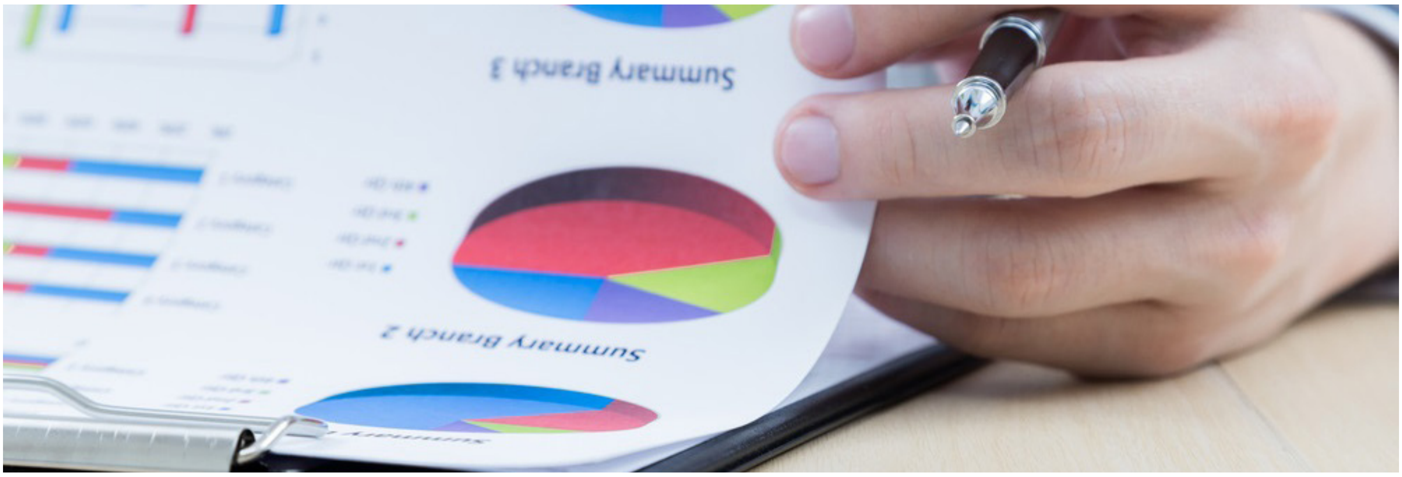
INDUSTRY INSIGHTS

By Robyn Karam

The new financial year – time to review business performance



With the financial year at an end, and a new one just beginning, small and medium sized businesses have been busy preparing financial statements and income tax returns for lodgement with the Australian Taxation Office (ATO).

From a strategic perspective it's important, at this time, that company directors and managers take time out to consider what the financial statements say about their business.

The historical perspective

Specifically, they should examine:

- **Profitability** – which is the ability of the business to earn a profit. A profit is what's left of a business's revenue after it pays the expenses that relate directly to revenue generation (including costs related to producing the product or service) and the costs of conducting business activities.
- **Cash flow** – the life-blood of the business. This isn't just the money transferred into and out of the business. It also relates to the expectations and requirements for cash at different times, and having cash available to discharge expected obligations. Even when a business is profitable, insufficient cash flow may undermine its ability to survive. The cash flow record indicates how the business managed its available cash resources over a prior period. It can also provide an insight into any need for change (e.g. an overdraft).
- **Net assets** – which are the total assets minus total liabilities. The net assets represent the owners' equity in the business.
- **Liquidity** – which is a measure of the business's ability to pay off its liabilities when they are due, or how easily and effectively it can access the money it needs to cover debts.
- **Working capital** – which reflects the liquid assets a business uses to make debt payments. It's the capital used in the business's day-to-day trading operations, calculated as the current assets minus the current liabilities.

Smaller business entities may not prepare financial statements. They might instead simply rely on bank statements and invoices as their only means of record keeping.

This isn't recommended, as it can lead to misinformed,

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ad hoc decision making, based on incomplete information. In this situation, businesses tend to focus only on cash accounting, ignoring the creation of assets (such as debtors) or the accrual of liabilities that may be incurred but are not yet due to be paid (e.g. PAYG withholding tax, superannuation, payroll tax, GST, insurance etc).

Bank statements may show a positive cash balance, but don't reflect any anticipated debtor collections or payment of accrued liabilities due at a future point in time.

Well-prepared financial statements, on the other hand, accurately record the historical performance of the business. They reflect, in a more comprehensive way, how the business has performed over a prior period (e.g. monthly, quarterly, annually).

Until such accounts are produced, the picture is incomplete.

A key question is whether the historical accounts match the owner's expectation or understanding of how the business has performed.

The forecast

Businesses should also prepare forward-looking financial data. These are best captured in a three-way

budget that comprises the following:

- **Forecast profit and loss statement (P&L)** – which includes forecast revenue (the number of units expected to sell and the selling price per unit), forecast expenses (purchases, direct costs and indirect costs) and the forecast profit/loss amount.
- **Balance sheet** – which comprises forecast assets and liabilities (e.g. any purchase of property, plant and equipment (PPE), any new loans to fund growth or trading, improvement in the collection of debtors, and provisions for doubtful debts based on historical results).
- **Cash flow forecast** – which includes forecast cash collections and cash payments. The cash flow forecast is linked to the P&L and balance sheet (e.g. collection of debtors, receipt of loans/advances, purchase of PPE).

These three elements are integrated to provide an insight into what the business might look like in a future period (e.g. monthly, six-monthly, annually).

Focusing on just one aspect (e.g. cash flow) without regard for the others may cause a business to focus on performance in one key area potentially to the detriment of others (e.g. the source and application of funds will affect both the P&L and balance sheet).

Once forecasts are prepared, a business owner needs to regularly monitor actual results and compare these to the forecast to measure how the business is performing.

The importance of comprehensive record-keeping

Maintaining financial information in the ways described above enables a business to monitor its performance and health across key areas.

With accurate, comprehensive financial records, business owners can confidently plan ahead, taking potentially difficult times (e.g. seasonal factors) into account.

Such records help owners to identify and track the

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key factors that affect overall bottom line results. For example, they can determine whether a specific issue is one of demand, selling price, cost of goods or overheads.

Businesses can identify how actual results track against the budget, thereby ascertaining areas in which there may be room for improvement.

They can then implement changes that are likely to have the most significant positive impact on the business and will generate the best results over the long term.

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We also work with financiers, solicitors, accountants and creditors to address the needs of all stakeholders when businesses face financial challenges.

How BRI Ferrier can help

BRI Ferrier can assess your current situation and advise on a path forward to minimise further risk.

Early intervention is often the key for a successful restructure of your business. If you or your client is experiencing financial challenges then don't delay, contact us today.

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