



CAREER CLUSTER

Finance

CAREER PATHWAY

Corporate Finance

INSTRUCTIONAL AREA

Financial Analysis

FINANCIAL STATEMENT ANALYSIS EVENT

PARTICIPANT INSTRUCTIONS

- The event will be presented to you through your reading of the General Performance Indicators, Specific Performance Indicators and Case Study Situation. You will have up to 60 minutes to review this information and prepare your presentation. You may make notes to use during your presentation.
- You will have up to 15 minutes to make your presentation to the judge (you may have more than one judge).
- Turn in all of your notes and event materials when you have completed the event.

GENERAL PERFORMANCE INDICATORS

- Communications skills—the ability to exchange information and ideas with others through writing, speaking, reading or listening
- Analytical skills—the ability to derive facts from data, findings from facts, conclusions from findings and recommendations from conclusions
- Production skills—the ability to take a concept from an idea and make it real
- Priorities/time management—the ability to determine priorities and manage time commitments
- Economic competencies

SPECIFIC PERFORMANCE INDICATORS

1. Discuss the analysis of a company's financial situation using its financial statement.
2. Manage the risk of errors and fraud.
3. Project future revenues and expenses.
4. Discuss limitations of using financial statements to assess business performance.
5. Describe the nature of income statements.

CASE STUDY SITUATION

You are to assume the role of financial analysts for NORTH AMERICAN DISTRIBUTION EXPERTS, INC., a wholesale distributor. The finance director has asked the team to present findings regarding the fiscal year-end financial statements of the company, specific to the income statement.

Below is the FY2017 income statement for NORTH AMERICAN DISTRIBUTION EXPERTS, INC.:

NORTH AMERICAN DISTRIBUTION EXPERTS, INC.		
INCOME STATEMENT		
FOR THE YEAR ENDED AUGUST 31, 2017		
Revenues:		
Sales (Net Refunds)		28,268,153
Cost of Goods Sold		(20,862,902)
Gross Profit		7,405,251
Expenses:		
Advertising	66,460	
Salaries & Wages	2,677,458	
Repairs & Maintenance	17,675	
Rent	753,891	
Taxes & Licenses	256,627	
Interest	360,350	
Donations	9,259	
Depreciation	13,635	
Selling, General, & Administrative	3,189,679	
Travel & Entertainment	2,441	
Charitable Contributions	21,552	
Miscellaneous Expenses	121,899	
Total Expenses		(7,490,926)
Other Revenues & Expenses:		
Interest		2,617
Capital Gain		3,222
Other Income		17,278

Net Income Before Income Taxes		(62,558)
Income Taxes		(16,584)
NET INCOME (LOSS)		(79,142)
Retained Earnings - Beginning of Year		1,567,879
Retained Earnings - End of Year		1,488,737

YOUR CHALLENGE

The finance director would like a comprehensive review on the company's performance. As a team, you may discuss any topics you deem pertinent to the above income statement.

Prior to your meeting, the finance director sent your team over an email disclosing the following information that might be useful to your financial statement analysis:

1. This is the first fiscal year that NORTH AMERICAN DISTRIBUTION EXPERTS has experienced a NET LOSS.
2. On October 5, 2017, the company's owner infused cash, in the form of a Loan from Shareholders, into the company in the amount of \$375,000.
3. During each quarter-end, a charity event was hosted at company headquarters where all proceeds went to a registered 501c3. Average collections reach approximately \$8,000-\$9,000.
4. Effective this fiscal year, the CFO has requested the finance director to initiate an audit of financial statements for the past 3 years.
5. Travel & entertainment, charitable contributions, and miscellaneous expenses were not deducted on the 1120 Federal Income Tax Return.
6. It is predicted that in FY2018, the company will reach \$30 million in Sales.

At the end of the email, the finance director added a few questions that he/she would like you to cover:

- Do you anticipate a similar financial outlook at the end of FY2018?
- Are there any footnote disclosures that need to be added?
- In the coming months, should an audit team be formed internally or externally in regard to the current year's income statement?

SOLUTION

General Financial Analysis

- Gross Margin = Gross Profit / Sales
 - $\$7,405,251 / \$28,268,153 = 26.2\%$
- Profit Margin = Net Income / Sales
 - $(\$79,142) / \$28,268,153 = (0.28\%)$
- Operating Margin = Operating Income / Sales
 - $(\$85,675) / \$28,268,153 = (0.30\%)$

Limitations of Income Statement

- Intentional Misrepresentation – preparers of the income statement could impose different interpretations and reporting of financial data and as a result misrepresent the company's financial performance.
- Miscellaneous Expenses – there is no breakout of these expenses which equates to large, unaccountable expense.
- Cash Consideration – with respect to the accounting methods and principles, an income statement does not reflect cash changing hands as it is more focused on the matching principles of expenses to recognized revenue.

Projection of Revenues and Expenses

- Sales projection of \$30 million FY2018 is a 6% increase year-over-year.
- Applying a straight-line application of 6% across the entire statement would yield a NET LOSS in FY2018 of \$83,991.
- With the increase of sales, usually selling, general, & administrative (SGA) expenses would result in a linear increase (see next point for clarification)
- In order for the company to yield a NET INCOME FY2018, either the gross margin needs to increase, or expenses would need to decrease.
 - Increase margins = higher priced goods sold to consumers
 - Increasing expenses = third largest expense category of RENT many times consists of leases for buildings which increase year-over-year based on lease contracts.
 - Decrease SGA expenses = while SGA is correlated to sales, a lot of general and administrative expenses can overinflate this line item, with potential for cut backs on certain budget line items

Notes to Financial Statements

- Debt/Subsequent Events – While a loan from shareholders is usually presented on a balance sheet, it is still important to disclose that a \$375,000 loan from the company's owner took place post-fiscal year close.
- Risk and Uncertainties – At the discretion of management, the fact that this is the first year a NET LOSS was posted on the income statement should be disclosed. In addition, a statement regarding the pending audit engagement should be taken into consideration.

Audit Engagement Process

- The PCAOB (Public Company Accounting Oversight Board) releases auditing standards related to consideration of fraud in financial statements.
- The following are high-level considerations that should be covered (taken from AU Section 316):
 - Description and characteristics of fraud
 - Importance of exercising professional skepticism
 - Discussion among engagement personnel regarding the risks of material misstatement due to fraud
 - Obtaining the information needed to identify risks of material misstatement
 - Identifying risks that may result in material misstatement due to fraud
 - Assessing the identified risks after taking into account an evaluation of the entity's programs and controls
 - Responding to the results of the assessment
 - Evaluating audit evidence
 - Communicating about fraud to management, those charged with governance, and others
 - Documenting the auditor's consideration of fraud

POSSIBLE QUESTIONS:

1. Do you believe there is a risk of material misstatement on the income statement? Justify your reasoning.
2. The company has been known to be very generous to its employees outside their regular compensation. Examples of generosity include expense accounts, auto allowances, cell phone reimbursements, and sales incentive gift cards. How does this level of generosity affect the income statement?



FINANCIAL STATEMENT ANALYSIS, 2018

Participant: _____

JUDGE EVALUATION FORM

State/Provincial Event 1

I.D. Number: _____

INSTRUCTIONAL AREA

Financial Analysis

Participant: _____

I.D. Number: _____

Did the participant:

Did the participant:		Little/No Value	Below Expectations	Meets Expectations	Exceeds Expectations	Judged Score
PERFORMANCE INDICATORS						
1.	Discuss the analysis of a company's financial situation using its financial statements?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
2.	Manage the risk of errors and fraud?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
3.	Project future revenues and expenses?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
4.	Discuss limitations of using financial statements to assess business performance?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
5.	Describe the nature of income statements?	0-1-2-3	4-5-6-7-8	9-10-11-12	13-14-15	
PRESENTATION						
6.	Demonstrate clarity of expression?	0-1	2-3	4	5	
7.	Organize ideas?	0-1	2-3	4	5	
8.	Show evidence of mature judgment?	0-1	2-3	4	5	
9.	Overall performance: appropriate appearance, poise, confidence, presentation, technique and responses to judge's questions?	0-1-2	3-4-5	6-7-8	9-10	
TOTAL SCORE						