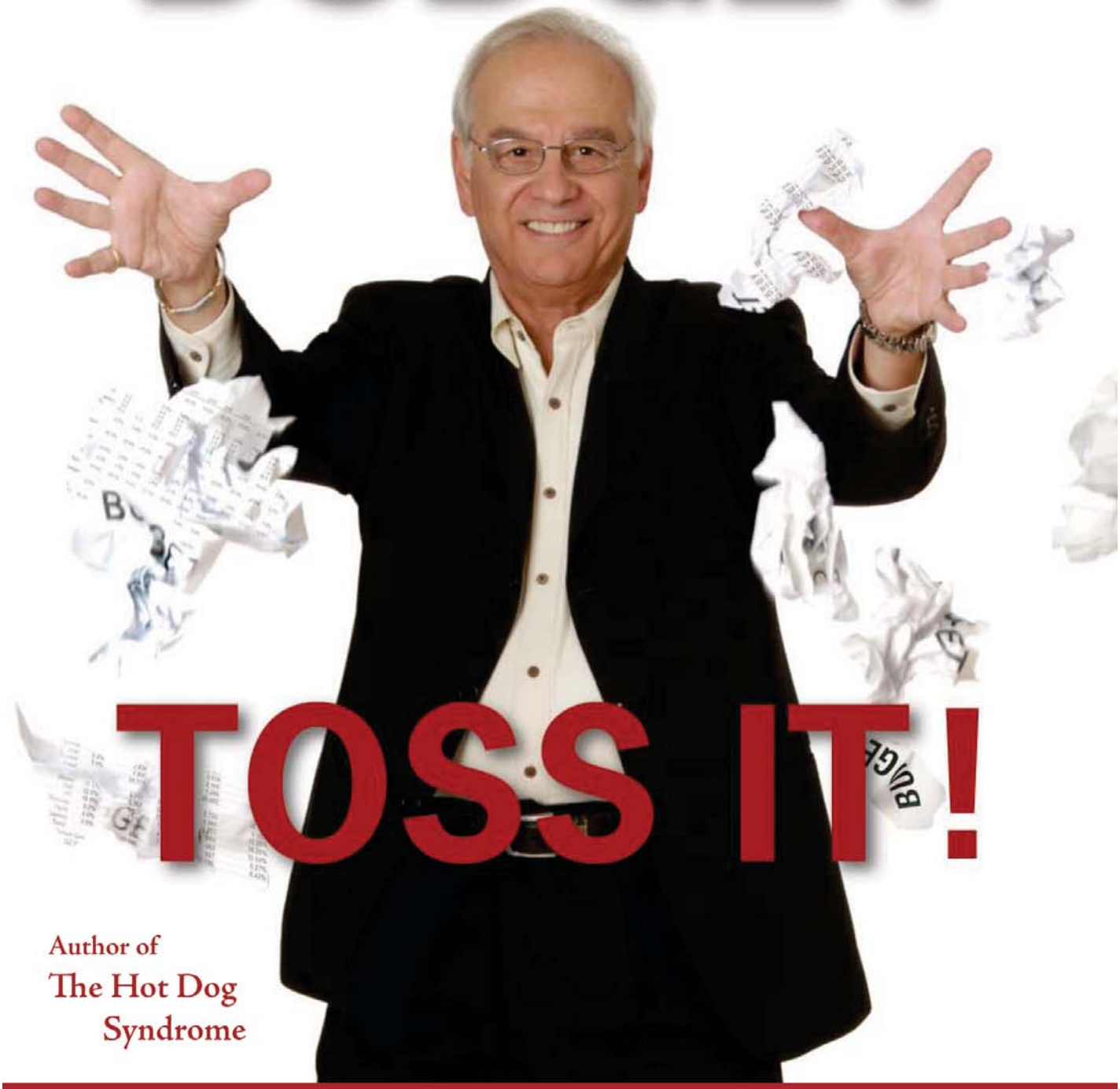
DON'T BUST THE BUDGET



TOSS IT!

Author of
The Hot Dog
Syndrome

How to Increase Profits and Cash Flow by Predicting Your Financial Future

HARVEY A. GOLDSTEIN, CPA

DON'T BUST THE BUDGET, TOSS IT!

How to Increase Profits and Cash Flow
While Predicting Your Financial Future

By
HARVEY A. GOLDSTEIN, CPA

DON'T BUST THE BUDGET, TOSS IT!

ISBN 0976757591

Printed in the United States of America by Lightning Source, Inc.

Published by The All Cities Library
18543 Devonshire Street #167
Northridge, CA 91324
www.allcities.org
www.upyourcashflow.com

First Printing

Published in the United States, Canada and the United Kingdom

Address all queries
c/o Eisenberg Media Group, Inc.
18543 Devonshire St. #167
Northridge, CA 91324

ABOUT THE AUTHOR

HARVEY A. GOLDSTEIN is a Certified Public Accountant and managing partner of the Southern California CPA firm of Singer, Lewak, Greenbaum & Goldstein. He has been actively engaged in the practice of public accounting for more than forty years.

Because of his unparalleled commitment to the small business community, Mr. Goldstein was appointed to President Reagan's National Productivity Advisory Committee, and appointed by the Governor of California to serve on California's Small Business Development Board.

Mr. Goldstein has regularly appeared as a guest specialist on local and national radio and television, offering business advice, legislative updates, and tax tips. He speaks to many business groups as well as publishing several articles every year.

It is this dedication that has led prestigious publications like *The Wall Street Journal, The Washington Post,* the *Los Angeles Times* and *Forbes Magazine* to select Mr. Goldstein to be the subject of several articles. He has been labeled "a crusader for small business," "a man possessed," and "America's small business ally."

Mr. Goldstein's philosophy of business (and life) is best exemplified by a small plaque adorning a corner of his desk in his West Los Angeles office. It reads, "Good Things Come to Those Who Wait—But Only Those Things Left By Those Who Hustle."

ATTENTION READERS

Author Harvey A. Goldstein has developed a software program called *Up Your Cash Flow XT2* that executes the concepts outlined in this book. It is an easy-to-use, menu-driven program that produces a complete business cash flow plan based on the concepts in this book. There are no formulas to develop or models to build.

Mr. Goldstein is available to address your group through speaking engagements and seminars regarding the concepts outlined in this book.

For additional information about the software or speaking engagements, please call 1-800-873-7789.

DEDICATION

To Rochelle, Caryn, Todd, Cindy, Jeff,
Jacob, Spencer, Brooke, Justin, and Jordon
I love you all.

ACKNOWLEDGMENTS

The ideas in this book are a result of the experiences I have had during many years in public accounting practice. I would like to acknowledge the many clients I have counseled over the years. I have learned everything I know about the techniques and strategies in this book from them.

Thank you all.

DON'T BUST THE BUDGET, TOSS IT!

CONTENTS

PREFACE

AS A PRACTICING ACCOUNTANT AND MANAGER of a successful accounting firm, I have advised entrepreneurial businesses for more than forty years. In that time, I have seen many entrepreneurial companies fail, and others thrive.

There are two major reasons for the failure of entrepreneurial businesses: poor company management and the lack of sufficient financial resources.

I believe, as one who has spent so many years in the field of helping entrepreneurs, that it is incumbent upon me to share the experiences I have had and to lend my expertise to help solve these problems.

I have attempted to do this in two ways. First, I have written this book, which addresses the problems of company management. The pages herein consist of techniques and strategies that will greatly enhance the management capabilities of owners and managers.

These techniques will result in greater productivity, the ability to understand the results of your company's activity and, most importantly, a marked increase in your company's profits and cash flow...

Second, I have spent a substantial portion of my personal time speaking to business groups and writing a number of books on the subject. As a natural progression, I have developed a software program to assist entrepreneurs and their management team to develop a sound financial plan.

By writing this book I hope I will have contributed toward the success of your business, and have helped to strengthen the entrepreneurial business community which is so vital to our country.

1

WHOSE BUSINESS IS IT, ANYWAY?

ERNIE HOUSEMAN, Tom Winters, and I were having a meeting to discuss Ernie's frustrations as CEO of their company.

"We've got serious problems and I don't know what to do," Ernie began.

Their company had been undergoing rapid growth, the cash flow was substantial, and Ernie and Tom were comfortably affluent. Ernie's complaint had sounded familiar. I nodded for him to continue.

"The employees, they're driving us nuts," he said. "Tom and I have been partners for ten years. I'm president, he's vice president, and we're trapped by details."

Ernie popped out of his chair and began to shout. "We're making $300,000 a piece and we don't know what the hell our functions are. We're lost." He points to his partner. "*He's* off teaching managers how to sell products and I'm solving every damn problem that comes along. We're expanding rapidly, but we're losing control. The larger we get, the less either one of us knows what's going on, and there are some days when I'm so swamped in details that I don't have time to go to the john."

By now, Ernie was standing in front of me, hands on his hips and glaring at me. Tom was nodding his head in silent, pained agreement.

Peering over the top of my glasses I said, "I assume you are waiting for me to say something." Without waiting for an answer, I continued. "Here it is. I want to find out how each of you spends your time. For the next two weeks, I want you both to write down everything you do, from the minute you get in to the moment you leave. Be as specific as you can. We'll meet in two weeks and review your lists. From the symptoms you discussed, I'd say you can count on some surprises."

Ernie and Tom resisted, but I was able to convince them to proceed.

Two weeks later, we met and the partners handed me their detailed lists of activities. My suspicions were confirmed. I told them, "You are paying about $210,000 a year for clerical and secretarial services."

"What are you talking about?" Ernie quipped.

I explained that 70 percent of the work performed by each of them, at their own admission, was really the work of an executive secretary or clerk. The partners were each making $300,000 a year, and 70 percent of the work they performed could have been handled by a $50,000-a-year assistant. Ernie and Tom had become the company's clerks.

BEING BUSY MAKES YOU FEEL GOOD

Ernie and Tom's dilemma is not unusual. The owners or managers of many entrepreneurial companies often unwittingly become company clerks. This happens because there is a level of security when the owner-manager is *busy*. Being *busy* feels good and it tends to satisfy ones' need to do things.

We are all schooled in the concept. If we are not pushing, pulling, preparing or being involved in some paperwork, we are not working. To prevent the guilt created by not working we tend to attract lots and lots of details. Eventually, every problem within the company must cross our desk. We become the company clerk.

The basic function of the owner-manager of an entrepreneurial

company is difficult to understand. Usually, most owners are highly skilled in a particular field. They tend to work for a company in a specialized area, watch *incompetent* bosses prosper, and then decide, *Hell, I can do better than they can.* They eventually leave the company and they're out on their own.

We've seen it countless times: the machinist who starts a machine shop, the pharmacist who opens a drug store, the computer programmer who opens a consulting business, the carpenter who becomes a contractor, and the garment salesman who becomes a manufacturer. Some of these entrepreneurs become successful but the majority does not. According to statistics, almost 70 percent of entrepreneurial businesses do not last more than five years.

The managerial skills of the owners and managers are the most important factors in the success or failure of a business. In the investment community there is an old adage: *Invest in a C idea with A people rather then an A idea with C people.* In other words, *management* is vitally important.

When people go into business, they have a good knowledge of the product or service they provide but little knowledge of managing people, marketing, finance, accounting, inventory controls, and a host of other areas needed to make proper business decisions. Most have little knowledge of the proper functions *they* must perform within their organization as managers.

Ernie and Tom were good examples of this. They were making great money, but they were crying for help. Their frustration with the details of the business became a nightmarish burden. They found themselves wanting to know what to do before they went crazy.

LEADERSHIP—THE CHARACTERISTICS—DO WE CARE?

The owner-manager of an entrepreneurial company is the company's leader. To most owner-managers, leadership is an abstract concept, one

not easy to understand.

We've all heard people refer to someone as a good *leader*. But when asked to explain what that means, it usually boils down to: *They seem to get the job done.*

Okay, so leaders get the job done. Of course, the next obvious question is: *What exactly is the job they get done*? Looking at the literature we find countless books written about the great leaders of corporate America. Most of the information quantifies the innate characteristics of these great business leaders.

Here are those characteristics:

Successful Leaders Like What They Do: Is it possible to be successful if you don't like what you do? Yes, I've seen it happen, but the general rule is that the love of what one does breeds the greatest success.

Successful Leaders Have a Desire for Wealth: Wealth may not be the strongest motivation for success, but it sure does help. Many successful leaders find the love of what they do more of a motivating factor than the promise of wealth. The ideal situation is obviously loving what you do and making money at it.

Successful Leaders Are Curious: They always look for better ways to do things. They are curious about the future. They have very inquisitive minds.

Successful Leaders Have Courage: They have the courage to take reasonable risks. This may be the one area that separates the entrepreneur from all else. They are risk takers. Most people are not.

Successful Leaders Are Persistent: They tirelessly try to improve their business and themselves. They want to be the best at what they do. They persevere in their desire to solve problems. They rarely give up.

Successful Leaders Have the Ability to Motivate: They motivate employees to be more productive, bankers to lend more money, and

customers to return. Effective leaders are focused on human values.

Successful Leaders Have the Ability to Persuade: They have great communication skills.

Successful Leaders Have a Strong Ego: Ego satisfaction can be the strongest motivation for success. Many of the most successful business people are driven by powerful egos.

How many of these eight characteristics do you possess? Can you be a successful leader if you only have two or three of the traits mentioned? What if you don't have any? If you're lucky enough to have all eight, does that guarantee success?

We, the leaders of our businesses, cannot run our companies on the theoretical notions of what leadership characteristics we *should* have. It doesn't matter. We are the leaders, like it or not. We are the people who must make things happen. We must *get the job done*.

WE ARE THE RULE, NOT THE EXCEPTION

There are more than fifteen million active businesses existing in the U.S. today. If each owner-manager possessed all the qualities outlined for successful leadership, we would indeed be a fortunate nation. We would be a nation with a cadre of highly effective leaders. Unfortunately, we're not.

A number of years ago writing in *U.S. News and World Report,* Warren Bennis, then a Professor of Management at the University of Southern California, indicated effective leadership is the exception, not the rule. He indicated that it is possible to increase the number of people with leadership qualities, but they will always be the exception to the rule. He said, "Individuals need some flair and talent to begin with, but we can help them improve."

Some of us may have the innate flair and talent of good leadership but

most of us do not. We are people who have somehow become owners of entrepreneurial companies. Our profits will not be huge and we won't be the subject of magazine articles. Our view of our company will not be based on some grandiose social purpose to aid humankind and we will never think of ourselves as leaders within the community. We will fight and struggle to maintain our capital. We will curse the government every time our taxes are raised and suffer the pain of a jumping prime rate.

THE SEARCH

One day we will look around us, shake our heads, and reflect: *Times have changed. Employees are different. They don't seem to want to work as hard as we did. They tell us inflation is down yet expenses are up. Competition is tougher. How the hell can they sell their product at that price? Details are maddening. Accountants, lawyers, and bankers are driving me crazy. This place needs help. What do I do?*

GETTING THE JOB DONE

In the pages that follow, I am going to outline specific steps that get right to the heart of the matter. *Getting the job done*. These steps begin with some key assumptions.

Step 1: We must always strive for greater profitability. We must develop a system that allows us to foresee and predict our own financial future. If we want to make a profit we must plan for it.

Step 2: We must develop a system that allows us to monitor the key financial elements of our companies and we must come to understand what financial numbers really mean.

Step 3: We must learn how to delegate authority and how to train people to perform vital tasks within the organization. We must realize that the school systems are not developing the talent we so badly need. When we get new people they will need training to make them better at what

they do. We must protect our most valuable asset—our employees.

Step 4: Stop sweeping the floor. Stop running the lathe. Stop filling the prescription. Stop attracting all the details and micro-managing.

As far as I'm concerned, the most powerful key assumption of all of this is: We will take the time necessary to build a better business.

We must get the job done. Let us begin.

EVERYTHING BECOMES FINANCIAL

Every day huge amounts of activity take place within your company: invoices are written, orders taken, receivables collected, bills paid, bills incurred, loans are made or paid, inventory grows or shrinks, services are rendered, deposits made, production increases, production decreases, costs rise and occasionally fall, equipment is bought and sold, sales increase, sales decrease. People here, people there, activity everywhere. All this activity ultimately becomes financial. And the only place you can see the results of this activity is on financial statements, a.k.a. *the company score card.*

2

HOW TO IDENTIFY AND MONITOR THE KEY FINANCIAL ELEMENTS OF YOUR COMPANY

DURING MY PROFESSIONAL CAREER I have seen companies in various industries—some with considerable sales volume—operating with systems that failed to provide their owners or managers enough financial data to make effective business decisions.

Some responsible small business studies have demonstrated that a lack of adequate recordkeeping and financial management is a major cause of business failure. With the software that is available today poor record keeping should never occur. Nevertheless, I have seen and continue to see entrepreneurs show little or no regard for the financial information necessary to manage their companies.

I have heard accountants referred to as a *necessary evil*—necessary only to help solve potential tax problems. I have seen people sell products without knowing what their costs are, and I've seen people bid on jobs not based on whether they can make a profit for their company, but on the basis of what their competition is selling it for.

I have often wondered why these attitudes and practices are so prevalent. I have concluded that many business owners simply disliked math in school and they shied away from anything that had to do with numbers. These behaviors started at a very young age and continue to this day.

In addition, owners and managers of entrepreneurial companies find themselves in the position of leadership by accident rather than by design. They often lack the necessary knowledge and/or training to understand and utilize financial data.

WHAT ARE FINANCIAL STATEMENTS FOR?

Over the last several years I have trained accountants and entrepreneurs in various aspects of business financial planning. My favorite question that I love to ask my audience is…*What are financial statements for*?

I get the following answers from entrepreneurs and even accountants:

To secure a bank loan.
To complete a tax return.
To impress investors.

After they tell me those three items…there is usually silence.

The purpose of a financial statement is to help the business make a profit. It is so rare that I hear that answer. Why is it that financial statement data is rarely viewed as a tool for making a profit?

The answer? Most entrepreneurs and accountants don't know how to use financial statements to help them make a profit. They use them for the three reasons indicated above,

Yet, as the owner-manager of your company, you are responsible for monitoring, managing, and evaluating the results of all that activity. The buck stops with you.

WHAT'S THE BOTTOM LINE?

Does any of the following sound familiar?

It was 9:00 a.m. on Thursday the 28th. The lights in our conference room beamed a warm glow over the table. Across the table from me was John Sloan. I handed John a copy of his quarterly report. His first words came quickly: "What's the bottom line?"

"A small profit," I reported.

"How much tax will I have to pay?"

"At this rate, not much," I answered.

"Good," John snapped back.

Today was going to be quite a day. Four meetings were scheduled, and all of them were for reviewing financial statements.

At 10:30 a.m., I met with Ron Agnew, the owner of a small design company. Ron's opening words were, "How did we do tax-wise?"

Three hours later, I met with Sharon Samuelson, who had just started in business the previous year. A tall, rather slender woman, impeccably dressed, Sharon has great taste in clothes. Her taste has made her boutique quite successful.

When I handed Sharon her annual report, she looked at it and said, "Could you help me interpret this?"

I smiled and proceeded to walk Sharon through the accounting data. She was a good student, but it was going to take more than one session to teach her how to use the information I had presented.

My last meeting of the day was with Eric Brown. His partner, Joe Scott, managed to take their company for an extra $250,000. When Joe left the company, all financial decisions fell to Eric. He was a fast learner. I presented him with his year-end report, but before he opened it, he fired a barrage of questions.

"What's the bottom line? Will my banker be happy? How much tax do

I have to pay? What I want is large profits to show the bank and no profits to show Uncle Sam!"

Yes, Eric had learned fast. He knew the creed well. "Large profits for the bank, no profits for the Feds!"

Sounds familiar, doesn't it? The meetings were typical—management not schooled in financial matters, always in a hurry, never taking the time to digest the results of operations, and only interested in the *bottom line*.

Yet, today's economic conditions demand that management of all companies, large or small, learn as much as possible about using and understanding financial accounting. Not too many years ago, we could solve our financial problems by passing on price increases to our customers. That was accepted as part of the times. Inflation helped hide mistakes.

Today, however, inflation is gone, competition is tougher than ever, business is more complex, and money is harder to come by. It is far more important to master the skills necessary to keep our business alive. We must run our business in a businesslike manner.

WHERE DO WE BEGIN?

First, we must learn to understand financial accounting. There are three ways to go about this:

Review the sample financial statement in this book and follow the step-by-step comments.

Enroll in an accounting course for owners and managers of small businesses offered at your local university or college. This is the most time-consuming and will take some real dedication on your part.

The third method is the easiest and the least time consuming. Every time financial statements are prepared, have your accountant explain them

in detail.

Begin with this simple question, "Now that you've prepared this data, how is the information going to help me and my business?" At this point, they will either panic because they don't understand the statements, or they will proceed to explain their meaning.

Don't be embarrassed. If you don't understand, ask questions; let your accountant know you don't understand. They are schooled and trained in the meaning of financial statements; you're not! So don't be embarrassed to ask questions. If they're good, they will take the time to explain the statements in a manner you can understand. If they can't explain them in a meaningful manner, seek help from someone who can.

HOW OFTEN?

Every business owner should *review* his or her financial accounting once each month. This data should be compared to your forecast (yes, I said *forecast*, not *budget*; more later) on a line-by-line basis. If there is a problem getting the data monthly, get it done at least quarterly.

In every case where I have seen a business person receiving monthly statements, the first comment has always been the same: "I don't know how I operated in the past without this information."

I've heard that time and time again.

Do not have an outside accounting firm prepare monthly statements; it is too expensive. Have your accountants train your bookkeeping personnel on how to prepare the company financial statements. With the bookkeeping software available today, getting regular financial statements is a piece of cake.

Let your accountants confine their activity to a cursory review *after* the bookkeeper has completed the major portion of the work. This should reduce professional fees substantially and provide you with much-needed

data.

If you do not have bookkeeping personnel, have your accountants recommend a competent freelance bookkeeper. This service is considerably less expensive than using professional accountants to do your bookkeeping.

Remember, you are trying to develop a system to provide financial data regularly and to develop your skills to interpret this data.

Understanding financial statements is not enough. You must have a management information system that monitors financial statements, cash balances, future cash needs, accounts receivable, and inventories.

CASH IS KING, ALWAYS HAS BEEN AND ALWAYS WILL BE

Not too long ago, I met Bill Hall and Frieda Gunter. Bill started in the glass business many years ago. At that time, Frieda was his bookkeeper. Today, Frieda earns about $250,000 per year and owns 25 percent of the company. Overpaid? Yes.

Our first meeting went something like this: I entered the reception area of their business and waited for about five minutes. A young lady asked me to follow her. We proceeded to walk through a maze of hallways, making turns, entering offices, then returning to more hallways and more offices. We finally ended our journey in a conference room.

There sat Bill and Frieda, both in their mid-fifties. Bill had a dark complexion, was gray at the temples, and was a little on the pudgy side. Frieda was also in her mid-fifties, but looked close to sixty-five. We started our conversation with small talk and ultimately got around to the financial condition of their glass company. The company was a highly successful business generating large profits and very large amounts of cash. A cash cow!

Bill and Frieda's banker had referred us to them. "What a fine

gentleman Dave Reese [the banker] is," commented Frieda. "He takes us out to lunch at least once every other month and pays."

"What balances do you maintain in your accounts?" was my first question.

"We keep about eight hundred in the checking account at all times."

"How do you manage to keep such a small float in the account?" I was obviously impressed with their cash management.

Frieda quickly corrected me. "Eight hundred thousand."

"Eight hundred thousand dollars in your checking account?" I quickly asked.

"Yes," Frieda beamed.

After I regained my composure, I managed to squeak out an "oh" without being too emotional. I clearly understood why the banker took them to lunch so often and paid. He was a real sport. The bank was making a small fortune on their balances.

"Frieda, do you know you could be earning an extra $40,000 to $50,000 per year on your money if you moved it to some kind of money market instrument?" I asked. She smiled but said nothing.

Ultimately, they became clients of our firm. The first thing we did was to fill out the forms for a money market account. It took Frieda almost six weeks to sign them and transfer the funds.

I was annoyed not only with Frieda's attitude, throwing away $40,000 to $50,000 per year, but I was also angry with her banker who was doing absolutely nothing to help his customer.

Why they never changed to another bank is beyond me. Incidentally, Frieda left the company when Bill concluded that $250,000 a year was too much to pay for a bookkeeper.

CASH COSTS MONEY!

Cash is one of the most expensive commodities we use in running our businesses. Think about it for a moment. In many businesses, other than cost of sales—and hopefully your salary—the cost of cash (interest) is one of the largest expense items a company has.

MAKE YOUR CHECKING ACCOUNT OBSOLETE

Try to deposit all daily receipts directly to a money market account rather than into your checking account. Transfer funds from the money market account to a checking account only when you anticipate writing checks. Confine check writing to once or twice per month to allow the float in the money market account to build and earn additional interest.

Don't get caught up by the notion that your banker will treat you better if you keep high balances in a checking account. He may like you better, but you should earn as much as you can on your money. Today, the banking business is far more competitive than it's ever been. If you are a good customer of your bank, you can have a lot of influence with your banker. But always keep another bank in reserve, just in case.

REDUCE THE RENT ON YOUR CASH

Sounds silly doesn't it? Yet, we do rent money. Therefore, our goal should be to reduce the rent.

The banking industry is extremely competitive, which means more favorable credit terms. Ask your accountant to help you select a bank and banker. Accountants and bankers have mutual referral networks which can be of value to you.

BANKERS HAVE PROBLEMS TOO!

Jane Cole started our phone conversation with an angry comment.

"The financial statement you sent us was wrong."

"Jane, we never sent you a financial statement, and we haven't even done any work on your account," I responded.

"Well, I sent what you gave me to the bank, and we got our loan, but the statement was wrong," Jane claimed.

"I don't know what you sent, but it obviously worked. Why don't you get a copy of the statement and read it to me, and let's see if I can figure out what you did?" I said.

Ten minutes later Jane called back.

"The name of the company is XYZ, Inc., and all the dates have 19XX" she said.

"Jane, you sent the bank a sample promotional statement we provide new clients. It is meaningless. It's a nonexistent company. The bank gave you money off of a sample financial statement? Wow! It doesn't say a lot about your banker." We both laughed.

If you're not bankable and using a lender other than a bank, you're more than likely paying interest in excess of what a bank would charge. I refer to these lenders as second-level financing companies. They usually base their loans on underlying collateral you've supplied as security for the loan, and they charge handsomely for the money. They are referred to as asset based lenders.

Your goal is to improve the financial position of *your* company, not theirs. You need to become bankable as quickly as possible. To do this, you have to become more profitable, improve your cash flow, and operate your business in a businesslike manner.

GET MORE MONEY BY BEING PREPARED

Here are some tips on how to be prepared:

- Have your accountant introduce you to a banker. He/she will have access to high levels in the bank that you might not otherwise have. Don't just walk in off the street.

- Bring current financial statements consisting of a balance sheet, a profit and loss statement, a statement of cash flow, and footnote disclosures. The bank may require these statements to be *reviewed* or *audited* by a CPA.

- Bankers will want to review your history, so be prepared to present two or three years' prior financial statements and/or tax returns.

- Generally, you will personally guarantee the business loan, so have your personal financial statements and tax returns available.

- Bring financial forecasts. This will consist of forecasted profit and loss and cash-flow statements for at least one year in advance. It will also show the banker that you are sophisticated in your management approach.

- Provide a breakdown of what you're going to use the money for.

- Prepare a packet of additional information, which might consist of brochures, sales literature, contracts, history of the company, publicity, research projects, etc. Gather all the propaganda you can muster to show the banker that you are someone they *must* do business with.

- Watch your appearance. First impressions are lasting.

IT'S 10:00 P.M.

Do you know where your cash is? If it's not in your pocket, it's more than likely in accounts receivable (amounts people owe you) and/or inventory—two items that sop up your cash like a slice of rye in a bowl of chicken soup.

THEY JUST GET LARGER AND LARGER

Do you remember the old joke about "The Three Famous Lies"? One of the lies was: *The check is in the mail.*

Now when you call a customer for payment they never say the check is in the mail. They say, "The check is being cut, but first we need a copy of the invoice. We seem to have misplaced it."

Does that sound familiar? (You wouldn't be doing that now by any chance, would you?) They have just borrowed your money for twenty-five additional days, interest-free. Five days to send the invoice copy, five days in their accounting department for approval, five days for *cutting the check*, five days for signature, then five more days back in the mail.

Always send invoices by e-mail. The mail should be obsolete.

Accounts receivable is probably the fastest growing asset in your company. The balance just seems to get larger and larger and larger. Remember, cash is king, and we have to get our hands on as much as possible. Therefore, monitoring and collecting accounts receivable is one of our most important functions.

BE SYSTEMATIC IN YOUR APPROACH TO COLLECTIONS

Here are some tips on speeding up the collection of your accounts receivable.

- Sit down with your bookkeeper or collector every two weeks and review a listing of the accounts receivable.
- Call delinquent customers immediately.
- Have nasty letters sent to slow pays. Three is sufficient, and they should generally follow this order: The first letter should ask for payment and give approximately twenty days for results. The

second letter, which is sent out after the twenty days, should be a threat to turn the matter over to your attorney for collection. Give them about ten more days. The third letter, which goes out after the ten days, should say the account is going to be turned over for collection within forty-eight hours. If you don't get any results within the forty-eight hours, turn it over for collection.

- These letters should be computerized. If you send a letter to a long-time customer and he calls and says, "Listen you S.O.B., I've been dealing with you for years and now you send me one of those letters! I'm P.O.ed!" Your quick response should be, "Oh my god, our computer screwed up! It's a computer error! I'm so sorry." Then gently ask for payment.

- Monitor the total receivable balances daily.

- When you are instructing someone in your organization on the procedures for collecting the accounts receivable, be specific; give names and phone numbers to call and amounts you'd like to see collected.

- Charge interest or service charges on old balances. If you can't get paid in full, ask for partial payment.

- If you are not being paid regularly, your invoice may be going through the bookkeeping department with little concern on their part to pay the bill. Send a copy of the invoice to your contact at the company with a note to "please take care of this." You may get faster results. Often times your contact may not realize your bill is not being paid.

- After your credit manager, bookkeeper or collector has called several times, the debtor knows exactly why they are calling and will ignore the call. Have the bookkeeper leave a new name; *Bridget* is a good one. There isn't a businessman alive who would not return a call from a *Bridget*. For those of you who are dealing with women customers, *Lance* might suffice. But if *Bridget* calls

you, watch out! She may be dunning you.

- Here is a familiar scenario: You instruct your bookkeeper to call on all accounts past due. She starts at the top of the list at the letter A, gets interrupted, starts over at A. She gets interrupted again, and starts back at A. Another interruption and back to, you guessed it, A. Once in awhile have the bookkeeper work up the list starting with Z.

- Put past due accounts on a cash-and-carry basis.

- Check your customer's current financial condition. They may be having worse problems than you.

- Bug the hell out of them.

- If all else fails, sue.

By monitoring your accounts receivable daily and becoming tough with the debtor, additional cash will be squeezed out of those accounts receivable balances. Cash is king.

THE FANTASY ASSET

I like to refer to inventory as the *fantasy asset*. More games are played and guesses are made on the value shown as inventory on financial statements than any other item in the statement. This occurs so often that many times management loses sight of the importance of proper control and evaluation of inventory—the single most important asset in determining company profitability. Yet the fantasy goes on. Need more profit? Up the inventory. Pay lower taxes? Lower the inventory. Take an inventory? Too much trouble. Price it right? Too much detail. What's the inventory? Nobody knows. *Plug in a number*, so the saying goes.

If you use an incorrect inventory for your financial statement, your profit or loss statement will be incorrect by the exact same amount. It's a

dollar-for-dollar ratio. Yet guesses are made, and the fantasy goes on and on and on.

A RULE TO REMEMBER

The profit and loss statement is absolutely worthless unless an accurately counted and priced (valued) inventory is used in the financial statements. You'll never know the true profit if the fantasy prevails; you're only fooling yourself.

FANTASY STORIES

Dave, Glenda, and Al sat quietly as I handed them their company's year-end statement. They were running a family business that was growing by leaps and bounds. Cash balances were running lower than their expectations, and they were concerned as to whether or not they were making a profit.

Dave began, "Are we on the right track? Are we making a profit?"

"Dave, I must be frank with you. The statement shows a profit, but as you know, much of the inventory was what you called an 'educated guess.' If the number you gave us is right, then yes, there is a profit. However, there are no cost records of your work-in-process inventory and no material and labor costs for work completed. So, to answer your question directly, I don't know. What you need is a cost system that will tell you the material, labor, and overhead on each job and reflect accurate inventory value. This is a must for your business."

Dave responded quickly, "Maybe later."

Jim Williams is a man in his late fifties. He and his son were running a company that manufactured toilets.

"Jim what does it cost you to manufacture a toilet?" I asked.

"I don't know" was his response.

"How do you know what to sell it for?" I asked.

"We've been selling it at that price for years" was his last comment.

Bill Bennett and his partner Harold Mahler thought they were very clever. They got into the business of manufacturing wood household products: items such as breadboxes, saltshakers, canisters, etc. Sales were almost $12 million. You may have purchased one yourself; their products were well made, and they were everywhere.

One day in a meeting we were discussing the financial statement of the company. I urged them to hire a controller. Harold's father, Sam, was doing the books, and he was incompetent. You couldn't rely on any of his numbers.

I also was bugging them to get a cost accounting system installed to ascertain proper inventory and product costs. They were manufacturing a multitude of different products, but there wasn't one piece of paper available to indicate what *this* product cost.

"Harold, you've got to get rid of Sam and bring in a controller and a cost accountant. The business is growing; you can no longer operate as a *mom and pop* organization."

"I know, but how can I fire my Dad?" Harold asked.

"That's a tough one, but you need a better controller," I said.

"Maybe later," was Harold's cool reply. "By the way, I've installed a cost accounting system."

"Huh? When did you do that?"

"Not too long ago. We measure the trash in the barrels."

"What?"

"Every night we go to the waste bins and measure our scrap lumber. This gives us a method of measuring costs. Too much scrap, too much cost."

Needless to say, I was amazed. I had never heard of such a thing.

Steve Jenkins was great with the fantasy asset. His company was losing its shirt, yet the financial statements indicated a profit. He was in the underwear business. Obviously, the company was losing its undershirt.

Anyway…after he left the company, we found out the games he was playing. At the end of every year he would change his computer to up the value of his inventory so that he would show a profit.

Eventually, Steve sold out to one of his employees. This has always puzzled me. The employees knew what Steve was doing, yet bought the business based on this fantasy inventory and phony financial statements.

Steve was last heard from somewhere in Arizona. The company, after forty-two years in business, went into bankruptcy. It was one of the oldest private companies in California.

By the way, Jim Williams' toilet business died a slow death. Dave Marcus' company is installing a cost system and doing well, and Harold fired his father just prior to a major creditor closing them down.

THERE ARE NO EASY SOLUTIONS

Inventory control is the most difficult area in running a business, yet also the most vital. There are no easy solutions to inventory control, but I do have some practical suggestions:

- Use perpetual inventory records for the large dollar amounts of

inventory. You don't have to maintain records on the entire inventory. Usually, 20 percent of the inventory items accounts for 80 percent of the dollars. Maintain records on 20 percent of the items that account for the 80 percent of the dollars, and not on the 80 percent of the items that account for 20 percent of the dollars.

- Take physical inventories regularly, and compare the physical inventory with your perpetual records to test the perpetual records for accuracy.

- If taking a physical inventory is a large task, take counts on a cycle system. This may mean counting a fourth of the inventory every three months or a sixth every two months.

- The small and low value items should not be included in your routine inventory counts. Count them once or twice a year; use your judgment.

- If the physical inventories and the perpetual inventory are in agreement, the perpetual inventories can be used for financial accounting.

- All differences between the physical inventory and the perpetual inventory should be reconciled.

- As soon as an item in inventory appears to be slow moving, reduce the price and get rid of it. This will keep your inventory fresh at all times.

- If you manufacture a product, a cost accounting system that determines the cost of your product should be developed. This will aid in the determination of the price your product will be sold for.

- Sell your product by calculating the sales price in the following manner:

Material cost	_____
Labor cost	_____
Factory overhead	_____
Selling costs	_____
Administrative costs	_____
Profit	_____
Total sales price	_____

- Don't be foolish when working with your inventory in determining costs and/or systems. If you are in doubt about what you are doing, seek professional advice.

- If you are in the construction business, whether you're building buildings or painting walls, develop job-cost accounting. This will allow you to keep track of materials and labor on all jobs, and it will be of great assistance in determining productivity, bidding procedures, and pinning down where you've made mistakes.

- Adopt and maintain written policies and procedures to implement all inventory procedures.

- Review inventory reports and procedures regularly.

- Stop fantasizing.

TAKE AN ACCURATE INVENTORY

Good housekeeping is an important factor in taking a physical inventory. Your inventory can be taken more quickly and more accurately if you begin with the following steps:

- Move identical goods to the same location.

- Place inventory in order.

- Make all items readily identifiable.
- Clear aisles and passageways.
- Segregate scrap and worthless items.

If your business is a manufacturing entity, schedule production so that work-in-process is kept to a minimum. This will reduce the time and effort required to count and price those items.

INVENTORY INSTRUCTIONS

Management should prepare detailed instructions for taking the inventory. These instructions should include cut-off procedures for shipping and receiving departments, complete procedures for counting the inventory, and the name of the individual to contact if there are questions.

All participants should attend a meeting to review the instructions.

ESTABLISHING THE CUT-OFF

A proper cut-off involves identifying the arrival and shipment dates of your inventory. This is essential, because it defines the items to be included in your inventory. Under ideal circumstances, all activities in the shipping and receiving departments would be stopped; however, many times this is not possible.

Goods received after the cut-off date should be physically segregated and counted separately. The receiving documents should indicate the date the shipment was received. This will facilitate the accounting of the related invoices. If the items are shipped during the inventory, the shipment date should be noted on the shipping records. This will identify the last invoices to be included in the current accounting period.

COUNTING THE INVENTORY

Thorough planning will help eliminate problems that can occur in counting inventory. Your planning should cover topics such as inventory counting teams, the layout of the warehouse, pre-numbered inventory count tags, and supervision.

- The counting teams should consist of two individuals: one as a counter and the other as a recorder. These individuals should be familiar with the items to be counted but, if possible, should not be employees who work in the warehouse. Employees who have regular access to the inventory may be able to hide any mis-appropriation by falsifying counts.

- Each counting team should be assigned an area of the warehouse. Those sections should be easily distinguishable from each other. For example, aisles may be used as boundaries. This will decrease the possibility of inventory being counted twice, thus creating false profits.

- Once the counting teams have been assigned their areas, pre-numbered inventory tags should be distributed to them. When filled in, the tags will contain a description of the item, the quantity of items counted, the units in which they were counted (for example, one dozen each), an identification of the inventory counting team, and test-count information.

- As the tags are issued, the supervisor should maintain a control sheet showing which tags were distributed to which teams. For example, tags 1 through 100 might be given to Counting Team A, and 101 to 150 to Team B.

- All items of inventory should be tagged. After the counts have been made, a tour of the areas to see that all items have been tagged is appropriate. After this is complete, then all tags should be pulled.

- The completed tags will be placed in the inventory areas in boxes

or on shelves. The supervisor will subsequently collect the tags, place them in numerical sequence again, and tabulate the results.

- Unused tags will be returned to the supervisor to ensure all tags have been accounted for. If your inventory tags are not pre-numbered and some are misplaced, your final figures will be inaccurate. Pre-numbering the tags is designed to eliminate that possibility.

- To count large quantities more efficiently, consider the following shortcuts: You can use a scale to determine quantity. For example, if you know that 100 bolts weigh approximately four ounces, you can calculate the total number of bolts by weighing them.

- You can also pre-count portions of the material prior to the formal inventory. In this way, in the weeks preceding the actual inventory, employees can use their *spare time* to count some of the items.

- If pre-counting is used, be sure a pre-count slip is attached to each container, showing the quantity and description of the item, as well as the initials of the employee and the date of the count. The containers should then be sealed. If any of the units are removed from a pre-counted container, it must be indicated on the pre-count slip.

- Adequate supervision is a must. It provides the assurance that all procedures are being followed as prescribed by management. The supervisor can solve problems that arise, such as identifying unusual goods, and should conduct random checks of some of the sections that have been counted.

The secret to a successful inventory is careful planning. These guidelines should make your inventory more accurate and more efficient, and prevent the complications typically associated with this procedure.

3

TOSS THE BUDGET

TO MANY PEOPLE IN BUSINESS, one method for achieving profitability is to establish a company budget to control expenses and limit spending.

To the entrepreneur, the word *budget* is clearly a word financial people use to put controls on the spending habits of company management, usually the owner. As a practicing CPA, I know never to speak to my clients about establishing a company budget. It will produce the greatest amount of lip service and absolutely no results.

Even when entrepreneurial companies prepare the *dreaded* budget, the process is usually for not more than one or two years. The mantra within the company during this two years is, "Don't bust the budget." However, they don't bust the budget; they "kill it." They bust the budget so often that the members of the management team begin to believe it's a useless exercise. Let me make clear that I have one caveat about budgets: Large companies use them effectively to provide financial accountability of lower level management. They work.

Entrepreneurial companies have great flexibility; decision making is usually done at the top, and if top management wants something they get it. No budget in the world will control the entrepreneurial management of small companies.

THE ENTREPRENEUR'S DEFINITION OF A BUDGET

- A method of worrying, in advance, about what you are going to

spend.

- A method of worrying about what you spent after you spent it.
- A method of saying *no* to somebody's request to spend money.
- An orderly system of living below your means.
- A useless exercise to keep the *bean counters* happy.
- A financial process that takes a lot of time and is always wrong.

So, toss the budget. For most entrepreneurial companies it *is* a useless exercise.

I know it's unusual for a CPA to say, "Toss the budget." But Toss It. I have the most powerful alternative to budgeting. And I am not using the word *powerful* lightly. Read on.

EVERYONE WANTS TO TELL YOU WHERE YOU'VE BEEN

How nice it is that everyone wants to tell you where you've been. Think about the amount of money you'll spend on CFO's, controllers, bookkeepers, outside accountants, and a myriad of other advisers who will counsel you on your financial *past*. Yes, they will tell you your sales were up or down. As if you didn't know. They'll also counsel that you spent too much *here* and maybe not enough *there*.

You'll spend thousands of dollars analyzing what you did. What is the major problem with this exercise? You cannot change the past. It's not possible.

How much do you spend to find out what you will do? Does anyone help you see the future? Do you want to know what lies ahead? Do you want to know how long your precious cash resource will last and when it will run out? Do you enjoy the anxiety produced from the fear of not

knowing what is going to happen? Do you sleep well? Has anyone given you an educated read as to your financial future?

3 A.M. AND STARING AT THE CEILING—AN AWFUL NIGHT

A number of years ago I started a software company that developed a specialized program designed to help management forecast future financial activities by predicting profit or loss, and cash flow of their business. The main premise of the program was to provide an understanding of how long cash will last and if a profit will be made. Having this information would provide management sufficient time to secure funds to keep the business running if cash was becoming scarce.

I started my company with about $200,000. I *knew* it would be more than enough to get the company into a profitable position. After several months the burn rate of cash was far beyond my expectations. I was just about out of money. My resources were tapped out. It was a nightmare. What made it worse was I was the managing partner of a very successful CPA firm in Southern California. We had never had a cash flow problem and had never run out of money. Here I was having a new experience…the pain of running out of money. It was awful. The anxiety was beyond anything I had ever felt during my business career. I knew it was just days before my dream was to end.

Have you guessed it yet? I developed a software program designed to predict profit and cash flow, and I hadn't used it for my own business. Here I was a CPA telling people how important it is to predict profitability and cash flow and not following my own advice. Shame, shame on me for not practicing what I have preached for so many years.

I immediately jumped out of bed, threw on some jeans and headed for my laptop. I needed to get a handle on just how long the little cash I had would last. I entered my assumptions, crunched the numbers…and was shocked to discover that the disaster I was sure of was at least three months away. Suddenly, there was no more anxiety; I had some time left to fulfill my dream. Best of all, I had the time to do what was needed to

get the resources and keep the company going.

So now, by my own experience, I discovered sleepless nights are not unusual. In fact, they are all-too-common. Whenever I ask entrepreneurs if they have ever had a cash flow nightmare as I described, I get a resounding *yes*.

LEARNING COMPASSION

The lesson I learned was not only to abide by my own financial philosophy, but to also be more compassionate as it regards the struggle entrepreneurs face while pursuing their dreams.

Every business operating in today's complex world must have a dynamic financial plan. A plan that changes as circumstances change. A plan that will forecast the financial future of the business. A plan that will tell management on a regular basis just how much cash they will need and when they will need it. A plan that will tell you what your company's cash balances will be at the end of every month for the *next* twelve months. A plan that will forecast the economic implications of management's decisions. A plan that tells management what lies ahead.

Do *you* want to sleep at night?

THE MOST POWERFUL TOOL IN THE WORLD…

…is the ability to see and manage the future.

Not too long ago, I was a guest speaker at a business event. I asked the audience my standard question: "There is only one thing in life that you can manage. What is it?"

Silence, as the audience thought for a moment. The answers began:

"Time," one man shouted.

"Money," from another.

"Myself," was the final answer I heard before the room fell silent again.

"Ladies and gentlemen," I began, "The only thing you can manage is the future. Every decision you will ever make will only impact the future. We spend so much time and so many resources looking at the past, yet we live for the future. The more we know about the future the more effective we can be at managing it."

Knowing what the future holds is powerful. And it is yours for the asking.

4

HOW TO FORESEE AND PREDICT YOUR FINANCIAL FUTURE

IT WAS 2004. The economy was booming, and so was Joel Riordan's manufacturing business. With his company's volume at an all time high, Joel was traveling around the country, hustling to get the volume even higher.

In June of that year, Joel, an associate of mine, and I were sitting in our conference room reviewing the financial statements of Joel's company. My associate and I were noting a trend. Sales were strong, but profits weren't where they should be. Expenses were increasing far too rapidly. "Joel, what's going on?" I asked. "Every expense category on your financial statement is growing out of proportion, and we're concerned."

"Accountants," Joel responded. "Our volume is greater than ever, we're on an upswing, and you worry. Too high a profit means too much tax to pay. I'm enjoying myself."

During the year things turned sour for Joel. His volume declined steadily. Six months later we met again.

"Joel, you've got to cut the fat out of the company," I warned. "You've shown a loss for the last two quarters and your expenses are too high. Let's put together a P&L and cash flow forecast. Let's see what your

future cash requirement will be, as we need to figure out how long your cash will last. I'm afraid trouble may be just ahead."

Joel responded in his typical manner: "What I need are better sales reps and a better general manager to help me run the company."

"What you really need," I insisted, "is to get expenses under control, cut down on some travel, stay home, manage the company, and have some realistic P&L and cash flow forecasts so we can anticipate what lies ahead before it's too late."

I thought to myself, *Most companies start forecasting what's going to happen when it is too late. When things start to hit the fan they get religion. We are about to have another living example.*

Joel's sales continued to decline, and although he managed to survive another year his company took its final breath in 2006. Joel could have saved his company and made a good living, but he had spent himself into so much debt when things were good that he couldn't continue when conditions changed.

Joel was not an isolated case. His *knock-the-world-dead-with-volume* and *spend, spend, spend* philosophy is practiced far too often.

I once asked Joel if we could crunch some numbers and let him know how much cash he would have in the bank at the end of every month for the year. He said yes. Unfortunately, it was never done. He was too busy to take the time to give us the information we needed.

When Joel's company went into bankruptcy, they hired a turnaround specialist whose first task was to develop a set of forecasts to get a handle on the company's future cash flow needs. It was a classic case of too little, too late.

Most people involved in entrepreneurial companies spend a great deal of time attempting to increase sales, but do little to control the financial

side of the business. Certainly, I wouldn't abandon the notion of increasing volume. But remember, with adequate financial control and reduced expenses, every dollar saved in expenses and operating costs results in a dollar more in profit. A one-to-one ratio. It may take $10, $15, $20 or even more of increased sales to produce the same one dollar profit.

Thus, when you view the profound impact of financial planning and *its* impact on the bottom line, it becomes essential that *all* efforts be made to plan for profit and cash flow…rather than wait for profitability to just happen.

WHEN YOU TAKE A TRIP, YOU PLAN YOUR ITINERARY

The two-week vacation is pretty much the standard in the business community today. A major part of planning the vacation is to hire a travel agent to set up flights, hotels, tours, basically everything that is needed to have a great and successful vacation. Family and friends become involved in this ritual of planning the itinerary. Everyone has a suggestion on the fun spots to visit and how to make certain there is not a moment wasted.

What I have found over the many years I have been in practice is how much time is spent on planning for a two-week vacation, but how little time is spent on the planning for the remaining fifty weeks…e.g., planning for profit.

WHY DO ENTREPRENEURS HATE TO PLAN?

Planning is boring.
Planning keeps them from doing what they want to do.
The plan takes too long to prepare.
Plans drown them in meaningless detail.
Planning is crystal ball gazing.
Results are never achieved.

Planning is too expensive.

KNOWLEDGE IS POWER

There's an old truism: "Knowledge is power".

There is no doubt that knowledge is power, but let's rework those three words. How about: "Knowledge is peace of mind"?

Planning is the most *powerful* thing that you can do. Planning allows you to see the future. We've said it before, but it's worth repeating: Can you have any more power than the ability to see the future?

Clearly, most entrepreneurs believe that developing a forecast of future financial events is somewhat akin to *crystal ball gazing*. Anytime one attempts to foresee future events, there is some guessing to be done. But if the process is dynamic (that is, it changes as conditions change), then the element of guessing will disappear—with the resultant forecast becoming the most powerful and useful tool in the arsenal of the entrepreneur.

YOU CAN'T MANAGE THE PAST

You can't manage the past. You can only manage the future. The more you know about the future, the more effective you can be. Need cash? How much? When? A solid financial forecast will provide the answers.

I was recently asked to speak at a Los Angeles banking conference. They wanted me to spend some time discussing how to develop a financial forecast. They had become frustrated with the number of their customers requesting loans who, when asked how much they needed, replied, "How much will you loan me?"

THREE STEPS TO BETTER FINANCIAL UNDERSTANDING

When I advise clients or groups of entrepreneurial business people to control their costs and expenses, the most common response I hear is defeat. "How can I? Suppliers are constantly hounding us with increases. A day doesn't go by without someone asking for more money."

Expenses can be controlled. It's up to you.

There are three steps that will lead to greater expense control:

1. Become familiar with the expenses of your business.

2. Anticipate in advance what those expenses should be.

3. Manage them by exception.

FINANCIAL STATEMENTS SHOULD TELL YOU A STORY

What are the expenses of your business? Be honest with yourself. Do you really know? It is not unusual for owners and managers to be so bogged down in details that they never take the time to review the various expense categories of the business.

What are you spending money on? I have sat in countless meetings where the management of the business doesn't have clue as to what makes up a given expense in the financial statement. Just look over your company's financial statements. Review the various categories of expenditure. Are they telling you a story? Are you satisfied with the detail? Too little? Too much? Do know what the expense is for? What did the bookkeeper bury in the category?

It's *your* company. Pay heed to *your* financial statements. They should tell *you* what you want and need to know to better manage profitability and cash flow.

DESIGN THEM YOURSELF

Here's an easy way to design financial statements that can be more meaningful to you and tell you the story:

Next time you sign checks, sit with your bookkeeper and have a detailed list of the company's expense categories available. As you sign each check, ask yourself if you want to know on a regular basis how much you spend for the item the check represents. For example, you sign a $250 check payable to the post office. You know you don't spend much on postage, so you are not concerned. But say the check is for $4,500. And now you're curious about what postage costs. You'd like to have this information on a regular basis. Ask the bookkeeper where this item is on the financial statement. The bookkeeper may tell you, "It's in office supplies." If it's lumped together with all the other items in the category of office supplies, direct the bookkeeper to set up a new category for postage so it will be reflected on your financial statement as a separate item. Now, each time you review your profit and loss, postage will be a separate line item giving you the information you want and need to know.

If you follow this procedure for *all* the bills being paid, you will develop financial categories that have meaning to you. Remember, the statement must tell *you* what is going on. You are the one responsible for the success or failure of the business. Therefore, it is essential to design expense categories for your needs, your curiosity, your style.

It's *your* money.

ANTICIPATE YOUR EXPENSES

Earlier, I said the most powerful tool available to the entrepreneur is a financial forecast that will predict the future for the next twelve months or longer. One of the great benefits in using the forecast is to always be in a position to monitor where you are against where you wanted to be.

Every business operating in today's world must have a dynamic financial forecast that changes as circumstances change. A forecast that

will tell management on a regular basis how much cash they will need and when they will need it. A forecast that will tell you your company's cash balances at the end of every month for the next twelve months.

Wouldn't you like to know?

You'll never be able to control expenses if you don't know what they *should be*. You can spend and spend, but you can't know if you've spent too much…if you haven't given any forethought as to what you should be spending.

Once you have determined what an operating expense should be and you compare it to what it actually is, you will be in a position to know if you have achieved the goal of controlling your expenses.

A THEFT COULD HAVE BEEN PREVENTED

Here is an example of how the process of comparing actual expenses to the financial forecast would have caught a company theft early, and quite possibly have prevented the indiscretion altogether.

Joe Scott and Eric Brown had been partners in the manufacturing business for ten years. They had started on a shoestring yet built their company to its present $8,000,000 per annum sales volume. Profits were consistently high.

Joe was about ten years older than Eric and had a nasty temper. He controlled the purse strings of the company and frankly was tough to deal with.

Eric's position in the company was in production. He paid little attention to financial matters and seemed only concerned with what his annual salary would be.

The office I was sitting in was cold. Joe always had the air conditioning on too high. He sat behind a beautifully polished Bank of England desk, unaware of my discomfort and vaguely annoyed about the

thrust of my request for the meeting.

Eric sat to my right. He also seemed oblivious to the chill and likewise to Joe's irritation with me. On the desk in front of us were copies of the financial statements of the past two years.

"My reason for this meeting," I said, tapping the most recent statement with my pencil, "is to express concern over the rise in the company's expenses. Compared to recent periods, they seem exceptionally high."

Joe took issue immediately. "Your concerns are unfounded and the figures must be wrong. Call in the bookkeeper."

In a moment we were joined by Sue, the company bookkeeper, a very thin, short woman who always looked as though she had been working for the past twenty-four hours. She was an excellent bookkeeper. "Sue, your numbers are wrong," Joe said.

Sue didn't give an inch. "You always say that, Mr. Scott."

We were at an immediate impasse, and to break it, Sue and I retired to her office to review the ledgers. When we reported that the numbers were indeed right, Joe began to mumble.

"When you spend money," I began, "how do you know if you're going overboard or not?"

"Sue prepares a report," Joe said brusquely.

"But we've just seen what happens when Sue presents the figures. You challenge them, and even when they check out, you don't pay any attention to them. You should be getting information more often, and both of you should compare the actual figures against previous targets. You should do this every month."

For years I had attempted to convince them to use some kind of forecast, and for years, they had passed. We parted with Joe and Eric upbeat. Why not? Profits were good, Eric continued to receive his salary

and Joe released some anger.

About a week later, Eric Brown, uncharacteristically agitated and concerned, called my office. “That S.O.B. Joe has been paying personal expenses through the business without my knowledge."

No wonder, I thought, that expenses hadn't seemed too high for Joe. "How much?" I asked.

"About $50,000. We're still checking."

We left matters with Eric's promise that he'd call me if Sue's investigations produced any more results. Two days later, Eric was back on the line. "We're up to $75,000" he said.

"Ouch," I said.

"You're telling me," Eric mumbled. We ended our conversation.

Two more days passed before I heard from Eric again. "This year alone, $250,000."

What happened? Neither of the partners was responsible to the company. Joe Scott, with control over the purse strings, was able to spend, spend, and spend. Eric, involved only in his production, didn't have any idea where the company was going and where it should be.

Had Joe and Eric reviewed financial data regularly and compared the data to predetermined goals, Joe would have had a difficult time spending company funds on personal expenditures. The variance from expected results would have been glaring enough to support my concern and would have been easily spotted. More than likely, the theft would not have taken place.

5

THE DYNAMIC FINANCIAL PLANNING PROCESS

THE MAIN PURPOSE of the forecasting process is to let management always know in advance how much cash they will need and when they will need it. In addition, the forecast will set flexible goals that are very effective in controlling expenses. Furthermore, the by-product of the information produced will make the information in financial statements significantly more meaningful and be effectively used for managing the business. How can you assess financial data if you don't know what the numbers *should* be?

Shell Taper, owner of a small manufacturing company, is an excellent case in point. Recently, when I handed Shell his P&L, it showed a $50,000 profit for the year. Shell looked at it, and then asked me, "How do you think I did?"

"A $50,000 profit seems okay, Shell, but we can't really know how you did if we don't know how you *wanted* to do. If you anticipated a $250,000 profit, you did miserably. If you anticipated $10,000, you did quite well. You should be predetermining the results of operations, and then when the results are in, you'll know if you're on the right track."

THREE ITEMS NEEDED FOR AN EFFECTIVE FORECAST

I have noticed over the years that budgets or forecasts prepared by a

company's internal staff tend to illustrate profit and loss without a cash flow or balance sheet forecast. They usually prepare a report that shows sales—less costs and expenses—profit, and that's all.

Not too long ago, I was asked to assist a company in the potential buyout of one of its competitors. My client was doing about $70 million in sales. It was a large and profitable company. I assumed the management of such a large company would be quite sophisticated on the financial side of the business. I set up a meeting with their CFO.

I started the discussion, "Let me make sure I understand the purpose of the merger. You believe that there will be substantial efficiencies in payroll and cost reductions. And the merged company will be in a good position financially to pay down the additional millions of dollars in new debt needed to complete the transaction?"

The CFO's response was quite positive.

"Have you prepared any P&L and/or cash flow forecasts as to what the anticipated cash flow requirements will be after the merger?" I asked.

"No," was his quick response.

Needless to say, I was quite surprised that no information was prepared to make certain they could sustain such a potentially large transaction.

My immediate advice to the president of the company was to have the forecasts prepared so as to reveal any potential cash flow problems they might encounter as a result of the merger. He agreed.

So why didn't the CFO prepare them? The answer is simple. It's too difficult and time consuming. And if they wanted to do any *what if* analysis, the time and energy was well beyond any effort the CFO wanted to deal with.

We were engaged to put together the forecasts. It took us about five hours. Two hours by my assistant and three for me. My three hours

included a meeting with the CFO to get some additional assumptions. How were we able to complete them so fast? We used my secret weapon. The software I created.

The three reports needed for effective forecasting are:

1. The twelve-month profit and loss. This report will let management know in advance if anticipated financial activities will produce a profit or not. It will also serve as a guide during the year as to whether expenses are under control or not. It is also great for looking at future tax requirements.

2. The twelve-month cash flow. This is the report that will let management know well in advance how much cash they will need and when they will need it.

3. Forecasted balance sheets for each month of the forecast. This report is the most neglected and is extremely important in the forecasting process. It tells you whether or not the other reports are realistic.

Several years ago, I was meeting with a client preparing a P&L and cash flow forecast. The company was profitable and had excellent cash flow. We sat in the client's conference room working on the forecast. When we completed the preparation, we were quite pleased as to the forecasted profit and amazing cash flow prospects. Everything was going to be terrific.

After reviewing the reports, we began to study the forecasted balance sheets. We both quickly realized there were major problems. The accounts receivable balances were forecasted lower than they had ever been. Payables balances were larger than they should have been, and inventory was forecasted too low. Basically, the balance sheet made no sense at all.

Then it hit me like a ton of bricks. The balance sheet was telling us that the forecast was wrong. Obviously, the assumptions used to develop the cash flow were way off. Collection on accounts receivable balances was too rich, and the payment of the payables was not enough. The balance sheet was the barometer as to the efficacy of the other reports. If it made no sense, the other reports were wrong.

OH MY GOD, THREE FORECASTS

There are three types of financial forecasts I have seen over the years. Don't become anxious; you'll only deal with two. Make it easy on yourself. Get someone else to prepare them. If you take the approach of someone else doing the forecast, then you must be involved in the process. Only *you* can determine the assumptions to be used in the forecast development.

Delegate the task to a bookkeeper who searches for every penny in balancing the accounts, or some new hire who wants to impress the boss. Find someone you can trust and let that person assist you in this vital work. You will make all the decisions regarding the plan assumptions. The clerk handles the details. And best of all, I have developed a software program that will do it all for you. It's much easier than struggling with a complicated spread sheet program.

DON'T FORGET A PROFIT

You must not only prepare a dynamic financial forecast of future events, but you must make certain the plan will produce a profit. Treat profit as if it were any other expense of the business. Most entrepreneurial companies simply don't have the net worth, resources, or clout to sustain losses. It makes no sense to forecast a loss. If the forecast looks like you'll be operating at a loss over the next twelve months, change the way you will operate the business now before it's too late.

Profit and positive cash flow is the name of the game.

FORECAST NUMBER 1—THE *PIE IN THE SKY* FORECAST

This forecast, generally prepared for bankers and other financiers, usually promises high sales, low expenses, and large profits. It may be helpful in securing loans or investors, but forget about it as a management tool. It's not only a *pie in the sky* forecast, but also a *Who do you think*

you're kidding forecast?

By the way; most good financial people will know the game you are playing; don't waste your time. Put it in your drawer and leave it there. Our management tool is forecast No. 2.

FORECAST NUMBER 2—THE *I HOPE AND PRAY TO GOD I MAKE IT* FORECAST

Achievable sales, honest operating expenses, and reasonable profits: This is reality. The forecast we are going to hang our hats on. The one we will make all efforts to achieve, so that __we never have to use forecast No. 3.

FORECAST NUMBER THREE—THE *I HOPE AND PRAY TO GOD I NEVER USE IT* FORECAST

This is the forecast for survival. If you cannot reach expected results, move into a survival mode.

I absolutely recommend a worse case scenario forecast. Most entrepreneurs operating small businesses generally do not react to changes in economic conditions on a timely basis. Prices increase, yet increasing sales prices lag well behind increases in the cost of doing business. I have seen it time and again. Large companies hire specialists, who attempt to predict economic future and may also employ large staffs to prepare forecasts based on predicted economic trends. This gives them a substantial edge in making it through hard times. We have no such advantage. Our edge is ourselves.

We make economic predictions based on *gut feelings* and *seat-of-the-pants planning*. It is absolutely necessary for us to react to changing conditions as quickly as possible. What do we do when our loan interest rates jump several points, expenses rise, sales are cut in half, and cash flow dries up? We must prepare for the worst well in advance.

The key triggering mechanism for going from a realistic forecast to the survival mode is a sudden or steady decline in sales. When things change, your best friend will be your forecast, assuming it can be revised for different levels of sales, expense and/or costs. If your sales are in decline, and you can quickly adjust your forecast this will give you an immediate view of the future and allow for a quick response to changing economic conditions.

6

DEVELOPING THE FORECAST

WITHOUT GETTING INTO THE TOOLS that you might use to prepare the forecast, let's spend some time on the development of the forecast and the assumptions to be used.

WARNING

I am going to present here a very detailed description on how to develop a financial forecast. The most important thing to remember in your financial forecasting is to *keep it simple!* After you begin utilizing these techniques, if you want to become more sophisticated in the process you can review this section and adapt more comprehensive methods.

Why the warning? I risk losing you here with the detailed descriptions that follow. It's a calculated risk I'm willing to take. You must understand the concepts…

You can certainly perform all of the following calculations yourself using a spreadsheet program, or you can contact us at www.upyourcashflow.com for further information on *Up Your Cash Flow XT2*, our software package that will complete all of the work for you—it's easy to use.

LET'S BEGIN

You should start with the development of the cash flow assumptions to be used in the forecast. As you know, there is a logical flow to the P&L. The top is the sales; below that is the cost of goods sold. Next is a series of expense departments, with the final department being "general and administrative expenses." We will follow this order in developing the cash flow assumptions. In future sections of this book I will be discussing some methods for determining the assumptions for sales and expenses.

Basically, there will be two primary assumptions to be used regarding cash flow.

The first step in developing cash flow is the manner in which sales will be collected. My preference is to forecast a *slow* collection process.

My preference regarding expenses is to assume all expenses will be paid *immediately*. This may not be very likely, but this is the most conservative method. The forecast produced will be almost a worst-case scenario for cash payout assumptions. Remember, we can always adjust assumptions to be more realistic at a later date.

SALES COLLECTIONS ASSUMPTION

There are four basic sales collection methods that can be used in forecasting sales collections.

Method 1: Collections as a percent of sales.

This method is simple.

Let us assume, for example, that your total sales are going to be $1,870,000 for the year, and then further assume that said total will be 80 percent collected during the year. This gives you total cash collections of $1,496,000 ($1,870,000 x .80). Go back to prior years to see what each month's relationship of collections is to the year's total collections. Then,

apply that percentage to the total annual collections you expect to receive.

Example:

Prior Year's Collection		% of Total Collection		*Expected Collection	Monthly Collection
Jan	137,000	9.3	x	1,496,000 =	139,128
Feb	130,000	8.8	x	1,496,000 =	131,648
March	135,000	9.1	x	1,496,000 =	136,136
April	160,000	10.8	x	1,496,000 =	161,568
May	140,000	9.6	x	1,496,000 =	143,616
June	120,000	8.1	x	1,496,000 =	121,176
July	120,000	8.1	x	1,496,000 =	121,176
Aug	100,000	6.8	x	1,496,000 =	101,728
Sept	110,000	7.4	x	1,496,000 =	110,704
Oct	110,000	7.4	x	1,496,000 =	110,704
Nov	100,000	6.8	x	1,496,000 =	101,728
Dec	115,000	7.8	x	1,496,000 =	116,688
Total	1,477,000	100.0			1,496,000

*Total sales 1,870,00—assume collecting 80% during year = 1,496,000

Method 2: Collections in a consistent pattern over several months.

After several years in business, a relationship is determined between the sending of invoices versus. the payment of same. (For example, an invoice with a thirty-day payment requirement will generally be paid in the month *following* the sale; if there is a ten-day discount offered, many of the invoices will get paid *within* the month of the sale.) In either case, management must assume responsibility for the pattern that is used.

Let us assume that January's sales will be $129,000. History indicates (or we can just make an arbitrary assumption) that those sales will be collected, let's say, 45 percent in the month of the sale, 40 percent in the first month following the sale, and 15 percent in the second month following the sale. We can then forecast our cash collections using this

method or formula for each month throughout the year.

Method 3: Collections determined by forecasting accounts receivable using day's sales in accounts receivable.

This is the most accurate method for determining sales collections. The collections are determined not by making a collection assumption but by developing the accounts receivable balance at the end of each month using a day's sales in accounts receivable calculation.

Using the accounts receivable balance to calculate the collections:

Sales / 360 = average daily sales.

Accounts receivable / daily sales (the result of sales / 360) = number of days sales in accounts receivable.

To be more precise, calculate the accounts receivable at the end of each month. Assume thirty days in each of the months *preceding* the A/R balance date. For example, using the month of January with forty-five days worth of sales in accounts receivable, the calculation is all of January's sales (thirty days) plus the prior December sales divided by 30. This represents one day's sales. Then, multiply each day's sales by 15 (45 days less 30 days = 15 days needed). The total of the 30 + 15 = 45 day's worth of sales. This number is the forecasted accounts receivable at the end of January.

Now we need to take the accounts receivable as calculated to develop the collections for the month. The formula is: take the *beginning* accounts receivable for the forecast (this should be the accounts receivable in the opening balance sheet), add forecasted sales less the accounts receivable (as calculated), and your end-of-the-month result is the month's collections.

Beginning accounts receivable = $250,000, plus forecasted sales for the month = $750,000, less calculated ending accounts receivable = $375,000. Collections = $625,000 ($250,000 + $750,000 - $375,000).

Method 4: Determine collections using an arbitrary collection assumption.

Want to make life less complicated? Use this method. Just reach into your entrepreneurial instincts and *voilà*! You have the answer as to what you may want to use for each month's collections. Easy? Yes. Accurate? No. Not at all. Pass on it.

EXPENSE PAYMENT ASSUMPTIONS

There are generally two basic methods for forecasting the payment of expenses:

Method 1. Payment in a consistent pattern over several months. Each month is a percentage of the expense to be paid. Never exceed 100 percent.

After several years in business, I discovered there is a pattern between the time when invoices (bills) are received vs. when they are paid. For example, an invoice with a thirty day payment requirement will generally be paid in the month following the month the expense is incurred. In this scenario, an expense is incurred in, let's say, January, and will not be paid until March. This means the expense will have a payment term of 0 percent in the month incurred (January), 0 percent in the first month following the month incurred (February), and 100 percent in the second month following the month incurred (March). Management will have to determine what the pattern is that should be used.

Method 2. Determine payments using an arbitrary payment assumption.

This is the less complicated method. Just reach into your entrepreneurial instincts to determine what month you anticipate the expense to be paid. Easy? Yes. Accurate? Could be.

There are a number of ways to forecast the payment assumption for an expense, but the most widely used is Method 1: The consistent pattern.

THE RIGAMAROLE

Now that I have re-read what I've written in the collection and payment methods used in cash flow forecasting, it seems so complex that most readers will conclude they will not bother with the *rigamarole*.

Clearly, the development of a cash flow forecast can be very time-consuming and complicated. This is the reason why the CFO I previously discussed didn't develop the cash flow forecast, just the P&L. Even though it was necessary to determine whether to proceed with the merger, he opted not to do it. It's difficult and time consuming. Discouraged? Don't be.

Make life easy; you can do it yourself by developing the formulas and model building using Excel, which is an excellent but complex spreadsheet program, or you can hire your outside accounting firm to do it, and they will tackle the formulas and model building for a nice fee.

OR, BEST OF ALL...

...take a look at the software I developed. Its *only* function is to prepare a financial forecast. All the methods mentioned in this section are menu-driven in my software program. There is no need to create formulas or build models. It is all done for you. It even integrates the P&L, cash flow, and balance sheets.

I developed the software in 1989, because I was preaching to the business community the need for and importance of forecasting, or predicting, the financial roadblocks that lie ahead and the importance of having a handle on how much cash you will need and when you will need it.

TO THIS DAY I DON'T KNOW HOW TO DO IT

My primary motivation for developing my forecasting software was

that I did not know how to use a spread sheet program. I took one look at the size of the manuals that came with spreadsheet software, and I said to myself, "I will never have the time or patience to learn how to formulate and build an appropriate model. Neither will my clients. It would a painful experience." So I hired a programmer, and we started our journey to develop a software program that was easy to use and cost-effective. After about a year, I became the programmer. It turned out to be great therapy for me, and after all these years, it has become the most comprehensive forecasting software in the marketplace today.

ENOUGH SAID; LET'S MOVE ON

Now that we have spent some time on the appropriate assumption methods needed for cash collections and cash-out flow (paying bills), let's move on to developing the profit and loss. The P&L forecast is the main forecast, with the cash flow and balance sheets being developed from the information on the P&L.

7

THE PROFIT AND LOSS FORECAST

THE DESCRIPTIONS THAT FOLLOW are not any different for forecasting purposes than they are for developing a company budget. The primary difference is how you use the results. Your responsibility is to determine the assumptions to be used and to use the results as a management tool to increase profitability and cash flow. This will be discussed later in the book.

STEP 1—SALES FORECAST

The first step in the process is the sales forecast. Ideally, you should confer with customers, sales managers, and/or sales representatives to project the next years expected sales. Many owner-managers find the process of securing the input from others to be rather time-consuming, cumbersome, and of little accuracy. Here are two methods to help you predict the next year's sales:

Method 1: Take the previous year's sales dollar volume and add to it the current year's expected price increases and anticipated volume increases. I call this a *reasonable guess*.

Example:

Previous year's sales	1,580,000
Estimated price increases at 7½ %	118,500
	1,698,500
Volume increased at 10 %	169,850
Expected sales	1,868,350
Use (rounded)	1,870,000

Method 2: A more precise method in computing sales dollar volume is to begin with the number of units of product to be sold during the year. Convert units sold to a dollar value. If you compute sales by product, it will be far more accurate than a *reasonable guess*.

The biggest problem here is figuring out the number of units to be sold for any product. The best way to do this would be by reviewing history, and then adding or subtracting units depending on your view of the coming twelve months. Include sales people in the process.

Example:

Unit Sales	Previous year	This year Increase	Total Units	Unit** Price	Total
Product A	50,000	10,000	60,000	11.50	690,000
Product B	35,000	2,000	37,000	20.00	740,000
Product C	100,000	17,000	117,000	3.75	438,750
Expected sales					1,868,750
Use (rounded)					1,870,000

Method 3: My favorite method is to forecast sales by customer. This is similar to Method 1, except it will be more precise due to developing data in greater detail (by customer). This method works best if you have a small number of customers that make up a substantial percent of the company's sales. If you are able to do this, it may be the most accurate method of them all.

In practice, review the history of each customer and then add or

subtract any changes expected for the coming twelve months. Again, include sales people in the process.

Example:

Sales Previous year		This year increase	Total Units	Total
Customer A	500,000	100,000	600,000	600,000
Customer B	350,000	20,000	370,000	370,000
Customer C	1,000,000	170,000	1,170,000	1,170,000
Expected sales				2,140,000

STEP 2—SALES: MONTH-BY-MONTH ANALYSIS

Once you have determined the dollar amount to be used for your expected annual sales, you must then project how the sales will be spread on a month-by-month basis. This step gives you tight financial control. In addition, it is crucial for calculating each months profit and/or loss and cash flow during the forecast period.

Method 1: Predict each month's sales and use the result. This method is simple and can be of great value if you gather enough data to predict with accuracy.

Method 2: Assume that the relationship of each month's sales to the year's total sales will be the same as the prior year sales. Thus, if last January's sales were 10 percent of last year's total sales, then we can assume that in our current forecast year, January sales will be 10 percent of the year's total. Review the prior year or past years' sales month-by-month to determine the relationship of each month's sales in your forecast to the annual sales. This method may lack some accuracy; however, it is simple to use and will account for any seasonality.

Example:

Prior year's sales		% To Total		Expected Sales	Monthly Sales	%
January	100,000	6.9	X	1,870,000	129,030	6.9
February	100,000	6.9	X	1,870,000	129,030	6.9
March	100,000	6.9	X	1,870,000	129,030	6.9
April	100,000	6.9	X	1,870,000	129,030	6.9
May	150,000	10.3	X	1,870,000	192,610	10.3
June	150,000	10.3	X	1,870,000	192,610	10.3
July	125,000	8.7	X	1,870,000	162,690	8.7
August	100,000	6.9	X	1,870,000	129,030	6.9
September	150,000	10.3	X	1,870,000	192,610	10.3
October	100,000	6.9	X	1,870,000	129,030	6.9
November	125,000	8.7	X	1,870,000	162,690	8.7
December	150,000	10.3	X	1,870,000	129,610	10.3
Total	1,450,000	100.0			1,870,000	100.0%

Method 3: If you select sales by product, the monthly sales will be spread over the forecast based on the products to be sold each month.

Method 4: If you are forecasting sales by customer, you will spread sales in the same manner as Method 2 above, except it will be done for each customer.

EXPENSES: THERE ARE PLENTY OF METHODS

I have come up with ten methods for determining an expense in developing a profit and loss forecast. Although I have come up with ten methods to calculate an expense, only two will be used regularly: a percentage of sales and a fixed monthly amount.

Here is the list:

Method 1: A percent of sales.

1. This is obvious. Sales multiplied by a percentage = the expense. Advertising is 10 percent of sales. Sales = $1,000,000 * 10%. Advertising is $100,000. The 10 percent should be applied to each month's sales.

2. A fixed monthly expense. Easy to use. Use a given amount for each month. Typically, rent is fixed each month.

3. An expense as a percent of another expense. In No. 1 above, advertising was calculated at $100,000. Let's assume ad supplies are 10 percent of advertising. Ad supplies = $10,000 ($100,000 * 10%).

4. An expense drilled down into many elements with the forecasted amount being the total of all the elements. Let's say you have three autos, and you wish to forecast an expense for each auto.

Auto A expense is $5,000 for the year.
Auto B expense is $15,000 for the year.
Auto C expense is $5,500 for the year.
Add all three together, and auto expense forecasted for the year is $25,500.

5. An expense as a percentage of a specific product's sales. Same as No. 1 above, except the percentage is applied to each sales category developed in the sales forecast.

6. Using units times a unit cost. Develop the units to be used and multiply them by an expense factor. Let's say you will have ten employees for the first six months of the year, and twelve for the last six months.

An expense that is directly related to the number of employees is health insurance. Assume $250 per month, per employee. Expense for each of the first six months is $250 * 10 employees, or $2,500 per month. The last six months will be $250 * 12 employees or $3,000 per month. Annual expense is $2,500 * 6 = $15,000 + $3,000 * 6 = $18,000. Total $15,000 + $18,000 = $33,000.

7. Taking last years expense and increasing or decreasing by a specific amount or percent.

8. A weekly expense. Did you know that there are thirteen weeks in each calendar quarter? Therefore, each month has either four or five weeks within the month for calculating purposes. Let's assume a weekly expense is 500 per.

Assume January has four weeks, February has four weeks, and March has five weeks. Simply multiply each month's weeks by the weekly amount, and you have forecasted the month's total expense.

9. An expense computed using linear regression. Linear regression is an interesting concept. It is a mathematical formula that will calculate a fourth number if you supply three numbers.

Let's say we're doing a forecast for 2007, and we want to forecast office supplies for the month of February. We have the February 2004, 2005, and 2006 amounts. Therefore, using a linear regression calculation it will predict the February 2007 expense.

When I added linear regression to my forecasting tool, I looked up the formula on the Internet and found a huge amount of information on the subject. Much to my chagrin, I didn't understand any of it.

I received some help on developing the formula and then added it to the program. It works fine, but should it be used to develop a forecasted expense? Some may use it if they have no other method they deem appropriate, but I don't recommend it. Reason: the past is often not always a great predictor of the future. It's best that management gets what it believes will occur rather than a mathematical formula.

10. Anything you want. When all else fails, guess and forecast an expense as you think it will occur.

STEP 3—COST OF GOODS SOLD

The next item to be considered in the forecast is the cost of goods sold—how much you will pay for what you sell.

I have listed two basic methods for determining the cost of goods sold. Pick the one you find the simplest and use it.

Method 1: The Percentage Method. Let's assume that over the years your business has been operating on a consistent cost of goods sold percentage. Let's further assume that you would like to continue to operate at the same level for the coming year and believe you will. Simply multiply that percent by each month's sales; the result becomes the cost of sales for the month. This method may prove to be the simplest way to forecast cost of goods sold; however, its major weakness will be discovered when the actual costs are more or less than what was forecasted, and you try to find out the reasons why.

Unlike most of the expenses of your business, the actual cost of goods sold can vary depending on several factors: an incorrect beginning inventory, sales recorded in the wrong period, purchases recorded in the wrong period, an incorrect ending inventory, improper valuation of the inventory, and an inaccurate count of the items in the inventory. Therefore, if you have a variance between the actual percent of cost of goods sold compared to the estimated percent used in the forecast, pinpointing the reason for the variance can be quite difficult.

In general, a company will not compute the actual cost of goods sold until an accurate physical inventory is taken or reliable perpetual inventory records are maintained. Therefore, management may prepare their actual financial statements using the forecasted cost of goods sold and oftentimes will not compute the actual cost of goods sold more than once or twice a year when inventories are taken.

Only when the actual costs are computed can meaningful comparisons between actual and forecasted cost of goods sold take place.

Method 2: For a more precise method of determining your forecasted

cost of goods sold, begin with the number of units of a particular product that you anticipate selling (see Sales Forecast, Method 2) and price the units to be sold.

Do this for each product line of sales.

Example:

	Units to be Sold	Anticipated Cost of Each Unit	Cost of Goods Sold
Product A	50,000	7.80	390,000
Product B	35,000	12.75	446,250
Product C	100,000	1.25	125,000
Cost of Goods Sold			961,250

STEP 4—EXPENSES

Here is a list of the expense items generally found on most financial statements, followed by brief comments on how these items may be forecasted. This list is not all inclusive; you may have items on your financial statements not shown here. Any items of importance to you should be reflected on your financial statements to allow you to keep an eye on the expenses.

Advertising: If advertising is not a major expenditure, determine your forecasted amount by using the prior year's advertising expense as a percentage of the prior year's sales. Apply this percentage to the current year's predicted sales. This percentage should be applied to each month. If advertising is a significant expense, consider establishing your forecast in conjunction with your ad agency.

Automobile: Estimate a reasonable cost for operating an auto during the year, and multiply that cost by the number of company cars. This will give you your annual expenditures. To arrive at the monthly expenditure, divide this number by twelve. Using this result, however, is not as good as

determining what each month *should* be, and entering the monthly amounts in the forecast.

While you are in the process of counting autos, you might consider whether the company needs as many autos as it's currently paying for. Also consider whether you may be able to use less expensive automobiles, or whether you should lease. Be sure to figure in insurance, interest payments, repairs, and maintenance. If you do opt to lease, all payments should be included in the forecast. Don't forget the IRS record-keeping requirements.

Bad debts: Review historical data to track bad debts as a percentage of sales. Take your historical percentage and apply it to the sales for each month of your forecast. If you believe the percentage is excessive, a reduced percentage may be in order. However, try to be realistic; now may be the time to review credit policies, put some delinquent accounts on a cash only basis, and cut off others. Develop a consistent policy and stick to it.

Business promotion: Take the number of people in the company who are in sales, and multiply that by the number of dollars you consider appropriate for each person to be spending for promotion during the ensuing year. Compute promotion as a percentage of sales. Apply that percentage for every month of the forecast. Or, take the annual amount and divide it by twelve, and apply the 1/12 to each month of the forecast. Again, using this result is not as good as determining what each month *should* be, and entering the monthly amounts in the forecast.

Collection costs: Because accounts receivable are getting tougher to collect, you should consider forecasting some additional dollars for collections during the year.

The best way to determine the amount would be to review what percentage of sales the collection costs have been running historically, and apply that percentage to each month's sales. You may want to forecast additional costs if you plan on taking a hard-line approach to collections.

Continuing education: This is an area where few entrepreneurial

companies spend significant dollars. After you've read this book, I hope you will have been convinced to spend on this extremely important expense.

To determine your forecast, review the people in your organization and see which ones might benefit from continuing education. Don't forget to include yourself. Multiply the number of people by the dollars decided for each. This will be your annual expense. For simplification in applying the dollar amounts to the monthly forecasts, just divide the total allocation by twelve.

Depreciation: This item is purely a function of methods that you are already using for tax or financial statement purposes. Take your annual amount, divide it by twelve, and apply this amount to each month of the forecast.

If your tax depreciation produces an excessive expenditure, consider using a different method for financial statements. Longer useful lives with lower depreciation rates will enhance your financial statements and present a better picture to whoever uses the statements.

Donations: This too should be forecasted. Decide on your annual amount, stick to it, and if you think you may want to add an extra amount for unanticipated causes, by all means do so, but do it in the beginning of the forecast year. For your monthly forecast divide by twelve and apply the amount to each month of the forecast.

Dues and subscriptions: Now is the time to make certain that all those organizations you've joined and publications you subscribe to are of benefit to your company. Then, look at the previous year and add for increased costs. If you are anticipating some additional expenditure in this area you should certainly forecast them at this time. Apply 1/12 to each month of the forecast.

Insurance: General insurance is the cost of insuring equipment, liability, etc. Call your insurance agent and find out exactly what you should anticipate in insurance premiums for the year. Use this amount for your forecast. Or, if you are consistently paying the same amount from

year to year, look at the prior year's financial statements and use that number plus a percentage increase. Since insurance is expensive, try to be as realistic as possible in forecasting monthly amounts.

While reviewing your forecast, you should determine whether your coverage is adequate. A complete review of your insurance program at this time may save dollars.

Group insurance: There are several items that will be based on the number of employees you have in your organization. To determine these items you should forecast the number of employees you anticipate having in each month over the next twelve months. This will require you to plan when you will be adding or possibly reducing your personnel. To forecast your group insurance, take the number of employees each month, multiply that by the group insurance rate, and you have your forecast.

Life insurance: Life insurance is generally an item provided to a few people in the organization. Call your insurance agent and find out what you should be forecasting for life insurance. Ask your agent when the premiums are due and place it on your forecast on the due dates. The life insurance industry has developed many new products over the past few years. Have your coverage analyzed to see if costs can be reduced.

Interest: This item depends on what you are going to be borrowing and what the interest rates are going to be in the future. It is best to anticipate high when it comes to interest, therefore, when you review your cash requirements, project high. A 20 to 30 percent increase over the previous year may be in order. Keep your fingers crossed that it won't happen. Only God and the chairman of the Federal Reserve Board can tell us where interest rates will be going.

Since interest is a function of loan balances, forecast it by amortizing any term loans by using the loan payment schedule and credit line interest based on the credit line balance at the end of each month.

Legal and accounting: To determine what to forecast for legal and accounting, ask your lawyer and accountant what they anticipate your costs will be during the year. If you feel that their anticipated fees are

high, negotiations may save you some money.

Office supplies and postage: Sometimes this can be a tough category to anticipate. Go back and look at what the annual percent has been running for the past few years; apply that percent on a month-by-month basis to your forecast. Also, consider whether the percent has been reasonable in the past and if you feel you may be able to reduce it. Generally, historical percentage is the best method for forecasting this item.

Rent: This forecasted number is easy. Just use your monthly rent figure for each month of the forecast. Don't forget any cost of living increases, mall charges, or property tax and expense escalations. If rent is a percentage as in many retail operations, then forecast using the percentage.

Repairs and maintenance: Review the annual percentage over the past few years, and apply that percentage on a month-by-month basis to each month's sales.

Don't forget to include contracts for preventive maintenance. Now may be the time to consider whether to upgrade and improve equipment that requires constant maintenance.

Salaries: This item is not difficult to forecast if you prepare for it by thinking through your plans for each employee. My suggestion for forecasting salaries is to literally count the numbers of employees you anticipate each month. Add up each employee's anticipated monthly salary and you have your forecast for the year.

Remember to forecast approximate salary increases. If you have a large number of employees, tell your bookkeeper to prepare a schedule of employees with anticipated raises.

While you're reviewing salaries, you should consider developing standard policies for sick leave, vacation, holidays, and other fringe benefits. Your company's policies should be communicated in an employee manual. This is a must. It will prevent confusion, conflict, and even

lawsuits.

Taxes and licenses: Determine the historical percentage and apply that factor to the current year. Check appropriate city, state, and federal sources for potential increases. Divide by twelve and apply it to each month of the forecast.

Taxes and Payroll: This should be forecasted by taking a percentage—anywhere from 10 to 12 percent—of the gross payroll cost. Apply the percentage to each month's payroll.

Telephone and utilities: Check prior years' records to get a rough estimate of the percentage of sales. Apply this percentage to each month; add 10 to 15 percent to this number. Another method is to take the prior year's dollars, add 10 to 15 percent to that number and divide by twelve to determine each month's expense.

Travel: Increasing travel costs make it necessary to plan realistically and early. If you anticipate extensive travel, this is the time to sit down and decide what trips will be taken, where you will be traveling, and who will be going. Develop a written travel policy. Avoid travel by whim.

If your company travel plans are modest, take the total annual dollars and divide by twelve to determine your monthly forecast. If you project extensive traveling, I recommend that you calculate each month separately by the actual anticipated trips for the given month.

Company travel can result in employee abuse of the privilege. Make certain adequate documentation is available after each trip. This will result in controlled costs and fewer headaches with the IRS.

Look closely at trips to conventions and trade shows. Are they necessary, or are they just social gatherings?

8

THE CASH FLOW FORECAST

IN CHAPTER 7, WE DISCUSSED items that that have a direct impact on the profit and loss and cash flow. In this chapter, we will be discussing items that have little or no impact on the profit and loss of the business but a profound impact on the cash flow.

I MADE A PROFIT; WHERE'S THE CASH?

As you know, most entrepreneurial companies may not generate sufficient cash flow, to operate the business, from the normal operating activities of the business. This often results from an increase in accounts receivable (uncollected sales or customers not paying on time), and/or an increase in inventory (resulting from overstocking or a slowdown in sales). In addition, the company may need to put down payments on equipment, and pay their suppliers faster then the company gets paid from their customers etc.

NO FUNDS AT ALL

In addition to the above, another major reason for a lack of cash is an inadequate investment by the entrepreneur when the business was started. I have seen this countless times. Overconfident entrepreneurs thinking they can start the business with a small investment or starting a business with no funds at all.

This could be a result of inadequately forecasting or predicting the cash requirement of the business during the formation of the business—a crucial mistake.

Because of insufficient cash from business operations and an inadequate original investment in the business, the business more likely than not will rely heavily on its ability to borrow. Your banker will become your best friend.

Borrowing: Generally, there are two types of borrowing that an entrepreneurial company will be involved with: Term debt with a monthly scheduled pay back and/or a credit line.

Term debt will usually be based on the purchase of equipment and is not usually considered funds that are available for running the business on a daily basis (working capital). If there is a need for working capital, it should be considered in connection with a line of credit. For cash flow forecasting purposes the term debt will be forecasted when management believes the funds will be needed or the forecast will be used to develop what the needs are.

Each month of the forecast must reflect the pay back of any term debt being used.

The line of credit for your company will be the lifeblood for the operation of the business. For your banker the line of credit will be viewed as if they are *investing* in your company the cash that you never began the business with. To protect themselves they will place restrictions and/or milestones that must be met to continue the relationship. The forecast you prepare will be a great in helping you understand whether you will be able to meet your lenders restrictions or not.

The credit line available will oftentimes be based on the level of your accounts receivable. For example, your accounts receivable at the end of the month is $150,000. If the bank will loan 70 percent of the balance, then $105,000 is available. If in the next month your receivables are $120,000 with the 70 percent borrowing rate, the amount available is

$84,000. The bank will expect a pay down of $21,000 ($105,000 - $84,000). To forecast this type of activity, the monthly balance of the accounts receivable must be forecasted. This is an important reason the forecast of the balance sheet becomes so vital.

As I have indicated on several occasions, the forecast of cash flow is complex and is many times passed over because of its complexity. If the cash flow forecast is not prepared, then you will never know in advance how much cash you will need and when you will need it.

Loans from others: If you have a friend or relative who is willing to fund the business, this should be forecasted as to when the funds will be available and when they will be paid back. Do this for each month of the forecast.

Purchase of equipment: If you are planning to buy equipment during the forecasted period, plan it in advance. It will affect cash balances (down payments) and debt financing.

Dividends: Most entrepreneurial companies if incorporated will not pay out dividends to shareholders. The exception will be if the company files its tax return as an S corporation. By the way, speak to your financial advisor as to whether it is appropriate to file as an S corporation. Without getting into details, there may be some important advantages in doing so. If you do expect to pay dividends, forecast the expected amounts on the dates anticipated. The dividends can be a big drain on the company, especially if you're profitable S corporation and the shareholders need money to pay the tax on their share of the S corporation earnings.

Interest on cash balances: If your cash balances are slim, don't forecast this item. If they are substantial, it may be appropriate to do so.

Estimated tax payments: As you know, the payment of income tax can be quite burdensome on a company's cash flow. Actually, it can be awful. Especially when the business shows a profit, it will be required to pay tax even though the cash may not be available (too high accounts receivable and/or too much inventory). This item must be included in the

cash flow forecast. Contact your accountant for the amounts to include and for the proper due dates.

9

WHAT DO YOU DO WITH YOUR FORECAST NOW THAT YOU HAVE ONE?

YOU NOW HAVE the best tool available for managing your business, controlling expenses, and getting a view of the cash requirements that lie ahead. You now have some idea of how much cash you will need and when you will need it.

Here is what you need to do. On a monthly basis, compare the operations of your company with the forecast on a line-by-line basis.

As you make your monthly review, you will be able to locate differences between what you thought would happen and what actually did happen. This helps enormously. Now you can avoid being a crisis manager; you can confine your management activities to the exceptions, items that are significantly different from what you forecasted.

In my accounting firm, there was an extended period when our office supplies (a large expense in a professional office) never came within our forecast. I made numerous inquiries, and of course the administrator always had some plausible explanation. Even so, we consistently overshot the forecast for office supplies.

After continued frustration, I suggested we check other sources for our supplies. You guessed it. Our friendly vendor whom we used for years was 20 to 30 percent higher than his competitor. Now the expense is under

control. That's what this process is all about—keeping expenses under control.

When you're not hitting your target, shake your head in bewilderment. Ask questions, and then keep on asking until you get the answers you need to keep within the framework you've provided in your forecast.

WHAT IF THE FORECAST IS WRONG?

Unlike a stagnant budget, change it! A forecast is a *living document* which changes as conditions change. We use the forecast to establish achievable and realistic goals. We must use the forecast to see the financial implications of the decisions made. We use the forecast to tell us what our cash requirements will be in the coming months. It is not for playing games by establishing ideals that make no sense in the real world. It's a document predicting your financial future,

After you have reviewed particular items for a number of months, and have taken corrective action and are still consistently over or under the forecast, correct the forecast. But remember this: A forecast should be changed only *after* you have exhausted all remedies to bring your actual expenses or income in line with your original estimates.

Changing the forecast will provide a meaningful analysis of where you are headed. It is the *only* tool available that will provide a reasonable prediction of what is going to take place in the future. It is powerful.

ARE YOU SATISFIED?

One of the most important items in the preparation of your forecast is your compensation and the profit you have allowed or forecasted for your company. Make certain that the salary you have established for yourself and the profits are adequate. It makes no sense to work for peanuts. Making a reasonable salary and a reasonable profit is why you're in business.

If your salary and profit do not meet your expectations, you must give thought to whether your goals are realistic or not. A forecast must be based on an honest assessment of what you think you can achieve in the coming period. Take whatever action is necessary to achieve your desired objectives. Success or failure is your responsibility.

Controlling expenses means you must design meaningful financial statements, compare *actual* results against *anticipated* costs, manage the exception rather than the rule, and ask appropriate questions to get sufficient information to make your business decisions. If you do so you will be in a better position to:

- evaluate business activities
- decide where to cut costs
- monitor your financial successes
- understand the nature of your operation and the consequences of your decisions
- be in a better position to react to economic conditions quickly
- become a better manager
- stop making scared money decisions
- make more money

10

IN SUMMARY

THESE POINTS CANNOT BE OVER-EMPHASIZED:

Management must monitor cash and accounts receivable daily. Know what your commitments are, work the cash, and work the accounts receivable. With unpredictable interest rates and economic uncertainty, cash management will be the difference between success and failure. Cash is king, queen, prince, and all other titles of royalty. It is the blood of the business.

Cost accounting and inventory controls are absolutely necessary when appropriate to your business. You will never be in the position to know whether your business is profitable or not without accurate inventory information. This means proper counts and pricing of your inventories is essential.

Monitor your company financial statements every month. These financial statements should be compared to previously established targets and goals.

A financial forecast is a must. It must consist of a profit and loss forecast, a cash flow forecast and forecasted balance sheets. This will enable you to monitor the future financial impact of the decisions you've made. You will know in advance how much cash you will need and when you will need it. Set goals and achieve them.

As an owner-manager of a business, you must keep your finger on the pulse of all phases of the operation. Set in motion a management information system that gives you a constant flow of information

regarding your company's financial position and the efficiency of operations at all levels.

Regularly monitor sales, accounts receivable, cash balances, and forecasts. You will not compile this type of information. Do not bog yourself down in details. Monitor and review the information provided by others, distribute it to subordinates and meet regularly and take corrective action when necessary.

11

WHAT DO ALL THE NUMBERS MEAN?

FINANCIAL STATEMENTS are a summary of all financial transactions that have taken place within the company. Before an analysis of the financial statements can be made, you must have a basic understanding of the terminology used. The following list details the most widely used terms in financial statements. This list corresponds to the items listed on the financial statement at the end of this chapter. Make a photo-copy and check against the various categories as you read through the terms and their applications.

(A) The Balance Sheet is a statement of the assets, liabilities, and net worth of the company at any given time.

1. *Current assets* are assets which will generally convert to cash within twelve months.

2. *Property and equipment* are assets that have a useful life to the business over a substantial period of time, and which are amortized (or depreciated) over this useful life.

3. *Other assets* are assets that cannot be listed in categories one and two. They are often not liquid and are held for some purpose other than the general operation of the business. This may include purchased goodwill, securities held for investments, etc.

4. *Current liabilities* are those liabilities which are expected to be paid within twelve months or within the operating cycle of the

business.

5. *Long-term debt* comprises liabilities which are due to mature beyond twelve months. Only the twelve-month maturities are in the current liability section.

6. *Stockholders' equity* is the book value or book equity of a corporation. It consists of the original investment and subsequent investments by the shareholders, plus the net earnings retained in the business. The stockholders' equity is reduced by any dividends paid.

7. The equivalent of *stockholders' equity* in an unincorporated business is called *Proprietor's Equity*. This is the money the owners have put into the business, plus profits remaining in the business, less any funds taken by the owners, and less any losses of the business.

(B) The Statement of Income is the statement that shows the final results of all the revenue and expense transactions of the business. They either produce profit or a loss.

1. *Sales* are generally the first item on the income statement, indicating the amount of sales for the period indicated.

2. *Cost of goods sold* is the direct cost of the items sold during the period. In a manufacturing business, this would include direct materials, labor, and overhead. A service business generally does not have cost of goods sold.

3. *Gross profit* is the profit before operating expenses of the business. Gross profit is the result of sales minus the cost of goods sold. This is often called the *gross margin*.

4. *Selling and administrative expenses* are the operating expenses of the business.

5. *Income before officers' compensation* is the income before any compensation is paid to officers. Many companies like to have this

number shown on the income statement so that they can explain to bankers and other users of the statements what the income of the business is without consideration of the owners or officers compensation.

6. *Compensation paid to officers* is shown separately to display to the users the amount of monies being taken by officers and/or owners.

7. *Income before provision for income tax* is the pretax earnings of the business. Proprietorships, partnerships and S Corporations usually do not have this item on their income statement. The proprietors and/or partners of an unincorporated business and the shareholders of an S Corporation report their share of the income on their personal tax returns. Their tax expense is not that of the business.

8. *Net income* is the *bottom line*. This is the profit or loss of the business.

(C) Statement of Cash Flows. The Statement of Cash Flows is quite a meaningful statement. It tells you where the cash went. Cash-in vs. cash-out from an historical perspective.

The Statement of Cash Flows includes three sections: cash flows from operating activities, from investing activities and from financing activities.

1. CASH FLOWS FROM OPERATING ACTIVITIES. The cash flows from operating activities will generally include the cash inflows and outflows derived from the actual business activity. The major source of cash for most businesses will be cash receipts from customers. The major expenditure within the operating activities will be cash paid to suppliers and employees.
   This section will also include, but will not be limited to, interest paid, interest received, taxes paid and/ or tax refunds received and any other items that would be of an operating nature.

2. CASH FLOWS FROM INVESTING ACTIVITIES. This section in the Statement of Cash Flows will include a summary of cash inflows and outflows from investing activities. Investing activities

include:

a) Monies received from the sale of property and equipment used in the business.

b) The receipts from the sale of equity investments in other enterprises and for returns from the investments in those enterprises. It does not include the return on investments. The return on the investments is included in cash flows from operating activities.

Cash outflows include payments for equity interest in other enterprises and disbursements for loans made by the enterprise.

3. CASH FLOWS FROM FINANCING ACTIVITIES. Cash inflows and outflows from financing activities include:

c) Inflows: proceeds from issuing equity instruments, and proceeds from various long or short term borrowings.

d) Outflows: repayment of borrowed funds, dividends or other distributions to owners.

As you can see, the classification of an outflow or inflow of cash between the various sections can be complex. However, for most closely held businesses, the statements should be easy to read and answer the question: *Where did the money go?*

The Statement of Cash Flows also includes a reconciliation of net income to net cash provided by (used in) operating activities with additional information required.

USING RATIOS TO INTERPRET THE DATA

The financial statement alone will give some indication of the company's health, but seeing beyond the raw data, greater analysis is

necessary. Most accountants and users of financial statements use ratio analysis. This is an excellent tool to determine the health of the company, and whether management has made good use of company resources.

The following is a ratio analysis of the financial statements appearing at the end of this chapter:

CURRENT RATIO:

$$\frac{\text{Current Assets}}{\text{Current liabilities}} = \frac{510{,}862}{163{,}679} = 3.12$$

The Current Ratio tells you how many dollars should be available within the next twelve months to pay the liabilities that will mature within the next twelve months. This example shows that $3.12 is available for each $1.00 in liabilities, a healthy current ratio.

A rule of thumb is $2 for each $1. Many small companies are struggling at a $1-to-$1 ratio or less.

QUICK RATIO:

$$\frac{\text{Cash \& Accounts Receivable}}{\text{Current liabilities}} = \frac{182{,}559 + 146{,}281}{163{,}679} = 2.00$$

The Quick Ratio gives an indication of how quickly a company can pay its current obligations without relying on future sales—which answers the question: *Will my cash and receivables be enough to pay the bills due in the next twelve months*? This example indicates a very healthy company $2 available for every $1 in debt due in twelve months. A $l-to-$l ratio is a good basic ratio.

Most quick ratios I've seen in small companies are less, 75 cents-to-$1, which means 75 cents available to pay $1 worth of liabilities without

relying on future sales. As this ratio gets smaller, you will find that paying bills will become more and more difficult.

DEBT TO EQUITY:

$$\frac{\text{Total Debt}}{\text{Total Equity}} = \frac{193{,}073}{553{,}907} = .35$$

The Debt to Equity Ratio is the ratio that compares the amount invested in the business by creditors versus the amount invested by owners.

When securing bank financing, this is an important ratio. Many banks will have a policy that will prevent them from loaning to a company if this ratio goes beyond certain levels. In the example that was given, the .35-to-1 ratio is extremely low. This may indicate that the owners of the business are not taking advantage of the availability of borrowing for possible business expansion or other purposes.

Most small businesses will have a 3-to-1 or larger ratio. This may be a result under-funding by the owners.

As this ratio gets larger and larger, it may be an indication that the company may have difficulty paying its debt and is in trouble.

NET INCOME TO EQUITY:

$$\frac{\text{Net Income}}{\text{Stockholders' Equity}} = \frac{119{,}487}{553{,}907} = .22$$

The Net Income to Equity Ratio indicates the return on the investment (ROI) that the shareholders are receiving based on the equity they have in the business. In the example given, the shareholders are receiving a 22 percent return on the equity remaining in the business.

A more appropriate measure of the return on investment would be to adjust the shareholders' equity from book value to market value, by adjusting the assets of the business for any increase or decrease in their value.

For example, in the company we are analyzing, if you look in the property and equipment section, you see they own land, which is being carried at $126,150. If the land substantially appreciated to, let's say, a value of $500,000, then the book value of the company should be adjusted for this appreciation. This increases the book value by the differences between $126,150 and $500,000, or $373,850.

This means that in calcu-lating the return on investment, you should be taking $373,850 (the increase in the value of the land) plus the net equity, $553,907, totaling $927,757, divided into the earnings of $119,487, indicating a return on investment of 12.9 percent. Quite a difference from the rate of return calculated before adjusting for the appreciation in assets.

Recently I spoke with some people who had a business that was producing approximately $25,000 per year of annual income. Many years prior to this, they had purchased the real property that was occupied by their business.

The property had increased substantially, and when asked the value, they indicated it was approximately $950,000. They were using $950,000 in real estate to produce $25,000 in income, which meant that they were getting a return on the real estate of approximately 2.6 percent.

To have a better utilization of their assets, they should have sold the real estate or developed it for another use and moved their company to quarters that were less expensive.

Businesses that are unincorporated and wish to determine the return on their investment must remember that the net income of their sole proprietorship or partnership should be reduced by reasonable compensation to the owners to determine the true net income to be used in the calculation.

INVENTORY TURNOVER:

$$\frac{\text{Cost of Goods Sold}}{\text{Inventory}} = \frac{778{,}082}{160{,}993} = 4.8 \text{ times}$$

The Inventory Ratio is the number of times that a business turns inventory during the year. In this example, the inventory turns 4.8 times.

To determine how many days of inventory you have on hand at any given time, divide the number computed into the number of days in the accounting period. For example, since the financial statement we are analyzing is for one year, we took 360 divided by 4.8 and it indicates approximately seventy-five days of inventory on hand.

When a company becomes more complex, and you choose to calculate profit and loss by type of sales, this ratio can become a more valuable tool in determining under-stocking, over-stocking, and obsolescence of inventory by product.

Many companies try to strive for the most turnovers within an operating cycle. Be cautious with this approach. To increase your inventory turnover, you must reduce the amount of inventory on hand, in relation to the cost of goods sold. This may result in lower sales if you have an insufficient amount of inventory available for sale to customers.

NET INCOME TO NET SALES:

$$\frac{\text{Net Income}}{\text{Net Sales}} = \frac{119{,}487}{1{,}336{,}454} = 8.9$$

The Net Income to Net Sales Ratio indicates how many dollars of profit you earn from each dollar of sales. In the example, for every dollar of sales, the company earns 8.9 cents profit.

ACCOUNTS RECEIVABLE TURNOVER:

$$\frac{\text{Net Sales}}{\text{Accounts Receivable}} = \frac{1{,}336{,}454}{146{,}281} = 9.1$$

The Accounts Receivable Turnover indicates how many times the accounts receivable are being paid and re-established during the accounting period. The higher the turnover, the faster the collections.

To determine the number of days' sales that are in accounts receivable, take the ratio derived and divide it into the number of days in the accounting period. For example, since this is a year, we will use 360 days divided by 9.1, which indicates we have approximately forty days' sales in accounts receivable. This is a healthy rate. Most small companies have from sixty to seventy or more days' sales in accounts receivable. What is yours?

The collection of accounts receivable is critical. Keep a close eye on this ratio. If it begins to indicate that collections are slowing down and the ratio is increasing, take strong action to improve the company's collection policies.

ACCOUNTS PAYABLE TURNOVER:

$$\frac{\text{Purchases}}{\text{Accounts Payable}} = \frac{792{,}362}{94{,}272} = 8.4$$

The Accounts Payable Turnover indicates the number of times accounts payable will be paid during the year. To determine the number of days a business will take to pay its bills, divide the amount indicated, 8.4, into the number of days in the accounting period. As our example is one year, we will use 360 days, thus indicating that the accounts payable are being paid every forty-three days.

If you look at the accounts receivable turnover—the example indicates forty days—compare this to the accounts payable turnover, which is every forty-three days. You can see that the company is paying its bills more slowly than it is collecting its accounts receivable. In effect, the company is borrowing from its suppliers to expand its working capital.

These analyses are intended to help you understand financial statements. As your business becomes more sophisticated and your statements become more complex, ask your accountant for help. You should be well prepared to discuss their meaning.

12

THE BUSINESS PLAN: WE MUST PLAN FOR THE FUTURE

I RECEIVED A CALL from an old friend, Rob Jenkins, who indicated he needed my opinion on a business matter and wanted to see me.

"Come on over," I said. About a half hour later, we met in the lobby of my office.

Rob, a young man in his early forties, wears a full beard, and was sporting a fresh tan. He is always impeccably dressed. *Great taste*, I thought to myself. *Right out of a Gucci ad*. We proceeded to my office, sat down, and started with our usual small talk.

When the small talk ended, Rob opened a Pandora's Box.

"My lawyer says I should take my company public," he said. "Frankly, I'm concerned that he may be giving me this advice because of the substantial legal fees involved. I need your objective opinion."

"How can you take your company public when you just sold off twenty-five locations?"

"No problem," he retorted. "We're buying them back."

Ouch, I thought to myself. *Sell them, buy them back—what's he doing?*
"A year ago you indicated that you wanted to get smaller."

"Yeah, but now I want to make a killing. And besides, you know I've been unhappy with my partner for years, and this may give me the opportunity to get him out."

"Rob, you confuse me. Every six months you've changed your mind: expand and open more locations, franchise, don't franchise, sell locations, become smaller, sell out, merge, go public, make the big bucks, settle for a substantial living."

"Forget that," he said, "I know all about our previous discussions; what do you think?"

"Rob, your lawyer is probably giving you sound advice, but it's a real tumult and very expensive. What is your opinion? It's your company. Your future head aches, your decision."

Rob hemmed and hawed and concluded with his typical *no decision* decision. We ended our meeting, and off Rob went, I presume, to *go public*. We've had countless discussions of this nature over the past five years. Rob is hard to keep up with.

Larry Jacobs surprised me when he stuck his head in the door of my office. Larry just celebrated his fiftieth birthday and has been in the manufacturing business for twenty years. "Hi," I said, peering over the top of my glasses. "What's up?"

"I'm in deep trouble, and things are just terrible. A hope and a prayer is all I have between me and bankruptcy."

Good grief, I thought, *twenty years in business and look where he's at.*

One evening I was waiting for a table in a restaurant, when suddenly I felt a hand grab my shoulder. I whirled around and was facing Don Altman. "My God, I haven't seen you in months," I said. "How are you?"

"Fine. Just fine. Let me introduce you to my wife." His wife and I smiled. We both knew we had been formally introduced by Don on ten different occasions.

Don and his father had been in the retail business for years; 2003 and 2004 had been very tough years for them. Sales were down and stores had been closed. It must have been a nightmare. I asked Don if his business problems had settled down.

"You know, we shrank from ten to two stores, it's probably just a matter of time before we'll have to sell out. The administrative overhead is still killing us, and I can't get it any lower."

"Is Wally [Don's unproductive alter ego] still working with you?"

"Yeah, we're paying him about $140,000 a year to run our South Gate store. As you know, he's been with us for years; how can I let him go?"

"What good is loyalty if you are out of business?" I asked.

Lowering his head, he replied, "I know, I know. By the way, do you think you could reduce your fee? It sure will help."

I looked at him and said, "Here's some advice. Get rid of Wally. Bankruptcy won't help anybody."

A few days later, I was sitting in my office, feet propped up on the desk, and I was wondering what the hell was going on. Here was Rob Jenkins off and running with his company in several directions depending on his mood swings. The company's sales were down and profits had shrunk considerably. Yet he still couldn't make up his mind about where he wanted his company to go. Larry Jacobs turned down establishing a financial plan to sustain what resources he had left, and Don Altman watched his company get smaller and smaller with his $140,000-per-year sidekick.

Can't they see a *hope and a prayer* isn't the answer? They are lacking direction. They need a well thought out plan or guide to help manage their company's financial future. In good or bad times, *seat of the pants* planning doesn't work.

Jenkins, Altman, and Jacobs may appear to be extreme examples, yet

they are the rule rather than the exception. Most small businesses have minimal, if any, concrete plans for the future. The planning process does not exist. Business is run on a hope and a prayer.

Most owner-managers of small companies have become so inundated with the day-to-day details and problem solving that when one mentions planning for the future, they throw up their hands and shout, "Who has time?"

My observation is that there *is* time, but planning for the future is such an abstract concept that people don't take the time to do it.

THE FIVE-YEAR PLAN: FORGET IT!

I recently had the opportunity to speak at UCLA as part of a business planning seminar. Fortunately, I was the last speaker at an all-day event. Can you imagine eight hours on how to prepare your business plan?

I arrived late, saving myself from the profound advice given by lawyers, underwriters, and other accountants. If it takes eight hours to learn how to prepare a business plan, we'll never do it.

The experts tell us that a five-year plan must be done. Yet who can worry about five years into the future when cash is short, sales are down, good employees are impossible to find, and interest rates are killing us? The future is elusive. It never comes.

First, let's get rid of the notion of a five-year plan. Don't do one. It's too abstract, difficult, and too time-consuming. Let's do it the easy way so we can develop *some* kind of a plan. What is needed is a written business plan that will allow us to measure our activities against established goals, and judge whether we are on the path to success or failure.

There are two kinds of plans needed in today's economic environment. The first, the subject of this chapter, is an operational plan to guide your company. The second, to be discussed in the next chapter, is a personal plan to protect your most important personal asset.

THE *WINE AND CHEESE* BUSINESS PLAN

To prepare your operational business plan—remember, this is going to establish your company's goals—we need five things: (1) a pencil, (2) a pad of legal size yellow paper, (3) a financial advisor, accountant, banker, lawyer, or anybody who has good business sense (we just eliminated the banker and the lawyer), (4) a package of cheese, and (5) a large bottle of wine: white or red, it makes no difference. I prefer a Chardonnay.

Once you have gathered the five items, it will be necessary to establish the proper setting. This can be your office, home, or anyplace that will be quiet and free from distractions. Your planning session should be scheduled after business hours when the phone has stopped ringing.

Follow these four simple steps, and you are on your way to experiencing your first wine-and-cheese planning session and establishing your company's goals and directions.

STEP 1—POUR A LITTLE WINE

Uncork the wine and pour a large glass, take a swig, and eat the cheese at will.

STEP 2—ASK QUESTIONS

Start to ask questions at random regarding various aspects of your business. This is a thinking-out-loud session with your financial advisor. As you ask the questions, write them down. Everything must be written; verbalizing is useless. You will never remember what you've discussed. By the way, don't forget to offer the advisor some wine and cheese.

One typical question you might start with is: What kind of business am I in? Sounds like a silly question, but it is one that should not be overlooked.

Boyd Reiter started his business by importing stereo equipment from Japan. Then he started to export stereo equipment to South America. When the bicycle craze hit he imported bicycles, then jeans. He started manufacturing fishing equipment in Korea and electronic levels in Hong Kong. When he was last seen, he was in New Jersey hiding from creditors. Hey, Boyd, what business were you in?

During this session, a major area to consider is your cash needs. How much cash will you need in the future? When will you run out of cash? Where will you get the cash? Bankers? Partner? Public? Profits? Or use your own? These questions lead to the need for doing cash flow forecasting as we have previously discussed. Do not do your cash flow forecasting in this session. As we discussed, it requires a lot of details and should be prepared, with your input, by your bookkeeper, accountant, or anybody you trust with the information.

After you've had a couple of glasses of wine, you'll probably find the questions come easier.

STEP 3—WRITE DOWN YOUR ANSWERS

As you and your advisor toss questions and answers back and forth, jot them down. Don't worry about grammar and refinement of your answers—just write them down.

THE QUESTIONS

I have a series of questions to consider. One word of caution: After you've read the questions I have provided, you may be tempted to just write answers to these questions. Don't. The free-wheeling dialogue that can develop between you and your advisor will produce greater results.

There are numerous areas to cover during your wine-and-cheese planning session. You may choose to break them down into the following

categories: production, marketing, personnel, facilities, and money.

WHAT BUSINESS AM I IN?

As I indicated earlier, this may seem ridiculous at first. However, it is not unusual to see some businesses going in several directions and not precisely defining what business activity they choose to emphasize.

PRODUCING THE PRODUCT

1. Do I know precisely what my product costs?
2. Will I need a cost accounting system?
3. What are the advantages of producing my own product?
4. What are the disadvantages?
5. What are the advantages of having others produce my product?
6. What are the disadvantages of having others produce my product?
7. Should I manufacture my product or go outside and have others manufacture my product?
8. Should I manufacture it domestically or abroad?
9. What processes do I eventually want automated?
10. Is my plant layout adequate?
11. If my plant layout is not adequate, how will I improve it?
12. Is my equipment obsolete?

13. If my equipment is obsolete, what new equipment do I expect to buy in the future?

14. Is the labor force in this area fulfilling my needs?

15. Are labor costs reasonable?

16. In what direction do I anticipate my future material costs going?

17. Is there an abundant supply of material available?

18. How can I control future costs?

19. Am I buying properly?

20. What can I do to take advantage of discounts?

21. How can I increase my gross margin?

22. Is the demand for my product strong?

23. How can I improve the production of my product or service in the future?

The questions listed above are only the beginning. The dialogue between you and your advisor is needed to expand the scope of your inquiry. If the process is getting overwhelming, stop. Go out for a walk to relax. If your head is beginning to feel scrambled, that's a good sign. It indicates that you are doing creative thinking.

MARKETING

1. Where will I get future business from?

2. Will I stay local, regional, or become national?

3. Will I advertise?

4. Should I use an ad agency?

5. Should I hire a public relations firm?

6. Should I do media advertising-television, newspaper, radio?

7. How much money should I spend on marketing in the future?

8. Will I need a sales manager?

9. Are my distributors adequate?

10. Should I change distributors or hire additional distributors?

11. Will I need brochures, advertising products, samples?

12. When is the best time for me to do my advertising?

13. What results do I expect from my advertising?

14. Is my showroom adequate?

15. Are my displays adequate?
16. Are my window trimmings adequate?

17. Am I using proper methods for submitting bids?

18. Who is the best person in my organization to be meeting with prospective customers?
19. Are my sales personnel trained adequately in the process of selling?

20. Are there trade associations I should join?

PERSONNEL

1. Are my personnel adequate for my future needs?

2. Am I training personnel properly?

3. Am I giving personnel adequate responsibility?

4. What training programs or training facilities will I utilize in the future to assist in the training of personnel?

5. Will I need to expand the number of personnel in the various departments throughout the organization?

6. What criteria will I use for determining who, when, and how to hire or fire?

7. Do I have adequate personnel manuals?

8. Do I have appropriate fringe benefits?

9. Are my salaries competitive?

10. Do I have proper recruiting techniques?
11. Am I following all the laws with regard to personnel?

12. Will I need a personnel director?

13. Will I need a greater level of expertise within our personnel?

14. How will I acquire this?

15. Are my personnel growing as the company is growing?

16. Am I capable of motivating personnel?

17. Do I display appropriate respect for personnel in my dealings with

them?

18. Is there an adequate review procedure to keep personnel informed of their progress within the organization?

19. Are the top levels of management able to function when I'm not around?

20. Do I encourage my employees to be creative and innovative?

21. As the leader of the company, am I accessible?

FACILITIES AND ADMINISTRATION

1. Are my facilities adequate for my future needs?

2. If they are not, will I buy or lease?

3. Where will I relocate?

4. When should I be planning for any future changes in location of facilities?
5. Will I need a purchasing agent?

6. Will I need a cost accountant?

7. Will I need a controller?

8. Is my accounting firm adequate?

9. Are my lawyers capable?

10. Is my rent reasonable?

11. How can I reduce my communication costs?

12. How can I reduce my administrative costs?

13. Do I need an office manager?

14. Are my plant and facilities well organized?

15. Am I using appropriate modern equipment?

16. Am I well insured?

17. What financial structure should I be?

MONEY

1. How much money will I need in the future? This question leads to the need for doing a cash flow forecast. (Refer to Chapter 6) No plan is complete without the answer to this question. Do not attempt to answer this question in your first session.

2. When will I run out of money? All small-and-medium-sized businesses will run short of cash during different times in the business cycle. Preparation in advance for this inevitability is a must. (Refer to Chapter 6)

3. Where will I get money to cover future needs?

    A. Bankers?
    B. Partner?
    C. Investor?
    D. Go public?
    E. My own money?
    F. Other financial institutions?

4. What will I need to prepare for a financial presentation to a

prospective financier? The answer to this question is simple. You will need the following:

A. A business plan
B. Reviewed or audited financial statements of the company.
C. Personal financial statements.
D. A forecast covering future earnings and proposed activity.

ONLY THE BEGINNING

All of these questions are only the beginning. This kind of planning and thinking out loud is a must to get your company moving forward.

STEP 4—THE NEXT DAY

When you have completed the session, two things will have occurred. One, you are probably feeling no pain (too much wine), and two, you've actually worked out a business plan. This plan will provide goals and direction for you and your company.

After you have taken two aspirin, start thinking about what you've prepared. Do the questions and answers make sense?

If you conclude that you've set the right direction and the process is meaningful, bring in others from within your company to seek their input and ideas. Not only should you get some valuable ideas from them, but this could be the start of a new method of dialogue between you and your staff leading to the development of a stronger management team.

Begin to rewrite or restate the questions you've discussed.

Define the answers with the input of others and lay out the plan in logical sequence. Develop a tentative time frame for the implementation of each phase.

Once you have satisfied yourself that your plan is complete, give a copy to all the personnel in your organization. This will give those involved with the company a better understanding of where your company is going and a greater sense of participation in the company's future.

THE BUSINESS PLAN FOR RAISING CAPITAL

The wine-and-cheese operational business plan is to be used for setting goals and directions for your company. These goals can be used by management for measuring short-term results and for providing short-term guidance for the decision-making process.

Often, companies need to develop a broader business plan that gives long range goals and ideas to convey the overall philosophy and direction of the company. These plans are used to secure capital through loans, private financing and/or venture capital.

A WELL-PREPARED BUSINESS PLAN...

- helps management delineate objectives, directions, and strategies.
- helps company officials reach a consensus about the company's future.
- gains the confidence of existing and potential investors.
- shows major suppliers your ability to pay.
- persuades potential customers to place orders by showing your ability to deliver.
- convinces bankers, investors, and other capital sources that your company has planned for its financial success.

A SUCCESSFUL BUSINESS PLAN...

- is prepared or reviewed by outside parties (such as a CPA, management consultant, or attorney).
- shows projected financing and how it will work for the company.
- contains a well-written narrative and a set of financial projections showing the company's projected financial condition, net income, and cash flow.
- is prefaced by a concise summary, which serves as an appetizer for the reader to continue reading.
- provides a tool for later comparison with actual operating results.
- contains all essential disclosures necessary for the reader's decision about your company.
- must be adapted for the specific company.
- is recognized as a dynamic planning tool, subject to change.
- is well written for the potential investor or creditor who is not familiar with the company's past or future operations.

OUTLINE OF A BUSINESS PLAN

The following outline of a typical business plan is intended only to serve as a skeleton guide. There is no such thing as a typical company; therefore any standard outline must be adapted to your specific needs.

When preparing a business plan, carefully identify and describe the characteristics which make your company different. Highlight those characteristics, and be realistic.

The heart of the business plan is a set of financial projections showing the bank or investor how effective you will be with their money.

THE COMPANY

- This section wets the reader's appetite and should be short and concise.
- Incorporation and location (indicate number of employees, etc.)
- Describe products and current stage of development.
- Summarize activities to date.
- Briefly outline the unrealized potential of the company. Be honest. Be realistic.
- Required financing. Be realistic.
- Use of the financing proceeds. Show where the money will go.
- Return on investment.
- Licensing or other agreements of value.

SELECTED FINANCIAL INFORMATION

- Your outside accountants can be helpful in the preparation of this section.
- Include a synopsis of the company's operating results to date.
- This section should include a summary of the results of projections

of the future operations of the company, if the financing plan being proposed is successful.

FACTORS TO CONSIDER

- Include a short, concise statement listing risks to be considered.
- If the company is just starting operations, then a brief narration of its limited operations should be discussed.
- Transactions entered into by the company and related parties should be disclosed, i.e., sales with shareholders, loans to shareholders, etc.
- Operational losses to date (if appropriate).
- Conflicts of interest.
- Applicable government regulations.
- Restrictions on stock transfers or the ability to trade equity securities.
- Loan covenants.
- Dependence on key individuals.
- Requirements for additional financing.
- Potential dilution of interest, because original promoters invested at lower per share amounts.
- Other uncertainties and risks.

Note: While you may believe that citations of risks may negatively affect an investor's or banker's opinion of the company, it conveys an appearance of honesty and lends credibility to the business plan.

Furthermore, if appropriate, the remainder of the business plan should mitigate the identified risks.

- Competition in the field.

USE OF PROCEEDS

If the business plan is to be used to acquire capital (e.g., sales of stock or bank loans), show a schedule of major areas of proceeds uses, followed by a brief textual discussion of each major use. For example, list uses for:

- Marketing
- Website development
- Research and development
- Working capital (breakdown by accounts receivable, inventory, etc.)
- Advertising and promotion
- Equipment and facilities
- Retirement of debt
- Expansion of operations
- Other important uses

PRODUCTS OR SERVICES

- Describe in detail products manufactured or sold to date by the

company.

- Show the historical expansion of product lines and other key operational activities.

- Summarize your intended expansion of product lines.

- List any license agreement related to products.

  Note: Emphasize how your products differ from those of your competitors. Highlight quality, advanced engineering, product appeal to customers, and customer satisfaction.

MARKETING

- Describe your marketing plans. Your marketing consultants may be able to assist in the writing of this section.
- Outline your company's economic base. Who do you serve and want to serve (by age, sex, industry, etc.)?

- Describe the image of your products and service in the eyes of users.

- Summarize marketing and promotion strategy to date.

- Show how marketing has been performed to date (in-house, dealers, distributors, etc.).
- Discuss briefly the market trends and other market data used in marketing decisions.

- Note any intended changes in marketing and promotion strategy.

- Show anticipated benefits of changes in marketing and promotion strategy.

- Name competitors (on a national, regional or local basis) and the

advantages or disadvantages you enjoy, and will enjoy, after carrying out marketing plans.

- Show reaction of customers.

MANAGEMENT

- List the officers and directors of the company.
- Describe their backgrounds, highlighting their experience in related fields.

FINANCIAL STATEMENTS

- Historical operations

PROJECTIONS—A LOOK AT THE COMPANY'S FUTURE

Note: Although projections may be the last item in the package, they are the heart of the plan. They should be highlighted and referred to frequently in the text of the business plan.

13

PERSONAL PLANNING IS A MUST

MOST OF US consider personal planning tantamount to a proper estate plan, good tax planning, setting up pension and/or profit sharing plans, making wise investments, and being adequately insured. In other words, doing everything necessary to keep our hands on what we earn and build an estate for future needs.

This kind of planning is complex and should be done with the help of a good professional advisor. Do not do your estate and tax planning alone. Hire a pro. However, there is more to personal planning than meets the eye.

YOUR MOST VALUABLE ASSET

It was January 31, 1964, and I was experiencing my first tax season as an accountant. I was standing in a large, brightly lit room containing rows of desks where people sat, heads bowed, working over stacks of papers. This is what is commonly referred to in the accounting profession as a *bull pen*, a very sterile, functional work area packed with people.

The back of my neck was killing me, and I ached all over. It was 7:30 p.m., and I couldn't wait to leave. The aching was unbearable.

I left at 8:30 p.m., got home, and my wife asked me if I'd like some dinner.

"No, hon. I just want to lie down and rest." And rest I did. Three days later I awoke and was rushed to the isolation ward of a nearby hospital. I had mononucleosis *and* hepatitis. It would be two and one-half months before I would return to work, on April 16, to be exact—great planning? One day after the end of my first tax season.

If you know anything about mono, as it's called, it's a condition that makes one sleep. The body is so exhausted that sleep is all you want to do and are able to do.

Yet I was so worried and distraught about my loss of income that after my initial three days of sleep and exhaustion, I started to have sleepless nights worrying about where the money would come from to support my wife and family.

My wife was working, but when my checks stopped coming in, it cut our income in half.

Because of those sleepless nights, the doctors started to give me sleeping pills to rest. Here I was suffering from a disease that makes one sleep, and yet I was taking sleeping pills to sleep. The power of a worried mind is incredible.

WHAT WILL HAPPEN TO YOUR BUSINESS?

How much thought have you given to the status of your business if you're not there for a sustained period of time? How many sleepless nights will you have?

Take a look around you. Will your company personnel keep it going? Will you continue to receive your income? Will the business continue, or is it finished because of your absence?

Who will collect the accounts receivable? Who will keep the equipment running? Who will take customer orders? Buy goods? Maintain inventory? Watch cash flow? Pay bills?

GOOD PEOPLE WILL MAKE THE DIFFERENCE

The most important and valuable assets in your company are highly trained and responsible employees. Your survival will depend on trained people. All the devices of high technology are worthless unless you have good people.

An investment in people is as important as an investment in equipment. Good people help us survive. Yet, time and time again, I have heard owners of small companies say that "employees are a pain in the ass; they drive me crazy." If you complain about your employees in this manner, take a hard look at who hired them. The buck stops with you. Good people will make the difference.

WE MUST DELEGATE AND TRAIN

The primary purpose of delegating is to allow owner-managers sufficient time to manage their company. Your time needs to be spent controlling company expenses, monitoring the key financial elements of the company, learning to understand what the company's financial statements mean, and planning for the future. Delegation is also a key element in the development and training of responsible employees.

WHY DO WE RESIST DELEGATING?

The owner-managers of small companies tend not to delegate for several reasons.

Incompetent staff. When we fail to have confidence in subordinates, we will not delegate to them. This can be overcome by hiring better people, providing training and making certain that those people who are incompetent are let go.

The glory of manual labor. A major portion of the functions of the

owner-manager are mental rather than physical. Often using one's brain is not considered working, thus we tend to do physical or manual labor rather than spending time thinking. We attract as much paperwork as we can to keep working.

The goal of owner-managers should be to work their way out of work. There is no glory in doing it all. Here's a thought: Work less, make more.

I can do it better myself. This notion is so ingrained in the personality of the individual who follows it that it is extremely difficult to change. You may or may not be able to do it better yourself, but there is only so much you can do. Your company will never grow beyond your capabilities. If you are guilty of this, let go of it. It's limiting your growth and your company's.

Just starting out. Often when an individual is just starting in business, he finds that his role is that of *chief cook and bottle washer*. He does everything. There is a lack of sufficient resources to hire people and delegate.

When starting in business, this is generally the case and not much can be done about it. However, an integral part of what you do, even though you're just starting out, must include the strategies outlined throughout this book.

MAKE A LIST

Get a small pocket notepad and carry it with you at all times. Every day for the next two weeks, jot down in this notepad all activities in which you have participated. Try to do this contemporaneously with the activity and be as detailed and specific as possible.

After two weeks, have the items on your list typed and numbered. Review the list and place a checkmark alongside each activity that could have been performed by some other individual in your organization.

Count the number of checks and compare them to the number of entries. By dividing the number of checks by the number of entries, you will have the percentage of work you do that could have been performed by others. If you have 140 entries and 75 check marks, for example, 54 percent of your work could have been performed by somebody else (140 divided by 75 = 54 percent).

MAKE ASSIGNMENTS

After you have reviewed your list and decided which tasks to delegate, decide who in your company is best suited for carrying them out. The assignment should be in writing, and you must inform all relevant personnel whom you have chosen to perform the task.

After the assignment has been made and you have informed the appropriate personnel, begin the training.

TRAINING BEGINS AT THE TOP

As an accountant, I have reviewed the financial statements of many, many companies. Consistently I have found few dollars, if any, spent on education. Why do we follow the notion that once we are in business, the process of formal education stops and the school of hard knocks takes over?

Our society and businesses have become so complex that the process of education must continue. The greatest idea, product, or process goes nowhere without highly educated and responsible people.

Remember Ernie Houseman, whose business was expanding? He was so inundated with detail that he was functioning as a clerk. Ernie was a trained chemist with no business education. One night a week Ernie attended class at UCLA studying anthropology. He enjoyed the break from his business routine but why wasn't he attending a class in how to

develop managerial skills?

Continuing education must begin at the top. The highest levels of management must be continuously educated and re-educated to keep up with the ever-changing concepts and theories of management in today's changing environment.

We'll spend twelve to fourteen hours a day running our business, yet we'll spend little time in learning the skills necessary for success. We spend little on our own formal training, and virtually nothing for the levels below.

HOW TO DELEGATE

- **Prepare the learner.** Let them know this new knowledge will be of value to themselves and the company.

- **Present the task**. Make certain your explanations are clear and concise.

- **Practice the job**. Allow the employee to learn by setting aside time to practice. Their other work may be delayed while they are learning their new assignments. Be patient.

- **Make certain the trainee is taking adequate notes.** Have the right attitude. Create an atmosphere where fear and intimidation are not present. Allow people to make mistakes.

- **Get feedback.** After your employee has been left alone re-check the work to make certain it is being correctly. Do this before they have completed the task.

- **Provide additional training.** Use formal educational courses at all levels of your company. Attend trade association meetings and learn from your competitors.

- **Always remember,** new ideas generate new profits.
- **Be patient.**

PROTECT YOUR MOST VALUABLE ASSET

Highly educated and responsible employees are your most important asset. They will protect your business in the event of your disability.

If one day you choose to retire, who better to purchase your interest than key employees? The key employees who have been trained and who are capable of continuing the company will allow you to reap the benefits of your company's value upon retirement.

One day you will die. Your heirs will be panicked. More than likely they will have very little knowledge of your business activity, and pandemonium may be the order of the day.

The business you have spent giving of your blood, sweat, and tears may have been of great value while you were alive, but what value on your death? Will an orderly liquidation or sale take place or will the business be over now that you're gone? Your educated and trained employees will make the difference between value and no value at all. *The continuing education of you and your employees will be your strongest personal asset.*

14

A MATTER OF MINUTES

ONCE THE SYSTEMS described in this book are in place, all it will take is minutes of your time each month to monitor the results of your company's activity to give you a better understanding of your successes and/or failures. You will build a better business and make more money.

The Forecast and Profit and Loss Statements.....20 minutes

To review forecast variances from the actual expenses on a line-by-line basis and ask questions of those individuals in your organization who will have answers as to why the variances are there should take no more than twenty minutes each month. Of course, as the company gets larger and the financial statements and forecasts grow more complex, this time may expand.

The Accounts Receivable.....30 minutes

To review the aged accounts receivable and give collection instructions should take about thirty minutes each month. Before you get the listing of the accounts receivable have your bookkeeper *red line* those customers that failed to pay during the month. This is the time to see who gets those nasty computer letters and a phone call from Bridget.

The Financial Statements.....20 minutes

Have your bookkeeper prepare the ratio analysis from the descriptions in this book. Compare these ratios with the previous months to see if your

financial position is improving.

Cash .....52 minutes

Four minutes a day, three days a week, is all that is needed to check cash balances and review your two-week cash forecast. Keep your money working for you and have your bookkeeper or secretary prepare the two-week forecast.

Now that you have reduced your time in reviewing your company's financial activity to about 122 minutes a month, you will have the time to spend an additional minute or two thinking about whether you are becoming a better manager.

As a better manager, you will control the expenses of the business by developing a forecast and monitoring it monthly.

As a better manager, you will develop a management system to monitor financial statements, cash balances, accounts receivable, and inventories.

As a better manager, you will take the time necessary to do both personal and operational planning. These plans will give the company direction and develop a team to carry out company's goals.

As a better manager, you will know that your attitude and style will be the spirit of the company, that the company is a reflection of the people at the top, and that **they must be the best.**

15

ALL IT TAKES IS LEADERSHIP

The title of this chapter speaks for itself.

Good luck and good skill.

Appendix
A Simplified
Company Financial Statement

(A) YOUR COMPANY, INC.
BALANCE SHEET
As of _____

ASSETS

(1)	CURRENT ASSETS		
	Cash	182,559	
	Accounts receivable—trade, net of allowance for doubtful accounts	146,281	
	Inventory	160,993	
	Prepaid expenses	12,120	
	Deferred taxes	8,969	
	TOTAL CURRENT ASSETS		510,862
(2)	PROPERTY AND EQUIPMENT—At Cost		
	Automobiles	13,428	
	Office furniture and equipment	10,867	
	Plant machinery and equipment	125,019	
	Leasehold improvements	8,579	
	Land	126,150	
		284,043	
	Less accumulated depreciation	109,045	174,998
(3)	OTHER ASSETS		
	Investment	45,305	
	Deposits	2,050	
	Cash surrender value of officers' life insurance	13,765	61,120
	TOTAL ASSETS		746,980

LIABILITIES AND STOCKHOLDERS' EQUITY

(4)	CURRENT LIABILITIES			
	Accounts payable		94,272	
	Accrued expenses		49,602	
	Payroll and sales taxes payable		7,308	
	Current portion of long-term debt		9,798	
	Income taxes payable		2,699	
	TOTAL CURRENT LIABILITIES			163,679
(5)	LONG-TERM DEBT, Net of Current Portion Above			29,394
	TOTAL LIABILITIES			193,073
(6)	STOCKHOLDERS' EQUITY			
	Common stock, no par value; 25,000 shares authorized, 3,180 shares issued and outstanding		3,180	
	Retained earnings:			
	Balance—July 1, 19XX	431,240		
	Net income for the year ended—June 30, 19XX	119,487	550,727	553,907
	TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY			746,980

(B) YOUR COMPANY, INC.
STATEMENT OF INCOME
For the Period Ended _____

		Amount		%
(1)	SALES		1,336,454	100.0
(2)	COST OF GOODS SOLD			
	Beginning inventory	146,653		
	Purchases	792,362		
	Total available	939,015		
	Less ending inventory	160,993	778,082	58.2
(3)	GROSS PROFIT		558,372	41.8
(4)	SELLING AND ADMINISTRATIVE EXPENSES			
	Selling expense	23,172		
	Administrative expense	88,031	111,203	8.3
	INCOME BEFORE OTHER INCOME		447,169	33.5
	OTHER INCOME		6,484	.4
(5)	INCOME BEFORE OFFICERS' COMPENSATION		453,653	33.9
(6)	OFFICERS' COMPENSATION			
	Salaries	250,600		
	Officers' life insurance	1,566	252,166	18.9
(7)	INCOME BEFORE PROVISION FOR INCOME TAXES		201,487	15.0
	PROVISION FOR INCOME TAXES		82,000	6.1
(8)	NET INCOME		119,498	8.9

(C) Your Company, Inc.
Statements of Cash Flows
For the Years Ended December 31,

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	8,550,362	8,094,504
Cash paid to customers	(8,526,349)	(7,777,007)
Interest paid	(66,773)	(66,519)
Interest received	9,653	12,087
Income taxes received (paid)	51,515	(79,364)
NET CASH PROVIDED BY OPERATIONS ACTIVITIES	18,408	183,701
CASH FLOWS FROM INVESTING ACTIVITES		
Purchase of property and equipment	(84,444)	(22,370)
Proceeds from sale of assets	—	6,465
Collections from (advances to) employees	1,032	(5,783)
NET CASH (USED IN) INVESTING ACTIVITIES	(83,412)	(21,688)
CASH FLOWS FROM FINANCING ACTIVITES		
Net borrowings (payments) on long-term debt	28,456	(94,304)
Proceeds from common stock subscribed	8,000	4,942
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITES	36,456	(89,362)
NET (DECREASE) INCRASE IN CASH AND CASH EQUIVALENTS	(28,548)	72,651
CASH AND CASH EQUIVALENTS - Beginning of Year	85,694	13,043
CASH AND CASH EQUIVALENTS - End of Year	57,146	85,694
RECONCILIATION OF NET (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net (loss)	(104,141)	(174,413)
Non-cash expenses included in net (loss):		
Depreciation and amortization	134,339	180,166
Loss on sale of assets	—	10,954
Provision for deferred taxes	(62,348)	(60,900)
Allowance for bad debts	10,026	31,687
Changes in assets and liabilities		
(Increase) decrease in accounts receivable	(61,405)	113,461
(Increase) decrease in unbilled accounts receivable	(129,187)	132,108
(Increase) decrease in deposits	(15,010)	129,538
Decrease (increase) in prepaid income taxes	48,231	(97,512)
Increase (decrease) in accounts payable and accrued expenses	215,775	(82,431)
(Decrease) increase in accrued pension costs	(17,872)	1,043
NET CASH PROVIDED BY OPERATING ACTIVITIES	18,408	183,701

(D) YOUR COMPANY, INC.
SCHEDULE OF SELLING AND ADMINISTRATIVE EXPENSES
For the Period Ended _____

	Amount	%
SELLING EXPENSES		
Advertising	1,645	.1
Automobile	12,238	.9
Conventions	170	—
Commissions	4,532	.3
Freight-out	765	.1
Insurance	1,606	.1
Promotion	1,566	.1
Travel	650	.1
TOTAL SELLING EXPENSES	23,172	1.7
ADMINISTRATIVE EXPENSES		
Bad debts	4,303	.3
Dues and subscriptions	370	—
Employee benefits	1,102	.1
Interest	4,257	.2
Janitors	1,924	.2
Office	2,783	.2
Professional fees	10,681	.8
Profit-sharing plan	48,308	3.6
Relocation	881	.1
Repairs	167	—
Rent	2,612	.2
Salaries-office	5,035	.4
Taxes and licenses	527	—
Taxes—payroll	784	.1
Telephone	4,297	.3
TOTAL ADMINISTRATIVE EXPENSES	88,031	6.5

Sample Reports, Inc.
Profit and Loss Forecast
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Account	Jan.	Feb.	Mar.	Apr.	May	June
Sales	796,181	773,188	784,710	800,000	1,000,000	1,100,000
Purchases	358,281	347,935	353,120	360,000	450,000	495,000
Labor	159,236	154,638	156,942	160,000	200,000	220,000
Overhead	39,809	38,659	39,236	40,000	50,000	55,000
Purchases	557,327	541,232	549,297	560,000	700,000	770,000
Gross profit	238,854	231,956	235,413	240,000	300,000	330,000
Officers salaries	18,000	18,000	18,000	18,000	18,000	18,000
Rent	10,339	10,339	10,339	10,339	10,339	10,339
Office supplies	8,121	7,871	7,988	8,144	10,180	11,198
Insurance	8,041	7,817	7,933	8,088	10,110	11,121
Truck & auto expense	7,325	7,098	7,204	7,344	9,180	10,098
Employee benefits	5,334	5,157	5,234	5,336	6,670	7,337
Telephone	4,299	4,206	4,269	4,352	5,440	5,984
Travel & lodging	3,742	3,642	3,696	3,768	4,710	5,181
Interest credit line	6,687	7,138	2,476	3,379	6,998	9,320
Payroll taxes	3,105	2,977	3,021	3,080	3,850	4,235
Repairs & maintenance	2,787	2,675	2,715	2,768	3,460	3,806
Depreciation	2,883	2,883	2,883	2,883	2,883	2,883
Meals	2,309	2,258	2,291	2,336	2,920	3,212
Legal and accounting	1,831	1,809	1,836	1,872	2,340	2,574
Interest CSV loan	1,833	1,833	1,833	1,833	1,833	1,833
Simple IRA	1,194	1,144	1,161	1,184	1,480	1,628
Dues & subscriptions	1,115	1,106	1,122	1,144	1,430	1,573
Taxes license	1,115	1,098	1,114	1,136	1,420	1,562
Utilities	1,115	1,059	1,075	1,096	1,370	1,507
Promotion	1,115	1,052	1,067	1,088	1,360	1,496
Operating supplies	557	549	557	568	710	781
Workers compensation	557	533	541	552	690	759
Interest on term debt	468	453	438	423	407	392
Donations	239	201	204	208	260	286
Engineering & others	159	139	141	144	180	198
Employee education	159	139	141	144	180	198
Advertising	80	93	94	96	120	132
Total department 4	94,510	93,270	89,377	91,305	108,520	117,633
Net before tax	144,344	138,687	146,036	148,695	191,480	212,367
Income tax	43,303	41,606	43,811	44,609	57,444	63,710
Net income/loss	101,041	97,081	102,225	104,087	134,036	148,657
Ebitda	154,383	149,161	151,834	155,380	201,768	224,962

Sample Reports, Inc.
Profit and Loss Forecast
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Total	%
1,200,000	1,200,000	1,100,000	1,000,000	1,000,000	1,000,000	11,754,079	100.00
540,000	540,000	495,000	450,000	450,000	450,000	5,289,336	45.00
240,000	240,000	220,000	200,000	200,000	200,000	2,350,816	20.00
60,000	60,000	55,000	50,000	50,000	50,000	587,704	5.00
840,000	840,000	770,000	700,000	700,000	700,000	8,227,855	70.00
360,000	360,000	330,000	300,000	300,000	300,000	3,526,224	30.00
18,000	18,000	18,000	18,000	18,000	18,000	216,000	1.84
10,339	10,339	10,339	10,339	10,339	10,339	124,068	1.06
12,216	12,216	11,198	10,180	10,180	10,180	119,672	1.02
12,132	12,132	11,121	10,110	10,110	10,110	118,826	1.01
11,016	11,016	10,098	9,180	9,180	9,180	107,918	0.92
8,004	8,004	7,337	6,670	6,670	6,670	78,424	0.67
6,528	6,528	5,984	5,440	5,440	5,440	63,910	0.54
5,652	5,652	5,181	4,710	4,710	4,710	55,354	0.47
6,493	2,410	875	1,697	875	2,974	51,323	0.44
4,620	4,620	4,235	3,850	3,850	3,850	45,293	0.39
4,152	4,152	3,806	3,460	3,460	3,460	40,701	0.35
2,883	2,883	2,883	2,883	2,883	2,883	34,597	0.29
3,504	3,504	3,212	2,920	2,920	2,920	34,306	0.29
2,808	2,808	2,574	2,340	2,340	2,340	27,473	0.23
1,833	1,833	1,833	1,833	1,833	1,833	21,996	0.19
1,776	1,776	1,628	1,480	1,480	1,480	17,412	0.15
1,716	1,716	1,573	1,430	1,430	1,430	16,784	0.14
1,704	1,704	1,562	1,420	1,420	1,420	16,675	0.14
1,644	1,644	1,507	1,370	1,370	1,370	16,127	0.14
1,632	1,632	1,496	1,360	1,360	1,360	16,017	0.14
852	852	781	710	710	710	8,337	0.07
828	828	759	690	690	690	8,118	0.07
376	360	345	329	313	297	4,602	0.04
312	312	286	260	260	260	3,088	0.03
216	216	198	180	180	180	2,132	0.02
216	216	198	180	180	180	2,132	0.02
144	144	132	120	120	120	1,395	0.01
121,596	117,498	109,141	103,141	102,303	104,386	1,252,680	10.66
238,404	242,502	220,859	196,859	197,697	195,614	2,273,544	19.34
71,521	72,751	66,258	59,058	59,309	58,684	682,063	5.80
166,883	169,751	154,601	137,801	138,388	136,930	1,591,481	13.54
248,156	248,156	224,962	201,768	201,768	201,768	2,364,066	20.11

Sample Reports, Inc.
Cash Flow Forecast
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Account	Jan	Feb	Mar	Apr	May	June
Collections	703,021	635,485	1,167,633	560,626	593,174	969,908
Purchases	334,353	347,935	353,120	360,000	450,000	495,000
Labor	159,236	154,638	156,942	160,000	200,000	220,000
Subtotal	493,590	502,572	510,062	520,000	650,000	715,000
Officers salaries	18,000	18,000	18,000	18,000	18,000	18,000
Rent	10,339	10,339	10,339	10,339	10,339	10,339
Office supplies	8,121	7,871	7,988	8,144	10,180	11,198
Insurance	8,041	7,817	7,933	8,088	10,110	11,121
Truck & auto expense	7,325	7,098	7,204	7,344	9,180	10,098
Employee benefits	5,334	5,157	5,234	5,336	6,670	7,337
Telephone	4,299	4,206	4,269	4,352	5,440	5,984
Travel & lodging	3,742	3,642	3,696	3,768	4,710	5,181
Interest credit line	0	6,687	7,138	2,476	3,379	6,998
Payroll taxes	3,105	2,977	3,021	3,080	3,850	4,235
Repairs & maintenance	2,787	2,675	2,715	2,768	3,460	3,806
Meals	2,309	2,258	2,291	2,336	2,920	3,212
Legal and accounting	1,831	1,809	1,836	1,872	2,340	2,574
Interest CSV loan	1,833	1,833	1,833	1,833	1,833	1,833
Simple IRA	1,194	1,144	1,161	1,184	1,480	1,628
Dues & subscriptions	1,115	1,106	1,122	1,144	1,430	1,573
Taxes license	1,115	1,098	1,114	1,136	1,420	1,562
Utilities	1,115	1,059	1,075	1,096	1,370	1,507
Promotion	1,115	1,052	1,067	1,088	1,360	1,496
Operating supplies	557	549	557	568	710	781
Workers compensation	557	533	541	552	690	759
Interest on term debt	468	453	438	423	407	392
Donations	239	201	204	208	260	286
Engineering & others	159	139	141	144	180	198
Employee Education	159	139	141	144	180	198
Advertising	80	93	94	96	120	132
Total department 4	84,940	89,936	91,156	87,519	102,018	112,428
Total cash out	578,530	592,508	601,217	607,519	752,018	827,428
Line of credit	196,366	77,350	(799,202)	154,727	620,423	398,069
Total other receipts	196,366	77,350	(799,202)	154,727	620,423	398,069
Estimated tax payments	0	0	0	170,516	0	170,516
Term loan paid	3,655	3,670	3,686	3,701	3,717	3,732
Subtotal other payouts	3,655	3,670	3,686	174,217	3,717	174,248
Net cash change	317,202	116,657	(236,472)	(66,383)	457,863	366,301
Beginning cash balance	250,000	567,202	683,858	447,387	381,004	838,866
Ending cash	567,202	683,858	447,387	381,004	838,866	1,205,168

Sample Reports, Inc.
Cash Flow Forecast
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Jul.	Aug.	Sept.	Oct.	Nov.	Dec.	Total
1,493,919	1,158,682	1,076,500	941,429	659,896	618,398	10,578,671
540,000	540,000	495,000	450,000	450,000	450,000	5,265,408
240,000	240,000	220,000	200,000	200,000	200,000	2,350,816
780,000	780,000	715,000	650,000	650,000	650,000	7,616,223
18,000	18,000	18,000	18,000	18,000	18,000	216,000
10,339	10,339	10,339	10,339	10,339	10,339	124,068
12,216	12,216	11,198	10,180	10,180	10,180	119,672
12,132	12,132	11,121	10,110	10,110	10,110	118,826
11,016	11,016	10,098	9,180	9,180	9,180	107,918
8,004	8,004	7,337	6,670	6,670	6,670	78,424
6,528	6,528	5,984	5,440	5,440	5,440	63,910
5,652	5,652	5,181	4,710	4,710	4,710	55,354
9,320	6,493	2,410	875	1,697	875	48,349
4,620	4,620	4,235	3,850	3,850	3,850	45,293
4,152	4,152	3,806	3,460	3,460	3,460	40,701
3,504	3,504	3,212	2,920	2,920	2,920	34,306
2,808	2,808	2,574	2,340	2,340	2,340	27,473
1,833	1,833	1,833	1,833	1,833	1,833	21,996
1,776	1,776	1,628	1,480	1,480	1,480	17,412
1,716	1,716	1,573	1,430	1,430	1,430	16,784
1,704	1,704	1,562	1,420	1,420	1,420	16,675
1,644	1,644	1,507	1,370	1,370	1,370	16,127
1,632	1,632	1,496	1,360	1,360	1,360	16,017
852	852	781	710	710	710	8,337
828	828	759	690	690	690	8,118
376	360	345	329	313	297	4,602
312	312	286	260	260	260	3,088
216	216	198	180	180	180	2,132
216	216	198	180	180	180	2,132
144	144	132	120	120	120	1,395
121,540	118,698	107,793	99,436	100,242	99,404	1,215,109
901,540	898,698	822,793	749,436	750,242	749,404	8,831,333
(484,611)	(699,922)	(263,200)	140,885	(140,885)	359,757	(440,243)
(484,611)	(699,922)	(263,200)	140,885	(140,885)	359,757	(440,243)
0	0	170,516	0	0	170,516	682,063
3,748	3,763	3,779	3,795	3,810	3,826	44,882
3,748	3,763	174,295	3,795	3,810	174,342	726,945
104,020	(443,701)	(183,787)	329,084	(235,042)	54,408	580,150
1,205,168	1,309,188	865,487	681,700	1,010,784	775,742	250,000
1,309,188	865,487	681,700	1,010,784	775,742	830,150	830,150

Sample Reports, Inc.
Forecasted Balance Sheets
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Account	Jan.	Feb.	Mar.	Apr.	May
Cash	567,202	683,858	447,387	381,004	838,866
Accounts receivable	3,059,224	3,196,927	2,814,004	3,053,378	3,460,204
Inventory	219,433	219,433	219,433	219,433	219,433
Prepaid expenses	15,583	15,583	15,583	15,583	15,583
Deposits	37,915	37,915	37,915	37,915	37,915
Other Assets	533,785	533,785	533,785	533,785	533,785
Total	4,433,142	4,687,501	4,068,107	4,241,098	5,105,787
Property & equipment	750,000	750,000	750,000	750,000	750,000
Accumulated depreciation	252,883	255,766	258,649	261,532	264,415
Net property	497,117	494,234	491,351	488,468	485,585
Total assets	4,930,259	5,181,735	4,559,458	4,729,566	5,591,371
Accounts payable	959,517	998,176	1,037,412	1,077,412	1,127,412
Accrued expenses	356,687	357,138	352,476	353,379	356,998
Other payables	100,000	100,000	100,000	100,000	100,000
Income tax payable	120,303	161,909	205,720	79,813	137,257
Due on credit line	1,146,366	1,223,715	424,514	579,241	1,199,664
Term debt payable	466,345	462,674	458,989	455,287	451,571
Liabilities	3,149,218	3,303,614	2,579,111	2,645,132	3,372,902
Common stock	250,000	250,000	250,000	250,000	250,000
Beginning balance:	1,430,000	1,430,000	1,430,000	1,430,000	1,430,000
Net income	101,041	198,121	300,347	404,434	538,470
Ending retain. earn.	1,531,041	1,628,121	1,730,347	1,834,434	1,968,470
Stockholders' equity	1,781,041	1,878,121	1,980,347	2,084,434	2,218,470
Liab. & stockholders' equip.	4,930,259	5,181,735	4,559,458	4,729,566	5,591,371

Sample Reports, Inc.
Forecasted Balance Sheets
For The Periods Ending Jan 31, 2006 Through Dec 31, 2006

Jun.	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
1,205,16	1,309,188	865,487	681,700	1,010,784	775,742	830,150
3,590,296	3,296,377	3,337,695	3,361,195	3,419,765	3,759,870	4,141,472
219,433	219,433	219,433	219,433	219,433	219,433	219,433
15,583	15,583	15,583	15,583	15,583	15,583	15,583
37,915	37,915	37,915	37,915	37,915	37,915	37,915
533,785	533,785	533,785	533,785	533,785	533,785	533,785
5,602,180	5,412,281	5,009,899	4,849,611	5,237,266	5,342,328	5,778,338
750,000	750,000	750,000	750,000	750,000	750,000	750,000
267,298	270,182	273,065	275,948	278,831	281,714	284,597
482,702	479,818	476,935	474,052	471,169	468,286	465,403
6,084,882	5,892,100	5,486,834	5,323,663	5,708,435	5,810,614	6,243,741
1,182,412	1,242,412	1,302,412	1,357,412	1,407,412	1,457,412	1,507,412
359,320	356,493	352,410	350,875	351,697	350,875	352,974
100,000	100,000	100,000	100,000	100,000	100,000	100,000
30,451	101,972	174,723	70,465	129,523	188,832	77,000
1,597,733	1,113,122	413,200	150,000	290,885	150,000	509,757
447,839	444,091	440,328	436,549	432,755	428,944	425,118
3,717,755	3,358,091	2,783,073	2,465,301	2,712,271	2,676,063	2,972,261
250,000	250,000	250,000	250,000	250,000	250,000	250,000
1,430,000	1,430,000	1,430,000	1,430,000	1,430,000	1,430,000	1,430,000
687,127	854,009	1,023,761	1,178,362	1,316,163	1,454,551	1,591,481
2,117,127	2,284,009	2,453,761	2,608,362	2,746,163	2,884,551	3,021,481
2,367,127	2,534,009	2,703,761	2,858,362	2,996,163	3,134,551	3,271,481
6,084,882	5,892,100	5,486,834	5,323,663	5,708,435	5,810,614	6,243,741

Sample Reports, Inc.
Financial Plan Assumptions 2006

Sales	Collected at 90% of sales reduced by $300,000 from Nov to Jan and an additional $400,000 from Feb to May. Collections are 90% of sales in the ratio collected in the prior year.
	x
Purchases	45.00 % of sales.
Labor	20.00 % of sales.
Overhead	
	x
Cost of sales	Total 70.00 percent of sales
Gross profit	Total 30.00 percent of sales
	x
Advertising	% of sales: Mth.1. 0.0%, Mth.2. 0.0%, Mth.3. 0.0%, Mth.4. 0.0%, Mth.5. 0.0%, Mth.6. 0.0%, Mth.7. 0.0%, Mth.8. 0.0%, Mth.9. 0.0%, Mth.10. 0.0%, Mth.11. 0.0%, Mth.12. 0.0%,_
Depreciation	At 2883 per month.
Donations	% of sales: Mth.1. 0.0%, Mth.2. 0.0%, Mth.3. 0.0%, Mth.4. 0.0%, Mth.5. 0.0%, Mth.6. 0.0%, Mth.7. 0.0%, Mth.8. 0.0%, Mth.9. 0.0%, Mth.10. 0.0%, Mth.11. 0.0%, Mth.12. 0.0%,_
Dues and subscriptions	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
Employee benefits	% of sales: Mth.1. 0.7%, Mth.2. 0.7%, Mth.3. 0.7%, Mth.4. 0.7%, Mth.5. 0.7%, Mth.6. 0.7%, Mth.7. 0.7%, Mth.8. 0.7%, Mth.9. 0.7%, Mth.10. 0.7%, Mth.11. 0.7%, Mth.12. 0.7%,_
Employee education	% of sales: Mth.1. 0.0%, Mth.2. 0.0%, Mth.3. 0.0%, Mth.4. 0.0%, Mth.5. 0.0%, Mth.6. 0.0%, Mth.7. 0.0%, Mth.8. 0.0%, Mth.9. 0.0%, Mth.10. 0.0%, Mth.11. 0.0%, Mth.12. 0.0%,_
Engineering & others	% of sales: Mth.1. 0.0%, Mth.2. 0.0%, Mth.3. 0.0%, Mth.4. 0.0%, Mth.5. 0.0%, Mth.6. 0.0%, Mth.7. 0.0%, Mth.8. 0.0%, Mth.9. 0.0%, Mth.10. 0.0%, Mth.11. 0.0%, Mth.12. 0.0%,_
Insurance	% of sales: Mth.1. 1.0%, Mth.2. 1.0%, Mth.3. 1.0%, Mth.4. 1.0%, Mth.5. 1.0%, Mth.6. 1.0%, Mth.7. 1.0%, Mth.8. 1.0%, Mth.9. 1.0%, Mth.10. 1.0%, Mth.11. 1.0%, Mth.12. 1.0%,_
Interest CSV loan	At 1,833 per month. Payment = month incurred 100.0%
Interest credit line	Line of credit information: inventory borrowing rate, 0%, Accounts receivable borrowing rate, 0%, Loan interest rate, 7%.
Interest on term debt	Payment per Month. 1. 4,124, 2. 4,124, 3. 4,124, 4. 4,124, 5. 4,124, 6. 4,124, 7. 4,124, 8. 4,124, 9. 4,124, 10. 4,124, 11. 4,124, 12. 4,124
Legal and accounting	% of sales: Mth.1. 0.2%, Mth.2. 0.2%, Mth.3. 0.2%, Mth.4. 0.2%, Mth.5. 0.2%, Mth.6. 0.2%, Mth.7. 0.2%, Mth.8. 0.2%, Mth.9. 0.2%, Mth.10. 0.2%, Mth.11. 0.2%, Mth.12. 0.2%,_
Meals	% of sales: Mth.1. 0.3%, Mth.2. 0.3%, Mth.3. 0.3%, Mth.4. 0.3%, Mth.5. 0.3%, Mth.6. 0.3%, Mth.7. 0.3%, Mth.8. 0.3%, Mth.9. 0.3%, Mth.10. 0.3%, Mth.11. 0.3%, Mth.12. 0.3%,_
Office supplies	% of sales: Mth.1. 1.0%, Mth.2. 1.0%, Mth.3. 1.0%, Mth.4. 1.0%, Mth.5. 1.0%, Mth.6. 1.0%, Mth.7. 1.0%, Mth.8. 1.0%, Mth.9. 1.0%, Mth.10. 1.0%, Mth.11. 1.0%, Mth.12. 1.0%,_
Officers' salaries	As you wish: Mth.1. 18,000 Mth.2. 18,000 Mth.3. 18,000 Mth.4. 18,000 Mth.5. 18,000 Mth.6. 18,000 Mth.7. 18,000 Mth.8. 18,000 Mth.9. 18,000 Mth.10. 18,000 Mth.11. 18,000 Mth.12. 18,000
Operating supplies	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
Payroll taxes	% of sales: Mth.1. 0.4%, Mth.2. 0.4%, Mth.3. 0.4%, Mth.4. 0.4%, Mth.5. 0.4%, Mth.6. 0.4%, Mth.7. 0.4%, Mth.8. 0.4%, Mth.9. 0.4%, Mth.10. 0.4%, Mth.11. 0.4%, Mth.12. 0.4%,_
Promotion	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
Rent	At 10,339 per month. Payment = month incurred 100.0%
Repairs & maintenance	% of sales: Mth.1. 0.4%, Mth.2. 0.3%, Mth.3. 0.3%, Mth.4. 0.3%, Mth.5. 0.3%, Mth.6. 0.3%, Mth.7. 0.3%, Mth.8. 0.3%, Mth.9. 0.3%, Mth.10. 0.3%, Mth.11. 0.3%, Mth.12. 0.3%,_
Simple IRA	At 0 per month. Payment = month incurred 100.0%
Taxes license	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
Telephone	% of sales: Mth.1. 0.5%, Mth.2. 0.5%, Mth.3. 0.5%, Mth.4. 0.5%, Mth.5. 0.5%, Mth.6. 0.5%, Mth.7. 0.5%, Mth.8. 0.5%, Mth.9. 0.5%, Mth.10. 0.5%, Mth.11. 0.5%, Mth.12. 0.5%,_
Travel & lodging	% of sales: Mth.1. 0.5%, Mth.2. 0.5%, Mth.3. 0.5%, Mth.4. 0.5%, Mth.5. 0.5%, Mth.6. 0.5%, Mth.7. 0.5%, Mth.8. 0.5%, Mth.9. 0.5%, Mth.10. 0.5%, Mth.11. 0.5%, Mth.12. 0.5%,_
Truck & auto expense	% of sales: Mth.1. 0.9%, Mth.2. 0.9%, Mth.3. 0.9%, Mth.4. 0.9%, Mth.5. 0.9%, Mth.6. 0.9%, Mth.7. 0.9%, Mth.8. 0.9%, Mth.9. 0.9%, Mth.10. 0.9%, Mth.11. 0.9%, Mth.12. 0.9%,_
Utilities	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
Workers compensation	% of sales: Mth.1. 0.1%, Mth.2. 0.1%, Mth.3. 0.1%, Mth.4. 0.1%, Mth.5. 0.1%, Mth.6. 0.1%, Mth.7. 0.1%, Mth.8. 0.1%, Mth.9. 0.1%, Mth.10. 0.1%, Mth.11. 0.1%, Mth.12. 0.1%,_
	x
Total department 4	4. Total 10.66 percent of sales
	x
Total expenses	Total 10.66 percent of sales
	x
	x
Net before tax	Total 19.34 percent of sales
Income tax	At 30.00 % of income. Estimated tax payments of 617,952.
	x
Net income/loss	Total 13.54 percent of sales

HARVEY A. GOLDSTEIN'S

DON'T BUST THE BUDGET, TOSS IT!

How To Substantially Increase Profits and Cash Flow
How to Cut Business Costs
How to Prepare a Forecast to Successfully Predict Your Financial Future
How to Monitor your Financial Success
How to Prepare a Business Plan that will Get You More Dollars
How to Make Your Checkbook Obsolete
Discover the Three Items Absolutely Essential for an Effective Forecast
And How to Get Your Banker to say YES!
***plus*, secrets of the singlemost effective business software on the market today ...**

"Harvey Goldstein's *"Don't Bust the Budget, Toss It"* is outstanding, and simply the best book of it's kind I have ever read. His financial plan is comprehensive and concise. If you are an entrepreneur, this tome is required reading."

Peter Y. Stephan, CPA
Tax Resolution Specialist

"If Harvey says it, then it's true. This book is indispensable! Goldstein is a master mentor, and every entrepreneur and business person can benefit from the wisdom that he shares in these pages."

Joel Block,
Founder, Growth-Logic

"Harvey Goldstein knows his subject well. A former appointee of President Ronald Reagan's National Productivity Advisory Board and Chairman of a top accounting firm, he now shares his expertise in this easy-to-read volume. A Top Ten Business Book of this or any other year."

Steve Sanders
President, Iron Mountain Media

"Goldstein takes a shot at the accounting profession for constantly telling us what has happened. He wants us to know what is going to happen. Definitely far more important."

Michael Podolny
Founder, The Podolny Group

Harvey A. Goldstein, CPA is the chairman at **Singer Lewak Greenbaum & Goldstein LLP**, Certified Public Accountants & Management Consultants. During the course of his forty years of professional service, Harvey has attained a wide array of experience with clients in a variety of industries and corporate management issues. He has an extensive record of achievement both on the local and national levels, including Ronald Reagan's National Productivity Advisory Committee, the White House Conference on Small Business, and California Small Business Development Board.

www.upyourcashflow.com

CATEGORY: Business

$15.95 U.S. 17.00 CAN 9.00 U.K.