

In-Your-Face Financial Statements

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Session Description

Let's face it, financial statements don't usually make for the most exciting topic, and they certainly aren't the easiest to understand!

However, as a business owner, understanding these documents and their interrelationship is absolutely critical for the profitable management of your company.

This session will provide you with a better understanding of accounting, financial statements, ratios and bench-marking results.

And while this session will not turn you into an accountant , we want to ensure you walk out far better prepared to read and interpret your financial statements.

Learning Outcomes

- Gain a better understanding of balance sheets, income statements and statement of cash flows.
- Learn the definition of the major components of each of the statements discussed.
- Recognize how each financial statement inter-relates with the other financial statements throughout your company's operating cycle.
- Understand how to calculate and understand key financial ratios and how to evaluate and benchmark results to those of the industry.

BALANCE SHEET

A “snapshot in time.” The balance sheet presents the financial picture of the Company as of a specific date.

Assets = Liabilities + Equity or; stated another way, what you own (assets) = what you owe (liabilities) + value to owners (equity)

ASSETS

Assets are everything you own (cash, inventory, investments, property and equipment) or have a right to receive in the future (accounts and notes receivables)

Assets are presented on the balance sheet in order of liquidity (how easily the asset can be converted to cash)

CURRENT ASSETS

Cash

Accounts receivable

Speculative homes under construction

Residential lots held for sale or speculative construction

Land held for development

Land and Land development costs

Developed Lots

Costs and estimated earnings in excess of billings on
uncompleted contracts (under billings)

CURRENT ASSETS

Finished Units (Spec Homes)

Other Current Assets

PROPERTY AND EQUIPMENT

Land

Building

Vehicles

Construction Equipment

Office Furniture

Leasehold improvements

OTHER ASSETS

Loan acquisition cost

Cash surrender value of life insurance

Deposits

LIABILITIES

Liabilities are obligations of the Company to others such as money owed to vendors, lenders or employees

Liabilities are presented on the balance sheet in two primary categories

- ✓ Current liabilities
- ✓ Long-term liabilities

Current liabilities are those obligations, which are due within one year from the balance sheet date

CURRENT LIABILITIES

Accounts payable – trade

Line of credit

Customer Deposits / Construction Draws

Billings in excess of costs and estimated earnings on
uncompleted contracts

Development and construction loans payable

Payroll taxes withheld and accrued

CURRENT LIABILITIES

Accrued wages

Accrued taxes

Accrued expenses

CURRENT LIABILITIES

Accrued losses on contracts in process

Notes payable - Shareholders

LONG TERM LIABILITIES

Notes payable – Bank

Notes payable – Shareholder

Notes payable – Related Party

SHAREHOLDER'S or MEMBER'S EQUITY

Shareholder's (S-Corporation) or Member's (LLC) Equity is what remains after you deduct total liabilities (what you owe) from total assets (what you own). Stated another way shareholder's/ member's equity is the value of the Company to its owners.

SHAREHOLDER'S or MEMBER'S EQUITY

Capital Stock or member's capital

Retained Earnings

Treasury Stock

Distributions

BALANCE SHEET

Items you do not want on your balance sheet include:

- ✓ Cash overdraft
- ✓ Loans to officers
- ✓ Loans to employees
- ✓ Current liabilities in excess of current assets
- ✓ Negative equity

INCOME STATEMENT

The income statement provides information on the profitability of a Company over a specified period of time, generally one year.

Contract Revenue – Cost of Contract Revenue = Gross Profit – Selling, General and Administrative Expenses = Net Income

INCOME STATEMENT

Contract revenue

Cost of contract revenue

Gross profit

Selling, general and administrative expenses

INCOME STATEMENT

Operating income

Other income

- ✓ Interest income
- ✓ Interest expense
- ✓ Gain (Loss) on sale of property and equipment

INCOME STATEMENT

- ✓ Income before taxes
- ✓ Taxes
- ✓ Net Income

Net Income Does Not Equal Cash

STATEMENT OF CASH FLOWS

The statement of cash flows provides information on the sources and uses of cash over a specified period of time, generally one year.

STATEMENT OF CASH FLOWS

The statement of cash flows reconciles the Company's accrual basis financial statements (balance sheet and income statement) to the cash basis focusing on three major business activities including operating, investing and financing

STATEMENT OF CASH FLOWS

Cash flows from operating activities are:

Cash inflows and outflows from routine activities of the Company

Cash flows from operating activities include:

- ✓ Payments received from customers
- ✓ Disbursements to vendors and suppliers
- ✓ Payments made to employees for salaries and wages, etc.

STATEMENT OF CASH FLOWS

Cash flows from investing activities are:

Cash inflows and outflows from the Company's productive assets such as:

- ✓ Property
- ✓ Equipment
- ✓ Investments

STATEMENT OF CASH FLOWS

Cash flows from investing activities include:

- ✓ Payments made to purchase property and equipment
- ✓ Gross proceeds from sales of property and equipment

STATEMENT OF CASH FLOWS

Cash flows from financing activities are:

- ✓ Borrowing money
- ✓ Repayment of principal amounts borrowed
- ✓ Issuing stock
- ✓ Purchasing stock and paying dividends
- ✓ Distributions to owners

STATEMENT OF CASH FLOWS

Non-cash transactions are activities, which do not provide cash inflows or outflows and are shown on the statement of cash flows as reconciling items

- ✓ Depreciation and amortization
- ✓ Gains and losses on the sale of property and equipment
- ✓ Purchase of property and equipment by issuing notes payable or entering into a capital lease obligation

NOTES TO THE FINANCIAL STATEMENTS

Summary of significant accounting policies

- ✓ Business activity
- ✓ Use of estimates
- ✓ Cash equivalents
- ✓ Method of accounting for speculative homes and contract homes

NOTES TO THE FINANCIAL STATEMENTS

Accounts receivable

Concentration of credit risk

Income taxes

NOTES TO THE FINANCIAL STATEMENTS

Costs and estimated earnings on uncompleted contracts

Line of credit

Long term notes payable

Retirement plans

NOTES TO THE FINANCIAL STATEMENTS

Lease commitments

Related party transactions

Commitments and contingencies

SUPPLEMENTAL SCHEDULES

Schedule of cost of contract revenue

Schedule of general and administrative expenses

Schedule of completed contracts

Schedule of contracts in process

RATIOS

Liquidity Ratios

Number of Days Cash

- ✓ Cash times 360 divided by annual revenue
- ✓ Number of day's cash should be seven (7) days or more

RATIOS

Accounts payable turnover

- ✓ **Cost of contract revenue divided by average accounts payable**

Age of Accounts Payable

- ✓ **360 days divided by accounts payable turnover**
- ✓ **Age of accounts payable should be 45 days or less**

RATIOS

Current Ratio

- ✓ Current assets divided by current liabilities
- ✓ Current ratio must be greater than 1.25 to 1.0

RATIOS

Leveraged Ratios

Debt to Equity Ratio

- ✓ Total liabilities divided by equity
- ✓ Debt to equity not greater than 3 to 1
 - In today's market getting tighter than that

RATIOS

Long-Term Debt to Equity

Long-term debt divided by equity

RATIOS

Profitability Ratios

Gross Profit to Sales

- ✓ Gross profit divided by annual revenue

NPBT

- ✓ Net profit before taxes divided by annual revenue

RATIOS

Return on Assets

Net income before taxes divided by total assets

THIRD PARTY ANALYSIS

Banks

ASSETS

Current assets should be assets collectible in the operating cycle

Accounts receivable not collected within one year should be classified as other assets

Analysis of costs and estimated earnings in excess of billings on uncompleted contracts

- ✓ A function of the Company's ability to properly and timely get bills out

LIABILITIES

Current liabilities should be any liabilities due within twelve (12) months

Long term liabilities are payments due after one year

LIABILITIES

Over billings

- ✓ If this number is large, is the Builder using funds from current jobs to pay off old liabilities
- ✓ Will lead to cash flow issues

INCOME STATEMENT

Format should be correct

Titles should also be correct

GROSS PROFIT ANALYSIS

Income Statement is compared Year to Year

Comparison of revenue from one year to the next year

- ✓ Also compared to gross profit percentage

Overhead analyzed as a percentage of sales

STATEMENT OF CASH FLOWS

Analyze to see if the Company has the ability to pay bills in a timely fashion

- ✓ Trade vendors
- ✓ Payroll
- ✓ Subcontractors
- ✓ Debt payment

SUPPLEMENTAL SCHEDULES

Schedule of cost of contract revenue

Breakdown of:

- ✓ Labor
- ✓ Materials
- ✓ Subcontractors

Analysis done to compare work subbed out versus self performed

SUPPLEMENTAL SCHEDULES

Schedule of general and administrative expense

Increase in general and administrative expenses from one year to the next

- ✓ Increase in all general and administrative expenses
- ✓ Increase in certain items due to tax planning
 - Bonuses
 - Retirement Plan Contribution

SUPPLEMENTAL SCHEDULES

Schedule of contracts in process and completed contracts is a must for banks

Schedule of Contracts in Process

- ✓ Number of jobs
- ✓ Size of jobs
- ✓ Gross profit by job

SUPPLEMENTAL SCHEDULES

Schedule of Completed Contracts

- ✓ Ability to estimate
- ✓ Compare gross profit from prior year or period to gross profit on contracts in process

Schedule of Completed Contracts

- ✓ Contract fade (decline in gross profit)

SUPPLEMENTAL SCHEDULES

Income earned on contracts in process schedule and income earned on completed contract schedule must equal contract revenue on income statement

Costs on contracts in process schedule and costs on completed contract schedule must equal costs of contract revenue on income statement

OTHER ITEMS ANALYZED BY THIRD PARTY

Excessive overhead expenses

Collectability of accounts receivable

Proper payment of accounts payable

OTHER ITEMS ANALYZED BY THIRD PARTY

Balance to bill on the contracts in process schedule minus the estimated cost to complete which gives available gross profit

- ✓ Compare to operating costs for the next year

Third parties like to see backlog that will produce enough gross profit dollars to cover overhead for the next six (6) months

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