BCS SPECIAL REPORT

Category: Financial Statements | Report: 201501 | December 9, 2015

What are you being told?

The value of financial statements analysis.

By George Scott

Do any of these situations sound familiar?

Scenario 1 - You wish you could understand what your financial statements are telling you. Thus far, you have experienced pretty good success with your business. However, you feel that you could be doing better - much better. You have a suspicion that an in-depth analysis of your financial statements will provide with critical insights, that, when applied, will improve your business operations on many levels.

If only you knew how to perform that in-depth analysis ...

Scenario 2 - You see your accountant only during tax season. He or she hands you your completed business tax return 7 - 10 days later. You say, “Thanks” and leave. Next year, during tax season, you repeat the same process.

Between tax seasons you and your accountant never speak.

Scenario 3 - Your bank requires quarterly financial statements. Since the loan officer is providing you with excellent cash management flexibility and availability, you have your accountant prepare the statements. As soon as you get back to your office, your copy of the financial statements is put in the filing cabinet – and you close the drawer.

In three months, you will file the next quarterly statements in the same drawer – and close it again.

If any of these scenarios do sound familiar, then you are missing valuable input from your financial statements that can greatly affect many of your management decisions.

Since the sole reason for creating a business out of your newly invented product or newly created service is to generate a substantial financial outcome, it makes great sense to understand what your financial statements are telling you.

There are three main components of a firm’s financial statements: 1) Balance Sheet, 2) Profit or Loss Statement, and 3) Cash Flow Statement.

The two categories of financial statement are *Internal* - prepared by the firm’s in-house bookkeeper or accountant and *External* –prepared by a non-employee CPA.

From lowest to highest, four levels of financial statement credibility exist, which are:

- *the internally prepared statements,*
- *compilation*: the CPA organizes (without investigating any of) the raw data received from the business,
- *review*: the CPA probes the reasons for the numbers being what they are,
- *audit*: the CPA performs in-depth due diligence regarding every bit of the firm’s financial matters.

The size and type of business will determine which credibility level financial statement is required by all or specific stakeholders. For example, audited statements are required for publicly-traded firms. Whereas a small business with less than ten employees may get by with only the internally prepared or compilation statements.

Many of the ratios gleaned from the financial statements are common to all businesses. Some ratios are industry specific. If you belong to an industry association, get a copy of its latest members financial statements reports. It will come in handy.

The best financial advice you can get is from a CPA who understands your size and type of business. If you have an accountant, great! If not, interview three to five CPAs and select the one with whom you are most comfortable.

Subsequent *BCS Special Reports* will provide further details about what your financial statements are telling you.

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