

DOMINIC LAMBRINOS

THE INIC INSTITUTE

FINANCIAL COURSES THAT MAKE SENSE



How to Understand Financial Statements in a Day

COURSE ONE - 13 MODULES

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Module 1

Course Summary

Making a difficult subject easy

- ❖ This Course takes a difficult subject and makes it easy – **promise**.
- ❖ This course is designed to provide you with an overview in understanding of financial statements by helping you understand where they come from, what their purpose is and how best to interpret them to strategise for future business success.
- ❖ This strategy can be conceived by either the business manager or by any consultant, and in many cases, this will be a financial consultant.
- ❖ Consequently, the objectives of this course are:
 1. To teach you the skills of how a financial system works for any business.
 2. To understand how these numbers are collated together to make up the figures in the financial statements.
 3. To show you what these numbers actually mean for the future of a business and how to maximise profitability.
 4. Build opportunities to better your business or in the case of a consultant provide a better service by understanding financial statements.
- ❖ Therefore, the ultimate intention of this course is to equip you with an understanding of financial statements, and where applicable, to broaden the services you offer to your clients.
- ❖ It is therefore designed to ultimately differentiate you from your competitors so that you can enjoy a competitive sustainable advantage.
- ❖ With the development of these skills, it is our wish that you will increase revenues, and in the case of consultants, derive new income streams from offering services based on skills you learn in this course. Furthermore, we wish that this will improve customer retention, referrals and the ability to earn a higher level of ongoing fees.

INTENDED PARTICIPANTS

- 1.** Business owners who are constantly bamboozled by their accountants and don't understand the financial statements they pay so much for.
- 2.** Consultants, such as mortgage brokers who wish to increase their product offerings and provide a more holistic service to their clients.
- 3.** Anyone who has an interest in understanding financial statements.



CPD HOURS

Industry bodies apply their own individual criteria for the awarding of continuing professional development (CPD) hours.

At present this course provides for 7 hours CPD for the Finance Brokers Association of Australia.



Module 2

Course Introduction

2.1 ORIGINS OF FINANCIAL ACCOUNTING

- ❖ We have a lot to be grateful to the monks of the Middle Ages, for they invented champagne, liquors and spirits and in another period of having nothing better to do, they invented the double entry bookkeeping system and financial accounting.
- ❖ In the 14th century, the Dutch used this system to keep track of all of the transactions and financial promises they made whilst they were trading and doing business.
- ❖ Things have not changed much since these origins and all kinds of businesses need to use the same system all around the world to keep track of their financial transactions and to summarise these transactions.
- ❖ Computers have certainly made it easier, and like with all things related to technology, they have been able to automate and complete in the background some tasks that used to be completed manually. However, the concept of financial accounting has never changed and still today, it is a system that summarises financial transactions and agreements.

2.2 WHO USES FINANCIAL ACCOUNTING?

- ❖ The concept of financial accounting can be applied to individuals for personal use, however for the most part; it is used to help businesses keep track of their transactions and their obligations.
- ❖ As a general rule of thumb, capitalism has made it safe to assume that a business is an activity or enterprise that exists to make a profit, and the concepts of financial accounting are employed to measure this profit and plan for greater future profit.
- ❖ A business can either sell a good or product (wholesale or retail) or it can be entirely service based. Businesses across this entire spectrum require financial accounting, from giants like Google and Amazon, to your local butcher and baker.
- ❖ Businesses all over the world use financial accounting to count their money, to organise their money and to plan to make more money in the future.
- ❖ For the sake of clarity, **financial statements** are sometimes called '**Accounts**' and the system that produces them which we call the **financial accounting system** is sometimes referred to as '**accounting**', '**bookkeeping**' and '**the financial system**'.
- ❖ All of these mean the same to us and for the sake of this course and for simplicity we say that the **financial accounting system** makes the **financial statements**.

"Businesses all over the world use financial accounting to count their money, to organise their money and to plan to make more money in the future".

2.3 BUSINESS STRUCTURES

- ❖ There are many different types of business structures, however in Australia the most predominant structures are outlined below (and these are for the most part 'similar' in concept to entities around the world). Keep in mind that each and every one of these structures requires a financial accounting system to provide financial statements.

Discussion with the author

Structure	Explanation
Sole trader	This is the most common form for a small business. It suits a small/single operation such as a tradesman, small accountant or solicitor, and even the typical small corner store. Generally sole traders do not employ many employees, if any at all.
Company	<p>A company is a separate legal entity, used by people in business to delineate their business activities from themselves.</p> <p>You can have a small company such as a family company where the directors and owners are the husband and wife, all the way to a public company where there is an independent board of directors and many shareholders, whose shares are traded on a stock exchange.</p>
Partnership	A partnership is when two or more people or companies agree to work in business together and share the profits in accordance with agreed percentages.
Joint venture	Joint ventures are like partnerships, however are usually used for a specific activity that has a limited life like a property development or an oil exploration platform, after which point the joint venture ceases to exist.

"Keep in mind that each and every one of these structures requires a financial accounting system to provide financial statements".

Discussion with the author (cont.)

Structure	Explanation
Trusts	<p>A trust creates a relationship between a person acting as a Trustee who is entrusted to hold property or other assets for the benefit of a group of persons, referred to as the Beneficiaries of the trust.</p> <p>The Trustee is the nominal owner of the property and assets and the Beneficiaries are only entitled to hold their interest in the trust. Unlike companies, a trust is not a separate legal entity, however some businesses are carried out through trusts.</p> <p>The ultimate say rests with the Settlor who has the authority to appoint and remove Trustees.</p> <p>There are two main types of trusts:</p> <ol style="list-style-type: none">1. Discretionary trusts. A discretionary trust permits the Trustee to distribute any surplus to beneficiaries at their discretion. This enables families, for example, to establish a business within a trust that allows their family members to act as beneficiaries to the trust without being involved in how the business is operated.2. Unit trusts. The Trustee of a unit trust has no discretion and income must be distributed in proportion to the units the beneficiaries hold (this is akin to a company distributing profits to shareholders via a dividend – the more shares you own the higher your dividend income).

Now, let's explore the crux of financial accounting...



Module 3

The Crux of Financial Accounting

The Transaction Summary System

- ❖ Whether you are aware of it or not, you would see financial accounting in your day-to-day business activities almost every day. These take the form of a business transaction.
- ❖ A business transaction can be something as simple as paying for your bus fare this morning on your way to work, or paying the energy bill you received last night.
- ❖ Every business has many, many business transactions every day – the **financial accounting system's** job is to summarise these transactions so that irrespective of whether you are Google or the local butcher all of the business transactions are summarised into TWO pieces of paper called the financial statements – which are also referred to as the Balance Sheet (AKA Statement of Financial Position) and the Profit and Loss Account (AKA Income Statement)".
- ❖ The **financial accounting system** is used consistently ALL over the world today.
- ❖ Now, the Statement of Financial Position and Income Statement are the end result of the financial accounting system. They are the ultimate summary documents after the system has worked its accounting magic.
- ❖ In other words, the system will efficiently summarise and categorise every transaction and every obligation into a systemised format, which will then be concisely summarised again in the Statement of Financial Position and Income Statement.

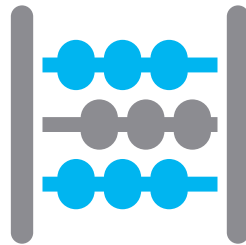
**BUT HOW
DOES IT
DO THIS?
- YOU ASK**



All of this came about because businesses wanted to do 3 things with their money:



They wanted a way of **organising** their money.



They wanted a way of **counting** their money.

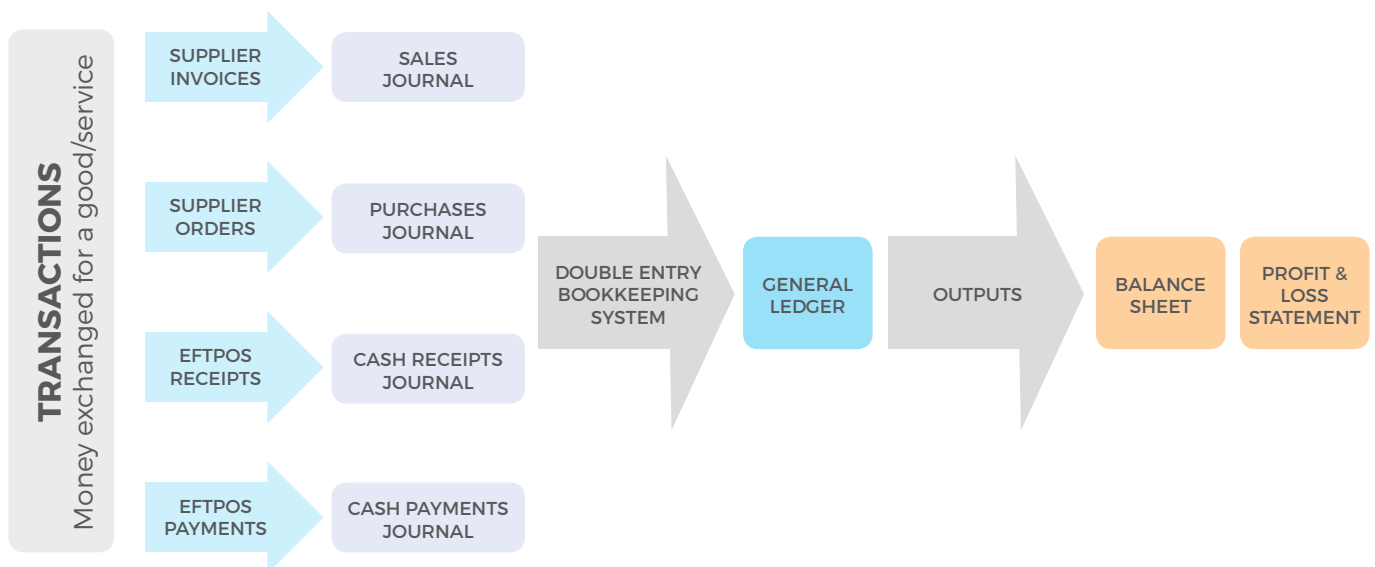


They wanted to know how to **make more money**.

**ORGANISING
MONEY**

**COUNTING
MONEY**

**MAKING MORE
MONEY**



So, let us now learn how to:

• Organise Money • Count Money • Make Money

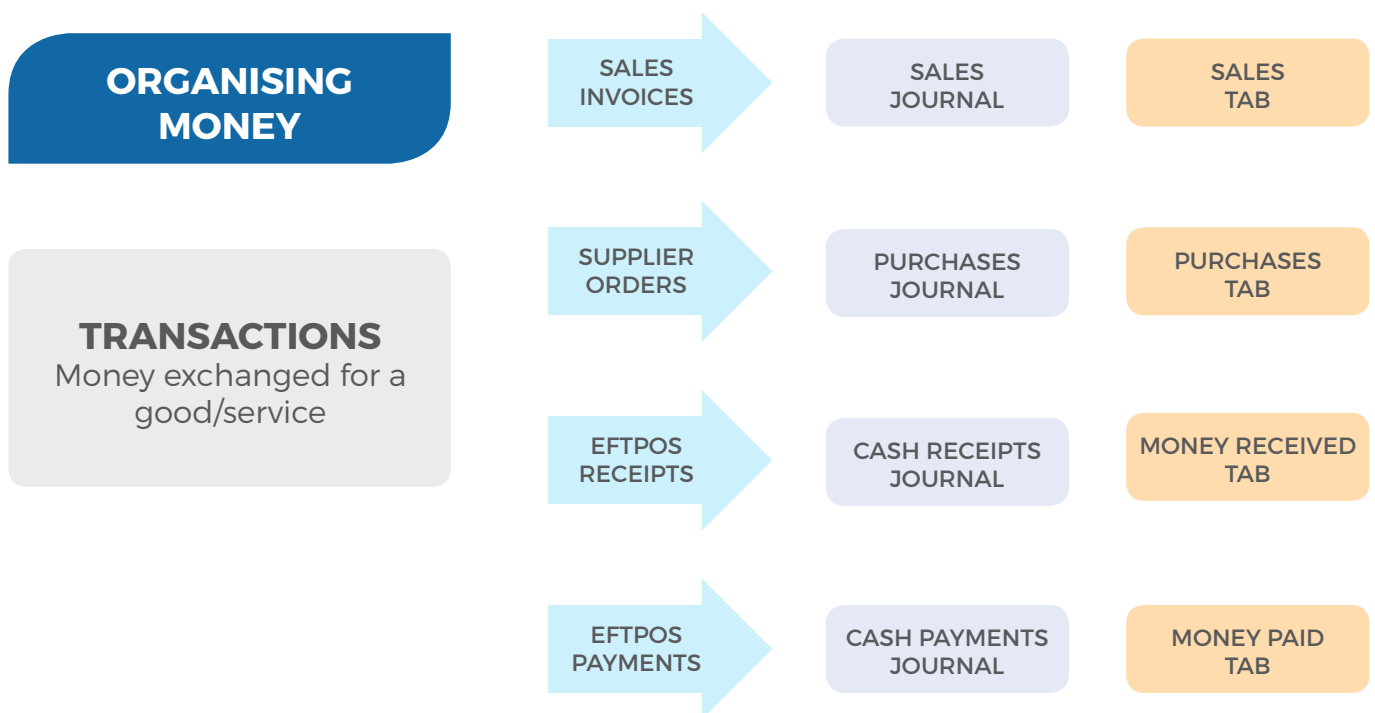


Module 4

Organise Money

Organising Money

- ❖ The foundation to the financial accounting system is organisation.
- ❖ You may recall that the first reason for a Financial Accounting system is to **organise** the business' money.
- ❖ At this point in time you have many various pieces of paper substantiating a transaction.
- ❖ For example, you may have an electricity invoice, or a telephone bill; you may have a copy of an invoice for something you sold, etc.
- ❖ These are all papers documenting money that changes hands (there are other similar papers which document financial obligations/promises as well).
- ❖ Businesses put like with like documents together and enter them into a computer, or in the old days, they would have been entered into journals.



“The foundation to the financial accounting system is organisation”.

4.1 Collating Like with Like

Documents	Type of Business Transaction
Sales Invoices	<ul style="list-style-type: none"> ❖ These are invoiced transactions that the business have raised and given to a customer, but the customer has not yet paid for these goods or services. ❖ These transactions summarise the total sales for the year and also act as a reminder to collect these monies from the customers. ❖ Sales invoices are grouped together are entered in what used to be a "Sales Journal" but under a computer system as a sale with a corresponding Debtor - Customer
Supplier Orders	<ul style="list-style-type: none"> ❖ These are invoiced transactions that the business has received from various suppliers, such as product manufacturers, stationery, legal fees, computers, etc, however has not yet paid for. ❖ The total of these transactions is summarised to amount to the total outgoings for the year and act as a reminder to pay the suppliers for these services. ❖ Supplier orders are also grouped together and entered into what used to be a "Purchases Journal", however these days, they are entered as outgoings with a corresponding creditor/supplier in the computer system.
EFTPOS Receipts	<ul style="list-style-type: none"> ❖ In most countries nowadays, the use of the cheque (check) is quite rare and more and more transactions are completed as interbank transfers. ❖ These include cash sales using a card machine to direct deposit in your bank account from customers who owe you money. ❖ The receipt of all cash (irrespective of how it is paid into your bank account) is also grouped together as "Cash Receipts" and entered into your computer programme as a cash receipt into your bank account.

4.1 Collating Like with Like (cont.)

Documents	Type of Business Transaction
EFTPOS Payments	<ul style="list-style-type: none"> ❖ These are the actual payments made by the business from its bank account. ❖ These can be cash payments or paying suppliers where we have received orders from. ❖ All of these payments are also grouped together as "Cash Payments" and entered into your computer programme as a cash withdrawal from your bank account.

This is often seen as the boring part of the Financial Accounting Process. However, without putting transactions together and processing them together in a 'Like by Like' manner, then none of the following process will work.

INTERESTING NOTE

The Financial Accounting Concept has been portrayed as a system that is difficult to understand; however, if you simply refer to it as a summary process which summarises each time a process is completed you will see that the ultimate two summary documents are the Balance Sheet and profit & Loss Account.

DISCUSSION WITH THE AUTHOR

Now that we have all of our business transactions Organised, let's learn how the Financial Accounting System splits these transactions into "sub-transactions".

4.2 Introducing DEB

- ❖ Once the first summary process is completed, the Financial Accounting System takes the end data, and before it summarises it again, translates it into a slightly different language – one that is much easier than Greek or Polish!
- ❖ In computer accounting packages, the translation appears seamless and in fact you don't see it at all. This is easier in the short term but when you are trying to understand financial statements and where the figures come from and what they mean – you need to understand this new language.
- ❖ The Monks from the Middle Ages were quite smart as they decided to understand every transaction (and therefore the total summary of like transactions) into two separate sub-transactions.
- ❖ I call this new language which splits every one transaction into two sub-transactions as "DEB" (short for double entry bookkeeping) – DEB is easier to work with.

Now, the first sub-transaction was to determine **where the money came from.**"

Most times it comes from the bank. However, money can come from loans such as credit cards, or for a business it can come in the way of additional capital from the proprietors.

The second sub-transaction was to determine **what the money was used for.**"

Was it used to pay off a bill like electricity or telephone? Or was it used to buy something important like a truck or a new computer?

- ❖ Let us call the part that determines '**where did the money come from?**' as the **source** and,
- ❖ The part that determines '**what was the money used for?**' as the **use**.

So, we now know that every transaction has 2 sub-transactions; one for the **source** of the money and one for the **use** of the money."

Let's look at some working examples

- ❖ Electricity is paid by almost every business. When we pay the electricity account this is a transaction.
- ❖ This transaction can then be broken down into two sub-transactions:

DETAILS	USE	SOURCE
Source of the money – bank account		\$500
Use of the money – paid the electricity account	\$500	

- ❖ If a business borrows money to buy a Delivery Van this is another transaction and the sub-transactions would look like this:

DETAILS	USE	SOURCE
Source of the money – new loan		\$50,000
Use of the money – bought a Van	\$50,000	

- ❖ If we wanted to be clever and sound like accountants we could easily substitute the Sources column with the word "Credit" and the Uses column with the word "Debit".
- ❖ Now if we were paying for Rent the transaction would look like this:-

DETAILS	DEBIT (was Use)	CREDIT (was Source)
Source of the money – bank account		\$1,200
Use of the money – rent	\$1,200	

CONGRATULATIONS!

You now can speak DEB and we can get onto our process of Counting Money

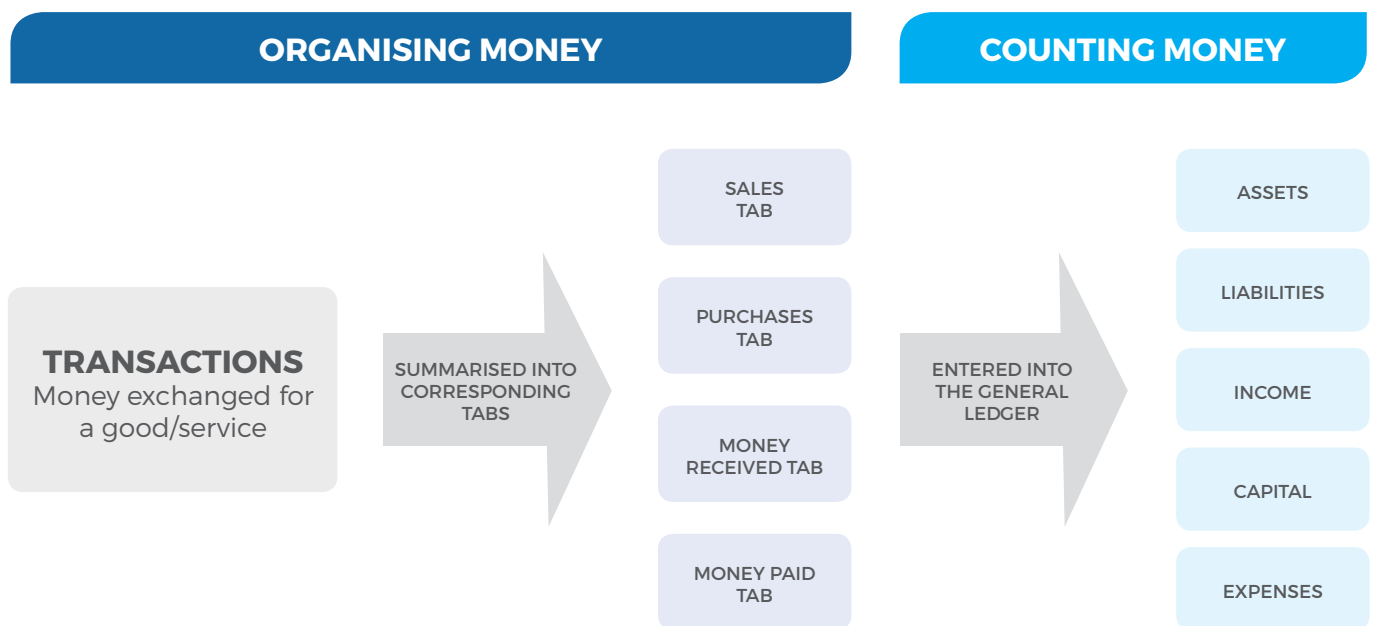


Module 5

Counting Money

5.1 DEB & ALICE

- ❖ Now that you understand that every single transaction is composed of two balancing sub-transactions; one a **USE** (debit) and the other a **SOURCE** (credit), we now need to categorise the transactions – I originally referred to this as a new language called **DEB**.
- ❖ Well, **DEB** allows us to re-summarise the transactions again into a part of the Financial Accounting System called the General Ledger. The name of this is not important, however the sections which make up this General Ledger are really important and we will spend some time understanding them.
- ❖ There are five categories in which to group every single **USE** and every single **SOURCE**.



Now that you've met DEB it's time to introduce ALICE...

5.2 Introducing ALICE

In Summary...

CATEGORY	QUICK DESCRIPTION
ASSETS	All the things you own
LIABILITIES	All the things you owe
INCOME	All the income you make
CAPITAL	All the money invested
EXPENSES	All the expenses paid

To remember these categories, think of the acronym ALICE... ALICE in Numberland.

However, before we can accurately categorise each sub-transaction, we need to fully understand what each of the above 5 categories entail. These are all explained in detail on the following pages.



5.2.1 Assets

Some examples of different types of assets are:

ASSET	DESCRIPTION
3 Types of Assets	<ol style="list-style-type: none"> 1. Current assets – These are assets that are expected to turn into cash within 12 months. Examples include cash in the bank account, inventory/stock, equipment like computers, receivables (customers who have been invoiced and owe money), etc. 2. Non-current assets – These are assets that are expected to turn into cash after 12 months. An example of this would be a long-term investment of some sort. 3. Fixed assets – These are assets that are used in daily business operations (and therefore contribute to revenue) and are therefore not expected to turn into cash. Examples include cars, trucks, forklifts, etc. My definition of a Fixed Asset is if you kick it, it will hurt
Inventory	<ul style="list-style-type: none"> ❖ Inventory is also known as stock and is what a business uses to conduct its operations. In other words, it is a supply of the goods a business sells that have not yet been sold, but hold value as they are expected to sell at market prices.
Receivables	<ul style="list-style-type: none"> ❖ Almost every business has to sell on account. In other words, it sells today, delivers the stock today but is paid on 14 or 30-day terms (say). ❖ All of this money that a business is owed but has not yet received is an asset.

“There are five categories in which to group every single USE and every single SOURCE”.

5.2.1 Assets (cont.)

ASSET	DESCRIPTION
Property, plant and equipment	<ul style="list-style-type: none">❖ When a business purchases an item of equipment, such as a delivery truck, it expects to be able to use that truck to make money over many future years.
Prepayments	<ul style="list-style-type: none">❖ This is an unusual type of asset, as it does not represent anything tangible such as inventory, receivables, equipment, etc. Prepayments are simply an accounting adjustment for expenses that are not matched against the revenue.❖ For example, if you paid \$12,000 for your yearly insurance premium on the 1st of June, it would be wrong to allocate the full balance of that insurance premium against the income made during the year ended 30 June X1. The correct thing to do would be to only allocate one month of the insurance premium in the 30 June X1 financial year, and 11 months are carried into the next financial year. That is, \$11,000 would be allocated to the next financial year.❖ The Financial Accounting concept that allows the \$11,000 to be transferred into the new financial year is called prepayments.

“DEB allows us to re-summarise the transactions again into a part of the Financial Accounting System called the General Ledger”.

5.2.2 Liabilities

Some examples of liabilities are:

LIABILITY	DESCRIPTION
Loan	<ul style="list-style-type: none">❖ The most common form of liability is a loan, and this could be a bank loan, credit card loan (credit card to pay for business expenses) and bank overdrafts.❖ These types of loans are easy to identify as they all have a statement at the end of the financial year that outlines how much is owed by the business.
Payables	<ul style="list-style-type: none">❖ This is the opposite to receivables in the asset class.❖ As it is common practice to sell its products on account, it is equally normal for a business to enter into obligations with suppliers and arrange to pay that debt under terms of 14 or 30 days (say).
Tax Debts	<ul style="list-style-type: none">❖ There are a number of tax obligations that arise whilst conducting a business.❖ Another tax obligation is PAYG installments, and these amounts are the tax due on salaries paid to employees.❖ There are other forms of taxes payable, however these are the main two types you will see in the Statement of Financial Position.

“The most common form of liability is a loan, and this could be a bank loan, credit card loan (credit card to pay for business expenses) and bank overdrafts”.

5.2.2 Liabilities (cont.)

LIABILITY	DESCRIPTION
Accruals	<ul style="list-style-type: none">❖ This is a term commonly used in Statement of Financial Positions under the heading of 'Current Liabilities'. Put simply, an accrual is no different to an invoice payable except that at Year End the invoice has not been received and the debt owing to the supplier has to be estimated.❖ This estimated debt is called an 'accrual'.❖ For example, say you called for a plumber on the 30th of June because you had a large water leak in the office. The plumber and his workers were there all day and they leave in the evening. At 30th of June you are aware that this is a liability owing to the plumber, however you are unsure how much the invoice is going to be but know it will be a material amount.❖ This is a liability that belongs in the current financial year and therefore in the absence of an invoice you estimate the amount of this service.



"An accrual is no different to an invoice payable except that at Year End the invoice has not been received and the debt owing to the supplier has to be estimated".

5.2.3 Income

Income refers to all the revenue a business has made in a given period of time. This is largely a result of cash inflows from:

1. The sale of its goods/services
2. The return on any investments such as dividends
3. Interest deposited into bank accounts from deposit-taking institutions



5.2.4 Capital

- ❖ Capital is the amount of money that has been invested into a business to start it and/or to keep it running.
- ❖ There are different types of capital, including subordinated debt, convertible notes and preference shares to name a few.
- ❖ At the end of the day, all of these things are still simply capital.



5.2.5 Expenses

- ❖ Expenses refer to all of the operational costs in running a business. These would include wages, rent, utilities, stationary, etc.



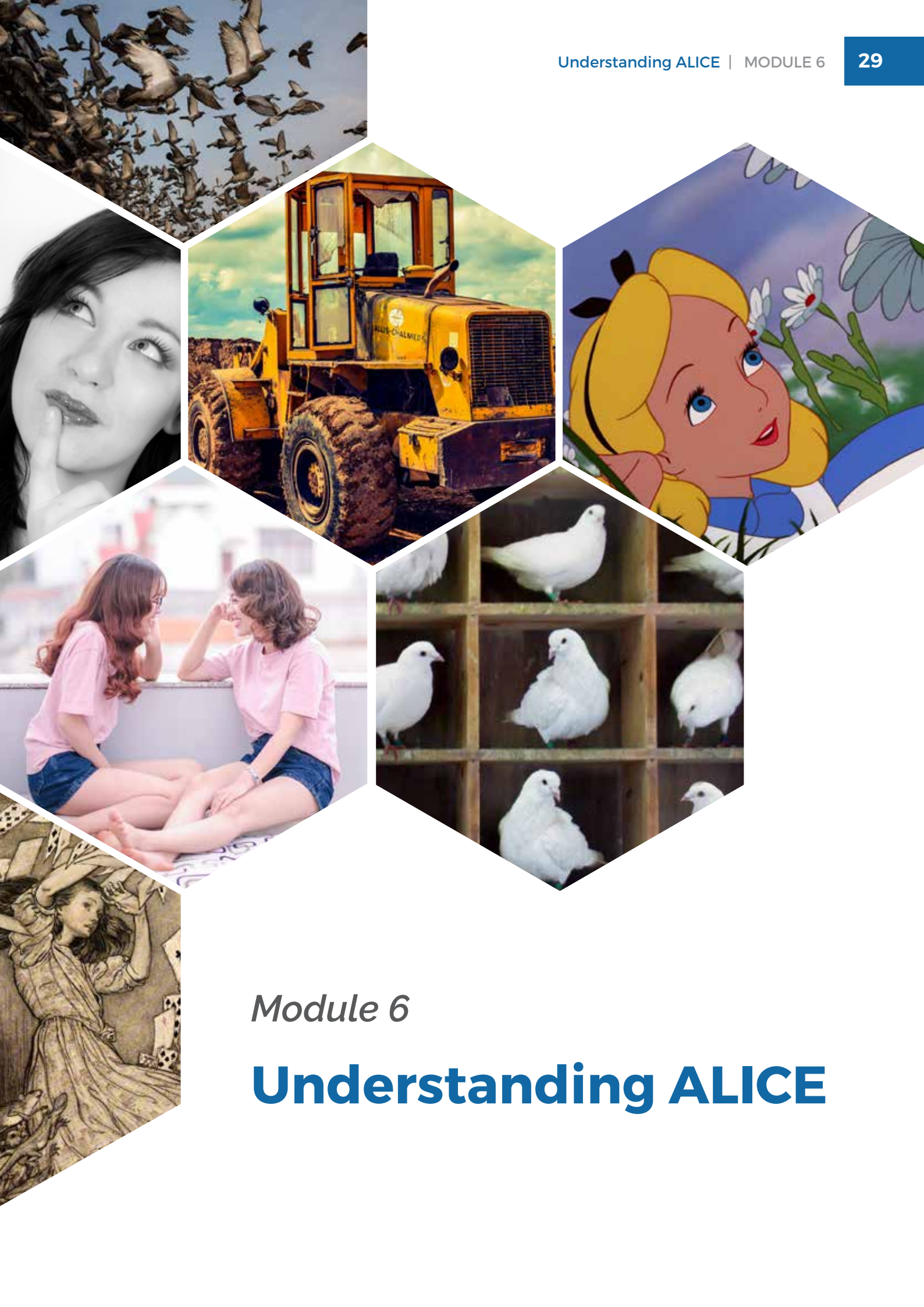
“Capital is the amount of money that has been invested into a business to start it and/or to keep it running”.

5.3 Exercise on Alice

ACCOUNT	A	L	I	C	E
Bank	✓				
Trucks & cars	✓				
Loan from financiers		✓			
Sale of product					
Electricity					
Rent					
Debtors					
Stock					
Creditors					
Bank charges					
Office supplies					
Wages					
Tax owing					
Mortgage owing					
Services money received					
Bookkeeping					
Audit fees paid					
Computer					
Computer installation					
Money put in business					
Loan from rich uncle					
Term deposits					
Computer repairs					
Shares in public companies					
Land and buildings					

5.4 Answers on Alice Exercise

ACCOUNT	A	L	I	C	E
Bank	✓				
Trucks & cars	✓				
Loan from financiers		✓			
Sale of product			✓		
Electricity					✓
Rent					✓
Debtors	✓				
Stock	✓				
Creditors		✓			
Bank charges					✓
Office supplies					✓
Wages					✓
Tax owing		✓			
Mortgage owing		✓			
Services money received			✓		
Bookkeeping					✓
Audit fees paid					✓
Computer	✓				
Computer installation	✓				
Money put in business				✓	
Loan from rich uncle		✓			
Term deposits	✓				
Computer repairs					✓
Shares in public companies	✓				
Land and buildings	✓				



Module 6

Understanding ALICE

Categorising Transactions into ALICE

- ❖ Now that you have a better understanding of what kind of things constitute an asset, liability, income, capital and expense.
- ❖ The next step in the financial accounting system is to assign one of the sub-transactions to one of ALICE's categories and the other part of the sub-transaction to another part of ALICE.
- ❖ Think of ALICE as a pigeon hole for every transaction. One side goes in one "pigeon hole" and the other side into another "pigeon hole". This process is also called Double Entry Bookkeeping (DEB) – for obvious reasons.

Let's revisit our first example of a transaction:

DETAILS	USE	SOURCE
Source of the money – bank account		\$500
Use of the money – paid the electricity account	\$500	

- ❖ We now need to assign an ALICE account to each sub-transaction.
- ❖ As we learnt above, cash is something that a business owns at a particular point in time, and consequently cash must be an asset. The telephone expense is an everyday business bill and therefore would be categorised as an expense.

Therefore, we would specify the following:

DETAILS	USE	SOURCE	ALICE
Source of the money – bank account		\$500	Asset - Bank
Use of the money – paid the electricity account	\$500		Expenses - Electricity

We can work out from here that if you add all of the Uses and all of the Sources in the General Ledger they actually balance (hence the derivation of the term Balance Sheet).

- ❖ For this transaction, a \$500 Use/debit would be recorded in the Asset category and a \$500 Source/credit would be recorded in the Expense category.

Categorising Transactions into ALICE

Now let's revisit the second example of a transaction:

DETAILS	USE	SOURCE
Source of the money – new loan		\$50,000
Use of the money – bought a Van	\$50,000	

- ❖ A loan is something that a business owes for an ongoing amount of time until it is completely repaid, and therefore is a liability.
- ❖ A new work vehicle is valuable because it will be used to increase/improve operations and ideally increase revenue over a long time, and therefore it is an asset.
- ❖ For this transaction, a \$50,000 debit would be recorded in the Liability category and a \$50,000 credit would be recorded in the Asset category, as below:

DETAILS	USE	SOURCE	ALICE
Source of the money – New Loan		\$50,000	Liability - Loan
Use of the money – Purchase Van	\$50,000		Assets - Van

“Think of ALICE as a pigeon hole for every transaction. One side goes in one “pigeon hole” and the other side into another “pigeon hole”.

Categorising Transactions into ALICE

Now let's look at a new example of a transaction:

Here we have invoiced someone for our consulting services.

DETAILS	USE	SOURCE
Source of the money – Consulting Services		\$2,000
Use of the money – Deposit in Bank	\$2,000	

- ❖ In this case we made some money. We billed a client for Consulting Services and as they paid at the end of the consultation, we banked the money straight away in our bank account.

ALICE would look like this:

DETAILS	USE	SOURCE	ALICE
Source of the money – Consulting Services		\$2,000	Income
Use of the money – Deposit in Bank	\$2,000		Assets

INTERESTING NOTE

As you know, the financial accounting system is one big summary process. It will therefore be no surprise that all of these transactions, with their corresponding ALICE-categorised sub-transactions, will be summarised once again. Ultimately, these ALICE accounts will be totaled and it is these totals which form part of the final summary process – the financial statements. It is this final summary figure that is often presented to the tax office or banks, however, a business must keep records of all of its receipts to justify how this final summary figure was calculated in case they are audited.



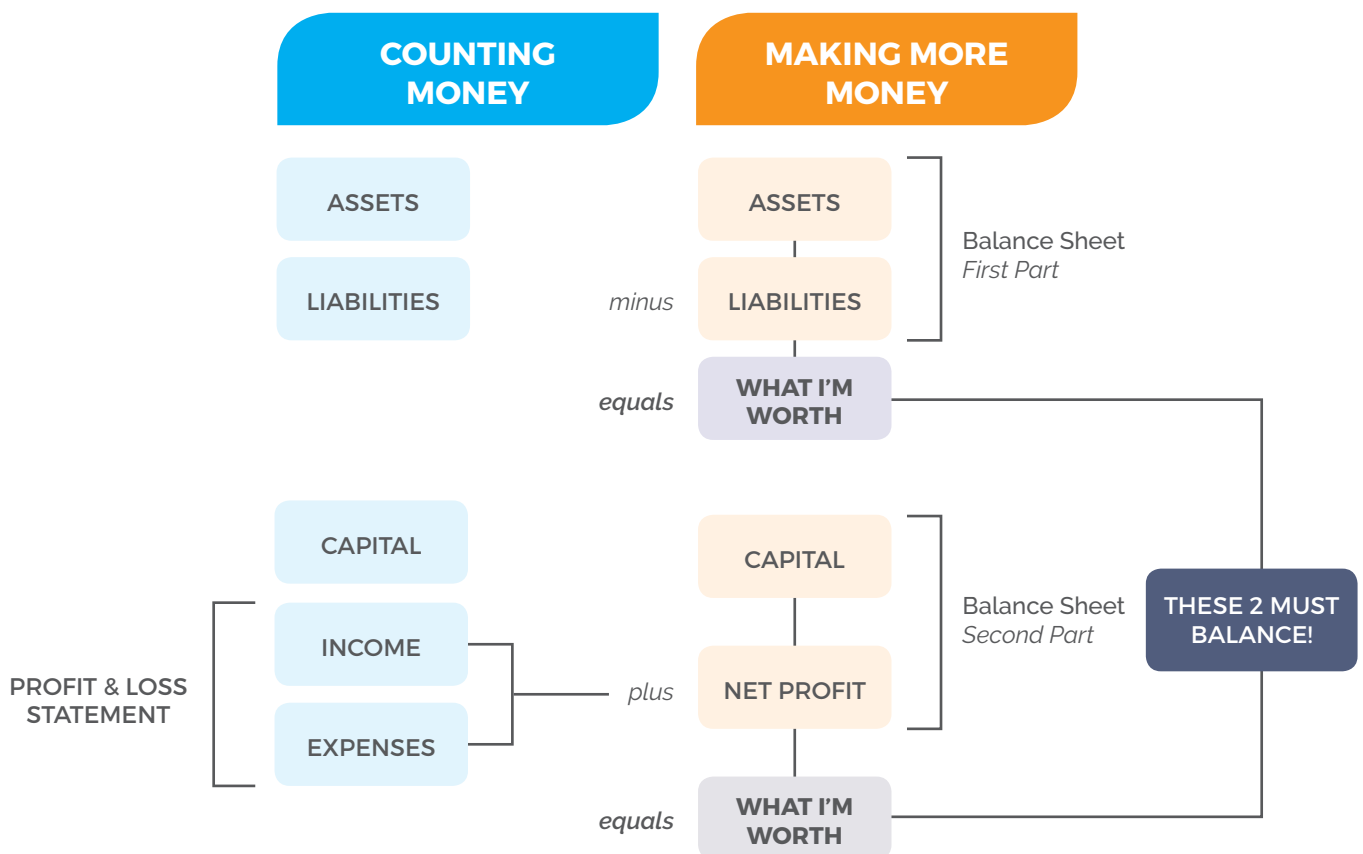
Module 7

Plan to Make More Money

Plan to Make More Money

- ❖ The whole purpose of the financial accounting system is to summarise everything a business has done by summarising ALL of its business transactions.
- ❖ Once this is done, we can use this information to identify the financial position of a business; what it is worth, how it is performing over time, what are likely to be opportunities or problems in the future and what can be done to maximise the profitability in the future.
- ❖ We can then take this financial perspective of a business and use it to create situations, opportunities and even implement different financial debt products to leverage the strengths of the business.
- ❖ The aim of doing any of this is to increase the revenue of a business. A solid understanding of the financial position of the business is invaluable in helping us plan to do this.
- ❖ So, we need to use all of this financial accounting information to essentially get a gauge of what a business is worth. So let's have a deeper think about ALICE.

7.1 It's all about ALICE



Plan to Make More Money

- ❖ ALICE actually provides us with two ways of assessing what a business is worth.
- ❖ The first way of thinking about this is that a business must be worth everything that a business **Owns** LESS everything that the business **Owes** then we should be left with a net figure of what the business is worth.
- ❖ To put this in context, think about a typical home purchase. If we purchase a home for \$1,000,000 and we borrow a \$700,000 mortgage from the bank then our personal value in the home is the difference of \$300,000.
- ❖ Therefore, the worth of a business is equal to its assets minus its liabilities.

In other words...

$$\text{Business Worth} = \text{Assets} - \text{Liabilities}$$

- ❖ The second way of thinking about this is that a business must be worth the sum of its daily operations; in other words, it must be worth the sum of everything it has **Made** less everything it has **Spent** plus everything it has **Put In** for that given financial year (plus any previous years).
- ❖ To put this in context, think about your own personal bank statement. The value of your bank account at the end of any given financial year is the sum of everything that has gone into the account during the year less everything that has come out of the account in that year, plus whatever was in the account at the beginning of the year.
- ❖ Therefore, the worth of a business is equal to the difference of its income less expenses, plus whatever capital was injected into it.

In other words...

$$\text{Business Worth} = \text{Income} - \text{Expenses} + \text{Capital}$$

- ❖ Therefore, if Business Worth equals Business Worth – then we can re-define ALICE as:

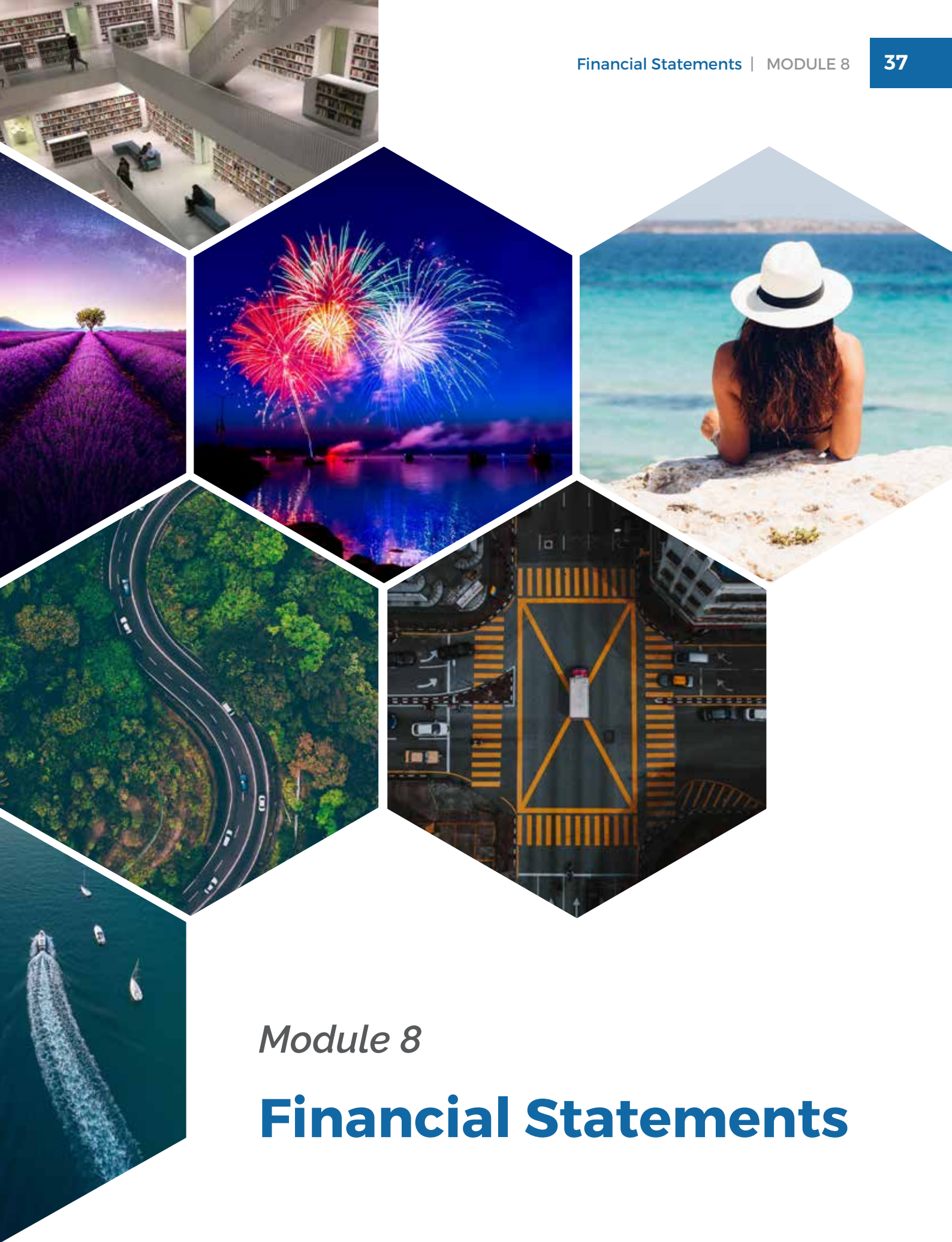
$$\text{Assets} - \text{Liabilities} = \text{Income} - \text{Expenses} + \text{Capital}$$

Plan to Make More Money

- ❖ This equation is the final summary of the entire financial accounting system.
- ❖ We have worked our way from a list of potentially thousands of transactions, divided them into two equal sub-transactions, assigned one sub-transaction as a Use/Debit and the other as a Source/Credit, categorised each into one of the ALICE accounts and eventually worked our way to this simple yet incredibly important equation.
- ❖ As this is an equality equation, the left-hand side of the equation must balance (in other words, be equal to) the right-hand side of the equation.

In other words, a Balance Sheet simply defines the two ways in which a company can calculate it's worth, and of course they have to be the same, hence the term "Balance Sheet". Nowadays, this document is also referred to as the Statement of Financial Position, which takes some of the magic out of it.

DISCUSSION WITH THE AUTHOR



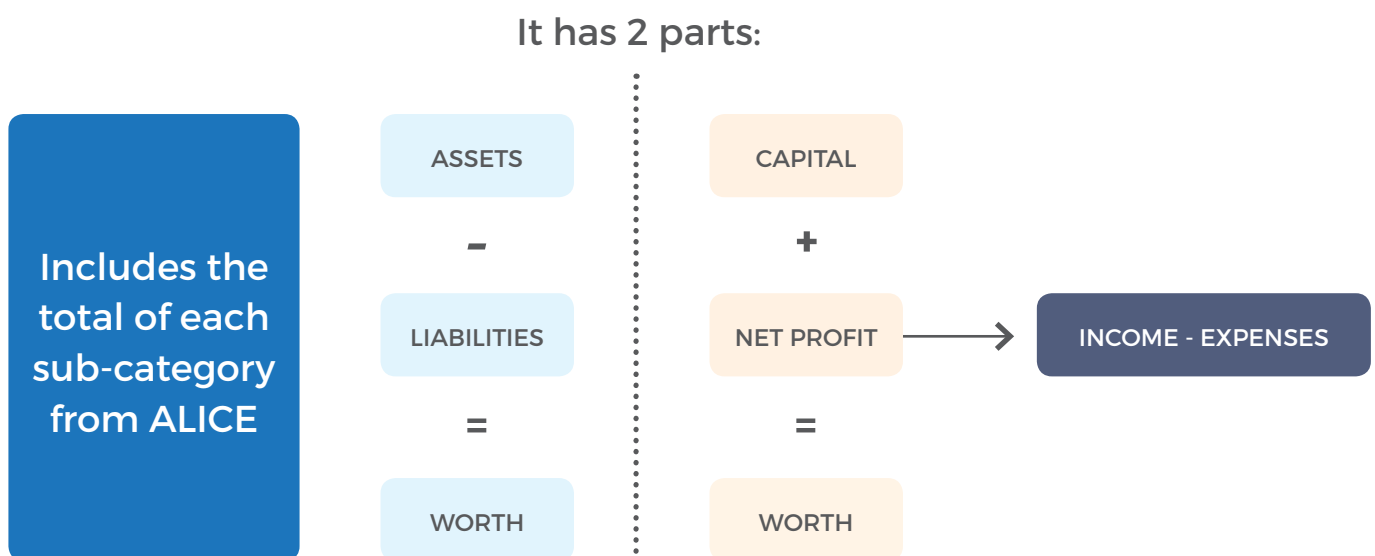
Module 8

Financial Statements

Statement of Financial Position

- ❖ The Statement of Financial Position (Balance Sheet) shows what a business is worth at a particular point in time, similar to how a photograph shows what somebody looks like at a particular point in time. It is true only at the time it is taken, and depending on transactions the business makes can easily change within the following week, day or hour.
- ❖ Consequently, Statements of Financial Position are published with the date at which they are true, in the format "Statement of Financial Position as at 30 June 20XX."
- ❖ Essentially, the Statement of Financial Position comprises of the totals of each of the ALICE accounts. The first half of the Statement of Financial Position represents the first equation above; the difference between assets and liabilities.
- ❖ The second half of the Statement of Financial Position represents the second equation above; the net profit (in other words, the difference between income and expenses) plus any capital injections.
- ❖ The intention is for these two figures to balance in order to formulate the Statement of Financial Position.

Balance Sheet (AKA Statement of Financial Position)



"Essentially, the Statement of Financial Position comprises of the totals of each of the ALICE accounts".

8.1 Assets

- ❖ Assets are described as either current or non-current in a Balance Sheet. The reason for this is that assets are defined as anything that is either cash or can be turned into cash.
- ❖ For example, cash in the bank is obviously cash. So is stock on hand that can be sold and turned into cash, and the same applies to the computers, delivery truck, etc. You will also find that people who owe the business money, 'receivables', are also an asset because they will turn into cash at some point.
- ❖ Current assets are, therefore, assets that are expected to be turned into cash within 12 months and non-current assets are expected to be turned into cash after 12 months.
- ❖ The last sub-category of Assets that you will see in the Balance Sheet are things called 'Fixed Assets. These are a particular class of assets that are tangible and if you kick them they will hurt your foot. This includes, for example, cars, trucks, forklifts, computers, etc.

I will be repeating some important points raised in Module 2 here

Inventory

- ❖ Inventory is also known as stock and is what a business uses to conduct its operations.
- ❖ Stock is not generally an area of concern unless there has been an increase in stock levels and a decrease in sales. This would generally indicate that there is an over-stocking problem, and consequently stock may not be able to be sold at a profit.

Receivables

- ❖ Almost every business has to sell on account. In other words, it sells today, delivers the stock today but is paid on 14 or 30-day terms (say).
- ❖ An important point to note with receivables is the aging of the receivables should not be too old. Old receivables lead to problems in collecting and having to write-off these receivables as bad debts.

"Assets are defined as anything that is either cash or can be turned into cash".

Property, Plant and Equipment

- ❖ When a business purchases an item of equipment, such as delivery truck, it expects to be able to use that truck to make money over many future years.
- ❖ The cost of the truck is required to be allocated over the current and future years, and the term given to the calculation for allocating this cost is known as depreciation.
- ❖ Depreciation is the expense allocation for the use of a truck for a particular financial year. Please note that depreciation is a means of allocating the cost of the truck over its life and has very little resemblance to what the truck is actually worth.
- ❖ You will note that every item of plant and equipment will have a corresponding item called 'provision for depreciation' and these two balances offset each other.
- ❖ Simply, this provision for depreciation is how much of the equipment has been allocated in deriving income.

Prepayments

- ❖ This is an unusual type of asset, as it does not represent anything tangible such as inventory, receivables, equipment, etc. Prepayments are simply an accounting adjustment for expenses that are not matched against the revenue.
- ❖ The important point to note is that when you see a prepayment in a Balance Sheet under the heading of 'Current Assets', it represents expenses that will be Expensed in the next financial year.

8.2 Liabilities

Loans

- ❖ The most common form of liability is a loan, and this could be a bank loan, credit card loan (credit card to pay for business expenses) and bank overdrafts.
- ❖ These types of loans are easy to identify as they all have a statement at the end of the financial year that outlines how much is owing by the business.
- ❖ It is important to note that interest paid should align with the liabilities outstanding during the financial year at the relevant interest rates.

Payables

- ❖ As it is common practice to sell its products on account, it is equally normal for a business to enter into obligations with suppliers and arrange to pay that debt under terms of 14 or 30 days (say).
- ❖ It is important to ensure that a business is not getting too far behind in accumulating payables and that it is able to pay its debts as and when they fall due.

Tax Debts

- ❖ There are a number of tax obligations that arise whilst conducting a business.
- ❖ Another tax obligation is PAYG installments, and these amounts are the tax due on salaries paid to employees.
- ❖ The final one is income tax payable on the profit of the business.
- ❖ There are other forms of taxes payable, however these are the main three types you will see in the Balance Sheet.

Accruals

- ❖ This is a term commonly used in Balance Sheets under the heading of 'Current Liabilities'. Put simply, an accrual is no different to an invoice payable except that at 30 June the invoice has not been received and the debt owing to the supplier has to be estimated.
- ❖ This estimated debt is called an 'accrual'.
- ❖ This is a liability that belongs in the current financial year and therefore in the absence of an invoice you estimate the amount of this service.
- ❖ Finally, when you see an amount of an accrual in a Balance Sheet please consider this as an account payable/trade creditor where the amount payable is estimated and not supported by an invoice yet.

"The main form of taxes is GST payable, the amount of which is offset against any amount of GST receivable".

8.3 Capital

- ❖ Capital is the amount of money that has been invested into a business to start it off.
- ❖ There are different types of capital, including subordinated debt, convertible notes and preference shares to name a few.
- ❖ Sometimes Investors want to back you and capital may comprise of Investors' money as well.
- ❖ At the end of the day, all of these things are still simply capital.

8.4 Retained Earnings

- ❖ Retained earnings are also referred to as accumulated profits in the Balance Sheet. They are simply the profit made by the business for the current year plus any accumulated profits made in any prior years.
- ❖ It is therefore the result of the difference between 'Income' and 'Expenses' over the life of the business.

Dividends

- ❖ Dividends are an appropriation of the profits a business makes, and they are the return to the investors or owners of the business for their hard work or investment.
- ❖ A company may decide to declare dividends or simply leave the accumulated profits in the bank account to fund future growth.

“Retained earnings are also referred to as accumulated profits in the Balance Sheet”.



Module 9

Reading Financial Statements

9.1 Statement of Financial Position

Balance Sheet Actual Example (ABCDE Group)

Statement of Financial Position

As at 30 June 2018

ABCDE Group	Note	As at 30 June	
		2018	2017
		\$m	\$m
Current assets			
Cash and cash equivalents	1	751	822
Trade and other receivables	2	5,109	5,479
Inventories	3	782	826
Loan Receivables	4	69	25
Current tax receivables		9	12
Prepayments		596	542
Total current assets		7,316	7,706
Non-current assets			
Trade and other receivables	4	1,221	1,078
Inventories	4	25	22
Investments – Local	6	1,301	82
Investments – Foreign	7	25	325
Property, plant and equipment	8	22,312	21,511
Intangible assets	9	9,095	9,449
Loans Receivable	10	1,954	1,749
Government Leases	11	65	49
Mastheads	12	241	133
Total non-current assets		36,239	34,398
Total assets		43,555	42,104
Current liabilities			
Trade and other payables	13	4,927	4,221
Employee benefits	14	895	843
Other provisions		135	152
Borrowings	15	1,598	2,519
Loans Payable	16	5	49
Current tax payables		147	169
Revenue received in advance		1,198	1,284
Total current liabilities		8,905	9,237
Non-current liabilities			
Other payables	17	77	82
Employee benefits	18	185	145
Other provisions		125	152
Borrowings	19	15,285	14,785
Derivative financial liabilities	20	405	572
Deferred tax liabilities	21	1,705	1,615
Defined benefit liability			
Revenue received in advance		1,395	1,050
Total non-current liabilities		19,177	18,401
Total liabilities		28,082	27,638
Net assets		15,473	14,466
Equity			
Share capital	23	5,000	5,000
Reserves	24	(208)	(195)
Retained profits		10,681	9,661
Equity available to shareholders		15,473	14,466
Total equity		15,473	14,466

9.2. Income Statement

- ❖ Whilst the Statement of Financial Position does summarise each of the ALICE accounts, the tax office and most financial institutions are also interested in how much money a business has made in a given financial year and how this compares to their performance in previous financial years.
- ❖ Consequently, the Income Statement provides detail on all of the different income streams for a business, and then lists of their expenses to calculate their profit for a given financial year.
- ❖ Let's revisit the second half of the Statement of Financial Position



The diagram shows a hand holding a magnifying glass over a blue horizontal bar. Inside the bar is the accounting equation: $\text{Assets} - \text{Liabilities} = \text{Income} - \text{Expenses} + \text{Capital}$. The magnifying glass is positioned over the right side of the equation, specifically over 'Income - Expenses + Capital'.

$$\text{Assets} - \text{Liabilities} = \text{Income} - \text{Expenses} + \text{Capital}$$

This part represents the
Income Statement

- ❖ Unlike the Statement of Financial Position, which is a snapshot of a financial position at a point in time, the Income Statement describes the result of a business' operations **over a period of time**.
- ❖ Generally, this is 12 months and is described as "Income Statement for the year ended 30 June 20XX."

Income Statement

Actual Example (ABCDE Group)

Income Statement

For the year ended 30 June 2018

ABCDE Group	Note	Year ended 30 June	
		2018	2017
		\$m	\$m
Income			
Revenue (excluding finance income)	25	26,911	26,527
Other income	26	3,531	2,285
		30,422	28,812
Expenses			
Labour		5,230	5,412
Goods and services purchased		8,798	7,725
Other expenses	27	4,961	4,591
		18,989	17,728
Share of net (loss)/profit from joint ventures and associated entities	28	(42)	28
		18,947	17,756
Earnings before interest, income tax expense, depreciation and amortisation (EBITDA)		11,495	11,056
Depreciation and amortisation	29	4,590	4,498
Earnings before interest and income tax expense (EBIT)		6,905	6,558
Finance income	30	94	149
Finance costs	31	695	735
Net finance costs		601	586
Profit before income tax expense		6,304	5,972
Income tax expense	32	1,521	1,748
Profit for the year		4,783	4,224
Profit/(loss) attributable to: Equity			
holders of ABCDE Entity		4,829	4,243
Non-controlling interests		(46)	(19)
		4,783	4,224

9.3 Simple Financial Statements Exercise

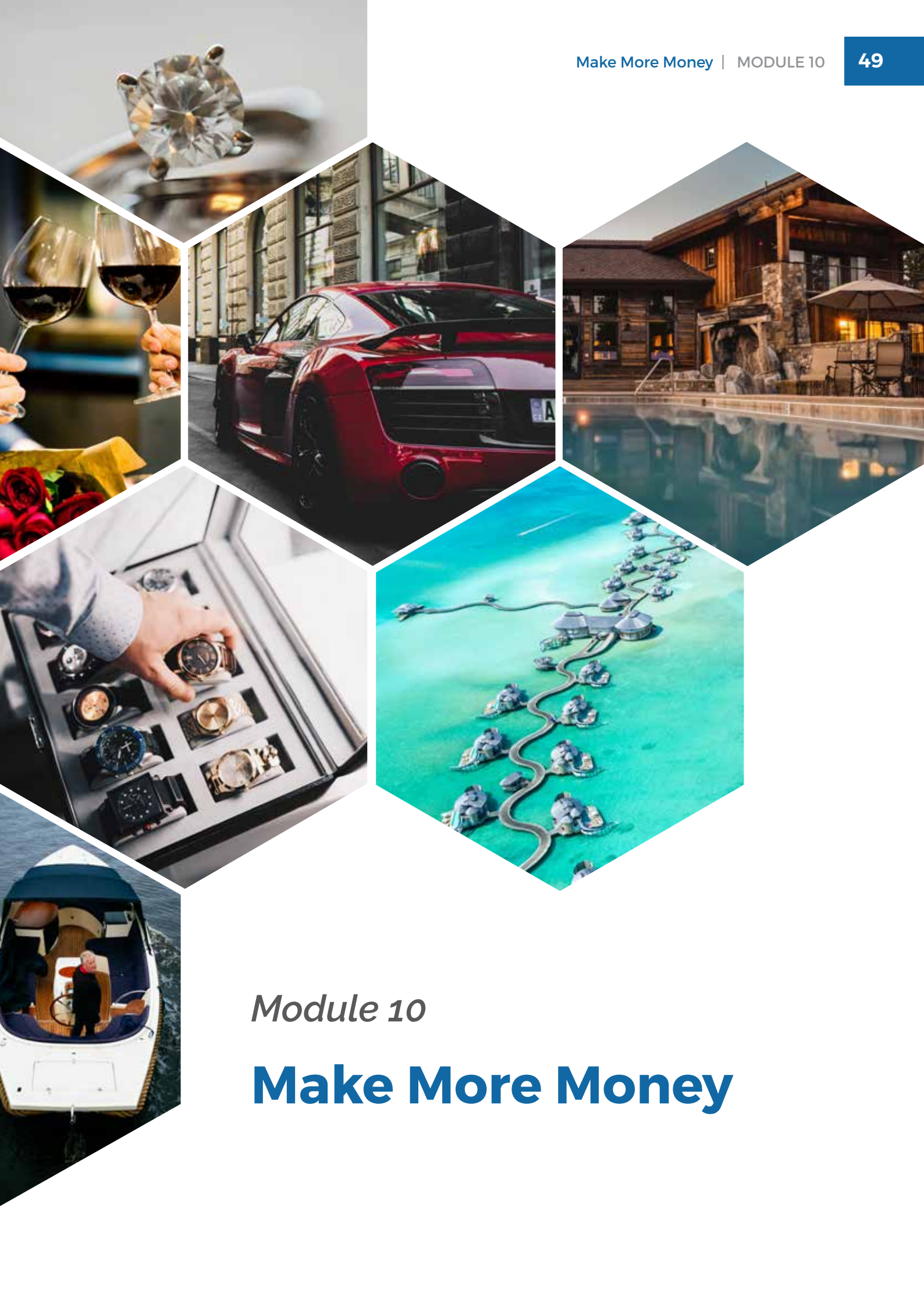
QUESTION	\$m
How much does ABCDE Group Own?	
How much does ABCDE Group Owe	
How much is ABCDE Group worth?	
How much did ABCDE Group spend on Labour	
How much did ABCDE Group spend on Finance Costs	
How much was the Depreciation (& Amortisation)?	

The Income Statement describes the results of a business over a designated period of time, usually one financial year.

9.4 Simple Financial Statements Answers

QUESTION	\$m
How much does ABCDE Group Own?	45,555
How much does ABCDE Group Owe	28,082
How much is ABCDE Group worth?	15,473
How much did ABCDE Group spend on Labour	5,230
How much did ABCDE Group spend on Finance Costs	695
How much was the Depreciation (& Amortisation)?	4,590

The Income Statement describes the results of a business over a designated period of time, usually one financial year.



Module 10

Make More Money

Learn to Use the Financial Statements

- ❖ By simply preparing a Balance Sheet and Profit & Loss Account a business does not make more money; in order to do so the business must understand how to use these reports.
- ❖ We can learn quite a lot from them. Essentially, we want to be able to dissect these documents to get a solid grasp of the financial health of a business, and then use this knowledge to structure and strategise a way to increase profits.
- ❖ The first thing to note is that these reports are historical, meaning that they report on things that have already happened. Notwithstanding their retrospect, and acknowledging that the past is no guarantee of future performance, these reports can provide us with two major lessons:
 1. In reviewing a company's past performance, they can help us identify any mistakes that were made in the management of the business, and encourage us to develop a program to avoid making the same mistakes in the future, and;
 2. The information they provide can assist us in predicting the future cash flows and ultimate profitability of a business.

"By simply preparing a Balance Sheet and Profit & Loss Account a business does not make more money; in order to do so the business must understand how to use these reports".

10.1 Looking to the past

- ❖ When analysing the past performance of a business, there are usually THREE key considerations to make.

10.1.1 First Key Consideration

- ❖ We need to compare the actual performance of the business with the projections that were made 12 months prior.
- ❖ If the business has not lived up to its expectations then each item in the Income Statement needs to be reviewed and dissected to see where exactly the business drifted from its plans.
- ❖ Profit is a function of revenue and costs, so if profitability fell short of expectations then either the sales decreased or the costs increased. Consequently, the three areas that most often prove problematic are:
 1. Sales figures are less than what was projected
 2. The cost of sales (e.g. manufacturing, etc.) were higher than projected
 3. Fixed costs (e.g. rent, wages, insurance, etc.) were higher than projected
- ❖ If this review does not reveal any problem areas then we must move on to our second level of analysis.

10.1.2 Second Key Consideration

- ❖ We must identify which expense items were materially different, say at least 5%-10% higher, than the previous year.
- ❖ If we notice that certain expenses have increased significantly since the last year then we need to understand why this was the case and we need to set in place a plan, specifically identifying new decisions to be made, that will prevent similar problems in the future.

"If the business has not lived up to its expectations then each item in the Income Statement needs to be reviewed and dissected to see where exactly the business drifted from its plans".

10.1.3 Third Key Consideration

- ❖ Produce an updated budget for the next financial period, and this is typically done for the following 12 months.
- ❖ This strategy straddles the Past and the Future
- ❖ This is a forecast and is simply a projected Income Statement with monthly figures instead of an annual figure.
- ❖ This way the actual results can be compared regularly, each month, to the budget to ensure that the business is tracking in the right direction.
- ❖ Most successful businesses prepare a budget generally 12 months into the future at the beginning of the financial year.
- ❖ Note that in the same way an architect would draw detailed plans before a building is constructed in order to ensure that the development is in accordance with these architectural drawings, an accountant prepares a budget in order to guide the business so that the actual end result is the same as the forecasted budget result.

"Most successful businesses prepare a budget generally 12 months into the future at the beginning of the financial year".

10.2 Looking to the Future

- ❖ The information contained in the Statement of Financial Position and Income Statement can be interpreted to determine a number of requirements for the short and medium term future.
- ❖ The most important of these is to predict short-term cash flows and forecast whether the business will be operating cash flow positive or negative.
- ❖ For example, let us say that our business currently has \$20,000 in the bank account and we want to know what the bank account is likely to look like in 30 days time.
- ❖ To do this we need to complete the following equation:

ITEM	EQUATION	\$
Cash at bank – current balance		20,000
Debtors receivable within 30 days – customers who we provided our good/service, have invoiced and are expected to pay within 30 days	+	40,000
Creditors due within 30 days – suppliers who have provided us with their good/service, have invoiced us and we are expected to pay within 30 days	–	30,000
Costs due in the next 30 days – wages, rent, tax, interest, etc	–	40,000
Projected Shortfall		- 10,000

- ❖ As you can see in the above example we have used the amounts from the Statement of Financial Position and Income Statement to determine whether the business will have a positive or negative cash outcome at the end of 30 days.
- ❖ In this case, whilst we have \$20,000 in the bank account today, we are expecting to be \$10,000 overdrawn at the end of the next month.

"The information contained in the Statement of Financial Position and Income Statement can be interpreted to determine a number of requirements for the short and medium term future".

This is not a favourable position to be in and requires us to take certain measures to avoid this from realising. These measures could include:

- ❖ Bring other debtors forward to be receivable within the next 30 days
- ❖ Make arrangements with creditors to extend their terms so that they are payable after 30 days
- ❖ If there is a large tax sum due, enter into a payment arrangement with the ATO to make monthly repayments rather than a single lump sum payment
- ❖ Put in place a borrowing facility to cover the deficit

"It is most important to predict short-term cash flows and forecast whether a business will be operating cash flow positive or cash flow negative in the future".



Module 11

Financial Health

Important Financial Ratios

- ❖ Within the financial statements, there are many ways we can compare one item to another to learn something important about the health of a business.
- ❖ Everything in life is relative, and so the way for us to truly understand the story of a company's wellbeing is to look at certain items relative to others. When we assess one number relative to another we must often interpret a ratio, and the five most important ratios that we will focus on in this course to determine the wellbeing of a business are:
 1. Debt to equity ratio
 2. Current ratio
 3. Gross margin
 4. Debtors ageing
 5. Inventory turnover

11.1 Debt to Equity Ratio

- ❖ The debt to equity ratio of a company is important because it provides an understanding of a company's total level of gearing relative to the amount of capital that its shareholders/directors have invested.
- ❖ Think of this as a debt multiple of capital invested. For example, if the debt to equity ratio is 1.7 then we have borrowed 1.7x as much as we have invested with our own cash. Again, if the debt ratio is 6.1 then we have borrowed 6.1x as much as we have invested with our own cash.
- ❖ Generally, the higher a company's proportion of debt, the higher its exposure to capital gains but also capital losses. In other words, the more a company borrows the higher its potential for increased earnings, however, there is also a higher potential for making losses or losing everything. This classic risk-reward relationship underpins all aspects of finance.
- ❖ This ratio uses two numbers in the Statement of Financial Position and calculates the total liabilities divided by the owner's equity, as shown below.

$$\frac{\text{Total Liabilities}}{\text{Owner's Equity}}$$

11.1 Debt to Equity Ratio

Total liabilities include all of the liabilities shown as current and non-current, there is no need to exclude any liabilities from this total. Owner's equity is the total amount that has been put into the business as capital, and does not include any retained profits from previous years.

Generally, a debt to equity ratio of about 3 times or less is a satisfactory result. However, this conclusion is significantly affected by different industries and the unique profiles of different businesses.

Using ABCDE Group's financials, let's calculate their debt to equity ratio.

Total Liabilities -

.....

Owner's Equity -

Answer

Total Liabilities	28,092
-------------------	--------

.....

Owner's Equity	15,473
----------------	--------

.....

= 1.82 times

"Everything in life is relative, and so the way for us to truly understand the story of a company's wellbeing is to look at certain items relative to others".

11.2 Current Ratio

- ❖ If you recall, in terms of financial accounting, "current" means within 12 months. Consequently, the current ratio is a 12-month analysis looking at the ability of a business to meet its short-term debt obligations.
- ❖ In order to do this, we need to compare the sum of all our cash and assets we expect to turn into cash (i.e. sold) within 12 months (current assets) with all our debts/liabilities that we are expected to pay within 12 months (current liabilities).
- ❖ A healthy company should have current assets that generously outweigh current liabilities, however if this is not the case then some planning and strategising will need to be undertaken now in order to avoid serious cash flow issues arising within the next 12 months.
- ❖ The current ratio calculation is a simple proportion of current assets to current liabilities (both taken from the Statement of Financial Position), as outlined in the below equation.

Current Assets

Current Liabilities

Using ABCDE Group's financials, let's calculate their current ratio.

Answer

Current Assets **7,316**

Current Liabilities **8,905**

= 0.82 times

(In this instance the result is unfavourable because the business is unable to pay their current 12-month obligations using their resources in the current assets list).

"The current ratio is a short-term analysis looking at the ability of a business to meet its debt obligations over the course of the next 12 months"

11.3 Gross Margin

- ❖ The word 'gross' is commonly misused in the business environment. When a business makes a sale and subtracts from that sale the cost of the goods in making that sale (cost of goods sold) the difference is known as the gross profit.
- ❖ The gross margin ratio measures the balance of gross profit for every dollar sold.
- ❖ Gross profit means the profit made before all of the expenses, such as telephone, rent, wages, etc. When you subtract the expenses from the gross profit you determine the net profit.
- ❖ We then divide this gross profit figure by the Revenue figure (also from the Income Statement and **excluding Other Income**). The Revenue figure is simply the revenue before any costs have been incurred. Note that we must ensure that both figures relate to the same time period, and if we take these from the Income Statement, this period will be for the previous financial year.
- ❖ The calculation is explained below.

Gross Profit

Total Sales

Using ABCDE Group's financials, let's calculate their gross margin.

Answer

Gross Profit (26,911 – 8,798 – 5,230) **12,883**

Total Sales **26,911**

= 47.87%

Based on this result, we can deduce that this business makes a lot of its revenue from selling its employees' time out in the field. Therefore, the associated labour costs have been included in the costs of sale, and consequently, the gross profit calculation.

Gross profit means the profit made before all of the expenses, such as telephone, rent, wages, etc. When you subtract the expenses from the gross profit you determine the net profit

11.4 Debtors Ageing

- ❖ Getting customers to pay within their credit terms is a challenge for all businesses.
- ❖ There are many different systems, computer programs and specialist vocations dedicated to this one task. This is because not being able to efficiently collect your customers' accounts places enormous cash flow pressures on the business.
- ❖ The debtors ageing ratio helps us understand how often (calculated as how many times during the past financial year) the receivables are completely refreshed.
- ❖ For example, if your credit terms were 30 days payable at end of month (EOM) and if all of your customers pay within these terms, the balance of your receivables would come to zero and start again every month.
- ❖ This would mean that the debtors ageing ratio would calculate the debtors ledger being refreshed 12 times throughout the year.
- ❖ The first number in this equation comes from the Income Statement and is the Total Income, however this figure must be offset for any discounts or rebates provided and any bad debts that have been written off.
- ❖ The second number in this equation comes from the Statement of Financial Position and is known as the "average receivables." This is most often calculated as the average of the receivables at the beginning of the year and the receivables at the end of the year (sum them and divide the total in half).
- ❖ We then complete the following calculation.

Total Sales -

.....

Average Receivables -

Using ABCDE Group's financials, let's calculate the age of their debtors

Answer

Total Sales

30,422

.....

Average Receivables (5,749 + 5,109)/2

5,429

.....

= 5.6 times

11.5 Inventory Turnover

- ❖ If a business holds stock in their warehouse unsold for too long it materially affects the operating results for the year. This is due to not selling stock but still having to pay supplier/manufacturing costs as well as business overheads.
- ❖ It is therefore important for a business to know how many times its inventory is theoretically refreshed and generally the more times it is refreshed the more efficient the business is operating (and the more sales it is making).
- ❖ This calculation must be carefully reviewed as some businesses, such as Fast Food Chain, need to refresh their stock in a very short period of time, say within a week, whilst a jeweler may refresh all of their diamonds and gold every two years. Both businesses would be equally efficient even though the results are quite different.
- ❖ The first number in this equation comes from the Income Statement and is the cost of sales. That is, the direct supplier/manufacturing costs that have been incurred prior to storing the stock ready for sale. This cost of sales does not include the indirect costs of running a business, for example, rent, electricity, etc.
- ❖ The second number in this equation comes from the Statement of Financial Position and is known as the "average stock." This is most often calculated as the average of the stock level at the beginning of the year and the stock level at the end of the year (sum them and divide the total in half).
- ❖ We then complete the following calculation.

Cost of sales -

.....

Average stock -

Using ABCDE Group's financials, let's calculate their inventory turnover

Answer

Cost of sales (5,230 + 8,798) = 14,028

.....

Average stock - (826 + 782)/2 = 804

.....

= 17.44 times

Or every 21 days which is an excellent result



Module 12

Saying Goodbye

Saying Goodbye

Well we've just about come to the end.

Organising Money

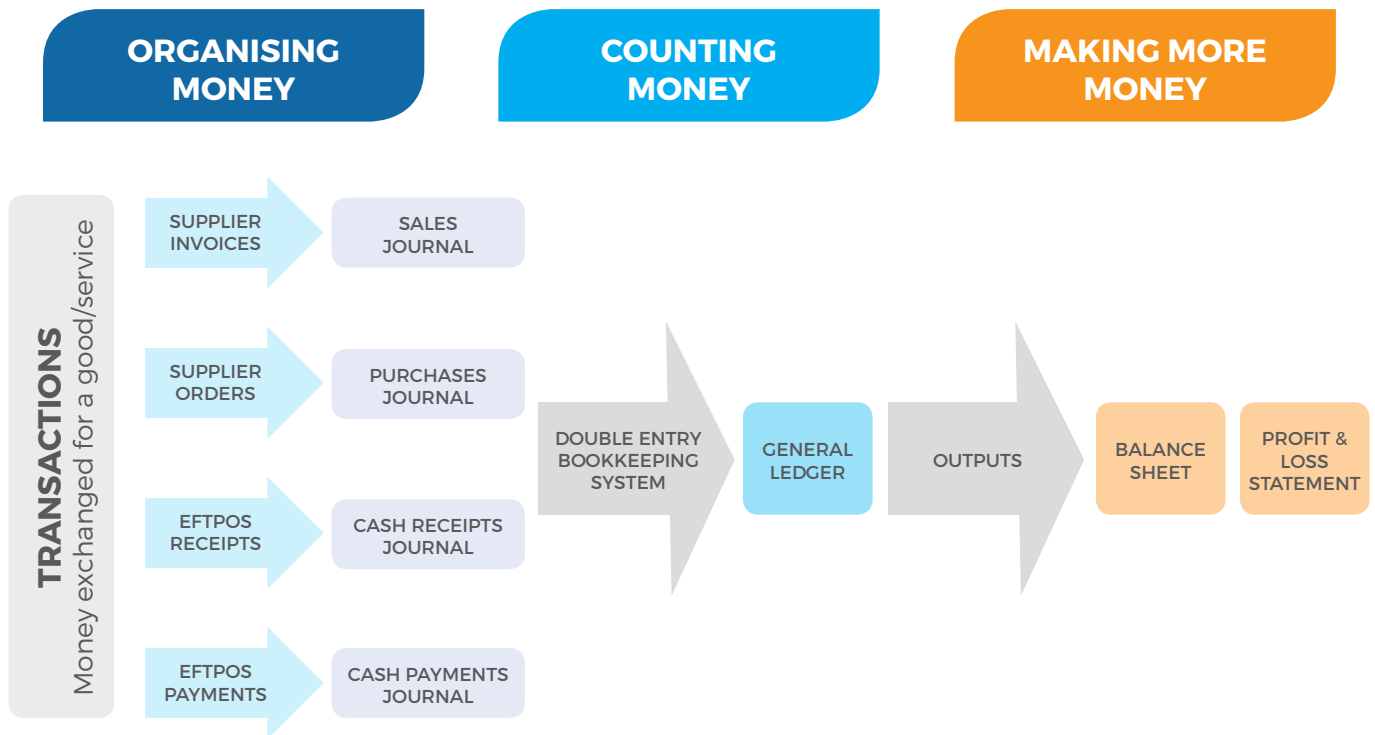
- ❖ We started by learning about how the Financial Accounting System summarises many pieces of paper that support the transactions of a business, over and over again until it produces a final and succinct 2-page summary called the Financial Statements.
- ❖ It started the process by taking all of those pieces of paper and collating them into 4 separate trays called, Sales on Account, Purchases on Account, Cash Receipts and Cash Payments.

Counting Money

- ❖ The Financial Accounting System then translated everything into a new language, which we called DEB, that was able to split every transaction into two separate sub-transactions.
- ❖ We called these two sub-transactions a "Source" and a "Use".
- ❖ We then learned that DEB was important to the summary process as it allowed the sub-transactions to be summarised again into the General Ledger which was itself made up of 5 major categories, Assets, Liabilities, Income, Capital and Expenses – we called this ALICE.
- ❖ ALICE was broken into other smaller categories which sat underneath ALICE and when we totaled all of these categories we could allocate them in a special way.
- ❖ This special way showed us the net worth of a business, which we then determined to be equal to the Assets minus the Liabilities. Ultimately, this resulted in the same net worth figure as if we calculated the Income minus the Expenses plus the Capital.

Making Money

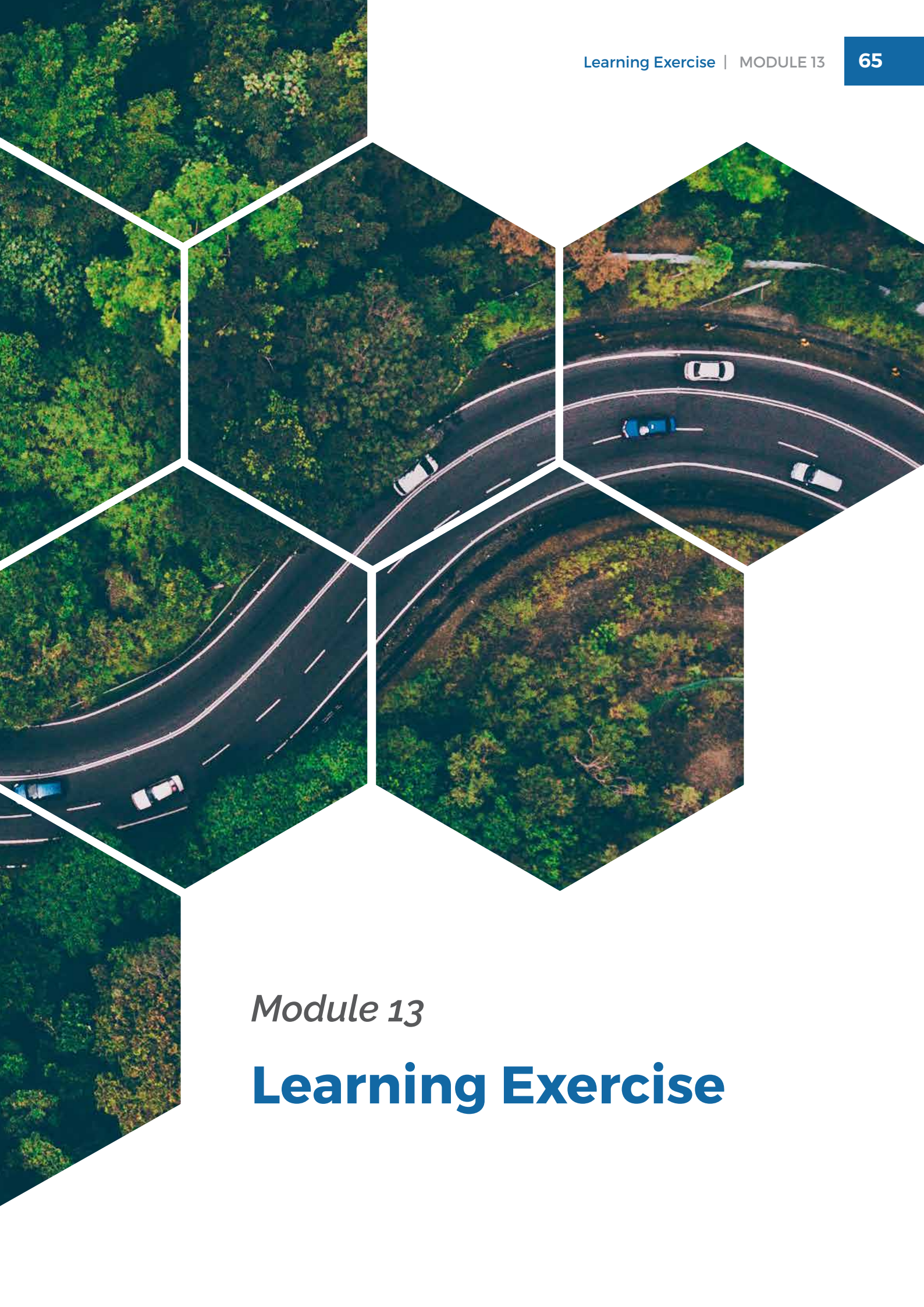
- ❖ In fact, it was this net worth calculation that produced the Balance Sheet, which is also known as the Statement of Financial Position and the Profit & Loss Account.
- ❖ Finally, we learned how to read the various lines in this statement and then apply tools and ratios to better plan and read the performance of a business.
- ❖ Remembering always that we simply started with a bunch of papers supporting a whole heap of transactions!



CONGRATULATIONS

I think you've made a marvelous effort to get to this place. I sincerely hope that you have seen that none of this is magic, but simply a clever summarising process that has gone on for over 700 years. It is important to remember that despite all of our technological advancements, the principles underpinning the Financial Accounting System really hasn't changed much over this time.

FAREWELL FROM THE AUTHOR



Module 13

Learning Exercise

Learning Exercise

GENERAL QUESTIONS

Do you believe this course is able to provide you with an all-encompassing understanding of financial statements? *(choose one)*

☐ Yes

☐ No

Why do we need to understand how to read financial statements?
(choose all appropriate answers)

- ☐ Many commercial transactions rely on financial statements
- ☐ Financial statements help people make money
- ☐ Accountants charge too much money
- ☐ Understanding financial statements presents opportunities for commercial consulting work

The three main reasons businesses use financial statements are:
(choose all appropriate answers)

- ☐ Report on past performance
- ☐ Predict future cash flows

- ☐ Keep accountants employed
- ☐ Keep track of how the business is going

The three aims of the financial accounting system are:
(choose all appropriate answers)

- ☐ Organise Money
- ☐ Save Money
- ☐ Make Money

- ☐ Distribute Money
- ☐ Count Money
- ☐ Give Money Away

Financial statements can tell you how much sales you will make in the future:

☐ True

☐ False

Financial statements are used by external groups like taxation departments?

☐ True

☐ False

There are normally two sets of financial statements for every business?

☐ True

☐ False

ORGANISING MONEY

What are the basic ways in which transaction documents are grouped? *(choose one)*

- ☐ Sales Invoices, Unpaid Invoices, Folding Cash Received
- ☐ Delivery Dockets, Supplier Invoices, Cash Receipts, Cash Payments
- ☐ Sales Invoices, Supplier Invoices, Cash Receipts, Cash Payments
- ☐ Sales Invoices, Supplier Invoices, Cash Receipts, Leasing Payments

Supplier Invoices Are? *(choose one)*

- ☐ All of the invoices that you have received from suppliers
- ☐ All of the sales made by your business but not yet paid into your bank account
- ☐ All of the cash sales that your business has made

The Financial Accounting System is simply? *(choose one)*

- ☐ A system to summarise documents that support financial transactions
- ☐ A system to make sure you never become bankrupt
- ☐ A system used to keep track of how many business deals you do?

All transactions can be split into two sub-accounts, these are called? *(choose one)*

- ☐ Uses and Debits
- ☐ Credits and Sources
- ☐ Uses and Sources

COUNTING MONEY

What does ALICE stand for? *(choose one)*

- ☐ Assets Loans Income Capital Expenses
- ☐ Assets Liabilities Income Cash Expenses
- ☐ Assets Liabilities Income Capital Earnings
- ☐ Assets Liabilities Income Capital Expenses
- ☐ Assets Liabilities Income Credits Expenses

Which of the following are Assets? *(choose all appropriate answers)*

- ☐ Cash at Bank
- ☐ Delivery Vans
- ☐ Inventory
- ☐ Taxation Bill
- ☐ Receivables

Which of the following are Liabilities? *(choose all appropriate answers))*

- ☐ Payables
- ☐ Credit cards
- ☐ Accruals
- ☐ Capital
- ☐ Rent paid

Is an investment in a business an...? *(choose one)*

- ☐ Asset
- ☐ Liability
- ☐ Income
- ☐ Expense
- ☐ Capital

MAKING MONEY - PART 1

What I own less what I owe is what I am worth?

☐ True

☐ False

Choose which configuration of ALICE determines what I'm worth:
(choose all appropriate answers)

- ☐ Asset - Liabilities
- ☐ Liability + Capital - Expenses
- ☐ Income - Expenses + Capital
- ☐ Income - Expenses + Assets
- ☐ Liability + Income - Capital

The two main documents in the Financial Statements are the Statement of Financial Position (AKA the Balance Sheet) and the Income Statement (AKA the Profit and Loss Account):

☐ True

☐ False

Profit is determined from using which two parts of ALICE: (choose one)

- ☐ Asset - Liabilities
- ☐ Liability - Expenses
- ☐ Income - Expenses + Capital
- ☐ Income - Expenses
- ☐ Liability + Income - Expenses

MAKING MONEY - PART 2

Ratios are read in conjunction with industry benchmarks?

☐ True

☐ False

The Debt to Equity Ratio is a measure of: *(choose one)*

- ☐ The gearing of a business against how much capital has been invested in it
- ☐ How well inventory is being deployed
- ☐ Whether receivables are paying on time

The Gross Profit is: *(choose one)*

- ☐ Is the total sales less all of the expenses
- ☐ Is the total sales less all of the costs incurred in directly making those sales also called the costs of goods sold
- ☐ Is the total sales less any taxes on those sales

What is the formula for Debtors Ageing? *(choose one)*

- ☐ Total Sales / Receivables
- ☐ Total Sales / Average Receivables
- ☐ Total Sales / Gross Profit

**Congratulations on completing all of the Modules in the
“How to Understand Financial Statements in A Day”**