The Basics of Financial Statement Analysis

FEDERATION of CREDIT
and FINANCIAL PROFESSIONALS

EXECUTIVE SUMMARY

Admittedly, it is not always easy to obtain financial information from a customer, much less a complete set of Financial Statements. When dealing with smaller or privately held companies, it is even more so. However, combined with traditional payment references and credit reports, Financial Statements are most important to the Credit Professional. Without them, it is very difficult to get a clear picture of a company's financial strength, or lack thereof.

Reviewing the High Credits in trade references, if they are even provided, and credit reports to get an idea of just how much open account credit to extend, is helpful, yet limited. Sometimes, you must even evaluate the present AR balance to substitute it for a missing High Credit. However, having a customer's Net Worth, Assets, Liabilities, Revenue and Expenses in front of you, together with those references and reports, makes arriving at a Credit Availability (Limit?) number that much easier.

Tom Gannon, CCE
Director of Research & Education
Federation of Credit and
Financial Professionals

FEDERATION of CREDIT and FINANCIAL PROFESSIONALS

The Basics of Financial Statement Analysis

Admittedly, it is not always easy to obtain financial information from a customer, much less a complete set of Financial Statements. When dealing with smaller or privately held companies, it is even more so. However, combined with traditional payment references and credit reports, Financial Statements are most important to the Credit Professional. Without them, it is very difficult to get a clear picture of a company's financial strength, or lack thereof.

Reviewing the High Credits in trade references, if they are even provided, and credit reports to get an idea of just how much open account credit to extend, is helpful, yet limited. Sometimes, you must even evaluate the present AR balance to substitute it for a missing High Credit. However, having a customer's Net Worth, Assets, Liabilities, Revenue and Expenses in front of you, together with those references and reports, makes arriving at a Credit Availability (Limit?) number that much easier. The following should provide a basic understanding of Financial Statements and their usefulness in credit analysis.

Types of Financial Statements

Financial Statements come in several forms, an understanding of which is important to your ability to rely on the data:

- **Management Prepared Statements**: These are prepared in-house, by the customer's accounting staff, using whatever tools and computer systems that may be available to them. Computer systems designed for accounting functions are great IF that data is entered properly AND there is proper oversight by a trained accountant. You may not know that both are true, so you should be cautious in your reliance on this type of statement. Still, some financial data is better than no financial data. As you analyze these Financial Statements, and you have questions or concerns, there is always the opportunity to ask the customer to clarify.
- **Unaudited Statements**: These are prepared by outside public accounting professionals and come in two versions:
  - **Compiled**: These are generally more professional looking than those prepared by a customer not using accounting software. Data will be presented in the proper format, but there is nothing done to ensure the accuracy of that data. If the accountant's client says that a number is such-and-such and lists it in a certain space, the compiled statement will have it right there. No questions are asked, generally speaking.
  - **Reviewed**: The outside accountant will go into the process a little deeper. For instance, if there is a long-term listed, but there is no indication of payments being due according to a schedule, the CPA may ask the client to clarify. Correspondingly, if there is no indication of interest being due, questions will be asked. At the very least, you can rely on these Financial Statements being accurate, BUT only to the extent that numbers are where they should be, by

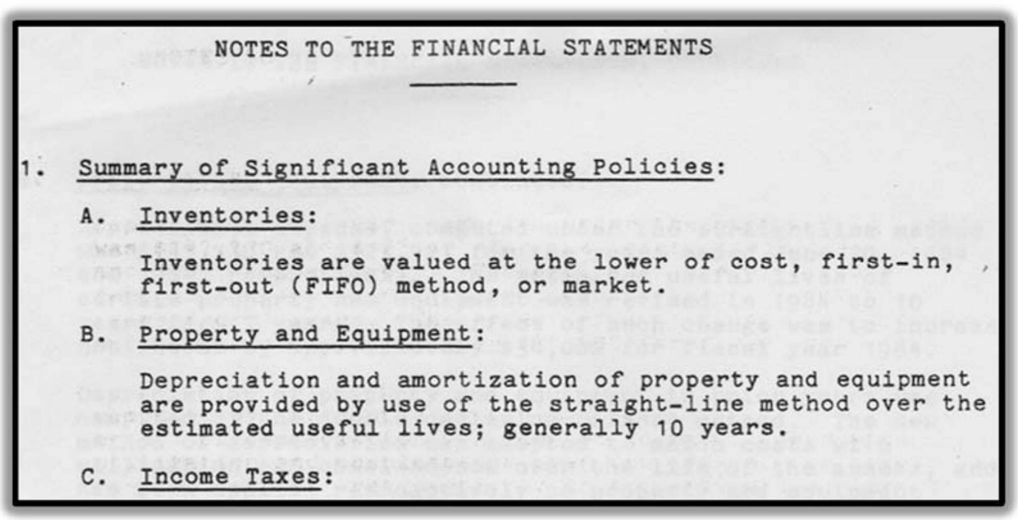
category. The CPA firm does not verify the actual data. In both cases described here, the CPA will provide a letter stating which process was used.

- **Audited Statements**: On the other hand, this is the most accurate and reliable form, because they are prepared by the outside Certified Public Accountant, according to GAAP (**G**enerally **A**ccepted **A**ccounting **P**rinciples), issued by FASB (**F**inancial **A**ccounting **S**tandards **B**oard). In the international arena, there is an equivalent IFRS (**I**nternational **F**inancial **R**eporting **S**tandards) issued by IASB (**I**nternational **A**ccounting **S**tandards **B**oard). FASB requires that any Financial Statements issued outside of a company must be prepared according to GAAP. A CPA firm will explain in its attached letter that the financial data was verified, is in accordance with GAAP, and that they fairly represent the company's financial condition, as of the time of the audit. Verification of the data means, for instance, that the firm's representatives actually conducted sample inventory counts, sent AR verification letters to customers and so on. Keep in mind that there is still some room within GAAP to manipulate data, but it is far more difficult to do so, making an audited statement reasonably reliable for the purposes of credit analysis.

Regardless of the type of statement, keep in mind the date, since even an audited statement is only pertinent as of that date, usually the end of the company's fiscal year end.

Notes to Financial Statements

At the end of the Financial Statements will be a Notes section, which is often more important than the data itself. Besides explaining certain company accounting policies, such as whether they are accrual or cash-based, whether inventory is valued at market value, generally the same as LIFO (**L**ast-**I**n, **F**irst-**O**ut) or FIFO (**F**irst-**I**n, **F**irst-**O**ut), they will also provide details on certain of the more critical data values. For instance, if there is long-term debt, the Notes will provide the terms and payment amounts. The Fixed Assets category on the Balance Sheet may be further broken down into sub-categories, such as Machinery and Equipment, Furniture and Fixtures, with their relative Depreciation amounts. The latter will also be explained, as to what type of method is used to calculate Depreciation, such as the Straight-Line method. (The sample statement is from an old file from the 1980s, when yours truly was a child!)



NOTES TO THE FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

A. Inventories:

Inventories are valued at the lower of cost, first-in, first-out (FIFO) method, or market.

B. Property and Equipment:

Depreciation and amortization of property and equipment are provided by use of the straight-line method over the estimated useful lives; generally 10 years.

C. Income Taxes:

The notes will also explain whether changes in various calculation methods occurred during that year, plus the effects of those changes on the actual data.

When dealing with smaller or privately owned corporations or an LLC (**L**imited **L**iability **C**ompany), the Notes may also disclose whether the Principal(s) personally guarantees any of the debt.

able. The note is payable in monthly installments maturing in September, 1989.(a)	266,550	297,613
Note payable bearing simple interest at 8% per annum. The note is due in September, 1989.(b)	35,000	45,000
Demand notes payable bearing interest due monthly at 18%.	18,750	25,000
Other	9,832	28,947
	1,233,465	1,151,560
Current portion	275,000	225,733
	$ 958,465	$ 925,827

(a) Personally guaranteed by certain officers of the Company. The Company is required to maintain minimum working capital and net worth balances, and cannot exceed a stated ratio of liabilities to net worth, as defined in the agreement.

(b) Personally guaranteed by [redacted] president.

It is very important to consider the Notes when doing your analysis, because, in some cases, they can change your perspective. For instance, if a Principal has already signed a Personal Guaranty, you may wish to see his or her (their) Personal Financial Statements, to see if they have the wherewithal to support a PG with your company. They will also explain anything that may have occurred before, during or after the audit that resulted in material changes to the data or circumstances.

Format of Financial Statements

Many people will understand that a set of Financial Statements includes a Balance Sheet and an Income Statement, when, in fact, there is a third type, called A Statement of Cash Flows:

- **Balance Sheet:** This provides a list of Assets, Liabilities and Equity. It is essentially a "snapshot in time", representing a company's financial position as of a specific point in time, only. Typically, this is at the end of a fiscal year, but can also be reviewed monthly and quarterly.
- **Income Statement:** Also referred to as a P & L (**P**rofit and **L**oss) Statement, this provides a look at what occurred over the period of time between fiscal period closings. Instead of being a snapshot, it is the accumulation of effects that result in that snapshot, aka Balance Sheet. It

includes the revenue and expenses that result in either a profit or a loss, which then has a material effect on the company's worth.

- **Statement of Cash Flows:** Using items from both of the previous statements, this statement details the ins-&-outs of cash, showing the effects on certain key accounts. It essentially shows from where a company gets its money and what it does with it. It is a key element in determining how a company goes about its business.

It is very important that, if one is fortunate enough to have a complete set of audited statements, the analysis of a company's financial strength includes the Notes and the Auditor's report, as stated in their letter. Then, the customer's creditworthiness is determined by this information, plus the results of a complete credit investigation. Statement numbers alone do not provide a complete picture for creditors, although they generally are sufficient for investors.

The "T" Account/ Balance Sheet

To the uninitiated, the terms "debit" and "credit" imply an increase (+) or a decrease (-) in some value. When working with a single asset account, such as Accounts Receivable, that is true. However, when dealing with a liability account, such as Accounts Payable, the opposite is true. (Also, note the grammar/ spelling aspect in that multiple A/R accounts are expressed as above, not "Account Receivables", as is often used orally. On the other hand, simply using "Receivables", outside of the actual written statement, is fine. The same is true for "Payables".)

When determining whether an item is a debit or a credit, it is necessary to first understand what is referred to as "The "T" Account", and to realize that the increase or decrease aspect is based on where the item appears. This will also be helpful when we discuss "double-entry" bookkeeping later. Welcome to the world of Accounting!

Perhaps, for convenience, it is better to refer to the "T" Account in terms of "left" and "right"? Not really, except in this display of it.

More importantly, this image, regarding the accounts shown in black, illustrates the basic Accounting Equation (Assets – Liabilities = Equity). In other words, what a company owns, less what it owes, is what it is worth. The Equity account shown above is for a corporation, since its owners are known as Stockholders. Other types of companies will vary:

- **Sole Proprietor:** Owner's Equity
- **Limited Liability Company:** Its owners are known as Members; therefore the account will be labeled "Members' Equity".
- **Partnerships:** These are owned by General Partners and Limited Partners, so it will be shown as "Partners' Equity", sub-divided by type. (Similarly, a corporation's Equity may be divided according to General and Preferred.)

Each item shown can have an adjustment that lowers its value. On the left side, labeled "Debits", are several Asset accounts:

- **Cash:** Actually, this refers to actual cash in the bank, even actual currency in hand. It is also relevant to marketable short-term securities or investments that can readily be "cashed out".
- **Accounts Receivable:** This obviously refers to money due from customers on open charge accounts. However, similarly worded accounts may reflect amounts due from customers over an extended periods of time, otherwise known as Notes Receivable, plus any other amounts due from anyone else, such as employees, principals and so on.
- **Inventory:** Obviously, this refers to material on hand, to sell to a customer directly or to be used in building something to sell to customer.
- **Plant and Equipment:** This general category in the slide is actually expanded to include Land, Buildings, Furniture and Fixtures, Vehicles, etc., titled Fixed Assets
- **Other Assets:** Although not shown on the PowerPoint slide above, this is often seen on Balance Sheets. It will include pre-paid debts and something known as Goodwill, an example of which may be shown in the case of an acquisition. The Buyer may pay an amount that exceeds the actual book value of the Seller's assets, less Liabilities, the difference of which will be carried as an additional asset, amortized over time.

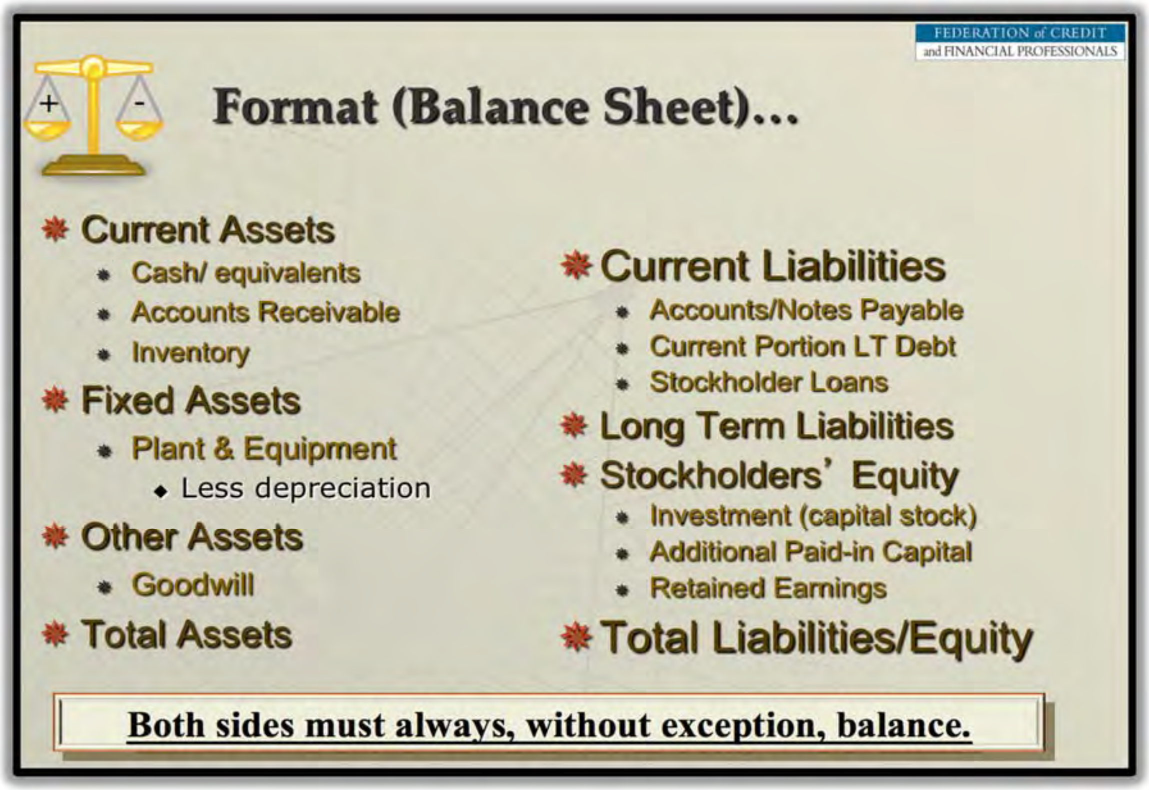
Some assets have what are known as "gross" and "net" values. For the sake of clarity, both values are, or should be, listed. Public firms must do so, but many, although not all, privately-held companies will not. For instance, A/R will usually have a potential for some losses due to bankruptcy or other reasons for non-payment. The F/S will show the billed Total Accounts Receivable, a deduction for an estimated Allowance for Bad Debts, then a Net Accounts Receivable. The same is true for Fixed Assets. Vehicles, for instance, have an estimated useful life, so there will be the actual cost of the vehicle(s), less Depreciation, and then the net value. The net values are part of the equation, and they are used in things like Ratio Analysis, discussed later. In accounting language, the adjustments, on both sides of the "T", are known as contra-accounts.

On the right side, labeled "Credits" are several Liability accounts and Equity:

- **<u>Accounts Payable:</u>** This general title includes what is owed for items purchased, either for sales to a customer, manufactured for sale to a customer or for used by the business, such as furniture. Sub-categories may include taxes payable and similar.
- **<u>Notes Payable and Long-Term Debt:</u>** The former are usually considered short-term debt, but they may exceed 12 months. Long-Term Debt usually consists of multi-year items, such as mortgages, large bank loans and so on. For the sake of the format shown, Notes Payable consists of the short-term variety, as in less than 12 months, plus the so-called current portion of the longer-term loans.
- **<u>Equity (Net Worth):</u>** Basically, this is the difference between Assets and Liabilities. However, it, too, has sub-categories:
  - **<u>Capital Stock:</u>** For the sake of simplicity, this may be considered the initial principal investment, although it may increase in value over time, as shares are bought and sold. Of course, this investment is called something else for the other types of business organizations. (Interestingly enough, not generally known, is that the limited shares in a Limited Partnership may be bought and sold publicly on the Exchange.) There are two primary types of stock shares:
- **Common:** Briefly, this type has voting rights, but is at the bottom of the distribution list in a liquidation scenario. Also, common stockholders may receive dividends.
- **Preferred:** The opposite is true, in that there are no voting rights and a slightly higher position in a liquidation scenario. Dividend rights are a little more complicated.
  - **<u>Additional Paid-in Capital:</u>** The principals may invest additional funds above and beyond the capital value discussed above. (This can be a tricky item, to be discussed in more detail later)
  - **<u>Treasury Stock:</u>** In this case, the company repurchased certain shares of previously issued stock, for whatever reason. They can be retired, resold or kept as is. (A concern may be the impact on the company's cash position.) No dividends are paid, and the shares are non-voting.
  - **<u>Retained Earnings:</u>** This represents profits retained in the business, beyond any dividends or other owner distributions. This is an important item, in that it represents the successes or failures of the company and the desire of its owners to increase its value.

<u>Note:</u> Both Assets and Liabilities include a "Current" sub-category. "Current Assets" include any asset that is considered to be convertible to cash with the following fiscal year. "Current Liabilities" are debts that will become due within that same period. The difference between the two is Working Capital, funds that are available for growth, or to cover a debt in the short term.

Below is a visual summary of the items just discussed. As shown, both sides of this "T" account must always, always and without any exception, balance, to the penny:

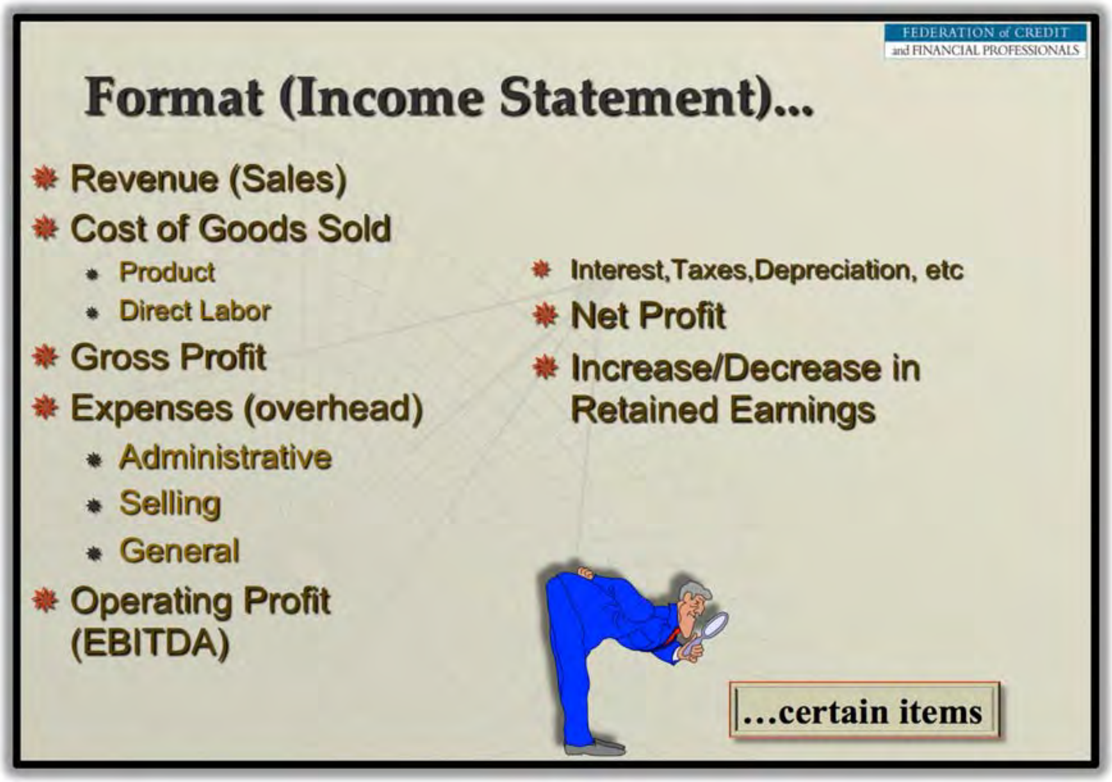


Special Note: As mentioned, some principals will invest additional funds, beyond their original amount. A true "investment" will show in the Equity section, as described. However, other principals will lend the money to the company, which is their right. Some, out of ignorance or intentionally, will show this loan as long-term debt. In reality, a Credit Professional may wish to assume that most people will, when the company trend is down, also within their rights, re-pay themselves before other creditors, regardless of the actual terms of the loan. Thus for the sake of analysis, it is suggested, even recommended, that Stockholder/ Member/ Partner/ Owner Loans always be "adjusted" to be current debt.

The Income Statement

Although the Income Statement, for the purposes of describing "Debits" and "Credits", was represented in the "T" Account, by referring to Revenue and Expenses, it is usually presented vertically.

The so-called "Top Line" down to the proverbial "Bottom Line" is a series of debits and credits, which summarize the day-day activities of the company throughout the fiscal period that results in the "snapshot" Balance Sheet. It is very important to understand what the company actually did during that timeframe, especially when analyzing changes between multiple periods and Balance Sheets. A Credit Professional can see the trends and relationships behind that "snapshot(s)".



Beginning at the top:

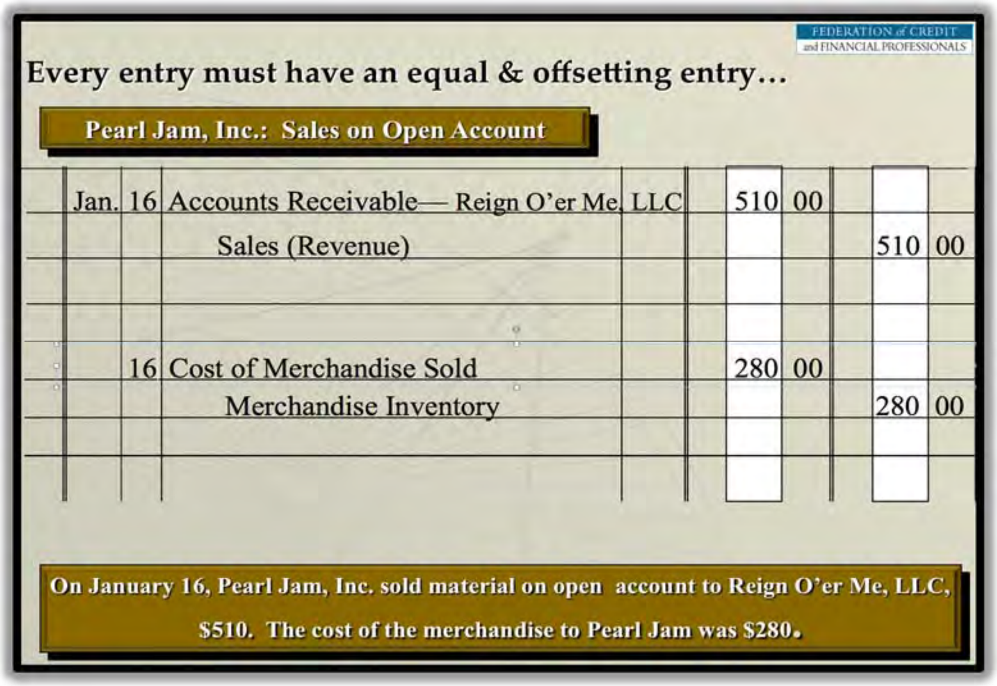
- **Revenue:** Another word is "Sales", but it also includes service work and so on. Some companies will list multiple sources of revenue, so they can see their own trends in different areas of their company. As with contra-accounts on the Balance Sheet, this item will generally show Gross Revenue, less returns and allowances, for a detailed understanding, followed by Net Revenue.
- **Cost of Goods Sold:** In order to sell something or provide a service, a company must buy something to sell or hire someone to do work. This is where one sees these values. "Product" may be self-explanatory, but "Direct Labor" requires a little more. While every company has employees, this category concerns only those who actually perform labor to build or install/ service its products, apart from other employees who provide support.
- **Gross Profit:** This is the difference between Net Revenue and Cost of Goods Sold. It provides an understanding about just how successful, or not, a company is with its basic defined purpose. This value must then pay for everything else that a company accumulates in terms of bills. A successful company will anticipate this, and budget accordingly with its pricing.
- **Expenses:** This is otherwise known as "Overhead", which is essentially every cost not directly attached to the sale of goods and/ or services. Everything from rent, the telephone bill, heating and cooling the office and indirect labor is included. (While some people refer to "Overhead" in a negative tone, one must consider that the Credit Department is part of it, and a company cannot spend "Revenue" or "Accounts Receivable. It can only spend the "Cash" generated by Credit, or it must borrow money, which eventually has to be re-paid, with added interest expense! Go Credit!!)

- **Operating Profit:** Also referred to by the acronym EBITDA (**E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization), this is an indication of a company's success/ failure with its day-to-day operation, before Management's contribution.
- **Net Profit:** This is the "Bottom Line". Everything that a company did during that particular fiscal period affects the result. Selling products/ services and then keeping all of the back office stuff in order, resulting in EBITDA, is one thing, but outside successes and failures, plus some management choices, such as borrowing money at high rates of interest, can also radically impact this number.
- **Retained Earnings:** The decision to keep profits in the business, rather than cutting dividend checks, can also dramatically affect a company's Balance Sheet. A negative or declining number here is cause for concern. (Note: Yours truly has seen some "highly" successful companies with deficit Net Worth numbers, simply because they have excellent cash flow, and they pay their bills on time. However, a good Credit Professional will never take his or her "eye off the ball", as they say.)
- **Certain Items:** Always take note of any strange looking numbers and their relationships with other numbers or circumstances. For instance, if the company operates from a building owned by the Principal, is there excessive Rent shown? Unusual pre-paid items could inflate the Net Worth. Be sure to include your open A/R balance, as of the appropriate date, when reviewing the A/P number. If your number alone exceeds their total, there is definitely cause to suspect inefficiencies, even potential fraud.

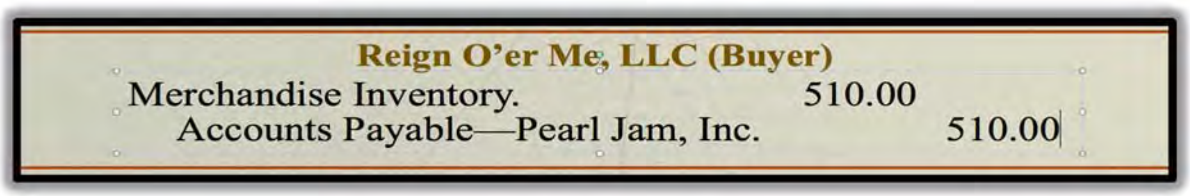
Double-Entry Bookkeeping

Every accounting entry requires an equal and offsetting entry elsewhere. Every Debit requires a corresponding Credit. To fully analyze a Financial Statement for credit-decision purposes, a Credit Professional must have this basic understanding.

When a sale is recorded as Revenue (Credit), its corresponding entry must either be Cash (Debit) or Accounts Receivable (Debit). Of course, the sale must be the transfer of material, in this case, or a service. The material was moved out of Inventory, so there is a reduction (Credit) in the value of that Inventory, at whatever cost, depending on the method used for valuing it. Since the full value of the sale included that cost, plus a markup, it must be reduced, via Cost of Goods (Merchandise) Sold (Debit).



Concurrently, the Buyer should make similar entries in their books, as shown here:



The Buyer records its inventory at the inflated value, which it now owes to the Seller. When it sells to its customer, it will record similar entries as shown in the previous slide segment, but at a further inflated value.

Statement of Cash Flows

There is one other area that a Credit Professional should consider, when reviewing a customer's Financial Statements, although it is generally only included in those prepared for the Reviewed and Audited categories. This is the Statement of Cash Flows. Using elements from both the Balance Sheet and Income Statement, it is formatted to present sources and uses of cash. Essentially, it shows the customer's ability to meet its obligations, at least in the short term, by isolating whether its cash comes from operations or borrowing. It also shows where the incoming cash is spent. The image below is taken from FCFP's **Financial Analysis Model**, a template to be used to easily compare multiple periods of financial data:

STATEMENT OF CASH FLOWS			
CASH FLOW FROM OPERATING ACTIVITIES	**2013**	**2014**	**2015**
Net Profit After Taxes		48	171
Depreciation		11	12
Decrease in Accts. Receiv.		-48	-8
Decrease in Inventories		-46	-9
Decrease in Other Assets		0	0
Increase in Accounts Pay.		10	14
Increase in Accruals		2	1
Increase in Taxes Payable		0	0
Increase in Other Current Liabilities		0	0
Cash Flow From Operating Activities		-23	181
CASH FLOW FROM INVESTMENT ACTIVITIES			
Increase in Gross Fixed Assets		-15	-5
Cash Flow from Investments		-15	-5
CASH FLOW FROM FINANCING ACTIVITIES			
Increase in Notes Payable		10	-60
Increase in Long-Term Debt		-2	-25
Changes in Stockholders' Equity		0	0
Preferred Dividends Paid		-1	-5
Common Dividends Paid (-)		-5	
Cash Flow from Financing Activities		2	-90
Net Increase In Cash / Marketable Securities		-36	86

As with all other variables involved in the credit decision-making process, everything must be viewed together with everything else. It must also be understood that accrual-based accounting identifies transactions that may not yet be complete, to the point of increasing or depleting real money (cash). For instance, an accrual-based Income Statement may indicate significant profits for a given fiscal period. When Cash from operating activities is greater than those profits, it usually means that the company's operation is well managed and maintained. If the opposite is true, there should be concerns as to why the stated Revenue was not turned into Cash. An immediate question is whether the stated A/R is based on poor credit decisions that makes collection less likely, at least in an appropriate timeframe to pay bills on time. If increases in Long-Term Debt trend higher than increases in Cash from Operations, then there should be questions about deteriorating Leverage (Debt compared to Net Worth).

Another example would be increasing Accounts Payable and decreasing Inventory. The latter may be due to an increase in Sales (Revenue), and insufficient Cash to pay the bills. Is that due to poor Accounts Receivable again, or is there an increase in paid Dividends? Is there simply an increase in Cash that is not being used properly? The point is that the Cash Flow Statement is a useful source of questions, prompting a search for answers.

Ratio Analysis

Various ratios can be used to evaluate financial data, again, in conjunction with other points of analysis, such as payment history. These ratios fall into several categories:

- **Solvency:** This aspect is determined by the Net Worth (Equity), which, in turn, is determined by the difference between Total Assets and Total Liabilities. A positive Equity value means that the company is solvent, as of that point in time. From that, two things are important to the Credit Professional:

- **Leverage:** The Debt/ Worth ratio can be very telling. Basically, the smaller the number, the better. This means that relatively less money comes from debt than investment and profitability. If the number is higher, or increasing from period to period, it means that borrowing money exceeds the investment. Having debt is not bad, since it may mean a growing company. On the other hand, an Equity number in excess of debt may mean a happy owner, but it may also mean a lack of growth or stagnation. Once again, all aspects of credit analysis are relative to the total picture.
- **Equity Trend:** For sure, a positive N/W is better than a negative one. However, a declining, but still positive, number is not so good. Then again, a decreasing deficit N/W, usually due to increasing profits, is a good thing.

- **Liquidity:** A customer must be able to pay its obligations, especially what is owed to you. This is where the aforementioned Current Assets and Current Liabilities come into play. During the 12 months following its fiscal year-end, a company should have at least $1.00 in Current Assets for every $1.00 in Current Liabilities. Ideally, there should be more Current Assets that Current Liabilities, but, at least, a 1-1 ratio is called for. Simply divide the Current Liabilities into the Current Assets, which gives you the Current Ratio. The higher this number is beyond "1", the better. This excess, in dollars, is known as Working Capital, which is money to support growth. Now, an important factor to consider is that one of the Current Assets is Inventory, which may not be convertible to useable cash during that year. To allow for this possibility, subtract the Inventory and re-compute the ratio. This is known as the Quick Ratio or "Acid Test". As before, an ideal answer is "1", but it is not unusual for a successful and prompt paying company to have a Quick Ratio of less than 1-1. In the case of any customer with questionable liquidity ratios, it is advisable to inquire about his or her access to working capital lines of credit, just in case.
- **Profitability:** Needless to say, an unprofitable company may not last long, particularly when losses exceed its Net Worth. Continuing deficits, both in Net Worth and the proverbial "Bottom Line" will most likely lead to Bankruptcy. Two things to consider:
  - Is the deficit N/W due to the principal(s) withdrawing the profits from an otherwise successful organization? If so, while it is their right to do so, a Credit Professional must look to his or her company's policies concerning risk vs. sales.
  - Are there trends toward an improving situation, along with other positive factors? The same company policy scenario arises, and a true business credit decision is required, which is why the Credit Professional is there to begin with.
- **Asset Turnover (Efficiency):** A successful business must use its assets effectively. Slow moving inventory and poor receivables will not only hinder growth, but they may also result in excessive debt, insolvency and the company's demise. On the other hand, high inventory levels and low turnover may be for good reason, such as having to buy in volume to get discounts that are needed to support low gross profit margins in a highly price-competitive industry. As in all true business credit decisions, one must consider all factors, not just one or two.

Summary

For the Credit Professional, the most important thing to understand is that financial analysis is only part of the decision-making process. It is an important one, for certain, but a full set of Financial Statements is not always available. They also do not take into account certain other external factors, such as the specific industry or other economic circumstances that can affect the numbers. Questions do arise, and they should be answered, but it is imperative to review and consider all aspects of a customer's file and the investigations conducted. Certain established guidelines were mentioned already, but here are two more:

- An assigned Credit Availability (Limit) should not generally exceed a customer's Net Worth. You do not want your company to invest more into a business than the Principal(s) did. At the same time, there may be exceptions, particularly with small businesses and contractors. Such an exposure is directly related to all of those other factors mentioned numerous times in this and other Papers.
- Another guideline is to assign a Credit Limit equal to 10-20% of a customer's Net Worth.
- **Note:** <u>It is extremely important to remember that these are simply guidelines</u>. Your company may have policies that require a more liberal approach or a more conservative one. You may also see other data and information that prompts you to do otherwise. (This is the World of Business Credit Management. It is challenging, and it can be very rewarding, in terms of job satisfaction, that is. It is FCFP's mission to provide you with the tools and information that you, the Credit Professional, need, to succeed.)

Remember, these statements are formulated using FASB rules and regulations. They are there to standardize the presentation of the numbers as much as possible, but there are variables within them as well. For instance, inventory valued according to LIFO may vary considerably from FIFO, as described earlier. The item is still there, unsold as of the date of the statement. A/R may appear to be high, but what credit terms were extended? Was there extended dating involved? The latter may arbitrarily inflate a perfectly collectible balance. Two nearly identical types of customer may be located in different geographic regions that are experiencing different economic conditions, due to the prominent industries in the area. Also consider the changes over multiple years. Always ask questions. Always conduct a full credit investigation.

Note: The Federation of Credit & Financial Professionals has developed an Excel based Financial Statement Analysis worksheet. Upon input of Balance Sheet & Income Statement information this model calculates key financial ratio's, performs a cash flow analysis, examines the customer's financial health utilizing a DuPont Analysis and runs a Z-score to determine probability of business failure. The model is available free of charge to all NNCFP members. To obtain a copy for download email your request to sbucci@federationofcredit.com.

FEDERATION of CREDIT
and FINANCIAL PROFESSIONALS

A Primary Source
for
Order-to-Cash Best Practices

www.federationofcredit.com

Printed in the United States of America
Federation of Credit and Financial Professionals
51 Cragwood Road, Suite 200
South Plainfield, NJ 07080
www.federationofcredit.com