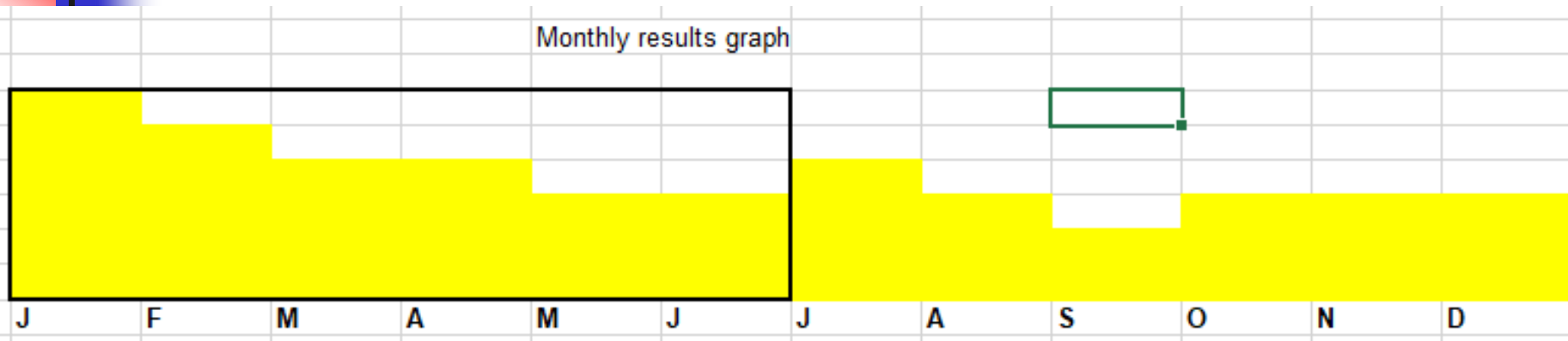
Good comparatives are important

- September prior year comparative monthly and YTD income statement information would be more useful because of seasonality
- Comparative September 30 balance sheet information would also provide a perspective of a comparison to the same date in the prior year

A better way to report comparatives

Problem, seasonality

Monthly results graph



- Solution, 12 month rolling comparatives, also know as TTM
- You will need to clarify differences from the budget year, although some organizations are adopting a rolling budget...



A better way to report comparatives

- Reporting rolling 12 month results with rolling 12 month comparatives is one of the best ways to see overall trends in the organization
- This is an excellent tip – few organizations report this way
- It removes seasonality and really tells you the velocity of the organization, important, even if there is no seasonality



Revenues

- In many businesses, revenues in a month are very sensitive to the number of working days, typically from 19-22 in a month
- This caused once CEO of mine so much stress that we almost thought of changing the reporting basis to try to deal with this, but we didn't
- We did report revenue per day, with comparatives to help



Did you note

- That the company may hit \$20M in revenues for the first time ever
- Sometimes certain round numbers are important, a \$10M, \$20M, \$100M, \$1B company
- This could be discussed in the narrative
- When I was taking a company IPO we focussed every week on whether we would reach a certain revenue number

Different ways of rolling up results that would be useful

- Can you think of any?





Roll ups

- Public companies have to segment information
- Not required for a private company but would you be useful
- What segments could you think of?



Possible segments

- By geography
- By industry we are selling to (plastic, trucking)
- Maybe some segments are doing better/worse than others and management doesn't know
- If the system can only report the revenues by segment, not the bottom line, that is still an improvement
- It is not clear what the corporate overhead is, this could be broken out
- (If you can analyze business trends and see things that others don't see, you will look good...)

By currency



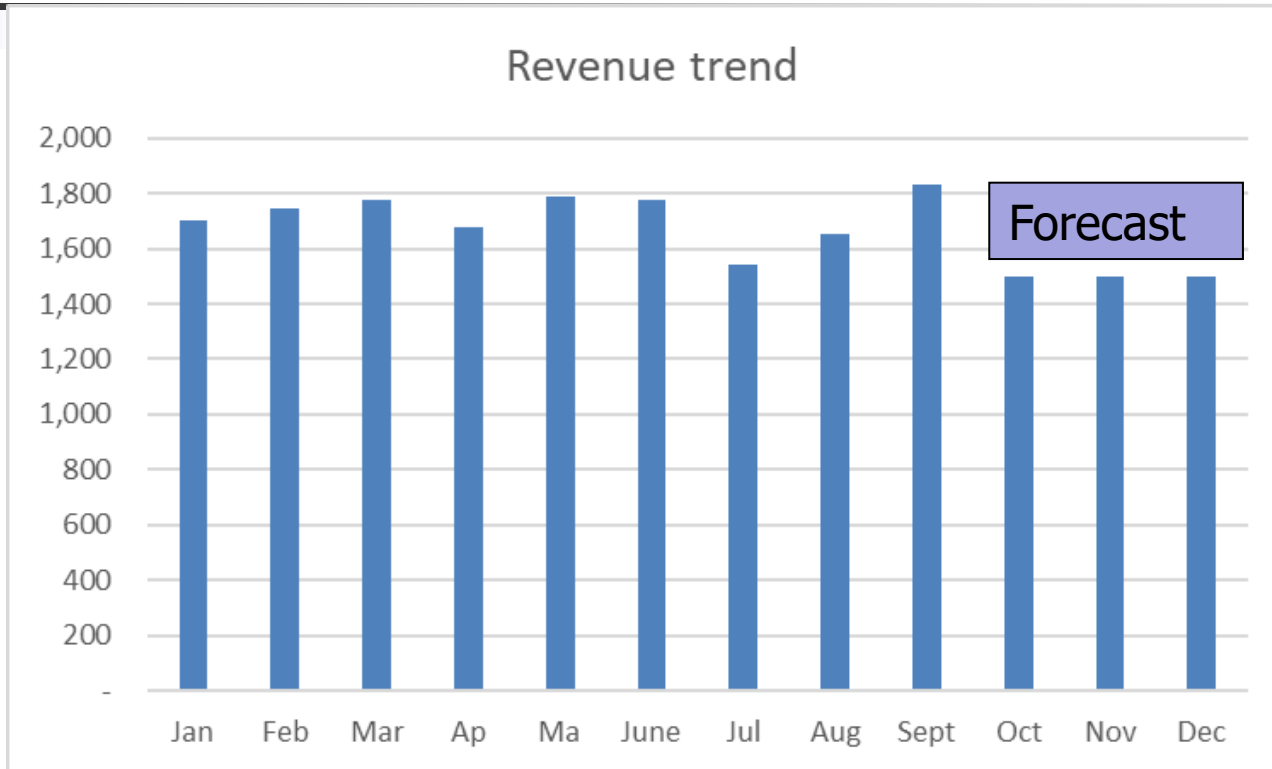
They could also

- Results by small, medium and large projects
- Which are we better at, which make more money?

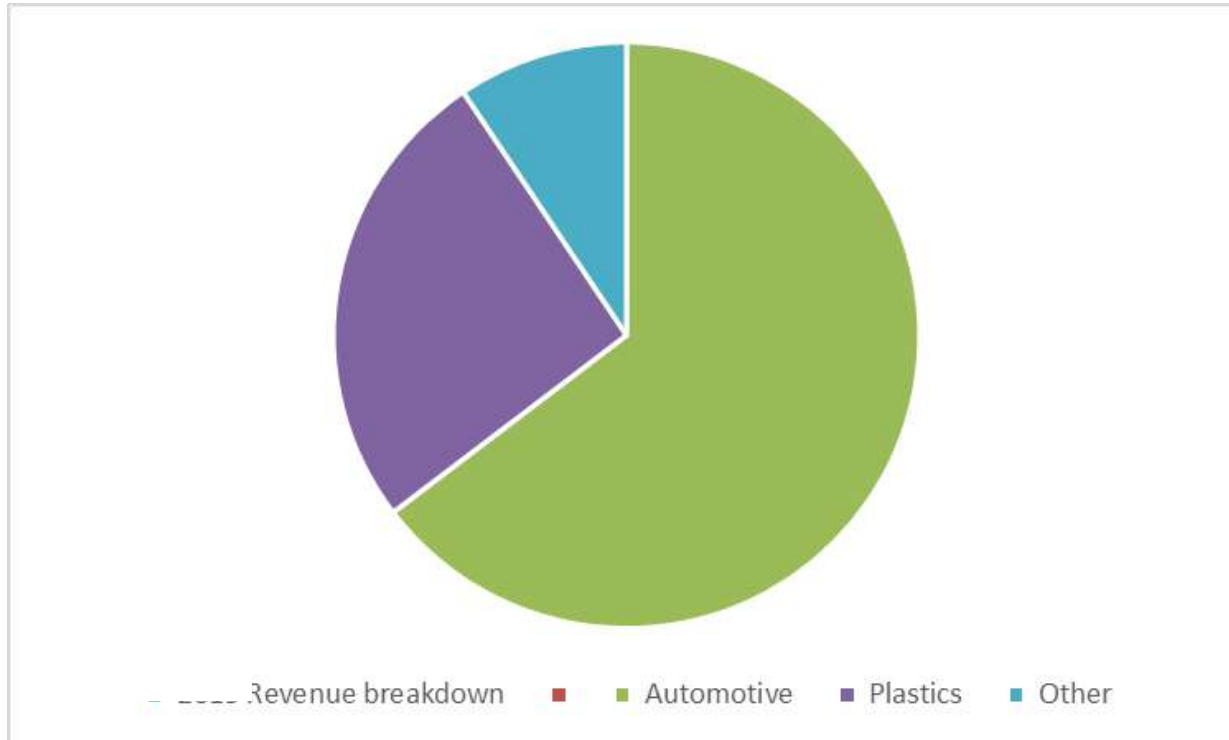


Various charts could be
provided

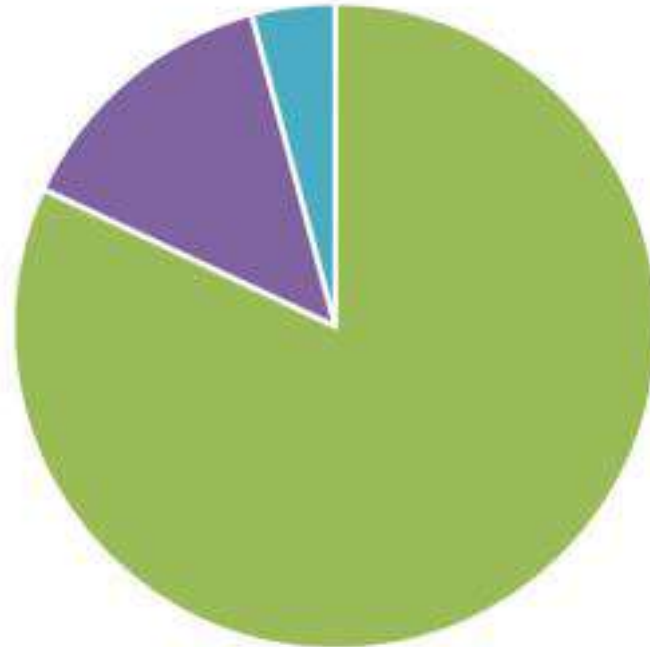
Revenue by month



Segment selling to



Geography



2020 Revenue breakdown

- Canada
- U.S.
- Other



Expenses



Direct costs

- Largest expense on the statement, has three key parts
- They should be broken out
- Sub-contracts, parts and labour



Other changes

- The expense captions are not that useful
- Rent would normally be included in General Administration
- Miscellaneous expense is much too large a % of total expenses - the major components should be broken out



Expense explanation

- The large increase in professional fees, reported under General Administration was due to the receipt of an unexpectedly large bill from the firm's lawyers, with respect to the Rio Properties dispute
- This should have been explained



EBITDA

- There might be value in presenting this number



EBITDA

- **Earnings Before I Tricked The Dumb Auditors**

Must be an accountant!





EBITDA

- **Earnings Before Interest Taxes Depreciation & Amortization**
- What really happened in the business, let's exclude non-cash and non-operating amounts

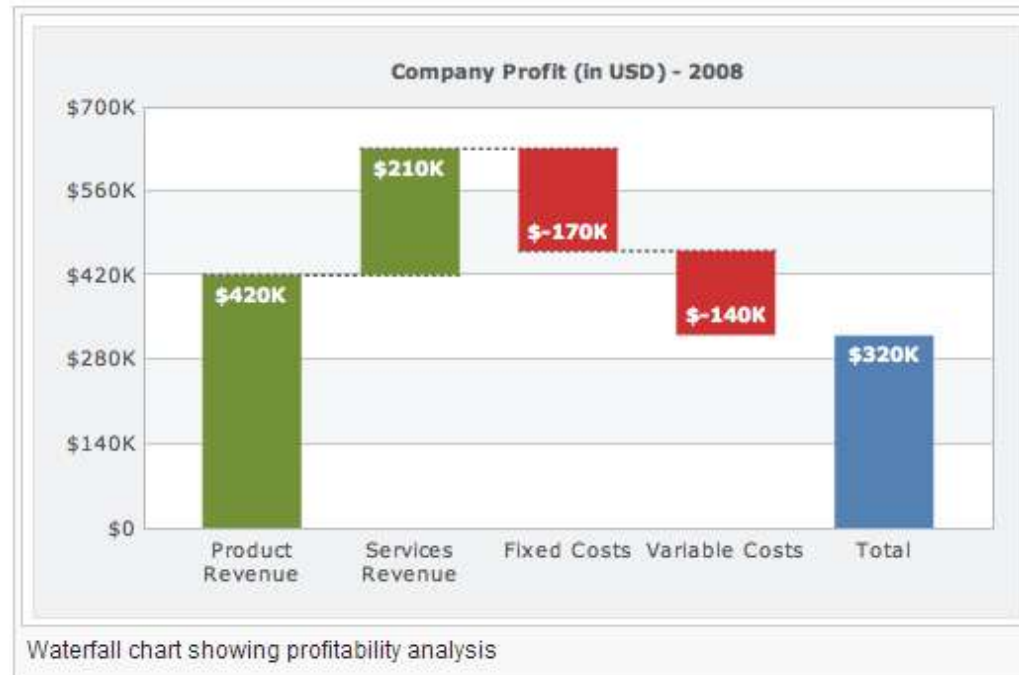


Budgeting

		Budget	Variance
	<u>September</u>	<u>September</u>	<u>Fav/(Unfav)</u>
Revenues	1,828,632	1,611,667	216,965
Direct project costs	<u>1,444,619</u>	<u>1,256,028</u>	(188,591)
Margin	<u>384,013</u>	<u>355,638</u>	28,374
	21.0%	22.1%	
<u>Other costs</u>			
Sales & marketing variable	51,072	57,825	6,754
Sales & marketing fixed	64,445	64,918	472

- The Budget versus actual variances in the current monthly financials are positive when revenues exceeded budget, but also positive when expenses are above budget
- This should probably be changed to the normal way of presenting, i.e. expenses above budget result in a negative variance, because they are bad news. The caption should state favourable/(unfavourable)
- Percentages could be shown
- (Some people use waterfall graphs to present budget versus actual)
- Budget amounts for both month and year to date should be presented

Waterfall graph





Budgeting

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- Percentages could be shown
- (Some people use waterfall graphs to present budget versus actual)
- Budget amounts for both month and year to date should be presented



A different way of budgeting

- The Budget variation for direct project costs budgeted as a \$ amount does not have much meaning, because most of the variation is due to the variation in sales
- It might be more meaningful for the budget amount to be a % rather than fixed, so that this is a flexible budget

More budgeting

- Flexible budget – one government accountant at the seminar said “I don’t understand flexible budgets, I thought it meant that at the end of the year, you force spending to equal budget”
- One live attendee asked if we could flex the lunch longer to 2 hours!





More budgeting

- The Budget probably needs revision, because of the huge C200 contract that was not anticipated in the Budget - otherwise the budget versus actual deltas will be large
- The Budget appears to be a flat monthly amount, this is likely not appropriate given the seasonality of the business, a more accurate budgeting process should be used
- Interest expense in the month is quite a bit under the budget, this needs to be explained



Balance sheet



Balance sheet

- Budget balance sheet information could also be provided, as well as balance sheet forecast information



Interesting balance sheet idea

- I always mentally calculate current assets less current liabilities (working capital), when I see a balance sheet
- For monthly financials, the format is flexible
- We know of a company that reports net working capital first on the balance sheet (current assets minus current liabilities)
- This is useful information for users



GAAP issue

- A Statement of Cash Flows has not been presented
- This is required by the CPA Handbook Section 1400.11 and moreover is useful to users, reconciling opening and closing cash
- They often don't balance for me!

Actual cash



- Cash is king they say
- Some forward-looking cash information should be included
- The unused amount on the line should be disclosed



Reflection

- One topic in any internal financial reporting is how much subsequent info should be disclosed in the narrative, considering the management implications, not the GAAP rules
- If it is very material, it should definitely be disclosed, rather than waiting for the following month
- Cash put in escrow is material, not a Type I subsequent event to be booked in the month, so probably best to disclose



Receivables

Accounts receivable	\$ 52,904
Allowance for Doubtful Accounts	(\$13,000)
	<u>\$ 39,904</u>

- It would be possible to report the trade A/R and holdbacks separately
- The could disclose the actual allowance for doubtful accounts
- Information on receivables and holdbacks could be segregated between complete and incomplete projects, there is no collection leverage available on the latter – an important difference
- The old Hobo Corp receivable should be discussed, it sticks out as very overdue, although not that large



Receivables

- There appears to be a difference between the A/R subledger and the G/L - the subledger is \$23,133 higher - this should be investigated
- Work in process and other receivables are very different assets and should be separated in the balance sheet
- The company could actually report a roll forward of receivables, which at least accountants would get a lot out of (also inventory/WIP)

Roll forwards – (not this company)

Opening inventory	\$ 14,322,323
Purchases and production costs	21,313,434
Write downs	- 430,000
Cost of sales	<u>1,604,829</u>
Closing inventory	<u>\$36,810,586</u>

Opening A/R	\$ 1,452,904
Sales	1,397,389
Collections	- 1,033,044
Closing A/R	<u>\$ 1,817,249</u>

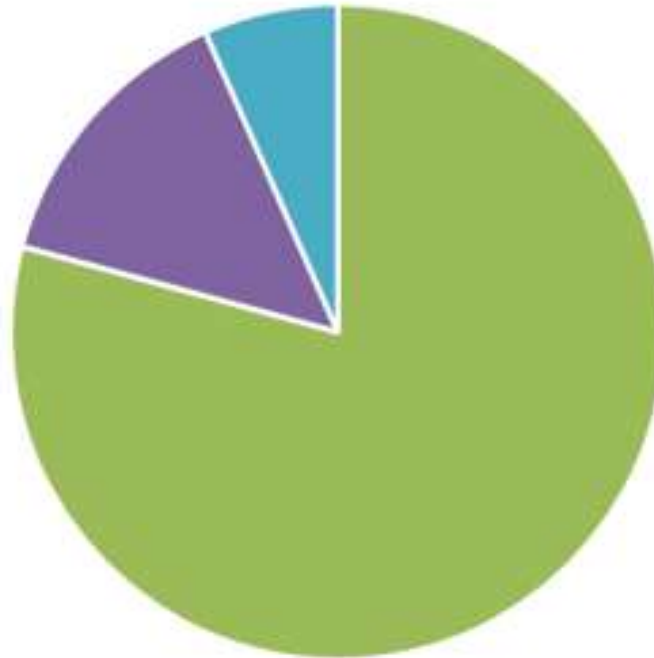


Various charts could be provided

- A/R currency
- A/R by industry
- A/R by geography



A/R by currency



■ A/R by currency @ Sept 30/ 2020 ■ Canadian ■ U.S. ■ Other



New line on the balance sheet

- During the month, the company acquired a patent, related to a useful concrete construction technology and it is reported as an intangible asset in the balance sheet
- This should have been explained to the users, including the business reason for the purchase and the amortization policy, which is shorter than the legal life of the patent is 20 years
- (This is the correct accounting, it is the lesser of the legal or the useful life)



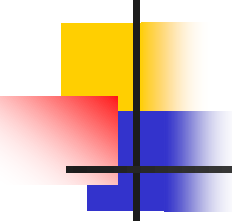
A note that might be useful

- I once reported share activity monthly (opening, sales, options exercised, redemptions, closing)
- Like a GAAP year end note
- It was very well received

I also reported Earnings Per Share, unheard of and not required for a private company, but the main shareholder and investors and employees loved it - how much money did my 3,000 share earn...

- I recently thought of an additional possible reporting item in this vein, Executive salaries per share!

Selling shares means the company has been valued, how?



This case is not technical
GAAP, but...



Possible GAAP departures

- The Wayly contract which is over budget should be checked to see if the loss for the entire contract should be booked, as required by ASPE
- It is possible that stock-based compensation accounting, Section 3870 must be applied because of shares sold to employees, depending on how the arrangement works
- The accounting for the share redemptions should be verified. It is only correct if the departing employee paid \$10 each for the shares, because there has been no change in retained earnings related to a premium



Possible GAAP departures

- Under ASPE, the taxes payable method may be used with no owner consent, it seems that this is the method that has been used
- However, with significant temporary differences potentially arising from construction holdbacks, not using the future income tax method, might distort the financials.



Possible GAAP departures

- A statement of Retained Earnings has also not been presented
- The company has taken a non-refundable deposit into income
- This is not consistent with % completion accounting – the stated accounting policy
- Although there might be an economic argument that the deposit is fully earned, because under no condition will it ever be paid, GAAP does not permit this



Note

- Note, you have to remember all this for this quiz



Comment

- Don't be stressed if you didn't think of all these things when you reviewed the case
- There are more....



Do you see any process
issues?



Do you see any process issues?

- Monthly financial statement review procedures should be put in place to find out exactly why the amortization error took place and to ensure that it does not happen again.
- It took the Accounting Manager 23 total days to report the month end results
- Steps should be taken to analyze closing procedures and improve the turnaround and carry out a faster close, so that better decisions can be made from more timely information



Note

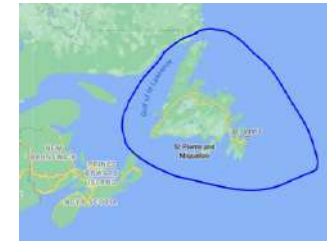
- Fast close tips are in the **Practical Tips for Controllers & CFOs** course



Prior month's error

- What should be done about the prior months' error?
- Have you ever made a monthly error you had to correct?
- If immaterial, could flush through this month, with or without disclosure
- The error is material relative to the excess of revenue over expenditure, but is arguably barely material relative to 1% of monthly revenues
- It is not cash (and won't put bank covenants off-side)

Prior month's error



- If material must re-state the prior period under GAAP requirements (Section 1506)
- I would prefer that – the skeleton in the closet belongs to the predecessor
- Someone in one seminar said: hold off and correct at year end
- But this is borderline unethical, you know about it
- One accountant said that in Newfoundland, all errors go through Miscellaneous Expense!
- It would be appropriate to inform the Board and executive immediately about it
- If comparative monthly financials are presented, September should probably be adjusted, in the spirit of Section 1506 of the CPA Handbook.



Interesting

- Just before the merger, the Ontario Institute of CAs had to correct an accounting error of a prior period, in the organization's audited financials – they had to be re-issued!
- I don't think the media picked up on this...



Industry comparative information

- Boards love useful comparative industry performance information
- It is easier to find comparatives for some businesses than others
- Where can you find them?

“Industry” comparatives are important

- To give context
- How about this?
- Deaths Feb-October 2020

COVID-19	10,000
----------	--------

“Industry” comparatives are important

- To give context
- How about this?
- Deaths Feb-October 2020

COVID-19	10,000
Cancer	53,333
Heart related	44,667
Accidents	8,667
Flu	6,000
Suicide	2,667
Other	<u>84,667</u>
	<u>210,000</u>



Sources of comparatives

- Google searches
- Benchmarking studies (may have to pay), some accounting firms have them (PWC)
- Public companies (www.sedar.com and www.sec.gov/edgar.shtml sites are useful)
- Industry trade associations
- Available government statistics (Statistics Canada, Industry Canada, Department of Finance, provincial governments) (accuracy!)
- Exchange data with similar but not competing private companies



Industry comparatives - Agrifood

- I know that **Canadian Association of Agri-Retailers** members regularly upload detailed statistics and benchmarks, which are averaged and shared with all members



Sources of comparatives

- Dun & Bradstreet (know your NAICS code, formerly SIC)
- www.fintel.us Financial Intelligence for Business
- Gartner Group or Forrester Research
- www.hoovers.com
- nielsen.com may have some info
- Your bank
- Companies who approach you to offer themselves for sale



Sources of comparatives

- Private sellers of industry benchmarking information
 - www.Firstresearch.com
 - www.Researchandmarkets.com
 - www.anythingresearch.com
 - www.profitcents.com

Can you think of others?



Statistics

- Statistical analysis may be useful in reporting, I have done it
- For example, the variance of a series of numbers or the standard deviation, compared over time can be quite informative but would have to be explained to users who don't understand statistics
- Eg Standard deviation of monthly revenues

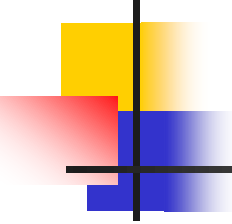
$$\sigma = \sqrt{\frac{1}{N} \sum_{i=1}^N (x_i - \mu)^2}$$

standard deviation for
population



What about some other KPIs?

- Many other key, non-GAAP, indicators concerning the organization could also be gathered and reported periodically
- Some would be appropriate as monthly information at a board level.
- Some are more management level and could even be presented weekly as special indicators in a one-page dashboard report



Try to think of useful KPIs that go beyond the financials

- Key Performance Indicators, also could be called the Vitals Signs or the Metrics, or whatever you want...
- They don't just come from the G/L!
- They tell a lot more with good comparatives, which also could be 12 month rolling in some cases



Most important KPIs

- Average over/under on jobs (most important) – budget & schedule
- Project backlog (broken down by age, industry, geography)
- Jobs being bid on, weighted, the pipeline



Most important KPIs

- Pipeline conversion ratio (even by sales rep')
- Lost bids
- Average bid price miss (if known)
- Business capacity use
- Billings
- Contract signings in the month
- Book to bill ratio (contract signings/revenue recognized)



Your job security would be
best measured at this
company by

- Backlog and pipeline



More KPIs

- Person hours worked
- Revenue per employee
- Gross profit/payroll (labour efficiency)
- Overtime hours worked
- Employees, opening, adds, departures, closing
- Employee morale



More KPIs

- On the job injuries
- Lost time due to injuries
- # jobs in progress
- Project risks & upsides
- Warranty claims (contractual)
- Warranty claims (goodwill)
- Key subcontractor info
- Idle assets
- Customer satisfaction/work quality



More KPIs

- Days sales outstanding
- Market share
- Website statistics
- Media mentions
- Average project size
- Debt service ratio



Invent a new KPI

- Contract win ratio
- Contracts signed in the period/sales & marketing costs
- Measures the payback from sales & marketing activities
- Could lag it
- Need to use contracts signed, not revenues



Note

- Looking good at work by inventing and creating new, valuable business KPIs is covered in the course **Practical Tips for Controllers & CFOs, in more depth**, including how to invent new ones



Ratios

- A financial executive should try to think of useful ratios that will help management in analyzing the organization



Ratios

- Consideration could be given to reporting standard ratios such as return on sales, return on equity, return on assets, etc. if they would be useful to the company
- Some companies like to use some of the new ratios, such as the Dupont ratios (variations on the traditional ROA, ROE ratios)
- If you start presenting these, they should be fully explained, and probably should not be done monthly, they should be done for a full fiscal year, or rolling 12 months, a month is too short a period



Note

- You should always be thinking of business/advisory comments when you are doing your work, even it is primarily financial reporting
- The bank covenant issue is the biggest one
- The company may have room, based on the balance sheet and the equity amount, for some additional long-term debt



Conclusion

- Reporting can always be improved
- Don't get stressed trying to dramatically improve your reporting immediately, do it over time, consulting users
- You will get a detailed handout with the completed slides on this, including a revised reporting package



I have about 20 other courses



Webinars before Christmas

My brain cramp!

Elevate Your Career with More Strategic Thinking (2 hrs)	Dec 6, 2024	2:00pm - 4:00pm
Contract Review Tips for Accountants (1 hr)	16-Dec-24	2:00pm- 3:00pm
Sharpen Your Business Loan Negotiation Skills (2.5 hrs)	17-Dec-24	9:30am - 12:00pm
Managing Lawyers & Legal Fees (1.5 hrs)	18-Dec-24	9:30am - 11:00am



And many practical humourous video courses

- See your body's website



Closing comments

- Was this boring?
- Send me an e-mail spriddle@bell.net, to get completed slides
- Do LinkedIn with me
- Please complete seminar evaluations



How are papers marked?

- Gerry explains his marking strategy on Mr. D - YouTube

FINANCIAL REPORTING CASE SUGGESTED APPROACH

Note:

This is a suggested approach, not a “correct” approach and it does not necessarily represent the only way the case could be handled.

General

The monthly financial reporting for Bild Construction Inc. could be improved significantly. Currently it exhibits the following general weaknesses, as well as many specific weaknesses:

- Lack of sufficient, decision-oriented information
- A very weak written, uninformative analysis of the month’s results from the Accounting Manager
- Lacks useful schedules
- No looking ahead to the future, even though October is almost over

It is also important not to overload the Board/senior management with useless information.

It would be best to label the financials “unaudited”. Putting draft or preliminary can also be useful.

Management issues

There may be some management and personal career risk issues here. Are you getting into a mine field? There has been poor past reporting, uninformed senior management, jobs with losses and possibly other possible skeletons in the closet.

Narrative

Here is a possible improved monthly narrative.

Members of the Board and Executives,

October 23, 2019

You will find attached the September monthly report. We have expanded the reporting to provide more relevant information to the Executives and the Board.

It was a relatively good month for BCI sales as revenues were higher than Budget, primarily due to revenues earned on the \$1,610,00 C200 project signed in July, that was not anticipated in the Budget. There were 19 regular working days in the month, compared with 22 in August and 21 in October. This shows that regular working day was high. We will be updating the Budget shortly, to reflect the inclusion of the C200 project.

Revenues for the month and the year were running 5.8% and 11.6% respectively, higher than the corresponding periods in 2018.

The key components of revenue are now set out in the report, graphically, as well as the monthly revenue trend for the year. The trend does show a decline after some very strong early months in the year. The decline should be explained.

The company's direct project margin year to date was lower than budgeted by 1.4% primarily due to the Wayly Plastics project. A new key project summary is found in the attached. On a weighted average basis, the projects are 3.7% under budget. The most risky project currently underway is the Wayly Plastics project. The risk relates to unanticipated soil problems. In the future, the company needs to consider ways to mitigate such risks. As seen in the attached, the project's costs are over-budget significantly. At this point in time, there are risks of penalty clauses being triggered.

Expenses were generally consistent with budget for the period. The large increase in professional fees, reported under General Administration was due to the receipt of an unexpectedly large bill from the firm's lawyers, with respect to the Rio Properties dispute. These fees will be monitored closely by BCI, until this matter is closed. We believe the \$164,000 Rio holdback is 100% collectible. If any Board members have industry contacts that could help in either of the Philips or Rio matters, please let me know.

I have noted that our contract win cost ratio, defined as variable sales & marketing costs divided by contract wins in dollars, has significantly improved over the prior year. It went from 27 to 1, to 34 to 1. This measure is not perfect, because some current costs will bring in future contracts, but I believe this represents a step forward in the business.

The bottom line for the month before taxes was \$54,269 and for the year, \$726,264. This represents 2.5% of revenues for the month and 4.6% year to date. This compares slightly favorably with a recently discovered industry average of 4% for BCI's sector. (Source: Construction Contractors Factbook, 2019). However, due primarily to higher General Admin costs, the month was less profitable than September 2018.

In terms of outlook, October is going to be a weaker month with about \$1.5 million of revenues, based on early results and a small loss will be reported. November and December revenues will likely be at the same level with small losses. As we move toward our December 31 year end, we believe the company has some chance of achieving the milestone of \$20 million in sales, for the first time in BCI's history. This is because year to date revenues plus three months at \$1.5 million give sales of \$19.985 million.

The company's cash position at September 30 was \$212,000 with no amount on the operating line. However, on October 12, 2019, under the terms of one of the company's contracts, the company was required to place \$68,000 in escrow with a third party lawyer, until certain conditions have been fulfilled. It is expected that the conditions will be fulfilled in early January. This will constrain the company's cash position in the near term. The sources and uses of cash in the month have been now set out in the Statement of Cashflow, similar to the one reported in the company's annual financial statements.

There is one old accounts receivable that is of concern, \$67,000 from Philips Limited. We ceased work entirely on the project, in an attempt to force the customer to pay. We will be reviewing legal alternatives in due course. An allowance for doubtful accounts of 50% of this amount has been provided.

The company's summary accounts receivable listing is set out in the attached, along with pie charts indicating the type of contract, currency and due date. There is currency risk in the company's

receivables since the company's position is not to hedge currency risks. The Board has no idea what the magnitude of the exchange risks faced is, at least this could be quantified. The Board might want to revisit the no hedging position in due course.

During the month, the company acquired a patent, related to a useful concrete construction technology and it is reported as an intangible asset in the balance sheet. The business reason for the purchase was _____. The cost of the patent will be amortized to income over 10 years, the approximate useful life. The legal life of the patent is 20 years. I will try to look into licensing the patent to third parties, so that it will generate additional income for BCI.

The company's share activity for the month is set out in a new note to the financials.

The company is on side with respect to all bank covenants, as now set out in the financial statements. However, the company's position relative to its minimum current ratio has deteriorated compared with August and it is close. We will be taking steps to improve this position over the next two months. I also need to check the treatment of the patent intangible asset in the debt-to-equity covenant from the bank. We have included the intangible in equity for this calculation, but the company would still be on side if it was excluded.

My statutory declaration is that all required source deductions were remitted on time in the month.

There is a summary of the company's business, financial history and critical accounting policies in a special attachment for our newest board member.

Please contact me if you have any questions about this report.

Yours sincerely,

New Controller

	Statement of Operations							
	2019						2018	2018
	Budget	Variance		YTD	YTD		2018	2018
	September	September	Fav/(Unfav)	YTD	Budget	Variance	September	YTD
Revenues	1,828,632	1,611,667	216,965	15,486,865	14,505,000	981,865	1,728,001	13,878,851
Direct project costs	<u>1,444,619</u>	<u>1,256,028</u>	(188,591)	<u>12,281,084</u>	<u>11,304,255</u>	(976,829)	<u>1,375,489</u>	<u>10,978,171</u>
Margin	<u>384,013</u>	<u>355,638</u>	28,374	<u>3,205,781</u>	<u>3,200,745</u>	5,036	<u>352,512</u>	<u>2,900,680</u>
	21.0%	22.1%		20.7%	22.1%		20.4%	20.9%
Other costs								
Sales & marketing variable	51,072	57,825	6,754	464,752	520,428	55,676	50,125	481,458
Sales & marketing fixed	64,445	64,918	472	586,452	584,258	(2,194)	59,425	501,428
Rent	19,541	19,541	-	175,866	175,866	-	19,541	175,866
General administration	96,425	60,013	(36,412)	571,759	540,121	(31,638)	61,252	512,485
Miscellaneous	<u>84,525</u>	<u>66,556</u>	(17,969)	<u>591,675</u>	<u>599,000</u>	7,325	<u>64,525</u>	<u>547,582</u>
	<u>316,008</u>	<u>268,853</u>	(47,155)	<u>2,390,504</u>	<u>2,419,673</u>	29,169	<u>254,868</u>	<u>2,218,819</u>
Income/(loss) before interest amortization and taxes	68,005	86,786	(18,781)	815,277	781,072	34,205	97,644	681,861
Amortization	12,052	5,444	(6,608)	68,408	49,000	(19,408)	10,078	65,478
Interest & bank charges, net	<u>1,684</u>	<u>1,167</u>	(517)	<u>20,105</u>	<u>10,500</u>	(9,605)	<u>2,405</u>	<u>22,458</u>
	<u>13,736</u>	<u>6,611</u>	(7,125)	<u>88,513</u>	<u>59,500</u>	(29,013)	<u>12,483</u>	<u>87,936</u>
Net income before inc. taxes	54,269	80,175	(25,906)	726,764	721,572	5,192	85,161	593,925
Income taxes	13,784	20,364	(6,580)	184,598	183,279	1,319	21,631	150,857
Net inc. after tax	40,485	59,810	- 19,326	542,166	538,293	3,873	63,530	443,068
Income as a % of revenue	3.0%	5.0%		4.7%	5.0%		4.9%	4.3%

	Balance Sheet	
	30-Sep	31-Aug
	<u>2019</u>	<u>2019</u>
ASSETS		
<u>Current Assets</u>		
Cash	212,133	3,072
Trade accounts receivable (see listing , net of of an	1,399,969	1,348,474
Work-in-progress and other receivables	211,458	424,255
Prepaid expenses	<u>41,252</u>	<u>42,522</u>
	<u>1,864,812</u>	<u>1,818,323</u>
Property, plant & equipment	847,582	843,431
Intangible asset	29,748	-
TOTAL ASSETS	<u>\$ 2,742,142</u>	<u>\$ 2,661,754</u>
LIABILITIES & SHAREHOLDERS' EQUITY		
<u>Current Liabilities</u>		
Operating line of credit	-	100,000
Accounts payable & accrued liabilities	1,062,045	888,549
Deferred revenue	57,060	54,286
Current portion of term loan	<u>114,222</u>	<u>114,222</u>
	<u>1,219,543</u>	<u>1,157,057</u>
Term loan	568,865	645,232
SHAREHOLDERS' EQUITY		
Common shares (see note 1)	354,125	314,125
Retained earnings	<u>585,825</u>	<u>545,340</u>
	<u>953,734</u>	<u>859,465</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 2,742,142</u>	<u>\$ 2,661,754</u>
<u>Bank ratios</u>		
Debt-to-equity (max 2.25)	1.88	2.10
CR (1.5 min)	1.53	1.57

	Cashflow	
	for the month of September	
Cash provided by (used in)		
OPERATING ACTIVITIES		
Net income/(loss)	40,485	
Amortization of property, plant & equipment	<u>12,052</u>	
	52,537	
Changes in non-cash operating working capital items:		
Trade accounts receivable	(51,495)	
Work-in-progress and other receivables	212,797	
Prepaid expenses	1,270	
Operating line of credit	(100,000)	
Accounts payable & accrued liabilities	173,496	
Deferred revenue	2,774	
Current portion of term loan	<u>-</u>	
	<u>291,379</u>	
INVESTING ACTIVITIES		
Purchase of property, plant & equipment	(16,203)	
Purchase of intangible asset	<u>(29,748)</u>	
	<u>(45,951)</u>	
FINANCING ACTIVITIES		
Term loan	(76,367)	
Issue of common shares	<u>40,000</u>	
	(36,367)	
Change in cash & cash equivalents	209,061	
Cash & cash equivalents, beginning of month	<u>3,072</u>	
Cash & cash equivalents, end of month	<u><u>212,133</u></u>	

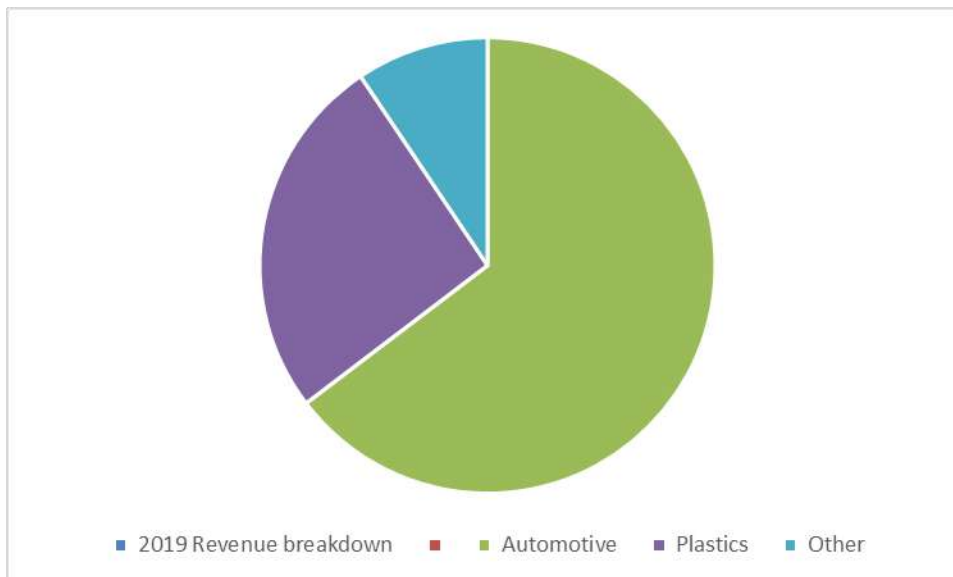
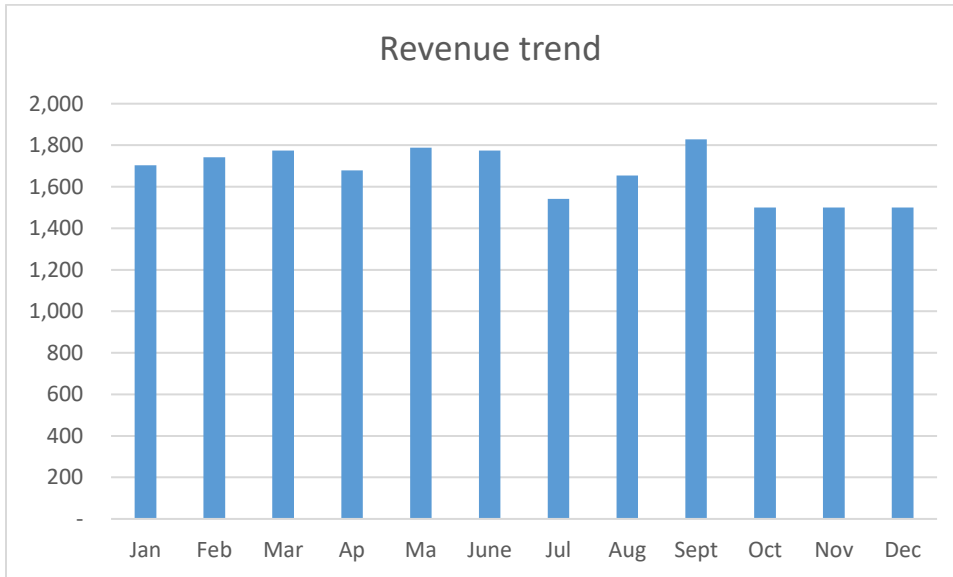
Note 1 -Common shares		
	#	\$
Opening	457,422	314,125
Issued	5,000	50,000
Redeemed	<u>(1,000)</u>	<u>(10,000)</u>
Closing	<u>461,422</u>	<u>354,125</u>

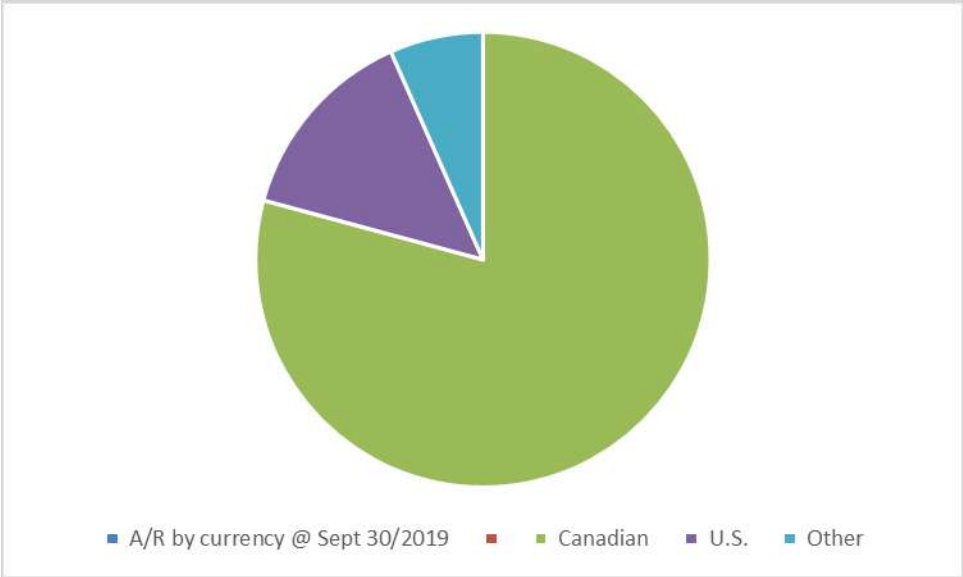
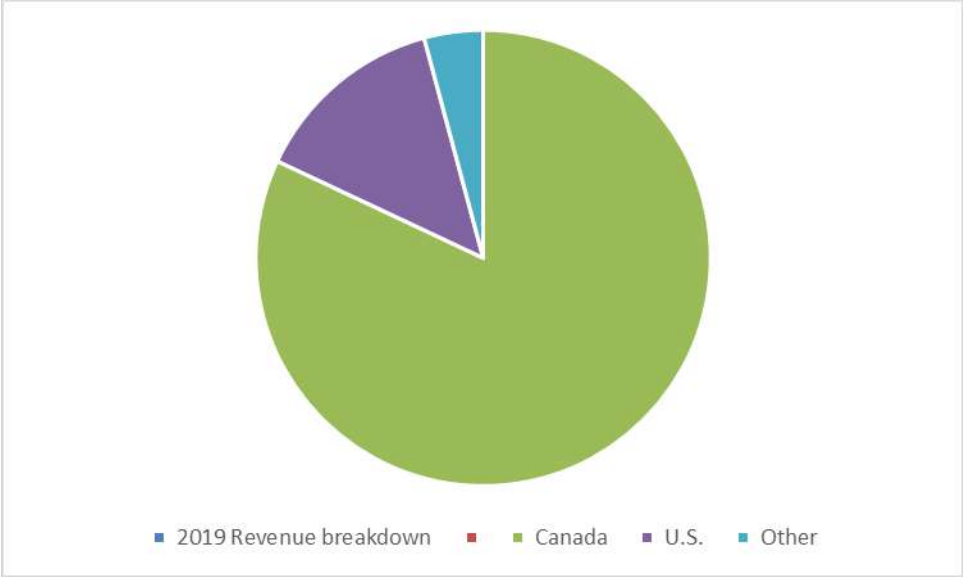
Additional financial information

	Accounts Receivable					TOTAL
	Sept 30, 2019					
	Current	1 - 30	31 - 60	61 - 90	> 90	
Artco		96,500				96,500
C200	241,022	106,000				347,022
Dock (1996) Inc.	19,544	8,512				28,056
Glenway Inc.		22,000				22,000
Hobo Corp	-	5,100			12,400	17,500
Kart Dev	66,792	5,645				72,437
Little Co.	5,978	12,840				18,818
Philips Limited		-			67,000	67,000
Regal Developments	42,000					42,000
Rio Properties		-			164,000	164,000
U.S. Northern	119,704					119,704
Wayly Plastics	241,525	1,740				243,265
Yellowmart	164,200	20,600				184,800
	900,766	278,937			243,400	#####

Major Project status report							
Project	Value	% compl.	A/R	Budget costs	Actual	Under/(over)	Notes
U.S. Northern	800,000	62.10%	119,704	347,020	346,203	817	No project issues
Yellowmart	910,000	44.0%	184,800	280,221	269,231	10,990	Ahead budget
Wayly Plastics	1,104,000	57.80%	243,265	480,033	640,033	- 160,000	Soil problems, high risk
C200	1,610,000	82.10%	347,022	925,012	940,121	- 15,109	Subcontracts low, BCI labour high

KEY HOLDBACKS @ Sept 30, 2019		
Customer	Amount	Expected release
Artco Inc.	96,500	Final inspection
Glenway Inc.	22,000	Nov-15
Regal Developments	42,000	Dec-31
Rio Properties	164,000	with lawyers
Other < \$50,000	169,458	various
	397,458	





Other possible changes or improvements

User needs

The financials should probably conform to GAAP, even though it is not required for private company interim financials. It might be required by the company's bank. Accounting Standards for Private Enterprises (ASPE or Part II of the CPA Handbook) will apply.

You should sit down with the VP, Construction and explain how the job reports provided to him from the accounting system relate to the monthly reports. A specific reconciliation probably should be provided. His monthly reports may not be on a GAAP basis. He or she should also be prepared for the additional questions that may come from the Board or management, now that more detailed project information is provided.

Consideration should be given to have a meeting with each of the executives and the Board to see if they are satisfied with the financial information they are getting.

Board members should be asking if the company has met its statutory remitting requirements, because they are on the hook for them. Therefore, it is a good idea to report the status monthly.

The new board member needs a 1-2 page financial briefing, the key financial issues related to the company, especially the important topic of revenue recognition. Alternately, there could be an orientation meeting with them.

Big picture

It would be good to discuss the tie-ins between the results and the company's overall business strategy. The company's competitors could be discussed, in relation to results.

A discussion of the macro-economy and the company's key customer sectors would be useful, if it is tied to the impact on the company. Sometimes the financing behind the customers is a critical issue.

New developments in the business environment the company faces, as well as any relevant new legislation or income tax, or tariff changes should be covered.

Input should be obtained from other executives, perhaps they should author a short section on their area.

Risks

A summary of the major risks faced by the company could be provided. It should also explain what management is doing about the risks. These risks include:

- Currency
- Technical
- Market segment concentration
- Competitive
- Credit and other

-
- Petroleum price (trucking and plastics industries heavily affected by it)

There could be a discussion of major upsides and downsides.

Reports

September 2018 comparative monthly and YTD income statement information would be more useful because of seasonality and is provided in the improved sample. In fact, more companies are reporting rolling 12 month results with rolling 12 month comparatives as the best way to see overall trends in the business. This is an excellent tip.

Reporting pre-tax income as a % of revenues, gives the executive a better sense of profitability relative to industry. The margin % is critical in the business and should also be included. Just because they are not included in the annual audited statements, doesn't mean they shouldn't be in the monthly statements.

Many users would like to see Earnings Before Interest Taxes Depreciation & Amortization (EBITDA).

Disclosure of the company's approximate monthly break-even revenue would be relevant to users. This could even be broken down into weekly or daily break-even.

A financial executive should try to think of useful ratios that will help management in analyzing the business, i.e. the contract acquisition ratio. Statistical analysis may be useful, for example the variance of a series of numbers or the standard deviation, compared over time can be quite informative.

If the balance sheet at the previous September 30, rather than the previous month was included, it would be more useful comparative information, because of the seasonality of the business. In fact, including several historic balance sheets would be more useful for comparison and trend analysis purposes.

Showing quarterly numbers and comparatives would be useful information, like a public company.

Prior period and year to date comparatives of revenue by industry selling to and geographic location would be more useful if provided. A prior year monthly trend would also be a useful comparison. Even better for management purposes, would be formal P&L segmentation by industry selling to and geography. Then management might realize for example that they are making the most money in say the trucking industry, which is a risk. Note that segmented reporting is not required under ASPE (it is only for public companies under Part 1 of the CPA Handbook and only if certain criteria are met) and may require a lot of systems changes. This could be taken even further through segmentation by type of construction if there are differences.

Direct costs should be broken out in to its parts. Likewise, sub-contracts should probably be broken out into different components, like design, mechanical, construction, etc.

It is not clear what the corporate overhead is, this could be broken out.

The expense captions are not that useful. Rent would normally be included in General Administration. Miscellaneous expense is much too large a % of total expenses. The major components should be broken out.

The report would not lose anything if all numbers were in thousands. (Make sure the reports still balance!).

Financial statement note on share activity might not be mandatory, but provides useful information to report readers.

Consideration could also be given to including full individual project status reports for very large jobs, that are already provided to the VP, Construction.

One topic in any internal financial reporting, is how much subsequent info should be disclosed in the narrative, considering the management implications, not the GAAP rules. If it is very material, it should definitely be disclosed, rather than waiting for the following month.

For monthly financials, the format is flexible. We know of a company that reports net working capital first on the balance sheet (current assets minus current liabilities). This is useful information for users.

Process

A detailed review of revenue recognition through percentage completion should be conducted since this an area which is prone to error due to the potential complexity.

Monthly financial statement review procedures should be put in place to find out exactly why the amortization errors took place and to ensure that they doesn't happen again.

It took the Accounting Manager 23 total days to report the month end results, that is about 15 working days. Steps should be taken to analyze closing procedures and improve the turnaround.

Bank and cash

The company's position relative to its bank covenants should be presented. This is not GAAP, but is useful information to the users. The calculation can be built into the financial reporting spreadsheet. The unused amount of the operating line of credit could also be presented.

No future-oriented cashflow information has been provided. Since "cash is king", this is very important for executives.

Receivables

It would be possible to report the trade A/R ex holdbacks, since this distorts the picture and to disclose the actual allowance for doubtful accounts.

Information on receivables and holdbacks could be segregated between complete and incomplete projects.

The old Hobo Corp receivable should be discussed, it sticks out as very overdue, although not that large.

There appears to be a difference between the A/R subledger and the G/L. The subledger is \$23,133 higher. This should be investigated.

Work in process and other receivables are very different assets and should be separate in the balance sheet.

The company could actually report **a roll forward of receivables**, which at least accountants would get a lot out of, for example (not actual numbers):

Opening inventory	\$ 14,322,323
Purchases and production costs	21,313,434
Write downs	- 430,000
Cost of sales	<u>1,604,829</u>
Closing inventory	<u>\$36,810,586</u>
Opening A/R	\$ 1,452,904
Sales	1,397,389
Collections	- 1,033,044
Write-offs	- 21,500
Change in allowance	- 43,000
Closing A/R	<u>\$ 1,752,749</u>

GAAP issues

A cashflow statement has not been presented. This is required under ASPE, and moreover is useful to users, reconciling opening and closing cash. A statement of retained earnings has also not been presented.

The company has taken a non-refundable deposit into income. This is not consistent with % completion accounting – the stated accounting policy. Although there might be an economic argument that they are fully earned, ASPE probably requires that they be deferred and recognized over the period that the fees are earned. I will be investigating if this has happened in the past and will report back to you.

Under ASPE, the taxes payable method may be used with no owner consent, it seems that this is the method that has been used. However, with significant temporary differences potentially arising from construction holdbacks, not using the future income tax method, might distort the financials.

The Wayly contract which is over budget should be checked to see if the loss for the entire contract should be booked, as required by ASPE.

It is possible that stock-based compensation accounting, ASPE Section 3870 must be applied because of shares sold to employees, depending on how the arrangement works.

The accounting for the share redemptions should be verified. It is only correct if the departing employee paid \$10 each for the shares, because there has been no change in retained earnings related to a premium.

Budgeting

The Budget versus actual variances in the current monthly financials are positive when sales exceed budget, but also positive when expenses are above budget. This should probably be changed to the normal way of presenting, i.e. expenses above budget result in a negative variance, because they are bad news. The caption should state favourable/(unfavourable). Some people use waterfall graphs to present budget versus actual.

Budget amounts for both month and year to date should be presented.

The Budget variation for direct project costs does not have much meaning, because most of the variation is due to the variation in sales. It might be more meaningful for the budget amount to be a % rather than fixed, so that this is a flexible budget.

The Budget probably needs revision, because of the huge C200 contract that was not anticipated in the Budget. Otherwise the budget versus actual deltas will be large.

The Budget appears to be a flat monthly amount, this is likely not appropriate given the seasonality of the business, a more accurate budgeting process should be used.

Interest expense in the month is quite a bit under the budget, this needs to be explained.

Future-oriented balance sheet information could also be provided.

What should be done about the September error?

The error is material relative to monthly income before taxes, but is arguably not material relative to 1% of monthly revenues. If the error was not amortization, it might be appropriate to inform the Board and executive immediately about it. However, since it is not that material and is non-cash (and won't put bank covenants off side), it can probably be dealt with in the October report rather than through restatement of the August and September financials. Suitable wording for this may be devised, without making the Accounting Manager feel bad.

Alternatives include:

1. Included in the month is a catch-up for amortization, not recorded in the prior two months.
2. No disclosure, just fix in the month.

If comparative monthly financials are presented, October should probably be adjusted, in the spirit of Section 1506 of the CPA Handbook.

Industry comparatives

Possible sources for industry comparatives:

- Google searches
- Benchmarking studies (may have to pay), some accounting firms have them

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- Public companies (www.sedar.com and www.sec.gov/edgar.shtml sites are useful)
 - Industry trade associations
 - Available government statistics (Statistics Canada, Industry Canada, Department of Finance, provincial governments)
 - Exchange data with similar but not competing private companies
 - Dun & Bradstreet (know your NAICS code, formerly SIC)
 - www.fintel.us Financial Intelligence for Business
 - Gartner Group or Forrester Research
 - www.hoovers.com
 - nielsen.com may have some info
 - Your bank
 - Companies who approach you to offer themselves for sale
 - Private sellers of industry benchmarking information

www.Firstresearch.com
www.Researchandmarkets.com
www.anythingresearch.com
www.profitcents.com

Other

By selling the shares at \$10 per share, effectively a valuation of the company has been determined. How was it arrived at?

Other business measures

The top ones:

1. Average over/under on financial budget on jobs (most important)
2. Project backlog (aged is even more useful)
3. Project backlog (broken down by age, industry, geography)
4. Jobs being bid on, weighted, the pipeline
5. Pipeline conversion ratio (even by sales rep')
6. Lost bids
7. Average over/under on completion date on jobs
8. Average bid price miss (if known)
9. Business capacity use
10. Billings
11. Billings as a % of revenue
12. Book to bill ratio (contract signings/revenue recognized)

Others:

13. Contract signings in the month
14. Person hours worked
15. Revenue per employee

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16. Gross profit/payroll (labour efficiency)
 17. Overtime hours worked
 18. Contract bookings
 19. Worker hours on projects
 20. Employees, opening, adds, departures, closing
 21. Employee turnover
 22. Employee morale
 23. On the job injuries
 24. Lost time due to injuries
 25. # jobs in progress
 26. Capital expenditure information
 27. Project risks & upsides
 28. Warranty claims (contractual)
 29. Warranty claims (goodwill)
 30. Key subcontractor info
 31. Idle assets
 32. Customer satisfaction/work quality
 33. Days sales outstanding
 34. Market share
 35. Website statistics
 36. Average project size
 37. Debt service ratio

There is an important question as to whether finance should validate the non-financial information. The answer is probably no, but if anything is obviously, wrong or inconsistent, it should be questioned.

In addition, consideration could be given to reporting relevant ratios such as return on sales, return on equity, return on assets, etc. if they would be useful to the company. Some company's like to use some of the new ratios, such as the Dupont ratios (<https://courses.lumenlearning.com/boundless-finance/chapter/the-dupont-equation-roe-roa-and-growth/#:~:text=The%20DuPont%20Equation%3A%20In%20the,turnover%20multiplied%20by%20financial%20leverage.>) If you start presenting these, they should be fully explained, and probably should be done monthly, they should be done for a full fiscal year, or rolling 12 months, a month is too short a period.

Although not common for a private company or required, calculating earnings per share is useful and helps shareholders see what their "piece of the profits is". Other variations could include for example executive compensation per share.

It could also be noted that the company may have room, based on the balance sheet and the equity amount, for some additional long-term debt.

It is not clear if the company has its US business in a US legal entity. If yes, there are consolidated financials, and should be labelled as such.

The project summary could classify the projects as green light, red light, or yellow, based on good, bad, or possibly problematic.

