

**Know the Numbers!**

**Finance for the HR Professional**

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**Presentation Objectives**

- Learn the purpose of financial statements
- Understand the principles of financial literacy
- Dive into the financial statements
- Understand financial challenges a business faces
- Learn to create financial engagement with management

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**What's Up with a Company?**

1. As a potential investment?
2. Degree of risk?
3. As an existing investment?
4. Cash flow?
5. Employment?
6. Its competition?
7. As a customer?

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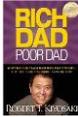
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### 4 Elements of Financial Intelligence

1. Financial Literacy: The ability to read numbers
2. Investment Strategies: The science of making money
3. The Market: Supply and demand
4. The Law: The awareness of accounting, corporate, state & national rules and regulations



(Kiyosaki, 1998, p. 10)

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### What Do Financial Statements Show?

- A. Financial position of the company
- B. Success of its operations
- C. Policies and strategies of management
- D. Insight into future performance
- E. All of the above

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### Accounting Regulating Agencies

- Generally accepted accounting principles (GAAP)
- Securities and Exchange Commission (SEC)
- Financial Accounting Standards Board (FASB)
- International Accounting Standards Board (IASB)

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## Basic Accounting Concepts

1. Historical Cost Principle
2. Double –Entry Bookkeeping
3. Accrual vs. Cash Basis
4. Matching
  1. Revenue Recognition Rules
  2. Expense Recognition Rules

GAAP makes all the rules!

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## General Ledger

- Chart of Accounts
  - 1 = Assets
  - 2 = Liabilities
  - 3 = Equity
  - 4 = Revenue
  - 5 to 7 = Expenses by Category

Set it up right and  
save a big  
headache later!

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The Trial Balance  
A listing of all  
accounts

Paul's Guitar Shop, Inc. Adjusted Trial Balance December 31, 2015		
Account	Debit	Credit
Cash	\$ 32,800	
Accounts Receivable	300	
Prepaid Rent	1,000	
Inventory	39,800	
Leasehold Improvements	100,000	
Accumulated Depreciation		2,000
Accounts Payable		\$ 49,000
Accrued Expenses		450
Unearned Income		1,000
Long-term Liabilities		99,500
Common Stock		10,000
Dividends	1,000	
Revenues		27,800
Cost of Goods Sold	10,200	
Depreciation Expense	2,000	
Rent Expense	500	
Supplies Expense	500	
Utilities Expense	400	
Wages Expense	750	
Interest Expense	500	
<b>Totals</b>	<b>\$ 189,750</b>	<b>\$ (189,750)</b>

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### THREE KEY FINANCIAL STATEMENTS

Balance Sheet		At 12/31
Cash		300
Other Current Assets		900
Current Assets		1,200
Property		825
Other Assets		225
Total Assets		<u>2,340</u>
Current Liabilities		790
Long Term Liabilities		650
Total Liabilities		1,440
Owner's Equity		900
Total Liabilities/Equity		<u>2,340</u>

Income Statement		YE 12/31
Net Sales		3550
Cost of Sales		<u>2550</u>
Gross Profit		1000
Operating Expenses		860
Operating Income		140
Non-Operating Items		40
Income Taxes		50
Net Income		<u>100</u>

Statement of Cash Flow		YE 12/31
Net Income		100
Less: Depreciation, Accruals		<u>(50)</u>
Cash from Operating Activities		50
Cash from Investing Activities		(350)
Cash from Financing Activities		<u>150</u>
Increase (Decrease) in Cash		(150)
Cash at Beginning of Year		<u>450</u>
Cash at End of Year		<u>300</u>

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## Balance Sheet: What We Own and How It Was Financed

**Balance Sheet** – summarizes a firm's financial position at a specific point in time.

**Assets** –  
things of value that the firm owns

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**Liabilities** –  
indicates what the firm owes to non-owners

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**Owner's Equity** –  
the claims owners have against their firm's assets

Assets – Liabilities = Owner's Equity

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## Sample Balance Sheet

		At 12/31
Cash		300
AR		490
Inventory		400
Other Current Assets		100
Current Assets		1,290
Property		825
Other Assets		225
Total Assets		<u>2,340</u>
Current Liabilities		790
Long Term Liabilities		650
Total Liabilities		<u>1,440</u>
Owner's Equity		900
Total Liabilities/Equity		<u>2,340</u>

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## What to See on the Balance Sheet

- Lots of Cash
- Current Assets – Current Liabilities = Working Capital
- Manageable Debt
- Reasonable Debt-to-Equity Ratio:
  - Long Term Debt / Owner Equity
- Look at the type of debt and why it's used



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## The Income Statement: Did We Make Any Money?

**Income Statement** – summarizes a firm's operations over a given period of time in terms of profit and loss.

**Revenue** – the increase in the amount of assets the firm earns

**Expenses** – the cash the firm spends or other assets it uses to generate revenue

**Net Income** – the profit or loss the firm earns

$$\text{Revenue} - \text{Expenses} = \text{Net Income}$$

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## Sample Income Statement

	<u>YE 12/31</u>
Net Sales	3550
Cost of Goods Sold	<u>2550</u>
Gross Profit	1050
[GR Margin 29.5%]	
Operating Expenses	810
Depreciation	<u>50</u>
Operating Income	190
Non-Operating Items	<u>40</u>
EBIT	150
[Profit Margin 4.2%]	
Income Taxes 33%	<u>50</u>
Net Income	<u>100</u>

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### What to See on the Income Statement

- High Revenue Growth
- COGS under control
- Gross Margin >40%
- 34% + tax rate
- Profit Margin: High profit margins show that the company is winning out against the competition



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### Statement of Cash Flows

*Statement of cash flows –  
Cash flowing into and out of the firm*



Operations + Investments + Financing  
=Cash in Bank

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### Sample Statement of Cash Flows

	YE <u>12/31</u>
Net Income	100
Add Back: Depreciation, Accruals	50
Increase in AR & Inventory	<u>(100)</u>
<b>Cash from Operating Activities</b>	<b>50</b>
<b>Cash from Investing Activities</b>	<b>(350)</b> purchase of an asset
<b>Cash from Financing Activities</b>	<b><u>150</u></b> loan
Change in Cash	(150)
Cash at Beginning of Year	<u>450</u>
<b>Cash at End of Year</b>	<b><u>300</u></b>

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## Understanding Cash

- **First rule**: Cash is the most important resource
  - More cash is better than less cash
  - Cash now is better than cash later
- Focus on cash flow not net income
- Growth often absorbs cash flow because of a higher need for working capital and fixed investments
  - Entrepreneurial firms with negative income and high growth can have a very fast cash burn rate
  - Today's investments are tomorrow's growth opportunities
- Focus on the dynamic picture of cash flow
  - Cash cycles (A/R collections, A/P payments), seasonality

**DON'T RUN OUT of CASH!!**

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## Cash Reserve

- Always keep enough cash on hand to cover expenses for at least 3 months
  - Provides cushion against "surprises"
  - What is your Working Capital need?
- Don't keep too much in cash
  - Invest excess in interest bearing instruments with priority:
    - Safety (gov't securities, CDs, etc.)
    - Liquidity
    - Return




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## 5 Critical Financial Planning Questions

1. How much cash will we really need?
2. What do the 5 year financials look like?
3. What's the path to profitability?
4. What are the risks and rewards?
5. How can these be managed successfully?

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## Challenges to Businesses

1. Owners work so hard they lose focus
2. Poor financial oversight
3. Ostrich communication
4. Expansion overrides abilities or systems
5. Money, not customers, becomes the boss



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## 4 'D's' of Employee Fraud



1. Debt
2. Divorce
3. Drugs
4. Disgruntlement

(<http://www.journalofaccountancy.com/issues/2001/feb/whyemployeescommitfraud.html>)

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## Theft & Fraud Dangers

- Cash register thefts
- Payroll Falsification
- Fraudulent Refunds
- Kickbacks
- Embezzlement
- Lapping – Moving AR payments from one account to another
- Check Kiting – Using a check from one account to cover one from another account and taking advantage of the float



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## Reasons for Fraud



- 10-80-10 Law
  - 10% will Never commit fraud
  - 80% will under the right circumstances
  - 10% will no matter what you do
- Opportunity
  - Weakness in internal controls or the person is in a position of trust
- Pressure
  - Unrealistic corporate goals, desire for revenge
- Rationalization
  - Believing the act is not really criminal

[https://chapters.theiia.org/ottawa/Documents/Fraud\\_Detection\\_and\\_Prevention.pdf](https://chapters.theiia.org/ottawa/Documents/Fraud_Detection_and_Prevention.pdf) 1-25

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## What Can You Do?

- Understand your organization's culture
- Support internal controls
- Promote fraud awareness training
- Help draft a fraud policy
- Encourage employees in reporting any suspected fraud



[https://chapters.theiia.org/ottawa/Documents/Fraud\\_Detection\\_and\\_Prevention.pdf](https://chapters.theiia.org/ottawa/Documents/Fraud_Detection_and_Prevention.pdf) 1-26

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## HR Meets the Financials: Strategic HR Metrics

- Revenue per Employee**
  - Important when evaluating the cost of a lost employee due to turnover
- HR to Staff Ratio**
  - Important because HR serves as the internal customer support staff
- Employee Absence Rate**
  - Evaluating the percentage of absences by department may show a culture problem
- Worker's Compensation Cost Per Employee**
- Overtime per Individual Contributor Headcount**
- Return on Investment (ROI)**

<https://workology.com/best-hr-metrics-human-resources-examples/> 1-27

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## How Do We Show HR's ROI?

### Measuring Human Capital in 5 Steps

1. Identify a specific business problem that HR can impact
2. Calculate the actual cost of the problem to the organization
3. Choose the HR solutions that addresses all or part of the problem
4. Calculate the cost of the solution
5. 6 to 24 months after implementation, calculate the value of the improvement for organizations
6. Calculate the specific return on investment (ROI) metrics

Mello, E. (2001) *Strategic Human Resource Management* 1-28

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## Examples of a Return on Investment

- HR introduces a new health and safety program
  - Effectiveness can be measured by the associated reduction in costs of work-related injuries



smallbusiness.chron.com/return-investment-human-resources 1-29

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## Examples of a Return on Investment

- New employee orientation program
  - What are the costs saved by correlated reductions in turnover?



smallbusiness.chron.com/return-investment-human-resources 1-30

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## Successful Financial Engagement

- Understanding financial implications makes a powerful argument
- Speaking the language adds credibility
- Using quantifiable metrics allows management to identify measurable ways HR services benefit the organization
- Knowing how HR services directly impact the bottom line



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## Questions?

Thank you for attending my session!

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