Financial Management

Day 1

Day 1

- Introduction
- Instructor
- Course Overview

What is financial management?

- Efficiency
  - How well are we using our funds?
- Liquidity
  - How much funds do we actually have?
- Prosperity
  - Are we growing all areas of the business?
- Stability
  - Are we keeping our debts manageable?

Types of decisions

- Investment
  - Should we purchase new capital assets?
    - Boats?
    - Gear?
    - Permits?
- Financing
  - Should we get new investors? Loans? Asset replacement funds?
- Operating
  - Are we operating as efficiently as we could?
    - Can we decrease expenses?
    - Can we increase revenues?

Non-financial considerations

- Need to weigh the financial, and the non-financial impacts of the business
- Non-financial
  - Environmental
  - Social
  - Community
- Social, environmental and financial - triple bottom line approach

Accounting versus Financial Management

- Financial management
  - Focus on the management of the company
    - Assets & Liabilities
    - Forecasting and planning future growth
- Accounting
  - Day to day accounting
  - Tool to analyse the company performance and plan future growth

What is debt?

- Debt is when one entity owes another
  - Loans
  - Lines of Credit (LOC)
  - Services or product (future delivery)
- Good or Bad?
  - Bad – when becomes unmanageable and an impediment to growth
  - Good –
    - Allows efficiencies
    - Allows growth through purchasing new assets

Debt example

- Say your company wants to purchase some new office equipment that will allow for the company to grow and this is valued at $5,000. Your company only has $1,500 available. The company can take a loan out for the remaining $3,500 at a reasonable interest rate, and payable over the next five years.

- Many lenders do require that companies that they lend money to adhere to certain conditions during the life of the loan. If a company doesn't follow these conditions, they risk having the lender require the loan to be repaid immediately. Some of these conditions include submitting audited financial statements annually, maintaining certain levels of revenue to debt ratios, or having a certain amount of funds in the bank account monthly.

- In our example, say you used the equipment for four years, and now have decided to sell and replace them. The loan balance at this time is $700, and you are able to sell the equipment for $4,000. Ignoring the interest expense over the four years, how much did this equipment actually cost the company?
- The sale of the equipment $4,000
- Less loan repayment (3,500)
- Cost to company $500

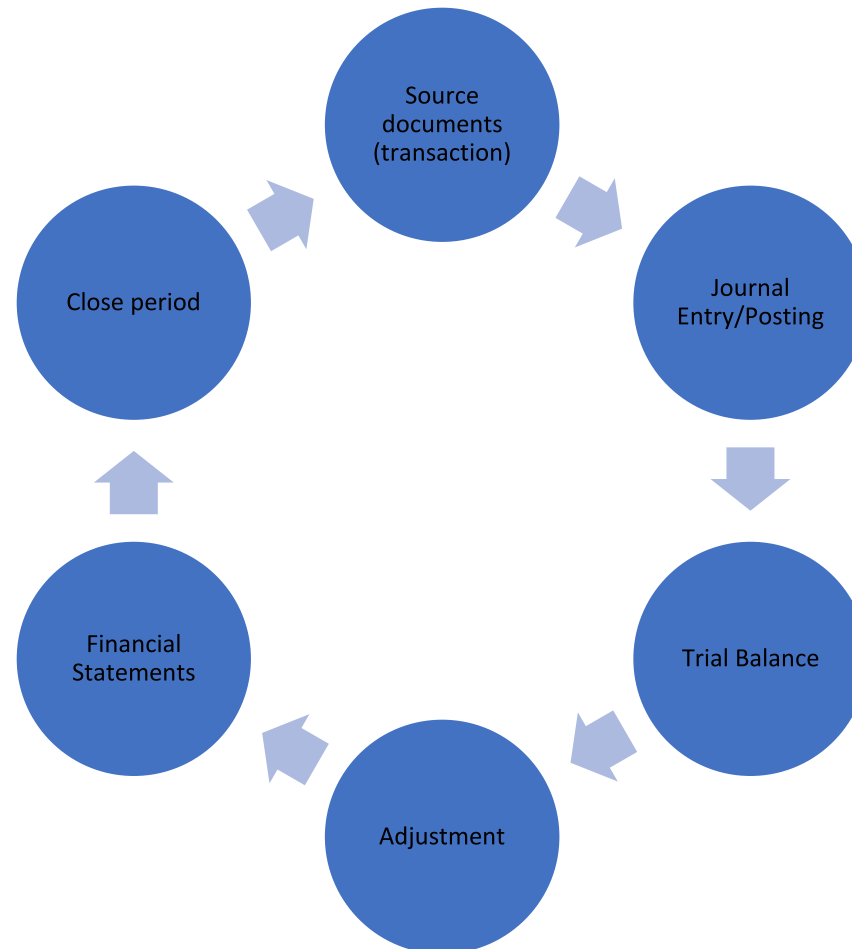
Financial management – who is responsible?

- All managers in a company
  - Not just the accountants
- Each manager is responsible for their area of the business
  - Need to understand how their area impacts the company

Accounting terms

- Exercise
- Match the definition to the words

The accounting cycle



Accounting basics

- Accounting equation
  - Assets = Liabilities + Equity
- Chart of accounts
  - List of all accounts in a company
  - All transactions are recorded in these accounts
- Double entry accounting
  - All transactions are recorded in at least two accounts
- GAAP
  - Generally Accepted Accounting Principles
  - Rules and regulations that accounting must follow

Financial Statements

- Three main statements
  - Statement of Financial Position (also known as the Balance Sheet)
  - Statement of Equity
  - Statement of Profit and Loss (also known as the Income Statement)

Statement of Financial Position

Mock Fishing Statement of financial position For the Period ending March 31, 200X			
Assets		Liabilities	
Current Assets		Current liabilities	
Cash	$5,950	Accounts Payable	$7,500
Accounts Receivable	8,800	Current portion of long term debt	5,000
Prepaid Expenses	700	Crew share payable	2,300
Government grant (prepaid)	1,500	Total current liabilities	$14,800
Total current assets	$16,950		
		Long term liabilities	
Long term assets		Vessel and equipment loans	25,000
Vessels, equipment and gear	$156,000	Total long-term liabilities	$25,000
Accumulated Amortization	(109,800)		
Net Vessels, equipment and gear	46,200	Total liabilities	$ 39,800
Permits	35,600		
Equipment replacement fund	85,900	Equity	
Total long-term assets	167,700	Contributions	$100,000
		Retained Earnings	44,850
		Total Equity	$144,850
Total Assets	$184,650	Total Liability and equity	$184,650

Statement of Equity

Mock Fishing Statement of equity For the Period ending March 31, 200X	
Opening Retained earnings (April 1, 200X)	$15,550
Net income for the period	29,300
Total contributions	100,000
Closing equity	$144,850

Statement of Profit and Loss

Mock Fishing Statement of Profit and loss For the Period ending March 31, 200X		
Revenues		
Sale of fish to processor	$145,000	
Sales direct	2,500	
Total revenues		$152,500
Cost of Goods Sold		
Fuel	$ 75,000	
Provisions	5,200	
Gear	2,000	
Bait and ice	500	
Misc. operating costs	800	
Total Cost of goods sold		83,500
Gross Profit		$69,000
Selling, general and administrative		
Port and harbour costs	$ 5,500	
Vessel and gear maintenance	7,500	
Fees	750	
Vessel insurance	4,500	
Professional fees	1,200	
Office expenses	4,250	
Depreciation and amortization	18,500	
Payroll (office stuff)	65,000	
Interest expense	2,500	
Total selling, general and administrative		$109,700
Net income before taxes and grants		$(40,700)
Operating grant received		70,000
Net income before taxes		$ 29,300

End of day 1

Financial Management

Day 2

Financial statements

- What are they used for?
  - The formal record of the business's financial activity for a specific point in time
  - Can be used to assist with:
    - Getting credit (loans, grants or investors)
    - To review the performance compared to other periods or other companies
    - As a tool for future planning

Reviewing financial statements

- How often should they be reviewed?
  - Depends
    - Size of company
    - Complexity of the operations
  - Annually
  - Interim financials:
    - Quarterly
    - Monthly

Presenting financials

- Financials should be presented to the owners and/or the board
- No need to go line by line
- Focus on
  - Major changes
  - Bottom line (net revenue)
  - Total revenue and any change (increase or decrease)
  - Reasons for changes

Basic bookkeeping

- Example #1: Posting a variety of transactions for a fishing-based business.
- *During the month, the company purchased $5,000 of fuel, bait and ice for $300, and various provisions for the boat for $350. The harbour costs were $300, and the boat repair invoice was paid for $750. There were bank fees of $50 and general office expenses of $125. The company did sell the remainders of their catch of 2,000 pounds for $3.50 per pound. The company also collected the remaining $9,000 of the accounts receivable*

Fuel bank	5000 5000
Bait and ice bank	300 300
Provision Bank	350 350
Bank A/R	9,000 9,000
Harbour costs Bank	300 300
Repairs Bank	750 750
Bank fees Bank	50 50
Office Bank	125 125
Bank Revenue – fish	7,000 7,000

- Exercise #2: Posting transactions for an office-based business.
- During the month, the company purchases some office supplies for $250, the utilities bill comes due for $650, and the office rent is due for $1,500. On top of this, the company received $2,000 for license leases and $750 for equipment rental. Bank fees for the month were $75.

Office supplies		250	
	Bank		250
Utilities		650	
	Bank		650
Rent		1500	
	Bank		1500
Bank		2000	
	License lease		2000
Bank		750	
	Equipment rental		750
Bank fees		75	
	Bank		75

FISHERIES ENTERPRISE
MANAGEMENT TRAINING

Reviewing financial statements

- Receiving a financial statement is just part of the picture
- Need to be able to read what they are telling you
- Is the company performing as it needs to?

Ratios

- Four areas that ratios look at:

1. Liquidity
   - Ability to cover debts immediately if required
2. Leverage
   - How much of the company's capital comes from debt
   - Can the company meet its financial needs?
3. Activity
   - Performance of the company and efficacy at generating revenue (mostly for companies that make products)
4. Profitability
   - Ability for the company to make a profit

Liquidity ratios

- Current ratio (working capital)
  - Current assets /current liabilities.
  - This ratio gauges the company's ability to pay any short-term liabilities.
- Quick (acid test)
  - (current assets – inventories) /current liabilities.
  - This ratio looks at the company's ability to pay short-term liabilities using only the most liquid assets.

Leverage ratio

- Debt to total assets
  - total debt /total assets.
  - This result shows how much of the company's assets are financed by debt.
- Debit to equity
  - total debt / total equity.
  - The resulting number shows as a percentage the amount of debt the company owes in comparison to the company's equity.
  - For example: a debt to total asset ratio of 1.50 is equal to 150% of the company's equity. (company has more assets then it owes the owners in equity)

Activity ratios

- Total asset turnover
  - net sales/ average total assets
  - This ratio can help determine if a company is able to efficiently generate sales from the company's assets
  - The higher the number in the results, the more efficient the company is.
- Inventory turnover
  - sales / average inventory balance
  - This ratio shows the company how fast they are able to turn over their inventory.
  - A higher number shows that the inventory isn't sitting on the shelf for a long time.
- Accounts receivable turnover
  - total credit sales/average accounts receivables balance.
  - This ratio shows if a company is effectively collecting their debts in a timely manner.
  - A higher number shows that the company is collecting in an efficient manner.

Profitability ratio

- Gross profit margin
  - revenue - cost of goods sold /revenue.
  - This calculation presents how well a company is producing their products.
  - The higher the result, the more profitable the company is at producing their products for sale.
- Operating profit margin
  - Gross income – (cost of goods sold +operating expenses) / sales revenue.
  - This ratio is a good indicator of how well a company is being managed and also how risky it is by displaying what proportion of the revenues are available to cover non-operating expenses, like interest expenses.
  - This is one of the more important ratios that lenders and investors tend to focus on.

Ratio formulas

Liquidity		
Current		
	Current ratio =	Current assets
		current liabilities
Quick		
	Quick ratio =	cash + accounts receivable
		current liabilities
Leverage		
Debt to total assets		
	Debt ratio =	Total liabilities
		total assets
Debit to equity		
	Debt/equity ratio =	long term debt
		common equity
Activity		
Total asset turnover		
	total asset turnover =	sales
		total assets
Inventory turnover		
	Inventory turnover =	Sales
		average inventory
Accounts receivable turnover		
	Accounts receivable turnover =	Total Credit sales
		average accounts receivable
Profitability		
Gross profit margin		
	Gross profit margin =	Revenue - COGS
		Revenue
Operating profit margin		
	Operating profit margin =	Revenue - COGS - Operating expenses
		sales revenue

TERPRISE
TRAINING

Review of Clearwater Seafoods

- Look at Clearwater's financials and perform some of the ratios
  - Current ratio
  - Inventory turnover
  - Accounts receivable turnover
  - Gross profit margin
  - Operating profit margin
  - Debit to Equity
  - Debt to total assets

End of day 2

Financial Management

Day 3

Financial Analysis and Metrics

Pro formas

- Projection financial statements
  - Give a company a good “what if” analysis
- Prepared to try and predict the financial outcome for a future course of action by the company.
- Prepared prior to:
  - Starting a new business
  - Changing business operations
  - Making new acquisitions
- Most pro forma financials are prepared on a five-year time line.
  - Allows for the impacts of the proposals to be fully reflected in the finances of the company over time.

Budgeting

- Are useful tools for a company for planning and controlling.
- Used to plan what a company wants to do, and to help with controlling the company from spending funds in an inefficient method.
- It is important to prepare and monitor actual results compared to budgeted results
  - This ensures that the company is performing as planned
  - Allows for adapting based on actual results
- As a financial manager, the budget is your map
  - Where are your operating funds coming in from?
  - Where are they expected to go?
- In best practices, a budget is prepared a few months prior to the end of the fiscal year
- Reviewed at the end of every quarter
  - Ensures that the company is still performing correctly and within the expected budget.

Budgeting cont'd

- Operating without a budget is similar to operating a ship without the marine charts
  - It is possible, but the risk of being wrecked on a submerged rock is greatly increased.
- The budget can show where the expected expenses for the year will arise, and also provide an estimate of the revenue coming in.
- Assist in planning possible new capital purchases
- There are different types of budgets:
  - capital budgets
  - operating budgets
  - cash budgets (to be covered in day four).

Capital budgets

- Used to plan out capital purchases
  - Obtaining funds for the purchase
  - Purchasing the capital asset
  - Operating the asset
  - Retiring of the asset
- For the purchase of large dollar items (land, buildings, vehicles, or ships), will be multi-year in scope.
- A good capital budget:
  - Will look at the current property and equipment
  - Takes into account any major repairs required
  - Takes into account any estimated funds that can be received upon either sale or scrap of it at the end of the useful life

Capital budgets cont'd

- Can be used for adding in new equipment that would be required for the company's expansion.
  - New land and buildings for an expansion of the office space
  - New operating equipment to expand the revenue generating operations (for example, a new fishing boat and equipment to add to the current fleet or rental stock).
- The last aspect of a capital budget
  - The estimated amounts that should be set aside each year from the company's profit for these new purchases, or major repairs that will be required
- A company can minimize any cash crunches that could arise for an unexpected repair or replacement.

Operating budgets

- The operating budget used as the blueprints for their operations
- What the company wants to see for the upcoming periods.
  - Estimated revenue that the company expects
  - Anticipated expenses
  - Based on prior performance of the company and the estimated growth within the industry
- For example:
  - Does the company expect that their catch will sell more this year versus the prior years, or will the prices that they can get go down?
  - Will the cost of supplies go up?
  - Will there be major repairs or gear replacements required during the year?
- All these items can be budgeted for and then tracked as the year goes along to ensure that the company stays on their projected business track.

Operating budgets cont'd.

- Should capture:
  - All expected revenue
  - All expenses expected.
  - Build in a small increase in expenses
- Allows the company a quick view of what to expect
- Can assist in rolling out expansion plans
- Outline expenses that need to be reduced

Budget variances

- Variances are
  - Actual results are different than what was expected in the budget.
- Budgets should be compared to actual results on a regular basis – monthly, quarterly or annually.
- This regular review can correct any major variance
- Can be used to identify any major changes
- Variances can arise:
  - When the revenue is not what was anticipated
    - For example, the price per pound was lower or higher than anticipated.
  - It can also arise when unexpected expenses arise
    - a boat suddenly requires engine work or gear is lost and needs to be replaced.
- Variances can be reviewed quickly
- Can then adjust their expectations for the rest of the year and adjust their operations as needed.

Budget variances

- For a budget to be effective:
  - It needs to be reviewed regularly
  - And an analysis on the variances
- A review of a budget can show expenses that are starting to trend higher and a financial manager can investigate to see why
  - Did the cost of these supplies suddenly go up?
  - Is the company using more than was anticipated?
  - Or is the company being billed for too many items and this error hasn't been caught?
- These are all examples that can be identified during a regular review of the budget.
- Reviewing the budget can also show developing trends on the revenue side.
  - Performance of items sold?
  - Are we receiving the lease payments on time, or is there a potential that we will have an accounts receivable collection issue in the coming months?
  - Have we leased out our assets at too low of a rate?

Capital budget example

- Capital budget example: purchase of new 34’ Troller:
- Cost of boat: $40,000
- Estimated life of boat: 8 years
- Disposal value: $5,000
- Operating cost of boat: $6,000 (licence, fuel, insurance)
- Current boat disposal: $2,000 (3 years left on estimated life)
- How much should be put aside each month to purchase boat in two years time?

Capital budget example

Funds required to raise:	$40,000-2,000	$38,000
24 months		$1,583.33 per month

Decision making

- A key component to financial managers
- Should the company do X or Y?
- How much of Z do we need to catch during the season to cover our costs?
- Expansion of the current operations
  - Purchase more licenses or equipment to increase revenue potential;
  - Moving to offer a different product or service;
  - and closing down parts of the company.
- All these decisions need to be made using the current financial information, and other analytical tools that the company has at their reach.
- These tools include
  - The various budgets that they prepared,
  - Any market or industry trends that they have access to,
  - And any industry knowledge that they possess.

Break-even analysis

- The break-even analysis is a way to determine what a company needs to do to cover their expenses.
- This is found by looking at the fixed costs, the variable costs and the per item revenue.
- The fixed costs are costs that don't change no matter the amount of sales.
  - These are items like office rent and insurance.
- The variable costs are the costs that do change based on the volume of sales.
  - These can be expenses like fuel for the boat, bait and ice, and crew wages.
- The per item revenue will be items like the per poundage of the catch.

Break even analysis

- Formula:

$$Break\ Even = \frac{Fixed\ Costs}{(Selling\ Price\ - Variable\ Costs)}$$

Break-even analysis

- Work out the break even point of the vessel for the year salmon fishing
- Fixed costs are $35,000
- Variable costs are $1.25 per pound
- Price for this season is $4.00 per pound for the salmon.
- How many pounds need to be caught to break even?

Break-even analysis

- BE = FC/(SP-VC)
- BE = 35,000/(4.00-1.25)
- BE = 35,000/2,75
- BE = 12,727 lbs

Sensitivity analysis

- A sensitivity analysis shows:
  - Highest (optimistic) projected impact of a decision,
  - the lowest (pessimistic) projected impact,
  - and a mid-point in between.
- This can give the company a best-worst case scenario for projected proposals.

Mock Fishing			
Statement of Profit and loss			
For the Period ending March 31,			
	Option 1	Option 1	Option 1
Revenues	Low	Mid	high
Sale of fish to processor	$75,000	$85,000	$95,000
Cost of Goods Sold			
Fuel (33%)	24,750	28,050	31,350
Provisions (2.3%)	173	196	219
Gear (1%)	750	850	950
Bait and ice (0.5%)	3,750	4,250	4,750
Misc. operating costs (0.5%)	3,750	4,250	4,750
Total Cost of goods sold (37.5%)	33,173	37,596	42,019
Gross Profit	$41,828	$47,405	$52,982
Selling, general and administrative			
Port and harbour costs	$5,500	$5,750	$6,000
Vessel and gear maintenance	7,500	7,750	8,000
Fees	750	775	800
Vessel insurance	2,500	2,750	3,000
Professional fees	1,200	1,200	1,200
Office expenses	4,250	4,250	4,250
Depreciation and amortization	4,000	4,000	4,000
Payroll (office stuff)	10,000	12,500	15,000
Interest expense	2,500	2,500	2,500
Total selling, general and administrative	$38,200	$41,475	$44,750
Net income before taxes	$3,628	$5,930	$8,232

Other considerations

- When comparing two or more options the financial impact on the company is just one component.
- You can also look at other tangible impacts that the proposal will have on the company, and the intangible impacts.
- Tangible impacts include:
  - a modernization of the company assets,
  - and a more efficient operating area.
- Intangibles can include:
  - a more favorable view of the company by the community,
  - and increased market share.

End of day 3

Financial Management

Day 4

Cash flow projections

- Also called a cash budget
- A monthly estimate of:
  - the flow of cash inflows (revenue received)
  - outflows (expenses paid)
- Can be instrumental for the planning of expenses
- Set on a month by month basis
- Chart out all areas that cash will come into the company and where it will go out.

Cash flow projections

- The first section that is filled out is the revenue section.
  - Based on the cash process (when cash is actually received)
  - All revenue should be included (sales of products, grants received, tax refunds, and any other cash expected to be received)
- All expenses will be laid out as they are expected to be paid.
- At the end of each month:
  - The total cash inflows or outflows for that month will be calculated.
  - This will then be added to (or subtracted from) the remaining cash balance from the month before.
- This projection is a great way to plan out any major purchases as well as estimating out the start-up capital required for the next fiscal year.
- Eg: at the end of fishing season, what expenses will have to still be paid for, and how to be prepared for these?

Cash flow projections example

- Build a cash flow projection for a fishing season that starts mid-May until October.
- There is a license lease out that is paid monthly by the lessee ($1200 annually).
- Ground fish are expected to peak in September and salmon in October.
- Opening cash balance is $2,000.
- A closing cash balance is required to be $2,000.
- Monthly costs to operate the office is $300.
- AR is collected the following month

	Salmon	Ground fish	A/R	COGS (not including office expense)
May	300	100	50 Salmon	50
June	500	375	75 Ground fish	300
July	500	375	75 Ground fish	300
August	800	500	100 each	700
September	950	600	150 salmon	700
October	1,000	250	100 Salmon, 50 Ground fish	600
November				300
December				200
Total	4,050	2,200		3,150

	April	May	June	July	August	Sept	October	November	December	January	February	March	Total
Salmon Sales		250	500	500	700	800	900						$3,650
Ground fish		100	300	300	400	600	200						1,900
Licence Lease	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Prior month A/R			50	75	75	200	150	150					700
Total	100	450	950	975	1275	1700	1350	250	100	100	100	100	$7,450
COGS	300	350	600	600	1000	1000	900	600	500	300	300	300	$ 6,750
Profit	(200)	100	350	375	275	700	450	(350)	(400)	(200)	(200)	(200)	$ 700
Opening Cash	2,000	1,800	1,900	2,250	2,625	2,900	3,600	4,050	3,700	3,300	3,100	2,900	2,000
Closing Cash	1,800	1,900	2,250	2,625	2,900	3,600	4,050	3,700	3,300	3,100	2,900	2,700	$2,700

PRISE
INING

Sources of funding

- There are two main areas to look for additional funding:
  - Internal sources
  - External sources
- Internal sources:
  - Funds from the shareholders
  - Can be as short-term shareholder loans, or long-term shareholder loan.
- External sources:
  - Loans from financial institutions
  - Grants from a government agency
- Financial institutions include the major chartered banks (RBC, HSBC, etc.)
- Also include the BDC (Business development bank of Canada) and smaller lending agencies

Sources of funding

- Grants from the various government agencies:
  - Business start-up grants,
  - New capital asset funding loans and grants,
  - and employment creation grants.
- No matter where the funding comes from:
  - It is never guaranteed
  - And may include some sort of contingency to receiving it
    - Certain employment quotas
    - Keeping a level of income or below a level of debt
    - Requirements to have a level of assurance completed on the financial statements annually,
    - etc.

Audits

- An audit is an external review of the company's financial statements by a qualified accountant.
- There are three levels of year end completions:
  - Compilation engagement – also known as a Notice to Reader. This is the lowest level of engagement. Very minimal review of the total by the external accountants.
  - Review engagement – this is where the external accountants look to make sure that the financial statements are a faithful representation of the company's period results
  - Audit engagement – this is the most in-depth of the engagements. During an audit, the accountant will test a random sampling of the balances to determine if they are a faithful representation of the results and that they are free from a material error.

Audits

- No matter the level of engagement, you may be asked to provide some information to the accounting team.
- This information can vary depending on the engagement.
- Every engagement requires the main items:
  - The accounting information for the year (general ledger transactions, bank statements, all receipts),
  - a listing of any new equipment purchased during the year,
  - any equipment that was disposed of,
  - and any significant issues
- Most of these items will be provide by the accounting department

End of day 4

Reflections

- End of day 4 – take time to reflect and determine how the topics today fit into your job role, and how you can utilize this knowledge in your day to day work?
- Has this module expanded your knowledge base for your position?
- Will you be able to make use of these tools?
- Will these allow you to better assess your role and the ability to add input into your workplace and CFE?