

PART ONE

OVERVIEW

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Introduction

A controller is responsible for a wide array of functions, such as processing accounts payable and receivable transactions, properly noting the transfer of assets, and closing the books in a timely manner. Properly completing these functions is critical to a corporation, which relies on the accurate handling of transactions and accurate financial statements. These activities clearly form the basis for anyone's successful career as a controller. However, the outstanding controller must acquire skills in the area of financial analysis in order to be truly successful.

By obtaining a broad knowledge of financial analysis skills and applying them to a multitude of situations, a controller can acquire deep insights into why a company is performing as it does, and can transmit this information to other members of the management team, along with recommendations for improvements that will enhance the corporation's overall financial performance. By knowing how to use financial analysis tools, a controller can rise above the admittedly mundane chores of processing accounting transactions and make a significant contribution to the management team. By doing so, the controller's understanding of the inner workings of the entire corporation improves and raises his or her visibility within the organization, which can eventually lead to a promotion or additional chances to gain experience in dealing with other departments. Thus, the benefits of using financial analysis are considerable, not only for the company as a whole, but for the controller in particular.

This book is designed to assist the controller in obtaining a wide and in-depth view of the most important financial analysis topics. Toward this end, the book is divided into four parts.

Part One covers the overall layout and content of the book, as well as the role of financial analysis and making management and investment decisions. This includes notations regarding the several types of financial analysis, as

well as the various kinds of questions that one can answer through its use. Part One concludes with a discussion of the need for judgment by a controller in interpreting analysis results.

Part Two covers the primary financial analysis topics. Chapter 3 discusses the evaluation of capital investments, which involves assembling cash flow information into a standard cash flow format for which a net present value calculation can be used to determine the discounted cash flow that is likely to be obtained. Chapter 4 describes the various financing options that a controller may be called on to review. For example, is it better to lease an item, and if so, should it be an operating or capital lease? Alternatively, should it be rented or purchased? What are the risks of using each financing option, and can the current mix of company financial instruments already in use have an impact on which option to take? All of these questions are answered in Chapter 4. Chapter 5 covers the essentials of why cash inflows and outflows are the key forces driving financial analysis and notes the wide variety of situations in which cash flow analysis can be used, as well as how to construct and interpret cash flow analysis models.

Chapter 6 is full of checklists and advice regarding how to conduct an analysis of any prospective merger or acquisition candidates, with an emphasis on making a thorough review of all key areas so that there is minimal risk of bypassing the review of a key problem area that could lead to poor combined financial results. Chapter 7 notes several ways to increase shareholder value and discusses the reasons why enhanced cash flow is the predominant method for doing so, as well as how to use leverage to increase shareholder value, while being knowledgeable of the dangers of pursuing this strategy too far.

Chapter 8 describes how to calculate the value of several types of intangible assets, and also provides numerous suggestions for enhancing the results of research and development activities.

Chapter 9 covers the deceptively simple topic of breakeven analysis, which is the determination of the sales level at which a company makes no money. The discussion covers how to calculate the breakeven point, why it is important, the kinds of analysis for which it should be used, and how to use subsets of the breakeven analysis to determine breakeven levels of specific divisions or product lines.

Finally, Chapter 10 covers the forecasting of business cycles. Although this is an issue normally left to bank economists or chief financial officers (CFOs), the controller is sometimes called on to forecast expectations for the industry in which a company operates. This chapter gives practical pointers on where to obtain relevant information, how to analyze it, and how to make projections based on the underlying data. These chapters comprise the purely *financial* analysis part of the book. Though Part Two alone is adequate for the bulk of all analysis work that a controller is likely to handle, there are still many *operational* analysis issues that a controller should be able to review and render an opinion about. That is the focus of Part Three.

Part Three covers operational analysis, which is the detailed review of

information about company operations, department by department. Chapter 11 covers the methods for choosing an appropriate set of performance review measures for each member of the management team, how to measure and report this information, and the types of behavioral changes that can result when these measures are used. Though the specific performance measures used are typically made by the CFO or the human resources director, these people may (and should) ask the controller's opinion regarding the best measures. If so, this chapter gives the controller a good basis on which to make recommendations.

Chapter 12 reviews how to analyze process cycles. These are the clusters of transactions about which a company's operations are grouped, such as the purchasing cycle and the revenue cycle. If there are problems with the process cycles, then there will be an unending round of investigations and procedural repairs needed to fix them; because the controller is usually called on to conduct the repair work, it makes a great deal of sense to analyze them in advance to spot problems before they fester.

Chapter 13 addresses a topic that many companies ignore—the evaluation of products and services with the goal of eliminating those that are unprofitable or which do not contribute to company goals.

Chapter 14 covers a *major* topic—the analysis of all primary departments, such as sales, production, engineering, and (yes) accounting. Specific measurements are noted for determining the efficiency and effectiveness with which each department is managed, alongside suggestions regarding why measurement results are poor and what recommendations to make for improving the situation.

Chapter 15 concludes the operational analysis section with a review of capacity utilization, how to measure it, why it is important, sample report formats to use, and recommendations to make based on the measured results. All of these chapters are designed to give a controller an excellent knowledge of how all company operations are performing, and what to recommend to the management team if problems arise.

Part Four covers a number of other analysis topics. Chapter 16 covers the primary formulas that a controller can use in the Microsoft Excel program to analyze financial statements, projected cash flows, investments, and risk. Chapter 17 expands on the use of Excel spreadsheets by detailing how they can be used to solve single- and multivariable problems. Chapter 18 includes many report formats that the reader can use for the reporting of such varied analyses as employee overtime, capacity utilization, and key weekly measures for the management team.

Chapter 19 discusses how to meld the cost of debt and equity to arrive at the cost of capital, and also notes how it should be used and where to use it. Finally, in Chapter 20, there is a discussion of risk—what it is, how it can impact a financial or operational analysis, what kinds of measurement tools are available for calculating its extent, and how to report a risk analysis to management in an understandable fashion.

There are also two appendices in the book. In Appendix A, there is a list of the most common symptoms of financial problems that a controller will encounter, alongside a list of recommended analyses and solutions for each symptom that will point one in the direction of how to obtain a fix to the problem. Appendix B contains a list of the most commonly used ratios, which are useful for analyzing both overall financial results and the specific operational results of individual departments.

This book is designed to give a controller, or anyone in the accounting and finance fields, a thorough knowledge of how to analyze an organization, from individual projects upward to complete departments, and on to entire divisions and companies. For those who are searching for specific analysis tools, it is best read piecemeal, through a search of either the table of contents or the index. However, for those who wish to gain a full understanding of all possible forms of analysis, a complete review of the book is highly recommended.