

Report to Management

On the second half of this page is a screen shot - extracts from the Financial Reports for a small business. Image you just completed the Income Tax Returns for this business, and you were asked by your manager to write a Report to Management highlighting whatever you thought was relevant to be brought to the attention of the owner.

On the following page is the type of report I expect would be produced by accountants without a deep grounding in business advisory.

There is nothing wrong with the report from a technical perspective – but it is not going to get the client too excited.

By contrast, the report on page three is likely to have the owner jump in their Ute, recklessly drive to your office and bang down the door demanding to learn more.



Diamond Plumbers		
Profit & Loss Statement		
	2022	2021
Sales	2,750,000	2,666,305
Cost of Sales		
Materials	1,375,000	1,275,890
Subcontractors	125,580	158,980
Direct Labour	560,000	537,600
	2,060,580	1,972,470
Gross Profit	689,420	693,835
	25.1%	26.0%
Overheads		
Accounting fees	22,000	22,000
Advertising	36,000	58,000
Computer & IT	5,400	10,250
Depreciation	2,750	2,750
Motor Vehicle Expenses	80,850	70,250
Telecommunications	7,850	7,690
Wages - indirect	142,365	130,640
Wages - directors	120,000	120,000
Other	185,780	182,500
Total Overheads	602,995	604,080
Net Profit	86,425	89,755

Diamond Plumbers		
Balance Sheet		
	2022	2021
Current Assets		
Cash at Bank	135,750	106,780
Accounts Receivable	210,958	185,780
Stock On Hand	45,890	53,890
	392,598	346,450
Non - Current Assets		
Plant & Equipment - WDV	18,750	21,500
Current Liabilities		
Accounts Payable	185,030	198,850
Tax Provision	73,580	45,780
Other Creditors	135,890	118,569
	394,500	363,199
Net Assets	16,848	4,751
Shareholders Funds	16,848	4,751

Report to Management (*A Little Boring*)

Dear Frank,

Having completed your Financial Statements for the year ended 30th June 2022 we wish to bring the following to your attention.

Relative to the previous year Sales Revenue increased by 3.2%, given the slowing economy this is a good effort. Your Gross Profit percentage dropped from 26.0% in 2001 to 25.1% this year. In ideal circumstances we would like to see this percentage maintained at a consistent level however the decline is marginal, and our benchmark reporting suggests it is still in the mid-range for similar businesses.

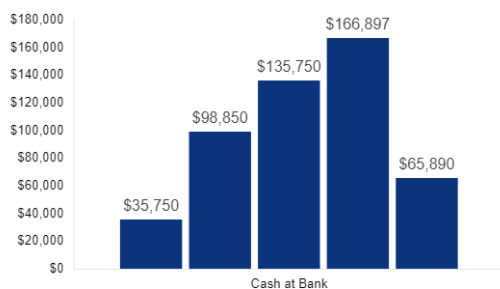
You were able contain expenses which is a great result given inflation was running at around 6.5% for last financial year.

Net profit was steady at 3.1% of revenue compared to 3.4% in 2001, when we add back directors salaries you generated total income from the business of \$206,425 compared to \$209,755 in the previous year. Again, this is in the mid-range of incomes for similar businesses as recorded in our benchmark database, so well done. (*It is a one family business*).

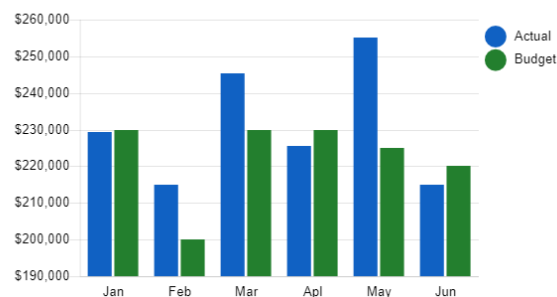
Net Assets have increased from \$4,751 to \$16,848 over the course of the year and the current ratio is 1.0 compared to 0.9 last year. Debtor days outstanding are 28 compared to 25 in 2001.

All in all, a steady year Frank, keep up the good work and please contact us if you need any help.

Cash Balance Last 6 Months to June 22



Sales v Budget - Last 6 Months



Outstanding Receivables

\$210,958

Debtor Days this Year

29

Debtor Days Last Year

25

Reserve space for another not so helpful
but flamboyant chart

Report to Management (*With a Touch More Impact*)

Frank,

Having completed your Financial Statements for the year ended 30th June 2022 I wish to bring some things to your attention, that if you act upon, will result in significantly improved results.

In all honesty, the results show you are just marking time. It is not that you aren't working hard, I know you are. In fact, since adding the extra employees you are probably working too hard for the good of the business in that you are so busy with operational issues you have lost focus on some key managerial areas – as this report will attest to.

In 2002 you employed 8 full time tradespeople; a review of your payroll records reveal they worked a total of 14,080 hours. However, the numbers of hours traceable into customer invoices is nothing like that many hours. You will be shocked to learn, I estimate the number of hours traceable into customer invoices to be only 8,025. I needed to make a few assumptions to arrive at this number, I will prove up those assumptions when we get together.

I am not suggesting your team are slacking off, I can see they are working a full day and charging solid hours on the time sheets, it is just that the hours are not being recovered. There is likely to be a number of reasons for this – another thing we will discuss when we meet.

For a maintenance business such as yours you cannot expect to recover 100% of the hours worked, but a realistic target is 5 hours and 10 minutes per day for each tradesperson.

Last year you recovered only 4 hours 42 minutes per person per day.

Let be clear about this, if you lift productivity by 28 minutes per person per day, based on the Gross Profit per hour you should achieve according to your standard hourly rate and mark-up on materials, the uplift in profit will be **\$114,986**. That is profit not revenue!

Frank, the potential improvement is more than your entire years profit. It requires no further investment in people or equipment – just improved productivity.

I know you struggle to understand the detail of the Financial Reports I prepare for you, but I do want you to look at this extract, across the last 4 years of trading.

Diamond Plumbers Profit & Loss Statement				
	2022	2021	2020	2019
Sales	2,750,000	2,666,305	2,402,989	2,355,698
Cost of Sales	1,960,580	1,970,890	1,734,206	1,660,360
Gross Profit	689,420	693,835	668,783	695,843
	25.1%	26.0%	27.8%	29.5%

You will notice there has been a decline in the Gross Profit percentage since 2019 – from 29.5% to 25.1%. Over the page I explain this – and it's important you understand it, so call me if you don't.

What the Gross Profit % means is this. In 2019 for every \$1,000 you invoiced to customers you made a Gross Profit of \$295. That is the profit after paying for direct materials and labour.

By 2002 that figure dropped to \$251 for every \$1,000 you invoice. What this means for you is this, if you just maintained the margin, you were achieving a few years ago, last year you would have earned an additional gross profit of \$121,830 and you would have earned this without the need for incurring an additional one cent in overhead costs – meaning it all ends up in your bank account.

So in summary, examining your reports from two separate angles suggest there is much to be gained by us getting together for the purpose of mapping out a plan to generate a substantial boost to your cash flow, I will call you later in the week to make a time.

SUMMARY & ADDITIONAL COMMENTS

- When looking at prior year comparisons, take a four or five year view, don't just look at last years. There should be a rolling schedule carried forward in the working papers each year. You will be amazed how instructive and helpful this is for both accountants and clients. (Recommend this to your boss.)
- Don't talk to clients about percentages and ratios, they don't understand them. Talk instead in real terms. Talk to the client about the additional cash flow they will generate as a result of achieving higher margins. Clients understand cash flow.
- Benchmarks can be interesting but there are inherent problems with them.
 - What do you know about the dataset? How large is sample size? What industry sector does it cover? What is the performance of cohort relative to the industry as a whole?
 - It is possible you are benchmarking the client against mediocrity – this is far from ideal.

WORKSHOP

Enrol in my free online workshop - **Introduction to Performance Reporting Productivity & Profit Improvement Planning** set down for on the Friday 31st March 2023 during which you will learn more about the calculations I referred to in the above Report to Management.

Follow the link in the above forum or contact me at philip@babb.com.au

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