# Workbook
# for
# The Fiscal Fitness System

## Understanding Balance Sheets, Income Statements and Cash Flow

by Gary W. Patterson
The Fiscal Doctor

# How to Use This Workbook...

Hello! I'm Gary Patterson, and first of all, I want to say thanks for purchasing my program, *The Fiscal Fitness System - Understanding Balance Sheets, Income Statements and Cash Flow*. You're going to love the ideas you encounter in my audio and in the pages of this workbook. Better still, you're going to love the results you get when you *apply* these principles! Here is how you can make the most of this program and get real value from the proven practices contained in the material.

- First, **listen** to the audio portion of the program and become familiar with the content. This will expose you to the material and give you an idea of what to look for.
- Next, **jot down** any questions you have about your business or problems you want to solve. Decide ahead of time what you intend to get out of my training.
- Now **remove all distractions**, sharpen your pencil, start the audio and crack open this workbook. (Printing it out will make it so much easier to work with.) Treat this study time with all the seriousness it deserves. Adopt the attitude that you've paid for my time as a consultant. After all – you have! Take this opportunity seriously, and you will be richly rewarded by your sincere commitment.
- Finally, **head to my website** at www.FiscalDoctor.com. Take advantage of the resources I offer there. Contact me with your questions and feedback. I welcome the opportunity to hear from you.

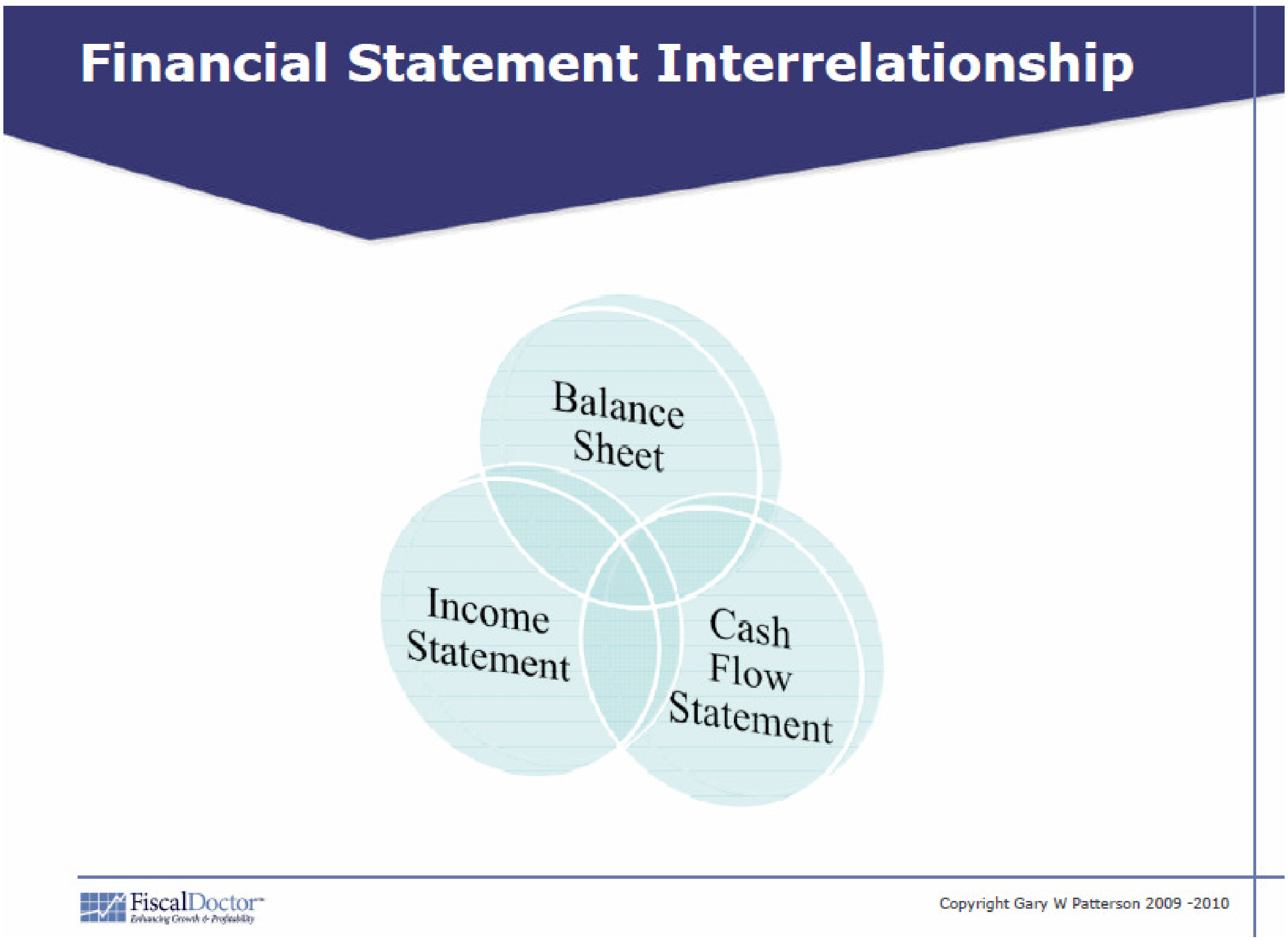
Remember that this program is a great start and will point you in the right direction. **For deeper insight and further expertise, you'll want to contact me to arrange a consultation.**

You'll be amazed by what you can achieve when you solve those problems that you didn't even know existed!

All the best,
Gary
Gary W. Patterson
The Fiscal Doctor

# The Financial Statement

Balance Sheet + Income Statement + Cash Flow Statement



## Section 1:
# The Balance Sheet

## The Balance Sheet Tour

**Statement of Financial Position**

| At December 31 (In millions, except share amounts) | General Electric Company and consolidated affiliates 2008 | 2007 |
|---|---|---|
| **ASSETS** | | |
| Cash and equivalents | $ 48,187 | $ 15,731 |
| Investment securities (Note 9) | 41,446 | 45,276 |
| Current receivables (Note 10) | 21,411 | 22,259 |
| Inventories (Note 11) | 13,674 | 12,897 |
| Financing receivables—net (Notes 12 and 13) | 365,168 | 376,123 |
| Other GECS receivables | 13,439 | 16,516 |
| Property, plant and equipment—net (Note 14) | 78,530 | 77,888 |
| Investment in GECS | — | — |
| Goodwill (Note 15) | 81,759 | 81,116 |
| Other intangible assets—net (Note 15) | 14,977 | 16,142 |
| All other assets (Note 16) | 106,899 | 122,848 |
| Assets of businesses held for sale (Note 17) | 10,556 | — |
| Assets of discontinued operations (Note 2) | 1,723 | 8,889 |
| Total assets | $797,769 | $795,683 |
| **LIABILITIES AND EQUITY** | | |
| Short-term borrowings (Note 18) | $193,695 | $195,100 |
| Accounts payable, principally trade accounts | 20,819 | 21,338 |
| Progress collections and price adjustments accrued | 12,536 | 9,885 |
| Dividends payable | 3,340 | 3,100 |
| Other GE current liabilities | 18,220 | 15,816 |
| Long-term borrowings (Note 18) | 330,067 | 319,013 |
| Investment contracts, insurance liabilities and insurance annuity benefits (Note 19) | 34,032 | 34,068 |
| All other liabilities (Note 20) | 64,796 | 59,316 |
| Deferred income taxes (Note 21) | 4,584 | 12,690 |
| Liabilities of businesses held for sale (Note 17) | 636 | — |
| Liabilities of discontinued operations (Note 2) | 1,432 | 1,994 |
| Total liabilities | 684,157 | 672,120 |
| Minority interest in equity of consolidated affiliates (Note 22) | 8,947 | 8,004 |
| Preferred stock (30,000 and 0 shares outstanding at year-end 2008 and 2007, respectively) | — | — |
| Common stock (10,536,897,000 and 9,987,599,000 shares outstanding at year-end 2008 and 2007, respectively) | 702 | 669 |
| Accumulated gains (losses)—net | | |
| Investment securities | (3,094) | 126 |
| Currency translation adjustments | (299) | 10,708 |
| Cash flow hedges | (3,332) | (668) |
| Benefit plans | (15,128) | (1,840) |
| Other capital | 40,390 | 26,100 |
| Retained earnings | 122,123 | 117,362 |
| Less common stock held in treasury | (36,697) | (36,896) |
| Total shareowners' equity (Notes 23 and 26) | 104,665 | 115,559 |
| Total liabilities and equity | $797,769 | $795,683 |

The sum of accumulated gains (losses) on investment securities, currency translation adjustments, cash flow hedges and benefit plans constitutes "Accumulated other comprehensive income," as shown in Note 23, and was $(21,853) million and $8,324 million at December 31, 2008 and 2007, respectively.

See accompanying notes.

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It is critical that you and your executive team fully understand the information that is available inside the company's "financial package." This includes the balance sheet, the income statement, and the cash flow statement. The cost of *not* knowing can cost you your business or job.

**What is a balance sheet?**

**What does your company's balance sheet tell you about the health of the business?**

**What is the single biggest "plus" in your balance sheet? Or**
**What is working in your organization?**

**What is the single biggest "minus" in your balance sheet? Or**
**What are your biggest potential problems?**

# Five Fundamental Premises

It's important to understand the five fundamental premises to enhance your understanding of how your company's balance sheet can give you insight into the health of your company.

**Fundamental Premises:**

1) Cash Rules
2) Fortress Balance Sheets
3) Reserves are Best Guesses
4) Historical Numbers Are *Not* Always Current Indicators of Value
5) Stay Current on your Contingent Asset Upsides and Liability Downsides

**Premise #1: Cash Rules!**

Cash is King, especially in an economy where lending and credit lines are extremely tight. Cash is not King if he's locked in the dungeon. If you can't write a check on all of your cash, your Cash King (or King Cash) is in the dungeon.

### How Much Useable Cash Does Your Company Have?

*(It needs to be immediately available to you today.)*

### What Steps Did Your Organization Take So There Would Be Available Cash?

### Where is Your Organization's King Cash Locked in the Dungeon?

**What Steps Can You Take to Unlock Cash in Your Organization?**

**Premise #2:  Fortress Balance Sheets**

Fortress Balance Sheets are a move toward a more conservative balance sheet with substantial amounts of equity in the business.

**Has your organization properly reviewed possible risks to your company's health?**

**What types of risks might jeopardize your company's future?**

**How well do you understand the risks you and your management team are taking?**

**Premise #3:  Reserves are Best Guesses**

Organizations often rely on gut instincts when determining reserves.  It's important to make sure reserves are validated with good analysis.

**What processes or lines item require more detailed analysis and qualitative review?**

**How do your reserves compare to your best competitors?**

**Premise #4: Historical Numbers are *Not* Always Current Indications of Value**

In accounting, book value or carrying value is the value of an asset appears in balance sheet account balance. For assets, the value is based on the original cost of the asset less any depreciation, amortization or impairment costs made against the asset. The amount someone would pay for that balance sheet asset or liability can be dramatically different.

**What are the areas or processes where you and your company can not "see" major risks?**

**What asset would you be better off selling today, regardless of the balance sheet balance to reinvest in a better long term opportunity?**

**Premise #5: Stay Current on Your Contingent Assets Upsides and Contingent Liability Downsides**

Most organizations do well with managing good news. The real test is how well bad news is handled within an organization. Does your organization foster open communication no matter what the issue is? Or are employees fearful to bring forth what might be considered bad news?

**What steps can *your organization* take to foster an environment where employees openly share both good and potentially bad news?**

**What steps can *you* personally take to foster an environment where employees openly share both good and potentially bad news?**

# Ten Key Definitions

## Balance Sheet Terms and Definitions

**Assets** are described as economic resources you own, which can be specifically quantified today. If it cannot be quantified precisely, it will be classified as a contingent asset.

**Liabilities** are described as your legal obligations to pay others specific quantified amounts today. Again, if this liability cannot be precisely quantified today, it will be classified as a contingent liability.

**Accumulated depreciation** is an account that reveals how much cumulative depreciation expense has been provided on your property, plant and equipment investment balance. Often people think of this as how much of the money that has been spent on fixed assets has been recovered through ongoing operations.

**Intangible assets** are identifiable non physical assets, such as Goodwill or trademarks. There is nothing to touch or see here.

**Goodwill** is often the largest dollar value intangible asset on your balance sheet. It is a non-cash accounting concept relating to assets and liabilities purchased in the past. Most people do not know Goodwill can be either positive or negative and that its value must be tested annually for impairment.

**Deferred revenue** is considered a liability until specific issues are completed or resolved. Do some research later on this term and the dreaded phrase "revenue recognition problems." Companies much smaller than Enron have run into enormous problems on this issue. In fact, small companies can sometimes be hit the hardest of all on this issue.

**Stockholders equity** is equal to total assets less total liabilities. This also is called equity, shareholders equity or net worth. This can be a proxy for the salable equity you have built up in your business since the beginning of time.

**Restricted cash** is cash that is not available for general use due to specific legal agreements of your business. Remember the statement that King Cash can be locked in the dungeon by loan covenants which prevent you from be able to write checks on the full cash balance you see on your balance sheet?

**Contingent assets** are assets  described as economic resources you own that can NOT be specifically quantified. Therefore, these are NOT recorded on the balance sheet, but may be recorded in footnotes. Think of these assets as your friends.

**Contingent liabilities** are described as your legal obligations to pay others that can NOT be specifically quantified at the present point in time. Therefore, these are NOT recorded on the balance sheet, but may be recorded in footnotes. Think of these liabilities as your enemies.

# Action Plan

**What 3 action steps does your organization need to take in the next 90 days to protect the company's assets?**

**1)**

**2)**

**3)**

**Is your company still growing, shrinking, or staying the same?**

**What steps can you personally take to ensure your company's success over the long term?**

## Observations & Comments:

## Section 2:
# The Income Statement

# The Income Statement

It's critical that you and your executive team fully understand the information that is available in your financial package. This includes the balance sheet, the income statement, and the cash flow statement. The goal of this program is to help you increase your understanding of the income statement and what it tells you about the financial health of your company.

# The Income Statement Tour

### Statement of Earnings

| For the years ended December 31 (In millions; per-share amounts in dollars) | General Electric Company and consolidated affiliates 2008 | 2007 | 2006 |
|---|---|---|---|
| **REVENUES** | | | |
| Sales of goods | $ 69,100 | $ 60,670 | $ 55,181 |
| Sales of services | 43,669 | 38,856 | 36,329 |
| Other income (Note 3) | 1,586 | 3,019 | 2,154 |
| GECS earnings from continuing operations | — | — | — |
| GECS revenues from services (Note 4) | 68,160 | 69,943 | 57,904 |
| Total revenues | 182,515 | 172,488 | 151,568 |
| **COSTS AND EXPENSES** (Note 5) | | | |
| Cost of goods sold | 54,602 | 47,309 | 43,279 |
| Cost of services sold | 29,170 | 25,816 | 23,494 |
| Interest and other financial charges | 26,209 | 23,762 | 18,879 |
| Investment contracts, insurance losses and insurance annuity benefits | 3,213 | 3,469 | 3,213 |
| Provision for losses on financing receivables (Note 13) | 7,518 | 4,431 | 3,062 |
| Other costs and expenses | 42,021 | 40,173 | 35,491 |
| Minority interest in net earnings of consolidated affiliates | 641 | 916 | 862 |
| Total costs and expenses | 163,374 | 145,876 | 128,280 |
| **EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES** | 19,141 | 26,612 | 23,288 |
| Provision for income taxes (Note 7) | (1,052) | (4,155) | (3,944) |
| **EARNINGS FROM CONTINUING OPERATIONS** | 18,089 | 22,457 | 19,344 |
| Earnings (loss) from discontinued operations, net of taxes (Note 2) | (679) | (249) | 1,398 |
| **NET EARNINGS** | 17,410 | 22,208 | 20,742 |
| Preferred stock dividends declared | (75) | — | — |
| **NET EARNINGS ATTRIBUTABLE TO COMMON SHAREOWNERS** | $ 17,335 | $ 22,208 | $ 20,742 |
| Per-share amounts (Note 8) | | | |
| Earnings from continuing operations | | | |
| Diluted earnings per share | $ 1.78 | $ 2.20 | $ 1.86 |
| Basic earnings per share | 1.79 | 2.21 | 1.87 |
| Net earnings | | | |
| Diluted earnings per share | 1.72 | 2.17 | 2.00 |
| Basic earnings per share | 1.72 | 2.18 | 2.00 |
| **DIVIDENDS DECLARED PER COMMON SHARE** | $ 1.24 | $ 1.15 | $ 1.03 |

### Consolidated Statement of Changes in Shareowners' Equity

| (In millions) | 2008 | 2007 | 2006 |
|---|---|---|---|
| **CHANGES IN SHAREOWNERS' EQUITY** (Note 23) | | | |
| Balance at January 1 | $115,559 | $111,509 | $108,633 |
| Dividends and other transactions with shareowners | 1,873 | (23,102) | (17,983) |
| Other comprehensive income | | | |
| Investment securities — net | (5,218) | (1,484) | (223) |
| Currency translation adjustments — net | (11,007) | 4,527 | 3,649 |
| Cash flow hedges — net | (2,664) | (539) | 223 |
| Benefit plans — net | (13,288) | 2,566 | 287 |
| Total other comprehensive income | (30,177) | 5,070 | 3,936 |
| Increases attributable to net earnings | 17,410 | 22,208 | 20,742 |
| Comprehensive income | (12,767) | 27,278 | 24,678 |
| Cumulative effect of changes in accounting principles | — | (126) | (3,819) |
| Balance at December 31 | $104,665 | $115,559 | $111,509 |

See accompanying notes.

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The income statement is a standard financial document that summarizes your company's revenue and expenses for a specific period of time, usually one quarter or an entire fiscal year.

The important thing to remember about an income statement is that it represents a period of time. This contrasts with the balance sheet, which is more like a snapshot of the company at a particular moment in time. The purpose of the income statement is to show managers and investors whether the company made or lost money during the period being reported.

**Take a look at your income statement and answer the following questions:**

### #1: Where Is Your Gross Margin Not Large Enough?

### #2: What are your keystone products?

**A: When you're counting on development of high-margin products to increase your company's profits, how well are you meeting the time frame and requirements that these products need?**

**B: Are your people comfortable telling you the truth about possible problems in bringing out new products?**

#### #3: Where Can You Better Optimize Your Operating Income?

**A: For example how would you take advantage of a major new opportunity To grow your business 10, 20 or 30 percent?**

#### #4: Who are your 10 most profitable customers? Also, what makes them so profitable for you?

#### #5: Which areas of your business processes, accounting systems and financial statements will have to change to comply with recent changes to the International Financial Reporting Standards (IFRS)?

# Five Fundamental Premises

**#1: Sooner or later you must make real profits to stay in business, hire great people, or create the resale value you want from your business or product.**

**A: What is your business's primary goal to create success?**

**B: How will you know when you have achieved it?**

**#2: Attracting the wrong type of customers or continuing serving customers who are no longer profitable will wreak havoc on your income statement.**

**A: Do you have any favorite customers who, like your favorite food, may not be good for you? Are there any customers who are actually a drain on your business?**

**B: Who is the ideal customer for your business? Clearly define their demographics, including gender, age, industry, level of education, and savvy within your marketplace.**

**#3: Know what is crucial in your company. An excellent process to do that involves some kind of summary financials or a flash report (see Definitions at the end of this section).**

**A: Where are you encountering lack of financial transparency or willingness to face up to problems at your own company? What issues are you deceiving yourself about?**

**B: What are the five to seven key performance metrics of your company?**

**C: Do your vendors welcome you with open arms and confidence, or do they run and hide?**

**#4: About 80 to 90 % of CEOs or CFOs recognize the need for an effective Enterprise Risk Management (ERM) program for their business, but only 25 to 30% actually have that process in place.**

**A: What issues are potential doomsday scenarios for your company?**

**B: How can you develop a "beer budget" approach to managing risk in your operations? That is, how can you make ERM economical to implement?**

**C: How committed are you, your executive team, and your board of directors to executing the risk strategy you've come up with?**

**#5: Your aim should be to develop a risk management program you can expand over time. The answers to the following questions can help provide continued benefits for up to three years:**

**A: What are your top three concerns that keep you awake at night?**

**B: What three actions are you willing to take to address these concerns?**

**C: What are your top three longer-term concerns that keep popping up after you've identified your immediate problems?**

**D: Now that you've identified these longer-term concerns, what three actions are you willing to take to solve them?**

**E: After you've addressed these issues, take a look at your upcoming opportunities. What are your three best opportunities for next year that you know are not adequately funded in this year's plans?**

**F: How can you best pursue these opportunities?**

**G: How can you create a laser-like focus on a single issue that could miraculously lead you to your desired opportunity?**

# Key Definitions

**Income Statement:** A standard financial document that summarizes revenue, costs and expenses for a specific period of time, usually one quarter or an entire fiscal year. Together with a company's Balance Sheet, they comprise a business's Financial Statement.

**Balance Sheet:** A report representing a snapshot of the company at a particular moment in time.

**Flash Report:** A report that's prepared quickly before full financial data is available, tracking key items such as those related to cash and working capital.

**Customer Relationship Management (CRM):** 1) The process of maintaining high quality interactions with existing customers and keeping them satisfied; 2) The department of a company responsible for CRM, formerly referred to as Customer Service.

**Budget Projection:** Estimate of revenue and expenditures for a specified period in the future.

**Cash Flow Projection:** An analysis of all the changes that affect a business's cash account during an upcoming accounting period.

**Breakeven Point:** The point at which sales equal costs.

**Cost of Goods Sold (COGS):** A figure that represents the cost of buying raw materials and producing finished goods.

**Net Income (or Net Earnings):** The amount remaining after all expenses have been met or deducted.

**Net Sales:** A figure that represents gross sales less returns and allowances, freight out, and cash discounts.

**Profit Center:** A segment of a business or organization that is responsible for producing profits on its own.

**Contingent liabilities:** liabilities waiting on a future event, a better ability to estimate, or specific accounting criteria.

**Flex budget:** A flex budget help when a possible wide variations of income or expense limit the value of traditional budgets.

**Key metrics:** a term often used for measuring 5 to 7 key results which best forecast future results.

# Action Plan

**Action 1: What is the first action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

**Action 2: What is the second action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

**Action 3: What is the third action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

**Observations & Comments:**

## Section 3:

# The Cash Flow Statement

# Cash Flow Statement

When you go for your annual check-up, your doctor examines you to get to the root of your health issues that you may not even be aware of. You may feel that you are fine, but your doctor may discover an underlying health problem (for example, a heart murmur) that only an expert can detect.

## The Cash Flow Statement Tour

**Statement of Cash Flows**

| For the years ended December 31 (In millions) | General Electric Company and consolidated affiliates 2008 | 2007 | 2006 |
|---|---|---|---|
| **CASH FLOWS — OPERATING ACTIVITIES** | | | |
| Net earnings | $ 17,410 | $ 22,208 | $ 20,742 |
| Loss (earnings) from discontinued operations | 679 | 249 | (1,398) |
| Adjustments to reconcile net earnings to cash provided from operating activities | | | |
| Depreciation and amortization of property, plant and equipment | 11,492 | 10,275 | 8,457 |
| Earnings from continuing operations retained by GECS | — | — | — |
| Deferred income taxes | (1,284) | 657 | 1,630 |
| Decrease (increase) in GE current receivables | (24) | (868) | (2,196) |
| Decrease (increase) in inventories | (719) | (1,562) | (1,514) |
| Increase (decrease) in accounts payable | (1,078) | (997) | (276) |
| Increase in GE progress collections | 2,827 | 4,622 | 642 |
| Provision for losses on GECS financing receivables | 7,518 | 4,431 | 3,062 |
| All other operating activities | 11,020 | 927 | 3,352 |
| Cash from operating activities — continuing operations | 47,841 | 39,942 | 32,512 |
| Cash from (used for) operating activities — discontinued operations | 760 | 3,380 | (1,057) |
| **CASH FROM OPERATING ACTIVITIES** | 48,601 | 43,322 | 31,455 |
| **CASH FLOWS — INVESTING ACTIVITIES** | | | |
| Additions to property, plant and equipment | (16,010) | (17,803) | (15,788) |
| Dispositions of property, plant and equipment | 10,975 | 8,457 | 6,795 |
| Net increase in GECS financing receivables | (17,484) | (44,237) | (37,146) |
| Proceeds from sales of discontinued operations | 5,423 | 11,574 | 11,009 |
| Proceeds from principal business dispositions | 4,986 | 2,746 | 1,883 |
| Payments for principal businesses purchased | (28,110) | (17,215) | (11,573) |
| All other investing activities | 195 | (9,910) | (6,053) |
| Cash used for investing activities — continuing operations | (40,025) | (66,388) | (50,873) |
| Cash from (used for) investing activities — discontinued operations | (876) | (3,116) | (1,774) |
| Cash used for investing activities | (40,901) | (69,504) | (52,647) |
| **CASH FLOWS — FINANCING ACTIVITIES** | | | |
| Net increase (decrease) in borrowings (maturities of 90 days or less) | (34,221) | 2,063 | 4,969 |
| Newly issued debt (maturities longer than 90 days) | 122,959 | 100,869 | 88,364 |
| Repayments and other reductions (maturities longer than 90 days) | (69,050) | (49,826) | (49,346) |
| Proceeds from issuance of preferred stock and warrants | 2,965 | — | — |
| Proceeds from issuance of common stock | 12,006 | — | — |
| Net purchases of GE shares for treasury | (1,249) | (12,319) | (8,554) |
| Dividends paid to shareowners | (12,408) | (11,492) | (10,420) |
| All other financing activities | 3,638 | (1,204) | (1,174) |
| Cash from (used for) financing activities — continuing operations | 24,640 | 28,091 | 23,839 |
| Cash from (used for) financing activities — discontinued operations | (4) | (154) | (172) |
| **CASH FROM (USED FOR) FINANCING ACTIVITIES** | 24,636 | 27,937 | 23,667 |
| **INCREASE (DECREASE) IN CASH AND EQUIVALENTS DURING YEAR** | 32,336 | 1,755 | 2,475 |
| Cash and equivalents at beginning of year | 16,031 | 14,276 | 11,801 |
| Cash and equivalents at end of year | 48,367 | 16,031 | 14,276 |
| Less cash and equivalents of discontinued operations at end of year | 180 | 300 | 190 |
| Cash and equivalents of continuing operations at end of year | $ 48,187 | $ 15,731 | $ 14,086 |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION** | | | |
| Cash paid during the year for interest | $ (25,853) | $ (23,340) | $ (18,438) |
| Cash recovered (paid) during the year for income taxes | (3,237) | (2,912) | (2,869) |

See accompanying notes.

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A company's cash flow statement contains critical information that can make you aware of potentially harmful business issues. Those issues can get you and your company in serious trouble if you do not take the time to learn what they are and address them before they grow like a cancer in your company, department, or life.  You need to know what you do not know is wrong in time to save your job or business. With that understanding you can recognize alternatives that you did not know existed before you gained a new level of understanding.

# Key Questions

A cash flow statement provides three types of information about how cash is captured or used throughout your business for the time period measured: They are: (1) operating activities, (2) investing activities, and (3) financing activities.

**#1: The difference between cash collections and accrual basis books can cause a major impact on the price you would sell your company for.**

**#2: Why is deferred revenue considered a liability?**

**#3: "Cash basis taxpayers include income when cash is received, and claim deductions when expenses are paid. " True or False?**

**#4: In accrual-basis accounting, do uncollected invoices count as cash income?**

# Five Fundamental Premises

**#1: The difference between cash-basis accounting and accrual-basis accounting has a material impact on tax reporting from year to year and on a company's daily financial operations.**

**A) How can a company change from cash basis to accrual basis accounting (or vice versa) when reporting to the IRS?**

**#2: The Cash Flow statement provides summary information on cash deposits and cash expenditures.**

**Complete these statements. A cash flow statement shows:**

**A: How changes occur in each of the ________________________________**

**B: How changes occur in _________________ and _________________**

**C: Breaks the analysis down to _________________, _________________, and _________________ activities.**

**#3: Cash flow provided from operations enables your long term goals.**

**A: What can you do to help your business generate more operating cash flow?**

**B: What more can you do in terms of reviewing your inventory items and gross profit margins?**

**C: Which items or services should you not be selling?**

**D: Which of your customers really do not pay their own way?**

**E: What more can you do to free up some cash for running the business or to build reserves for a rainy day?**

**#4: Cash flow provided from financing creates resources for obtaining your long term goals.**

**A: Why is prior planning essential for managing growth?**

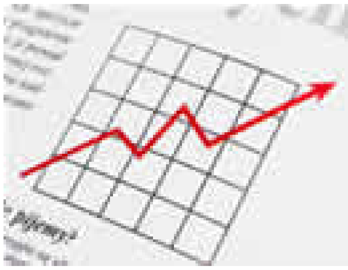
**B: What insider information is sitting in your cash flow statement waiting for you to unlock it?**

**#5: Cash equivalents are the quickest way to cash.**

**A: What can you do to accelerate your cash flow and ensure a smooth cash conversion cycle?**

**B: Can you put your finger on pertinent facts and figures you need to manage your business and accomplish strategic objectives immediately?**

## 10 Key Definitions



**Operations:** The department of a company that is concerned with the day-to-day functions of a business.

**Investment:** The use of capital to create more money.

**Financing:** Capital raised for the purpose of running a business.

**Positive Cash Flow:** The condition that exists when a company's revenue exceeds its requirements.

**Balance Scorecard:** When strategic non-financial performance measures are balanced against traditional financial matters.

**C-Level:** A term used to refer to the suite of corporate offers, usually Chief Executive Officer, Chief Financial Officer and Chief Operations Officer.

**Carbon Taxes:** Levied on a business for its pollution factor

**Enterprise Resource Planning (ERP):** The forecasting of resource requirements at the enterprise level.

**Infrastructure:** The skeletal make up of a business that includes human resources, systems and facilities.

**Metrics:** Critical factors used in measuring the success of a business project.

# Action Plan

**Action 1: What is the first action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

**Action 2: What is the second action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

**Action 3: What is the third action you plan to take?**

**Why is this action important?**

**What is the first step to accomplishing this?**

**When will you take this first step?**

**Who will help you with this action?**

**When does the action need to be completed?**

**How will you know the process was successfully completed?**

**What is your revenue goal for this action?**

**What other tangible benefits do you expect to receive?**

## Observations & Comments:

# Section 4:

# QuickBooks Tips

# QuickBooks Tips


The Fiscal Doctor's top seven accounting reports hold the keys to your company's survival and profitability. Here are tips for accessing them using Checkbooks accounting software. These key accounting reports focus on cash position, receivables, payables, and profit and loss. They will help you spot trends, help you understand where you are today, and guide you toward where you want to be tomorrow.

If you use another software program, whether it's basic like Peachtree or sophisticated like SAP, look for a slightly different title for the desired accounting report. The key concepts, however, remain the same.

# 7 Fundamental Reports

**#1: Rolling Previous 12-Month Expense Recap Report**

This report is important for two reasons:

6) Expenses represent cash going out the door.
7) The Recap Report allows you to spot trends and aberrations in these expense items.

A: Does your Expense Recap report reflect past business decisions such as changes in payroll or sales?

B: Are there trends in expenses which do not make sense or you did not anticipate?

C: Which expenses are the same each month, and which expenses are seasonal?

**#2: Cash Flow Projection Report**

**Sales without the timely collections of cash from your customers can be a critical stumbling block for both companies in rapid growth mode as well as those in decline.**

The Cash Flow Projection Report forecasts your cash flow in future periods. It will give you advance warnings and insight into how your business operations will impact the amount of cash coming into and going out of your business for the period. Sales without the timely collections of cash from your customers can be a critical stumbling block for both companies in rapid growth mode as well as those in decline.

How much do you expect your company to make during the projected period?

**#3 Profit and Loss versus Budget Report**

**In this report, revenue minus expenses equals net profit (or earnings).**

As you grow to appreciate this report more, circle back. How can you improve your budgeting process?

**#4 Sales Summary by Customer Report**

This report that allows you to see total sales for each individual customer during a given period.

Who are your top ten customers?

What percent of total sales do they account for?

Are sales well distributed among many customers?

**#5 Aged Receivables Trial Balance Report**

What is the aging point where the company should start making collection calls?

Is there an aged category, for example over 90 days, when you should send the receivable to a collection agency?

**#6 Aged Payables Trial Balance Report**

Accounts payable are payments due to vendors for goods and/or services that the company has bought but not yet paid for. A decrease in accounts payables is cash flow negative because you are paying off a debt. An increase in payables is cash flow positive because you are delaying payment. Payables in the older columns could indicate that you did not take advantage of a discount or are slow to pay. The Aged Payable Trial Balance Report will flag the following important questions for you:

Are you taking advantage of vendor discounts?

Are there suppliers that have not been paid on time?

What is the reason?

Is there a problem the company has with that supplier?

**#7 is the Report Capability created with the Export to Excel Feature**

Excel’s capabilities for data manipulation enable further research, and analysis. Excel also allows you to present information in unique and interesting ways.

How can you use Excel to get a clearer picture of your periodic financial standing?

What pitfalls do you need to avoid when using Excel for this periodic reporting?

What is your most efficient distribution channel for these reports to ensure that key decision makers are included in sharing this information?

# 3 Bonus Reports

**#1: Balance Sheet vs. Budget**

The Balance Sheet is a snapshot of your company's assets, liabilities and owners' equity – what you own and what you owe with owners equity making up the difference. The report helps you answer the question, "Are we on target or not?"

**#2: Profit and Loss vs. Budget by Product Line Report**

In this report, you can see how each product line is contributing to the bottom line – net earnings- and whether or not there are any material budget variances by product line in sales and expense categories that need follow-up.

**#3: Largest Vendors Year-to-Date**

This report captures the companies your company has purchased the most from for the financial year to date. This report is important because identifying your top vendors allows your company to focus on those which have the biggest dollar impact on its supply chain.

# 10 Key Concepts

Here is the method *to Stop Making Excuses about the Economy! Take Control of Your Company's Destiny.*

1. **The sooner you adapt to today's economic reality, the sooner your company will be poised to grow**. How can you seize new opportunities and create new revenue streams?

2. **Stop Manipulating the Numbers**. Where is your company playing financial games instead of providing quality financial information?

3. **The Cash King is not powerful if he is locked in the dungeon.** How opportunistic can your company be today and six months into the future?

4. **Put Your Money into Resources That Create New Opportunities**. Major initiatives for new opportunities only get off the ground with adequate resources and effective strategic planning. Where should you reallocate resources today so that next year's revenues and net income levels will bring about new opportunities?

5. **Don't Let Yesterday's Business Model Dictate Your Financial Decisions of Tomorrow.** From a financial perspective, is your business model still relevant? Is it time for a business model overhaul?

6. **Discard Data Minutia and Focus on Your Company's Five Critical Success Factors**. What are five areas of your operations that are absolutely essential to the health and well-being of your business?

7. **Fire Customers Who No Longer Support Your Company's Financial and Strategic Goals.** Aren't you tired of hearing your accounting people complain about how certain customers are costing you money, or worse, how they're abusing your employees? *Shed that dead weight to create company-wide goodwill and increase your company's profits.*

8. **If You Don't Think You Need a Contingency Plan, Think Again**. Create a contingency plan, whether it's as simple as a crisis communication plan, or as complex as preventing possible worst-case scenarios from becoming a reality. Would you rather be a success or a disaster story?

9. **Join the Modern Era.** Stop using budgetary constraints as an excuse for not investing in the latest technologies, including safety systems. What outmoded systems does your company need to upgrade for greater efficiency and profitability?

10. **Create a Fiscal Vision**. The goal of every company is to be financially solvent, and the only way to achieve solvency is to have a fiscal vision. Your strategy must be connected to your company's financial performance. What is your long term business vision?

## Conclusion:

As these points suggest, business leaders who have the courage to face the numbers squarely and create a growth strategy driven by the (financial) facts will not only survive but will thrive despite these uncertain, economic times.

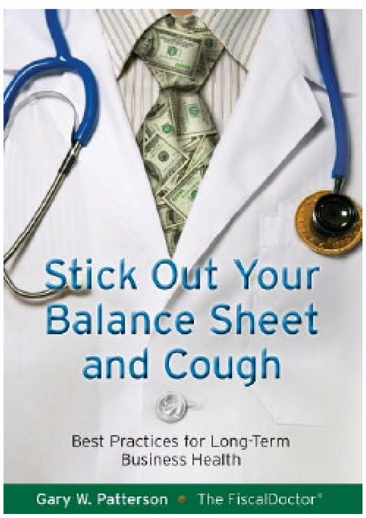
## Observations & Comments:

## Observations & Comments:

## Observations & Comments:

Remember that this program is a great start and will point you in the right direction. You'll be amazed by what you can achieve when you solve those problems that you didn't even know existed!

***For deeper insight and further expertise, you'll want to contact me to arrange a consultation.***





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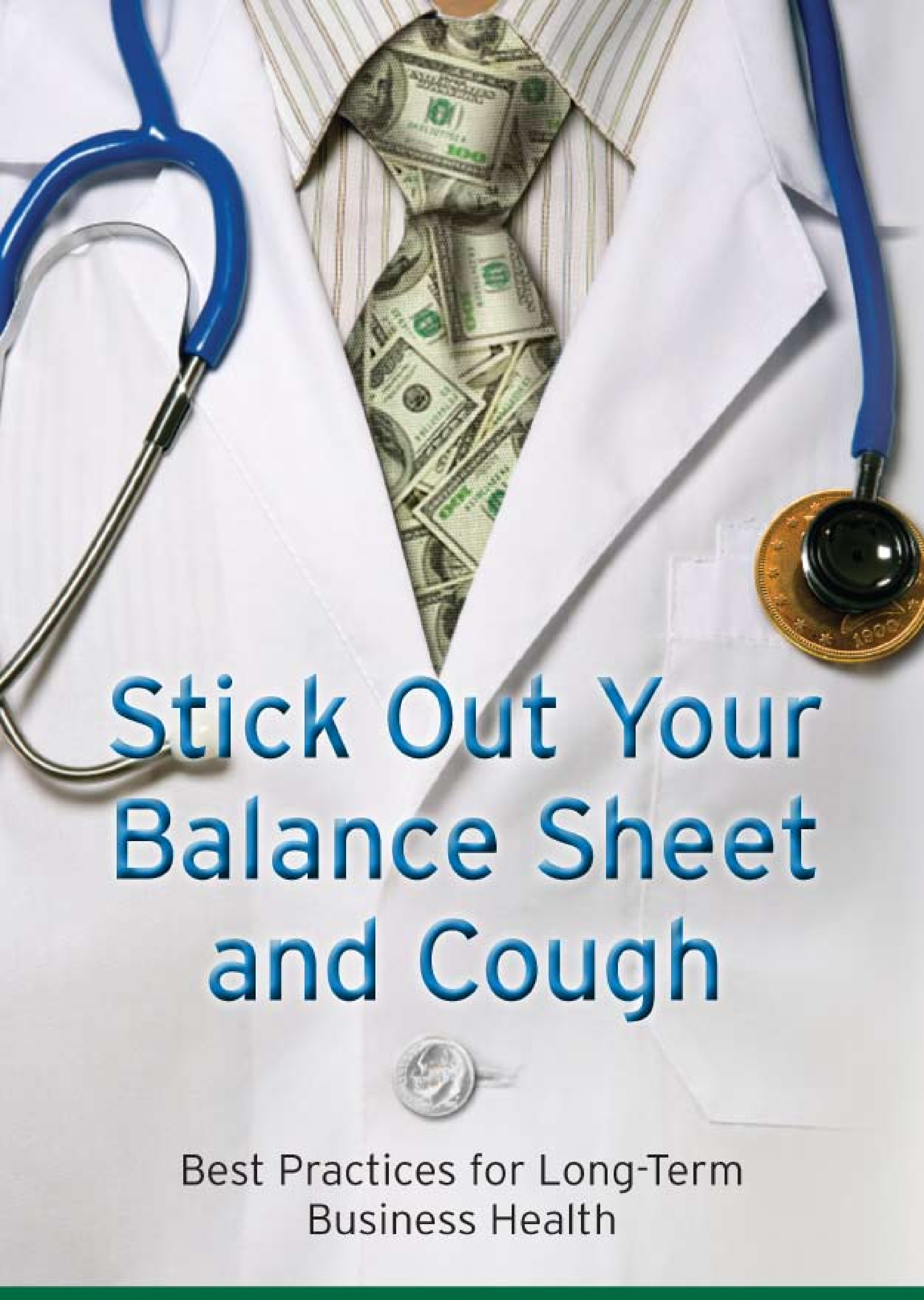

# Stick Out Your Balance Sheet and Cough

## Best Practices for Long-Term Business Health

Gary W. Patterson • The FiscalDoctor®

STICK OUT YOUR BALANCE SHEET AND COUGH:
Best practices for long-term business health



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# Table of Contents

# 4 The Internal Exam: Five Areas Where Risk Can Lurk

While numbers in and of themselves are neutral, the way they are interpreted can be misleading. According to a 2002 *Electronic Business* article, "A full 17% of respondents admitted that their CEOs had pressured them to misrepresent results at least once."

Without pointing fingers, could your financial statements, projections, and results use a more accurate interpretation? Besides giving you a more accurate picture of your company's financial fitness, an accurate understanding will have a major side benefit over the next year. The better you understand your company's real position, the more accurate the information will be that you depend upon to run your business. Depending upon how they are treated at your company, I've identified five areas that can either provide strategic benefits going forward if corrected, or be landmines where risk may be lurking in your company, if ignored. Let's make lemonade from lemons, if any of these issues still exist at your company.

How does your company stack up to these statements?

1. My business does not accurately know who its 10 most profitable customers are.

   ❍ True ❍ False

2. Occasionally my business capitalized expenses that created an asset with what now may be a questionable recorded value.

   ❍ True ❍ False

3. My company does not know how changes at one of our top 10 customers may affect our company's bottom line.

   ❍ True ❍ False

4. My business has an asset it would be better off selling at a loss to free up cash to pursue a more promising opportunity.

   ❍ True ❍ False

5. My business paints an overly optimistic picture of our company to a customer, vendor, or financing source.

   ❍ True ❍ False

## 1. The Value of Knowing Your Most Profitable Customers

How many times have you asked or been asked some version of this question: *If you find out who our 10 most profitable customers are, could you please let me know?* I can't tell you how many times I've heard top executives ask this question. Like a well-kept family secret, companies often can't accurately identify their 10 most profitable customers. Some companies may define their top 10 customers in terms of those with the largest revenue. At some point in the company's history that might have been a reasonable approach. In this case, there are reasonable time frames when the product line does not have to be very wide, customer service issues may be minor, margin erosion has not begun, and even costs of production are reasonably stable.

However, as your business becomes more complicated or more competitive requiring new or more modern software programs and/or incompatible record keeping systems, the business may not have the money to immediately upgrade information systems and must get by for now with what they have. In those cases, I've found that accurately knowing the 10 most profitable customers means digging a little deeper to get a better understanding of the numbers.

For example, I once worked with a steel company that had invested in software and hardware systems that could handle high volume manufacturing of a limited number of products with a limited choice of options. When the industry became much more competitive, customers demanded a wider range of customized product options, including color, length, and width. The more competitive environment meant they needed better operating information to become more cost effective while still meeting new and wider customer demands.

The information systems that worked well in the past could not meet these new customer demands. The company had not funded investment in new manufacturing systems or new data systems. Normally inside such companies, people solve these problems with unofficial Excel spreadsheets. Excel's flexibility solves the lack of flexibility inside the official system. After all, customers want their product delivered their way, how they need it, and when they need it, and do not care how the company's internal information system works.

However, even if the accounting department can deliver the financial statements and reports required by the SEC, management must have the right information to run the business successfully. If this is "offline" in a spreadsheet on a manager's laptop instead of in "the system," the information may not be easily accessible or in a format that is easily usable. Or it may take time and energy to integrate the spreadsheet data with the "online system" data. (Think of the last discussion or meeting you attended where a manager insisted they he or she couldn't get the information he or she was requesting.) Whatever the situation, there are clearly more costs associated with both providing the customized services to the client and accessing and presenting the data for management.

Often, the short-term answer is to throw bodies at the problem. Sometimes the mid-range solution is to get the right eight people in a room for a day and see what information is needed and how it can be delivered. That can initiate the process to obtain needed information and help clear red tape for management and their teams. Whatever level of access to this information your company has, I strongly recommend regularly obtaining the information about your most profitable customers. We will examine this issue in more detail later in this chapter. After all, you would be hard pressed to find anyone who disagrees with the statement that customers are the lifeblood of his or her business.

## 2. Question Today the Ongoing Value of Capitalized Items

Would you feel better about the issue of capitalization if you saw examples of how large companies with access to award-winning systems still make monumental mistakes when they misread the market? For example, Cisco had world-class information systems and processes for financial reporting and operational controls in place when it wrote off $3 billion of inventory in 2001. In a series of widely discussed articles about how a write-off of such magnitude could occur with a company that has such sophisticated systems, Cisco's executives admitted they misread the market downturn. At least Cisco made an honest, but embarrassing, mistake, but I wonder how many other companies would openly acknowledge such an error.

Another example is Fannie Mae. In business parlance, what Fannie Mae did is sometimes called "cooking the books"—not a good thing to do. Fannie Mae made highly questionable valuation decisions, not just once but twice. But the clean up team who was brought in to right the wrong appears to have made even more expensive and questionable actions than the "bad" people they had replaced. Possibly, the motives of the second team were less questionable than the motives of the first team and were closer to reckless risk taking than unethical behavior. Nonetheless, the net result was that in November 2008, Fannie Mae indicated that it would write off $20 billion in tax-related assets.

While it may be several years before we have better indications of the total costs to shareholders and taxpayers of today's financial institutions' failures to make tough decisions, we never will know the real total cost of these wrongdoings. Companies of all sizes have legitimately capitalized some item in the past that should be regularly questioned. All of us have read the horror stories of write-offs that in hindsight raise questions that often were not valid or even a factor when they originated.

If you have reserves, allowances or estimates for loss, it is a worthwhile hedge against downside risk to take a more critical look at them now and at least once a year going forward. When bad things happen to good companies, some of the reasons those things were not corrected earlier can be tremendously embarrassing later, when the bad things are on the front page of the *Wall Street Journal*. Why do you think incoming presidents of turnaround situations scrutinize everything and clean house–sometimes referred to as writing off everything including the kitchen sink? They would rather embarrass the outgoing leader than be the subject of embarrassment in the future.

## 3. Analyze Your Top Ten Customers' Profits

Companies that accurately know the profitability of sales of their top 10 customers often fail to surmount the next hurdle: *How will your company be affected when the profitability of your top customer decreases?* There is always a time when one of your top 10 customers will drop off your "A list." Consider that buggy whip manufacturers were profitable customers for some businesses until automobiles became the standard. Rather than laugh at that comparison, review how the product or service your company provides might become the buggy whip of tomorrow for one or more of your current best customers.

Even if you know your 10 most profitable customers, you still can be caught unaware if you do not have some understanding of how changes in your customers' business will impact your business. A company that has no clue who its most profitable customers are cannot even begin to estimate the damaging impact on their own company when their top customers' profits decline. The takeaway lesson here is to understand that your top 10 customers will change over time, so it's up to your management team to continuously analyze customer data to ensure you're serving the *right 10* best customers at all times and recognize that adjustments need to be made to those customer accounts that have fallen off the A list.

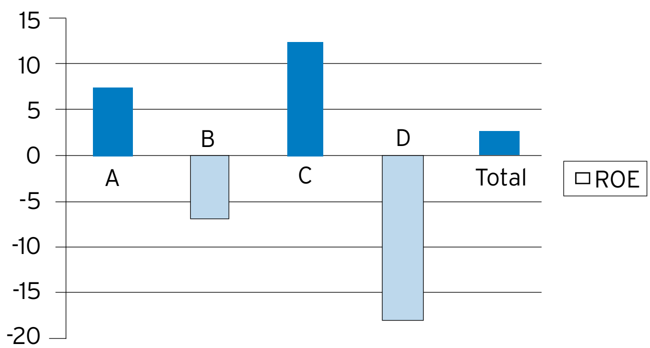
## 4. The Company Would Be Better Off Selling the Asset

Has your CEO, CFO, or financial department ever mentioned that the company has to keep losing money on a branch, service, or product because it can't afford the financial loss it would have to record to dispose of the asset? I've been privy to such discussions many times in corporations of all sizes. What happened to companies in those circumstances is that they either did not fully understand the real value of their assets, or they chose to look at their assets through rose-colored glasses.

A smaller-scale version of this situation occurs when a business fails to look at return on equity related to assets or departments. Many companies have one or more assets that can be associated with a band-aid solution, or assets that should be sold (even at a loss) and reinvested in another opportunity. This can be particularly true when the executive bonuses are mainly a function of the absolute dollar level of profitability, with limited influence from return on equity or similar measurements.

Let's use our "magic decoder ring" on a statement all too often heard. You (another person or company) would be better off selling stock, the asset, or even in some cases, the company, and just putting the money in treasury bills. In fact, I know of a situation where the subsidiaries of a holding company earned 2% on equity when the prime rate was 4%.

**Return on Equity % by Subsidiary and In Total**




| **Company X** | **ROE** |
|---|---|
| A | 7.5 |
| B | -7.0 |
| C | 12.5 |
| D | -18.0 |
| **Total** | **2.5** |

After viewing the chart, compare your business. Then ask, *What situation or valuation in our company are we looking at through rose-colored glasses?* A similar area where you might look for the rose-colored glasses within your company is your capital expenditures program (CAPEX). For those of you who are saying your company has a mechanism that investment proposals meet threshold rates, how often does someone report back convincingly that the actual investment return met or exceeded the level projected to get the funding? I suspect the answer is not as often as you think!

## 5. My Business Paints an Overly Optimistic Picture to Our Customers, Vendors or Finance Sources

How many companies have painted an overly optimistic picture to a customer, vendor, or financing source? According to *ADP Screening and Selection Services* "44% of Americans lie about their work history." (One well-publicized example was the case of Marilee Jones, who was the admissions director at Massachusetts Institute of Technology. While she claimed to have degrees from Albany Medical College, Union College and Rensselaer Polytechnic Institute, it turned out that she falsified her academic degrees: She had no degrees from any of them.) If any of those 44% work at your company, might they stretch the truth a little while representing your company?

The effects of this are extremely hard to quantify. When does puffery become misrepresentation? Murphy's Law suggests not knowing your company's real equity and risk areas will be a problem at the most inopportune time. Just take a look at all the items someone like me will ask for during a due diligence process and follow-up to see if your company's rough areas remain hidden. Also, if the numbers are clear, then it's more difficult to misrepresent them—whether intentionally or not.

## Coming Up

In the next chapter, we will take a closer look at decision makers' number one obsession—access to cash.

## Internal Exam Risk Checklist

- ❑ Know the value of your customers
- ❑ Question the ongoing value of a capitalized item
- ❑ Make adjustments to your top 10 customers list
- ❑ Identify assets that may need to be sold
- ❑ Know your company's true equity and risk areas

## R12 Do You Have a Question?

**To talk with Gary Patterson about your business:** This book covers a range of issues for high-growth companies and enterprise risk management concerns. A number of these issues can be discussed or researched in much more detail. If you have an issue you would like to discuss or suggestions for another book or service, please go to

www.fiscaldoctor.com/contact.html

and let Gary know how you prefer to be contacted. While you're at the contact page, request a free copy of the FiscalDoctor's Due Diligence Checklist, which is useful for operational assessments and enterprise risk management.

**For updates on enterprise risk management:** Gary Patterson blogs about ERM and other timely business concerns at:

www.fiscalclinic.com

**To apply these Best Practices to your business:** Gary Patterson can:

- Work with companies, worldwide on short-term or retainer-based projects
- Discuss your business problems, questions or comments
- Facilitate strategy or planning sessions
- Develop one-on-one coaching or mentoring
- Give a tailored speech on issues relevant to your situation
- Introduce his affiliates to your company
- Estimate the cost of what you don't know