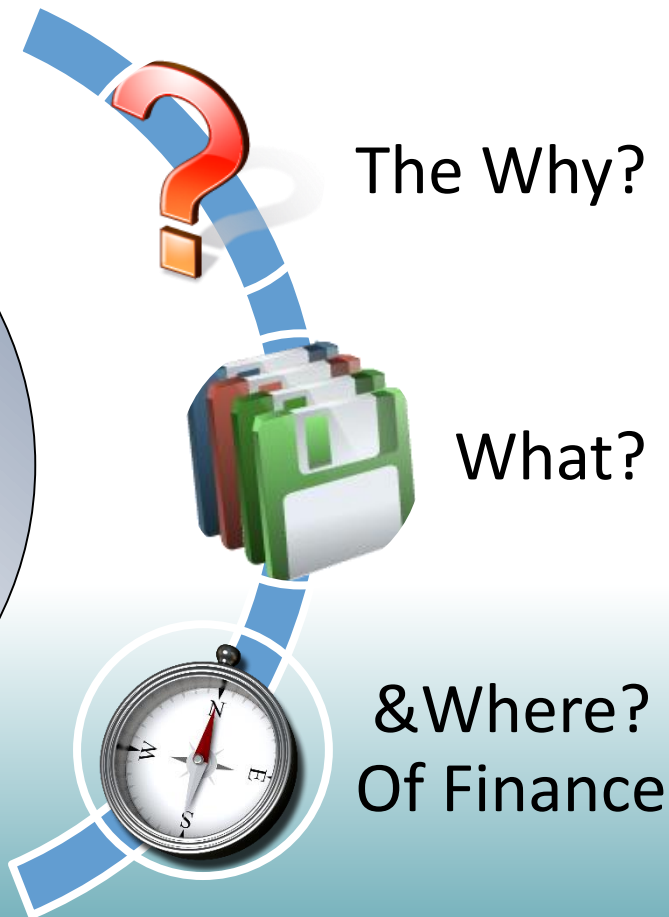


FINANCE FOR NON-FINANCIAL PROFESSIONALS, MANAGERS, & OWNERS

MODULE #1

The
Language
of Finance



EXPLANATION OF HELPFUL ICONS

This icon asks you keep in mind an important point that is central in the explanation of the topic at hand and something to **remember** throughout all of the content presented.



This icon serves as a bookmark tagging a helpful or **great tip** to keep in mind as you move through the course content as well as applying the financial concepts learned in the real world.



This icon serves as a bookmark tagging an extremely significant or **key concept**, idea, or point that will resonate not just with the material being presented but throughout all of the course content.



As you may surmise, this icon serves as a “red light” or **warning** that the going gets a little heavier here. You may have to slow down and digest this material more carefully and ponder it more than usual.



Let's Begin –
Our Vision!

THE LANGUAGE OF FINANCE – KEEPING IT SIMPLE



*Designed
With Main Street In
Mind!*

All modules offered will expose you to technical financial & accounting related concepts. It is not to “baffle” you with our BS or impress Wall Street but rather to introduce the basic finance concepts you need to succeed.

*Remember to
K.I.S.S.*

All Modules and Created Content have been designed around this one critical concept & acronym that needs to be remembered at all times.
“Keep it Simple Stupid”

*Simple & Easy to
Use Business Tools
for Business Mgr.*

Take complex and confusing financial & accounting topics and transform them into simple & easy-to-use business tools that everyone can confidentially understand, use, & apply.

It's Really
This Simple!

THE LANGUAGE OF FINANCE – LEARNING OBJECTIVES

Part 1: “Why” is Understanding Financial Information Critical?

- Turning a profit!
- It takes money to make money!
- Earning a financial return!

Part 2: “What” Financial Information Needs to be Understood?

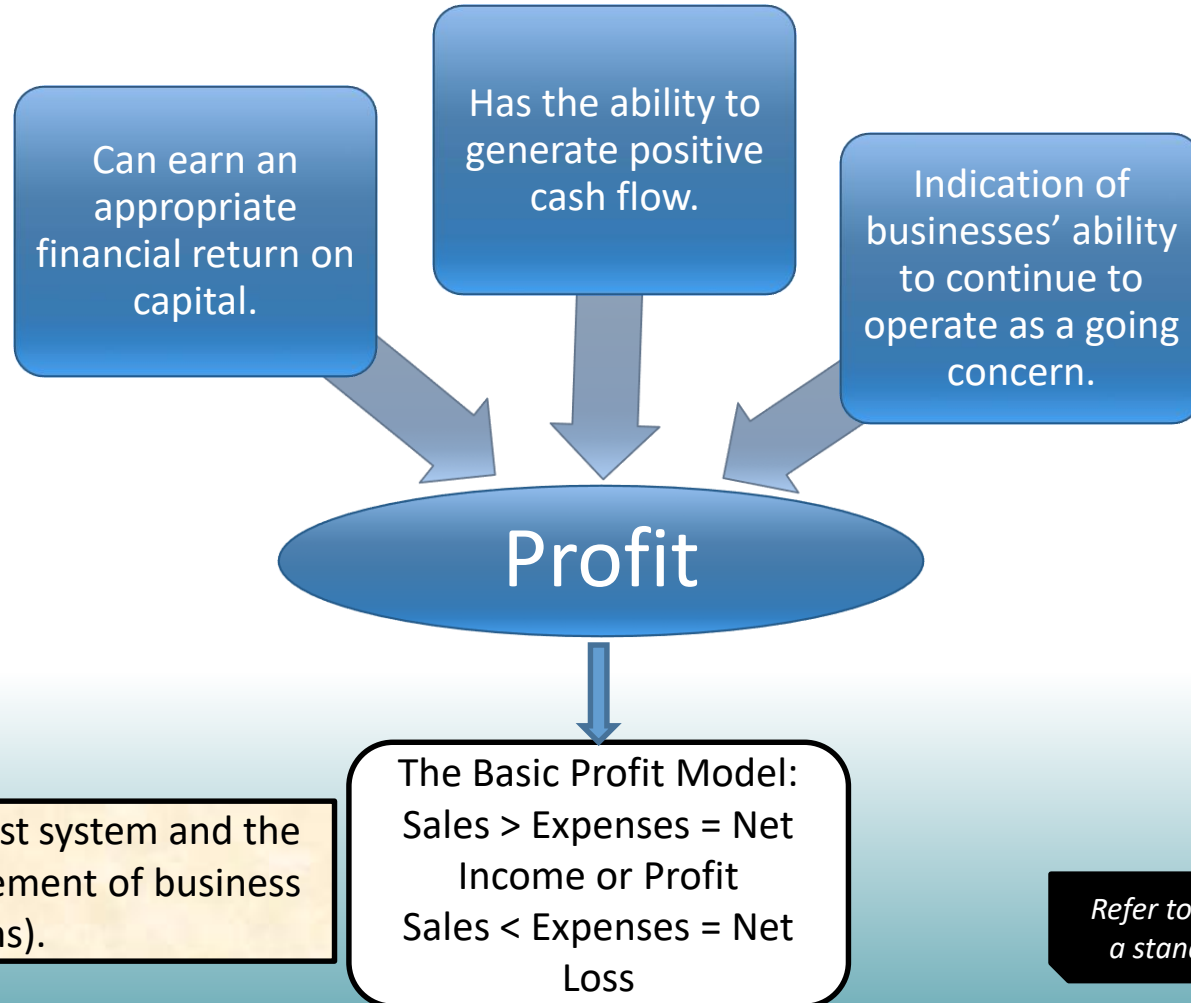
- Financial reports versus financial statements.
- Internal Reports – Managerial.
- External Reports – Financial.

Part 3: “Where” Does Financial Information Come From “The Numbers”?

- What does $2 + 2$ Equal?
- The role of the accounting system (internal).
- The role of the CPA (external).

Part 1 – The
Why?

THE LANGUAGE OF FINANCE – WHY IS PROFIT IMPORTANT?



Earning a “Profit” is the basis of capitalist system and the simplest or most fundamental measurement of business success (in financial terms).

Refer to slide 6 for an example of a standard income statement.

Part 1 – The
Why?

THE LANGUAGE OF FINANCE – THE CLASSIC PROFIT MODEL

Income Statement
For the Twelve Month Period Ending
(all numbers in thousands)

	<u>12/31/2012</u>	<u>12/31/2013</u>
Sales Revenue, Net	\$51,615	\$55,902
Costs of Goods Sold	<u>(\$23,179)</u>	<u>(\$26,122)</u>
Gross Profit	<u>\$28,436</u>	<u>\$29,780</u>
Total Operating Expenses	<u>\$24,165</u>	<u>\$25,665</u>
Operating Income (Loss)	<u>\$4,271</u>	<u>\$4,115</u>
Total Other Expenses (Income)	<u>\$2,120</u>	<u>\$3,645</u>
Net Profit (Loss) before Income Taxes	<u>\$2,151</u>	<u>\$470</u>
Income Tax Expense (benefit)	<u>\$753</u>	<u>\$165</u>
Net Profit (Loss)	<u>\$1,398</u>	<u>\$305</u>

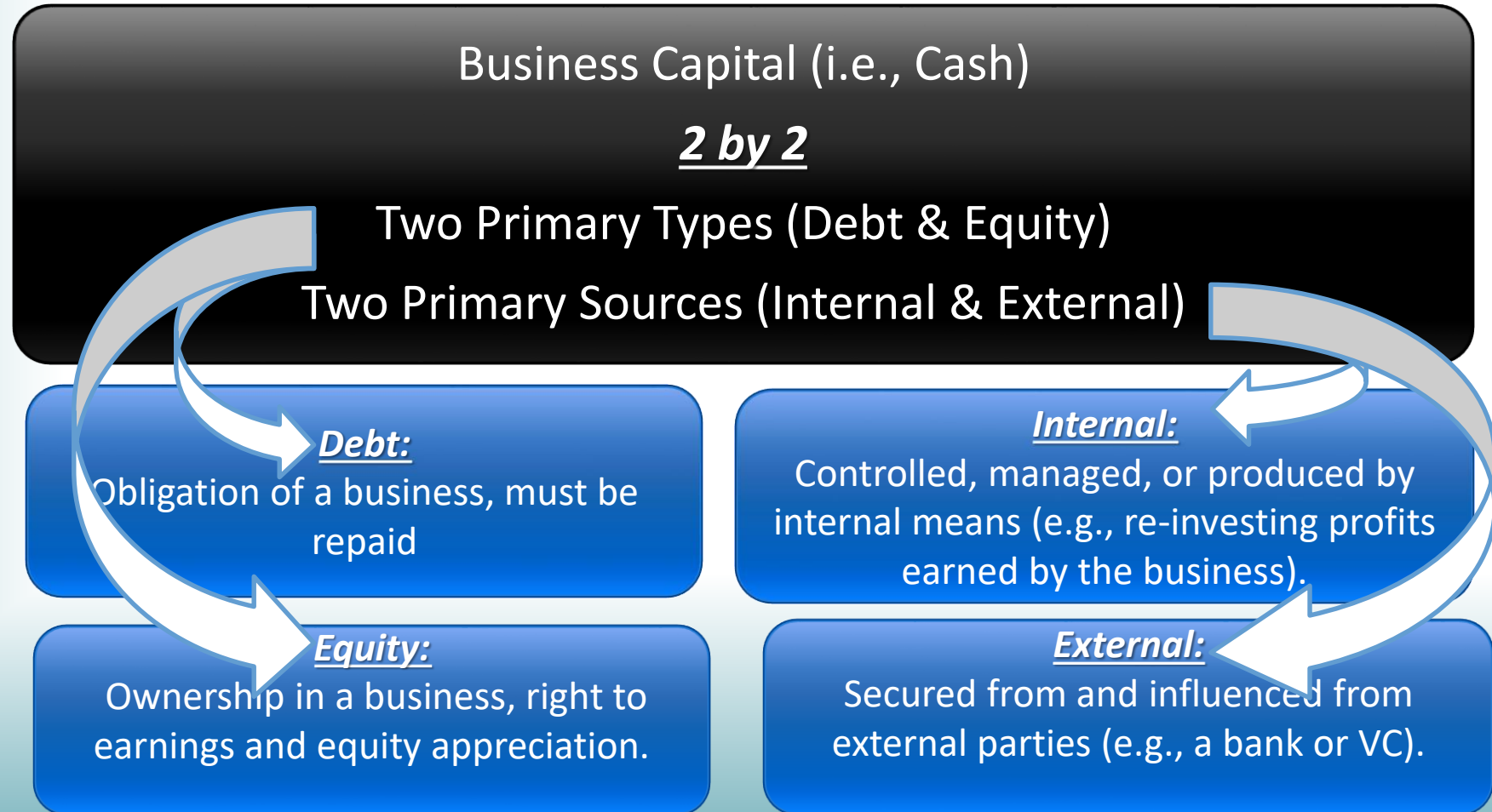
Sales Revenue is always reported first with costs of goods sold then reported to calculate gross profit.

Operating expenses are reported after gross profit and include general business expenses (e.g., advertising).

Net Profit (loss) is reported last and is commonly referred to as “the bottom line”.

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THE LANGUAGE OF FINANCE – TAKES MONEY TO MAKE MONEY!



Part 1 – The Why?

THE LANGUAGE OF FINANCE – THE CLASSIC CAPITAL MODEL

Balance Sheet - Right Side Only

Period Ending
(all numbers in thousands)

12/31/2012

12/31/2013

Liabilities

Current Liabilities:

Accounts Payable

\$1,973

\$2,158

Accrued Expenses & Other Current Liabilities

\$969

\$836

Current Portion of Debt

\$1,000

\$1,000

Total Current Liabilities

\$3,942

\$3,994

Long-term Liabilities:

Notes Payable & Other Long-Term Debt

\$2,500

\$6,500

Total Liabilities

\$6,442

\$10,494

Stockholders' Equity

Capital Stock

\$15,000

\$15,000

Retained Earnings

\$4,470

\$4,775

Total Stockholder's Equity

\$19,470

\$19,775

Total Liabilities & Stockholders Equity

\$25,912

\$30,269

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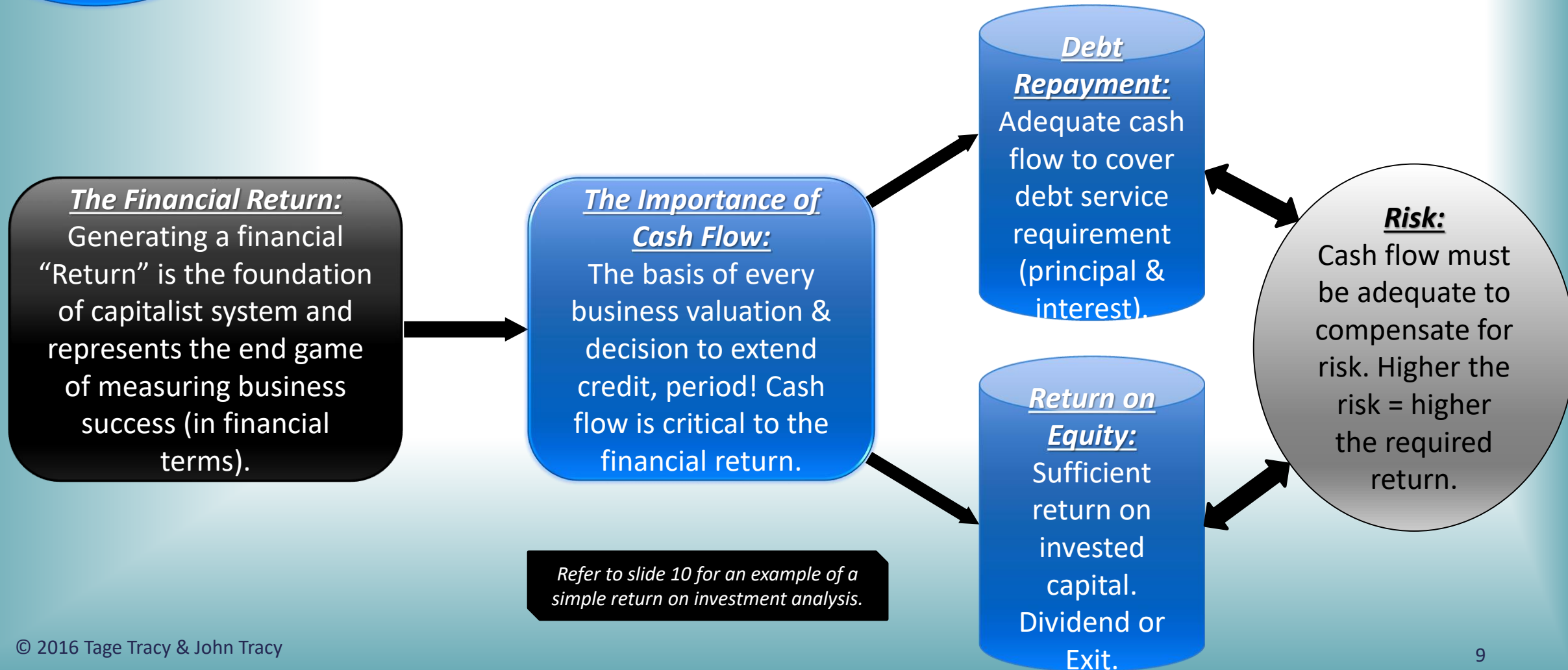
The company has used internal or "retained" earnings to help finance operations.

Both debt and equity has been used to finance operations. Secured from external sources.



Every business requires financial capital to operate. One cannot execute a business plan to generate sales revenue and a profit (hopefully) without having capital.

THE LANGUAGE OF FINANCE – WHAT IS A FINANCIAL RETURN?



Part 1 – The Why?

THE LANGUAGE OF FINANCE – THE CLASSIC INVESTMENT RETURN

Net profit from our profit model slide #6.

Total Stockholders' Equity from our capital model slide #8.

Return On Equity For the Twelve Month Period Ending

	<u>12/31/2012</u>	<u>12/31/2013</u>
Net Profit (Loss)	<u>\$1,398</u>	<u>\$305</u>
Total Stockholders' Equity	<u>\$19,470</u>	<u>\$19,775</u>
Return On Stockholders' Equity	<u>7.18%</u>	<u>1.54%</u>

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Our sample company's annual return on invested capital. Net Profit/Total Stockholders' Equity. Is this Adequate in relation to the risks? Not sure but the negative trend is a concern!



All investments require an eventual "Exit Strategy". Whether debt that is repaid or equity that earns a return!

THE LANGUAGE OF FINANCE – FINANCIAL REPORTS VS. STATEMENTS

The Financial Report
(includes the financial
statements)

Purpose:

- Provides a complete assessment or overview of a company's operating condition or performance at a point in time and/or over a period of time.

Includes:

- Multiple parts and components including executive letters, management discussion of operating results, financial statements, independent CPA audit report, financial statement footnotes, and supplemental information.

A Classic Example:

- Refer to the link below to get a feel for Intel's 2013 annual report and all inclusive nature of the information provided.

http://intc.client.shareholder.com/intel-annual-report/2013/Intel_ARand10K_13.pdf

Public financial reporting as governed by the SEC (e.g., for publicly traded companies) is generally far more detailed, cumbersome, and complex than private company reporting (and beyond scope of course).



THE LANGUAGE OF FINANCE – FINANCIAL REPORTS VS. STATEMENTS

The Financial Statements (part of the financial report)

Purpose:

- Measures the financial condition or performance of a company at a point in time and/or over a period of time

Includes:

- Primarily comprised of the big three financial statements – Balance Sheet, Income Statement, and Statement of Cash Flows (and may also include financial statement footnotes and a CPA audit report).

A Classic Example:

- Refer to the link below to get a feel for Intel's 2013 financial statements as offered on Google. Annual and quarterly data is provided as well as the income statement, balance sheet, and cash flow statement (simply click on the desired information).

<http://www.google.com/finance?q=NASDAQ:INTC&fstype=ii>

Financial statements represents the “Meat and Potatoes” or “Heart and Soul” of a company’s financial information. Before the financial report can be interpreted, the financial statements must be understood (and is the focus of course).



Part 2 – The What?

THE LANGUAGE OF FINANCE REPORTS IN MORE DETAIL

External Financial Reports are generally prepared for public distribution (e.g., publicly traded companies), governed by numerous regulatory bodies, tend to be very lengthy (often exceeding 100 pages of material), are prepared on a more infrequent basis (e.g., quarterly), and are usually comprised of five (5) main sections:

1 – Executive Letters, Business Overview & Assessment, or Management Discussion & Analysis (MD&A or sometimes referred to as MDOR).

2 - Company audited financial statements – the Big Three: Balance Sheet, Income Statement, and the Statement of Cash Flows.

3 -Independent CPA “audit” report on the fairness of the company’s financial statements.

4 - Financial statement footnotes, or commonly referred to as notes to the consolidated financial statements. The Devil’s in the Detail!

5 - Supplemental disclosures, financial reports, and other information that is of relevance and importance to the company.



THE LANGUAGE OF FINANCE – INTERNAL VS. EXTERNAL

Internal Financial Reports – Managerial Accounting

Purpose

- The process of identifying, measuring, analyzing, interpreting, and communicating internal financial information or results. It's the basis of which is used to assist company management with making business decisions.

Structure

- Comes in a large number of formats, styles, structures, and/or levels of detail (compared to external financial reports), driven by specific key business reporting metrics and not intended for external distribution to third parties.

Source

- Frequently produced, confidential internal company information that has not been audited, reviewed, and/or examined by an independent third party.

THE LANGUAGE OF FINANCE – INTERNAL VS. EXTERNAL

External Financial Reports – Financial Accounting

Purpose

- To provide external parties the ability to assess, analyze, evaluate, etc. the operating results of a company

Structure

- Prepared and presented in a summary format, in accordance with GAAP and industry reporting standards, on a consistent basis. Note: Different industries have different reporting standards (i.e., one size does not fit all).

Source

- Infrequently produced (e.g., quarterly or annual), publicly available external company information that is generally audited or reviewed in some capacity by an independent third party. Truthfulness is the overriding objective of providing audited financial information.

THE LANGUAGE OF FINANCE – ACCOUNTING THEORY - THE FIRST 2!

GAAP – Generally Accepted Accounting Principles

The common set of accounting principles, standards, and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information and financial results.

Accrual Accounting Method

An accounting method that measures the performance and position of a company by recognizing economic events regardless of when cash transactions occur. The general idea is that economic events are recognized by matching revenues to expenses (the matching principle) at the time in which the transaction occurs rather than when payment is made (or received). This method allows the current cash inflows/outflows to be combined with future expected cash inflows/outflows to give a more accurate picture of a company's current financial condition.

Part 3 – The
Where

THE LANGUAGE OF FINANCE – ACCOUNTING PRACTICE - THE SECOND 2!

Accounting: Art vs. Science

A critical concept to understand is that GAAP represents more of an “Art” than an exact “Science”. That is, GAAP provides a certain amount of leeway in applying accounting principles by businesses that have similar models yet use different financial and accounting strategies, estimating techniques, etc. for reporting purposes.

Accounting: Multiple Sub- Dialects

Finally, it should be noted that while the language of finance is universal in nature, the language of accounting often comes in many sub-dialects driven by multiple factors including the type of industry a business operates within, country location, public versus private business status, and other factors.



This simple question often posed to accountants. “What does 2+2 equal?” The clever or creative answer, what do you need it to be (which of course is what got the likes of Enron in trouble in 2001)?



THE LANGUAGE OF FINANCE – THE ROLE OF THE ACCOUNTING SYSTEM

Purpose:

- The overall purpose of a company's accounting system is centered in two primary functions. First is to properly safeguard company assets and business interests. Second is to ensure CART financial information is produced for internal and external decision making purposes.

Authorizations, Reviews, & Approvals:

- Proper management reporting chains including reviewing, authorizing, and approving financial information and transactions by the appropriately qualified management team members is essential to producing CART financial information.

Accounting Policies, Procedures, & Methods:

- All companies must establish, adopt, and implement acceptable accounting policies, procedures, and methods that will ensure the production of GAAP based financial information on a timely and consistent basis.

Segregation of Duties:

- Companies should actively implement a policy of segregation of duties or the concept of having more than one person required to complete a task. In business the separation by sharing of more than one individual in one single task is an internal control intended to prevent fraud and errors.



CART stands for Complete, Accurate, Reliable & Timely.

THE LANGUAGE OF FINANCE – THE ROLE OF THE CPA

CPA Responsibility in one word - *Independence:*

CPA firms *are not* responsible for the origination of business financial information. This is the responsibility of the business. Rather, the CPA firm will abide by standards to report on the truthfulness of business financial information they've been presented.

CPA Primary Functions in two words - *Audit & Compliance*

Audit: First, they may be retained to examine the company's financial statements and provide an opinion on the fairness of the financial statements.

Compliance: Second, they are often retained to assist a company with complying with various reporting requirements (e.g., preparation and filing of income tax returns).

THE LANGUAGE OF FINANCE – TYPES OF CPA FINANCIAL REPORTS

Three Types of CPA Firm Prepared Financial Statements

- **Complied Financial Statements:** CPA firm examination is limited in scope with no assurance provided that the financial statements are prepared in accordance with GAAP.
- **Reviewed Financial Statements:** CPA firm reviews financial information but does not audit any data. A review report is provided that states the CPA firm is not aware of any deviations from GAAP but yet cannot provide full assurance that GAAP financial statements have been produced.
- **Audited Financial Statements:** CPA firm completes a full audit and provides a fairness opinion (i.e., swears or attests) as to whether the company has produced GAAP based financial statements.

Two Types of CPA Firm Reports (only when an audit is completed)

- **Unqualified:** The desired audit report opinion is Unqualified or more popularly called a “clean” opinion. Basically this indicates the CPA firm has no significant disagreements with the financial statements and footnotes or disclosures of the company.
- **Qualified:** This is not desired and basically indicates the CPA firm has concerns, problems, and or disagrees with the company’s management about the fairness of the financial information presented. Qualified audit reports and opinions represent major red flags for external parties.

In Closing –
Three Keys

THE LANGUAGE OF FINANCE – THREE KEYS TO REMEMBER

Financial Responsibility

First and foremost, production of all financial information represents an internal business mgmt. responsibility. Without a highly reliable and properly functioning financial reporting system, both internal management and external capital sources will fail at their most important tasks – To Make Informed Business Decisions!

Financial Statements

Financial statements represent the heart and soul of measuring the financial performance and condition of a business. If you don't understand financial statements, you cannot possibly understand how a business operates and expects to succeed.

Financial Language

Finance, as a universal language, is how business success is measured or failure quantified, in any global capitalist market. Accounting is like the finance alphabet, and comes in many sub-dialects.

THE LANGUAGE OF FINANCE

THE 3 STEPS TO THE FLOW OF FINANCIAL INFORMATION

