PIPSO

Pacific Islands Private Sector Organisation

January 1

FINANCIAL STATEMENTS

2014

This Module reviews the financial reports prepared at the end of a reporting period & their use to derive performance measures for internal or external use against appropriate benchmarks. The module concludes with a detailed case study highlighting the type, & use, of information that may be extracted.

MODULE 2.6

FINANCIAL STATEMENTS (MODULE 2.6)

PIPSO

Contents

PURPOSE

This Module begins with a reminder of the financial recording process from source documents to financial statements.

After some revision exercises on material presented in previous Modules we look at the form of the financial information that is prepared &how it can be used by business owners & managers in measuring the performance of their businesses. The key to improving performance is first to be able to measure it.

A range of performance measures are discussed before a detailed case study is used to look at the ways performance measures may be used, whether looking into a business from the inside or the outside.

Performance measures may tell a story & at the same time raise questions to be asked of management or owners when assessing investment in a business or the lending of funds to the business.

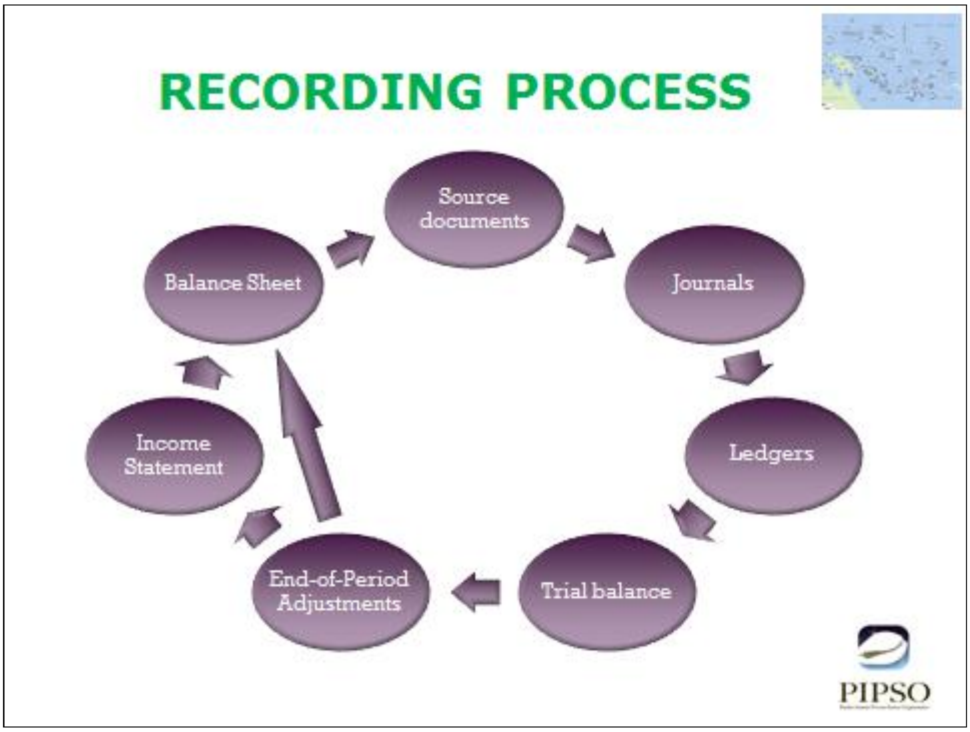
On completion of this Module participants should appreciate why a business prepares financial statements & be aware of a number of calculations that can be made using this financial information to provide performance measures for the business that can be used to compare performance with a range of benchmarks, both internal & external.

We only look at the most commonly used performance measures. For those with enquiring minds, other measures are available using an internet search.

RECORDING PROCESS

The form & timing of financial statements preparation varies from business to business, but is annually for most businesses as at either 31 December or 30 June. The frequency of management reporting depends on the number, & demands, of users & the time available for the preparation of the reports.

The cycle below represents the normal accounting cycle applied annually by most businesses & monthly or quarterly for those that adopt a management reporting cycle.

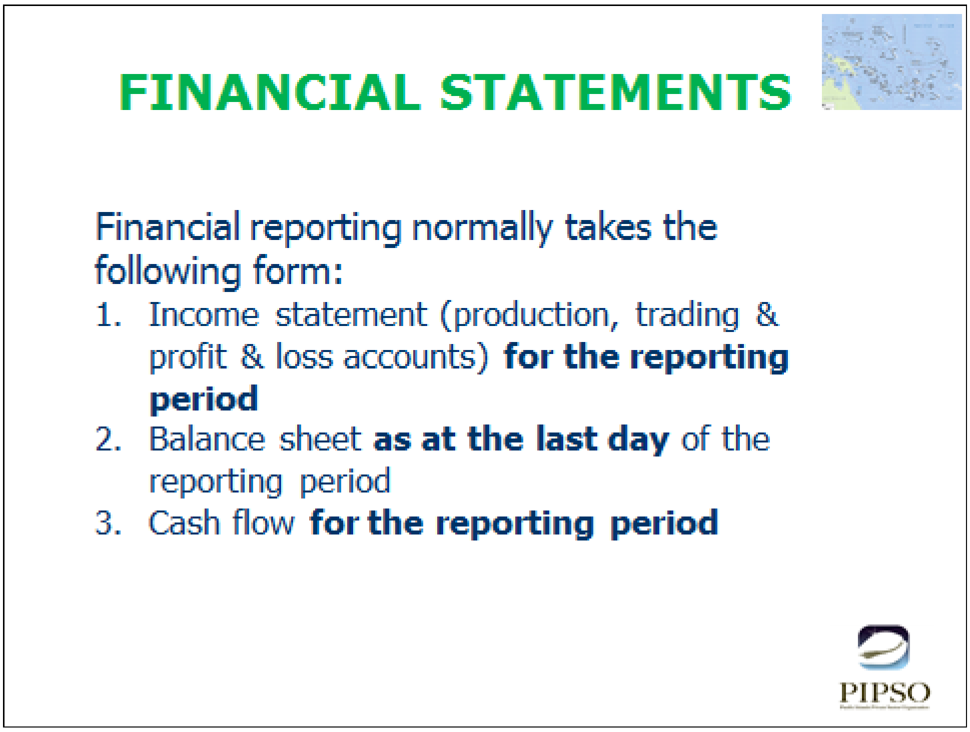


It is important to remember that the financial reports are the output that flows from the many inputs beginning with the source documents & finishing with the end-of-period adjustments, including all accruals & prepayments, depreciation plus others (bad & doubtful debts &other probable liabilities).

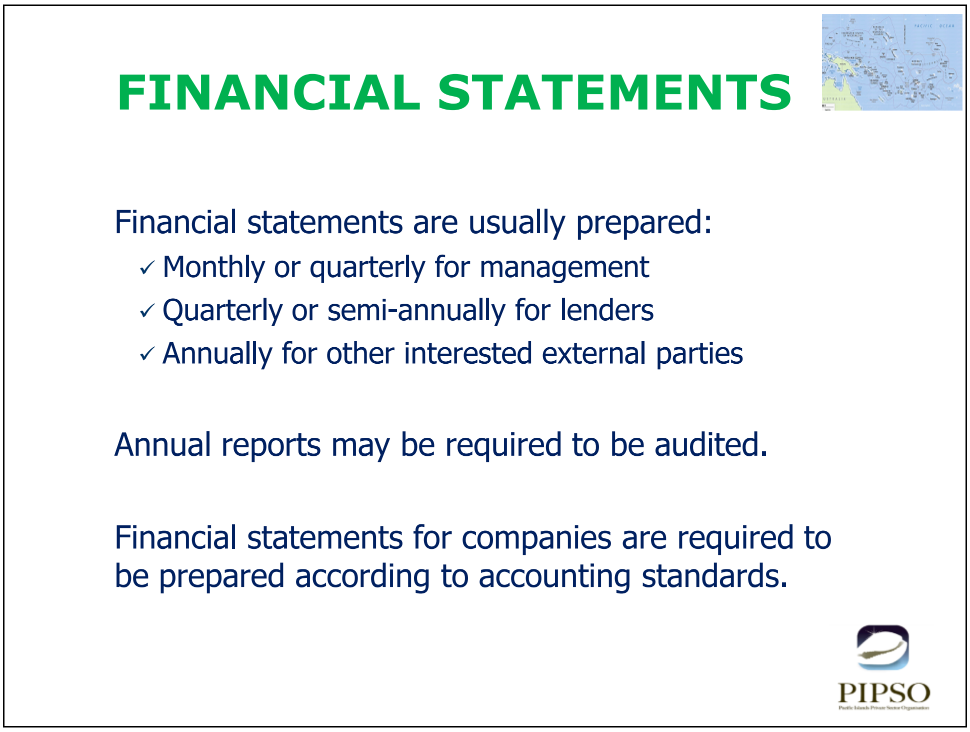
The process is continuous from one period to another & in a well organised business, relatively seamless.

Any outcomes resulting from these reports will depend on how the owners or managers of the business interpret the information provided by the reports & take action thereafter.

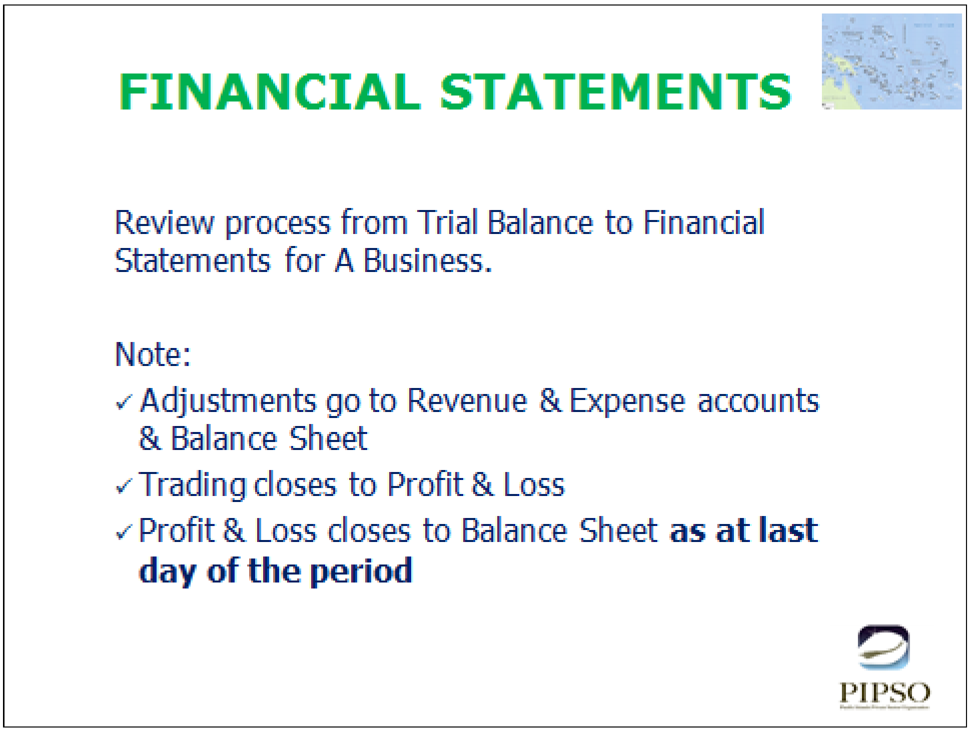
FINANCIAL STATEMENTS - FORM & TIMING



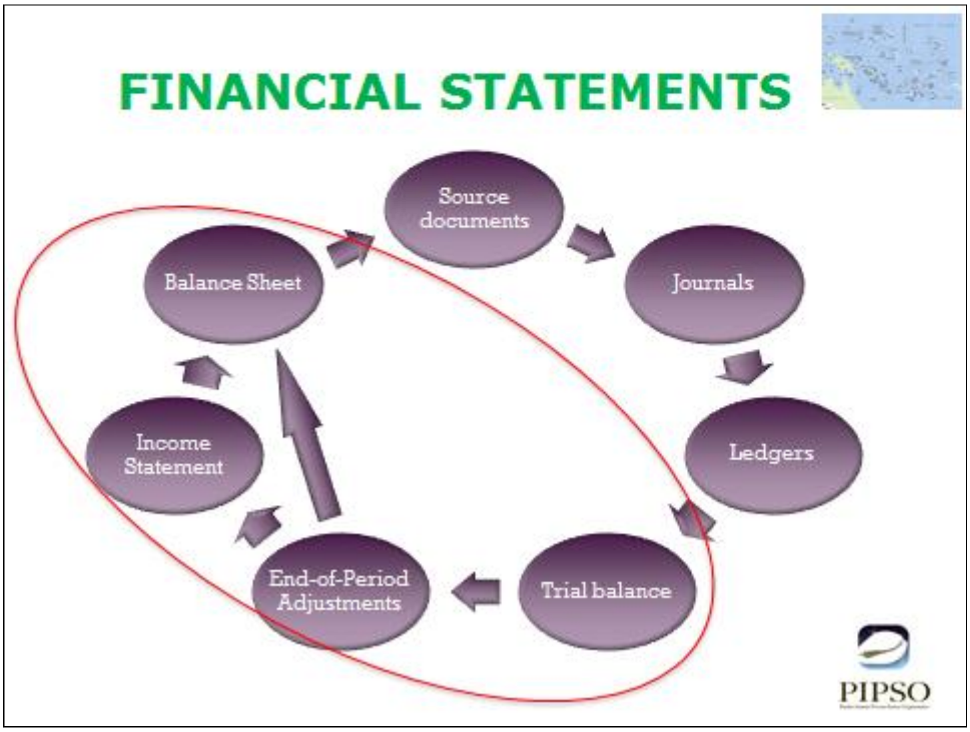
From time to time a business prepares its income statement. This is the combination of the trading & profit & loss accounts. The frequency of preparing the income statement is at management discretion. Usually the larger the business, the more likely that frequent (monthly) preparation of management financial statements will occur. Some sales & production reports may be prepared weekly.



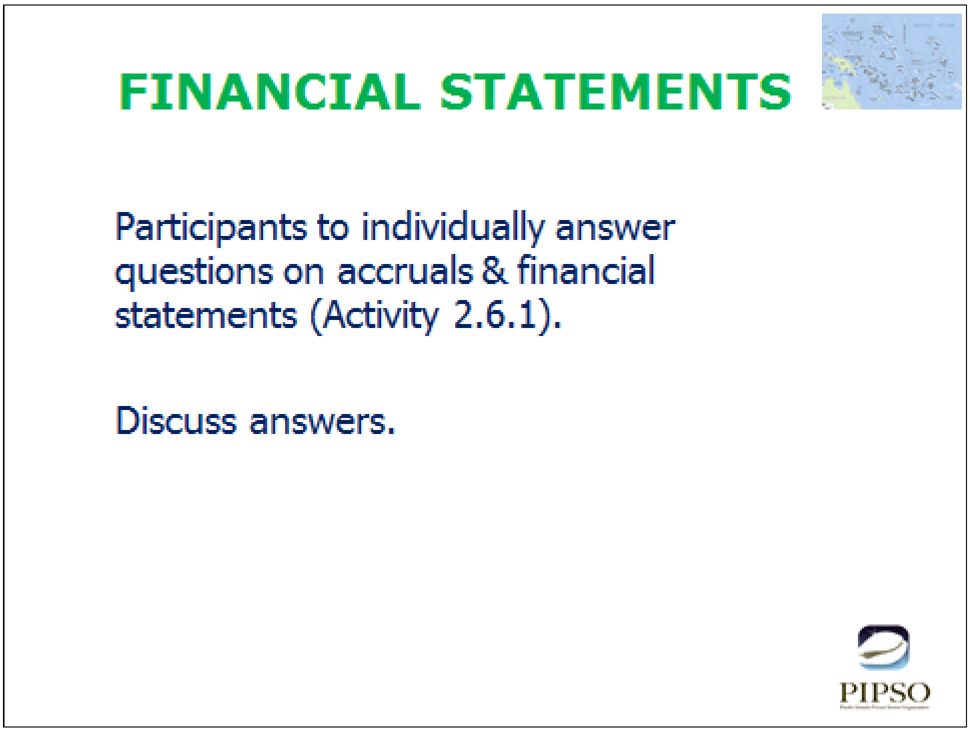
End of period reporting using an accrual system requires similar, if not the same procedure as for the end of the financial year. It may not require the same level of detail, but the procedure will be consistent, as follows.



This entails a number of the processes that occur at the end of a reporting period (circled in red below) to determine the profit for a business as outlined in Module 2.2, Profit.



We looked at this process briefly in Module 2.2, Profit. The following activity it intended to act as a refresher for income statement & balance sheet preparation.



It is important to have a sound grasp of the accounting principles before moving on to the important topic of performance measurement.

Why?

Because the performance measures derived from financial reports are only as good as the information that was used to generate the reports in the first place.

Remember, **RUBBISH IN = RUBBISH OUT**

Activity 2.6.1

FINANCIAL STATEMENTS QUESTIONS

SECTION A: TRUE OR FALSE

1. Depreciation is deducted from the value of the asset being depreciated.
2. Total assets less total liabilities equal working capital.
3. In a double entry system, only rarely are debits not equal credits.
4. The Balance Sheet contains all the items not included in Profit & Loss statement, except the net profit or loss.
5. The Income Statement is a result of business operations over a period of time.

SECTION B: MULTIPLE CHOICE

Question 1

The Profit & Loss Statement heading for financial year 1/7/2012 – 30/6/2013 should be:

a) Profit and Loss Statement as at 30/6/2013
b) Profit and Loss Statement
c) Profit and Loss Statement as at 1/7/2012
d) Profit and Loss Statement for the period ended 30/6/2013

Question 2

Cost of Goods Sold is $50,000. Opening stock is $20,000 and closing stock is $15,000. Purchases equal:

a) $45,000
b) $50,000
c) $55,000
d) $60,000

Question 3

Drawings for the year were $6,000. Additional capital introduced by the owner was $10,000. Opening balance of capital was $50,000. Closing balance of capital was $80,000. What is the net profit for the year?

a) $36,000
b) $30,000
c) $26,000
d) $34,000

Question 4

If assets increased by $10,000 and liabilities decreased by $4,000, and there was no additional capital or drawings for the year, the net profit would be:

a) $6,000
b) $14,000
c) $10,000
d) $4,000

Question 5

An overstatement in the closing stock would cause next year's opening stock to be

a) Overstated and next year's profit being overstated
b) Understated and next year's profit being overstated
c) Overstated and next year's profit being understated
d) Understated and next year's profit being understated

Question 6

The opening stock is $50,000. If purchases are $185,000, cost of goods sold is $180,000 and sales are $225,000, closing stock would be

a) $5,000
b) $10,000
c) $55,000
d) $280,000

Question 7

Accrued Revenue is classified as

a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 8

Revenue Received In Advance is classified as

a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 9

Prepaid Expense is classified as

a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 10

Which of the following is not classified under current assets?

a) Inventory
b) Accounts Receivable
c) Accrued Revenue
d) Land & Buildings

Question 11

If a business forgets to adjust for an accrued expense, then

a) Assets will be overstated
b) Revenue will be understated
c) Liabilities will be understated
d) Both a) and b)

Question 12

If closing stock is understated, what is the effect on net profit?

a) No effect
b) Increase profit
c) Decrease profit
d) Additional information is required

SECTION C: COMPREHENSIVE QUESTION

The following list of balances and adjustments for Chocolate Delight as at 30/6/2013.

	$
Accounts Payable	8,352
Accounts Receivable	25,345
Accumulated Depreciation - Computer	3,322
Bad Debts	902
Bank Overdraft	1,578
Computer	15,540
Discount Received	203
Electricity	1,253
Insurance	2,826
Interest on Overdraft	1,324
Inventory 01/07/2012	10,834
Office Expenses	3,096
Purchases	58,560
Rent	6,912
Rent Received	2,082
Sales	90,284
Telecom 12% Bonds	5,000
Wages	11,729

The following adjustments are required at 30 June 2013:

1. Physical stocktake of inventory on 30/06/2013 valued at $11,092
2. Wages accrued $460
3. Prepaid insurance $530
4. Interest on Telecom bonds to be accrued for four months
5. Computer to be depreciated by $5,150
6. July rent received in June $160

What is the final balance of the following accounts as at 30 June 2013?

1. Inventories
2. Wages
3. Insurance
4. Interest on bonds
5. Accumulated depreciation
6. Rent received

PURPOSE OF FINANCIAL STATEMENTS

PURPOSE OF FINANCIAL STATEMENTS

Why do we prepare financial statements?

Participants to offer reasons.

List on white board.

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PURPOSE OF FINANCIAL STATEMENTS

Why do we prepare financial Statements?

- ✓ To know we are making a profit
- ✓ To know how much profit
- ✓ To present to investors/lenders if we are growing
- ✓ To compare how we went with our plans
- ✓ To use for internal control
- ✓ To compare our performance with others
- ✓ To compare our historic performance
- ✓ To use as a future planning tool

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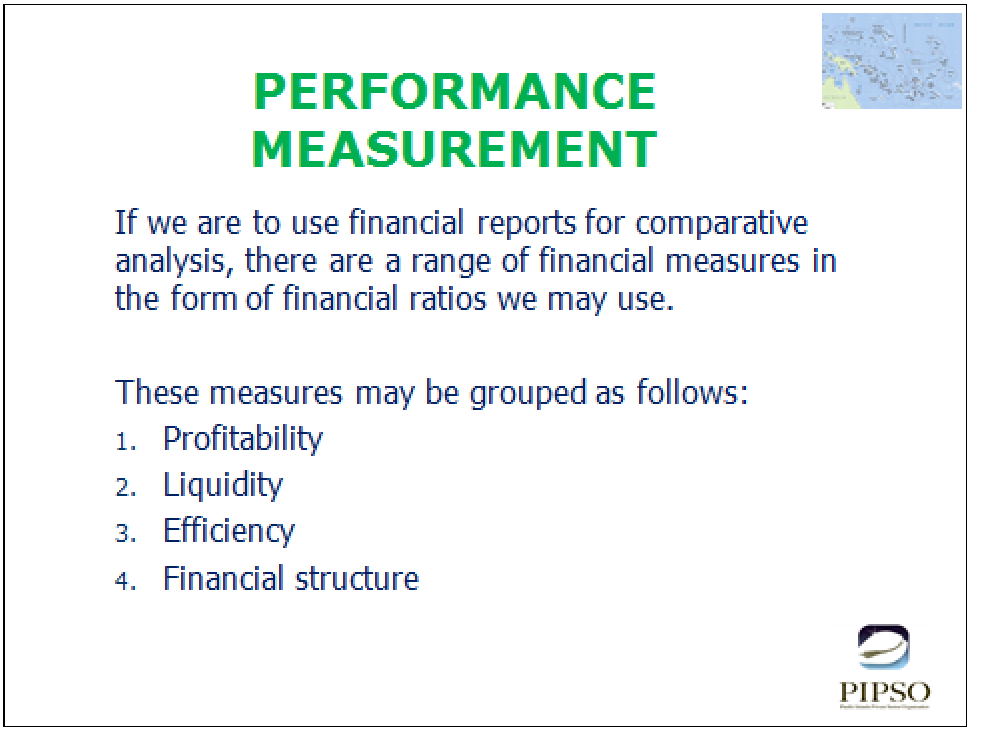
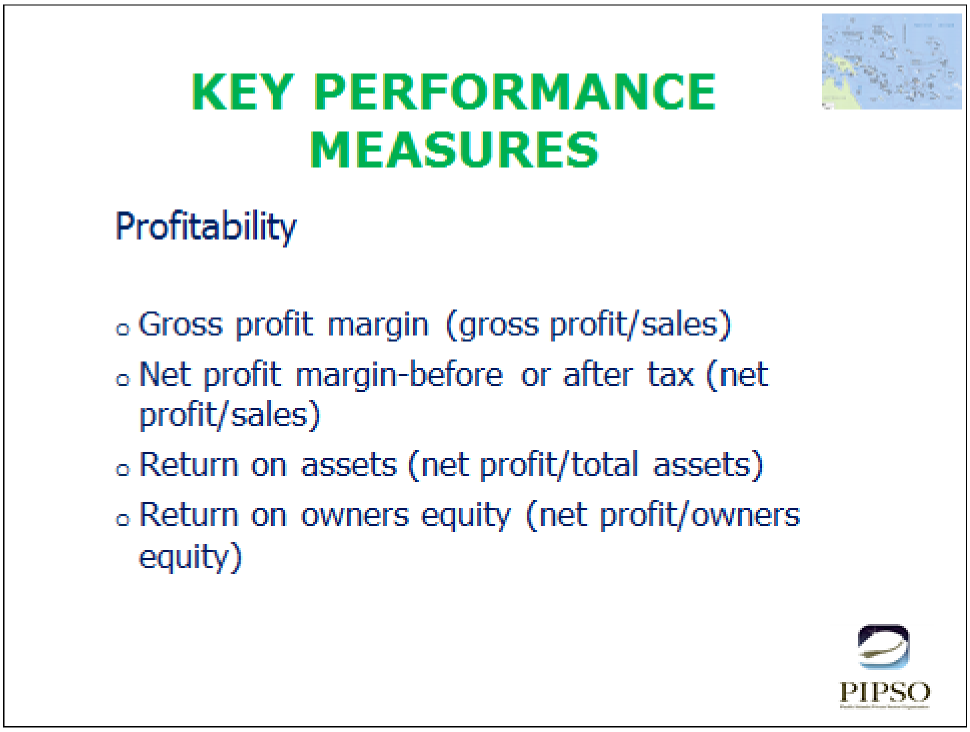
PERFORMANCE MEASUREMENT



The measures listed in this Module do not include all measures available, merely a sprinkling of important ones.Financial analysts use many more.

Not all performance measures are related to financial statements. For example, management may avail itself of internal information on sales by company representative, geography, age group, gender etc. Other analysis of a subjective nature may also be available. It may also use surveys & like informal methods of assessing customer satisfaction.



Profitability ratios

Profitability measures are derived from a business's income statement & are measures of the viability of the business. Return ratios compare income statement information with balance sheet information. The principal ratios are:

Gross profit ratio

This is a measure of the percentage of costs incurred getting goods ready for sale as a percentage of sales value. This is useful for setting selling price & determining its adequacy. It can be compared with past performance, to set targets & compare with published industry performance where information is available. This ratio does not apply to service businesses. The higher this ratio is the better.

Net profit ratio

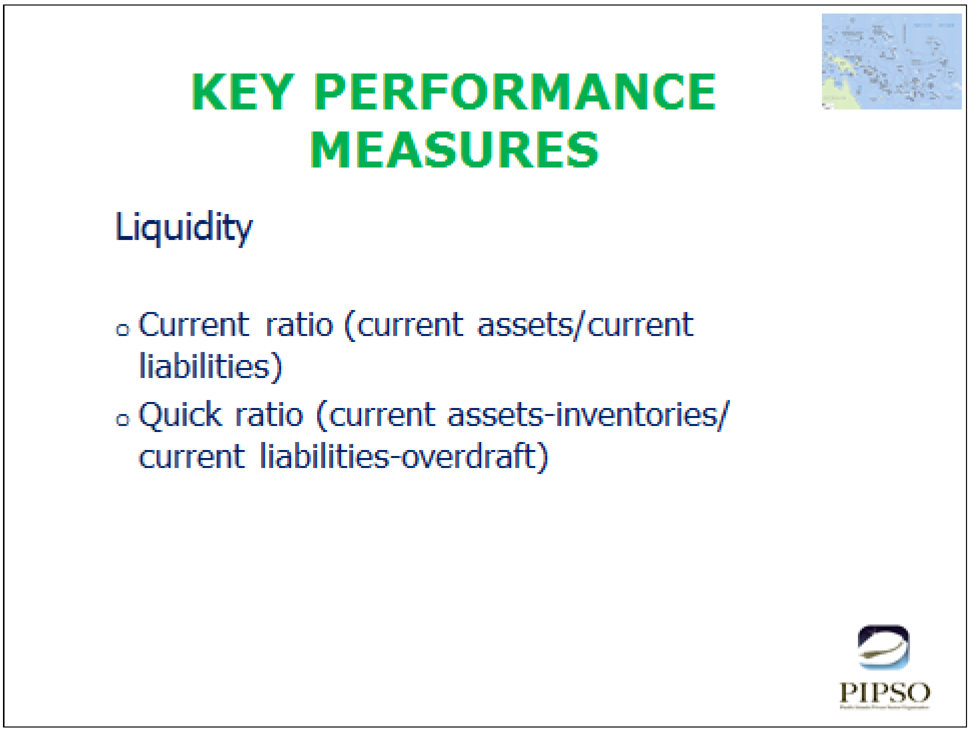
This ratio measures the profit,after deducting all expenses, generated from each dollar of sales. It can be used for budgeting, &compared with the past &relevant current industry benchmarks. This ratio is relevant to all businesses. It is the ultimate measure of business viability. The higher this ratio is the better.

Return on assets

This is a measure of performance that considers profit as a percentage of total assets used to generate that profit. The measure needs to be considered in the context of the value of assets required in different industries. Therefore different industries might establish different benchmarks for this performance measure. The higher this ratio is the betterafter allowing for industry standards.

Return on owner's equity

This ratio measures the return (profit) that the owner makes on the funds they have invested in the business. It indicates the effectiveness of the use of the owner's investment. This is an important ratio when looking at new investments & making decisions on whether to seek equity funding for future growth or borrow from a bank. Module 3.5 - Funding, Debt & Equity takes a closer look at these decisions. The higher this ratio is the better.



Liquidity ratios

Liquidity performance measures look at the ability of the business to meet its financial obligations, i.e. pay its bills/debts. These ratios use information available in a business balance sheet.There are two ratios commonly used.

Current ratio (also called the working capital ratio)

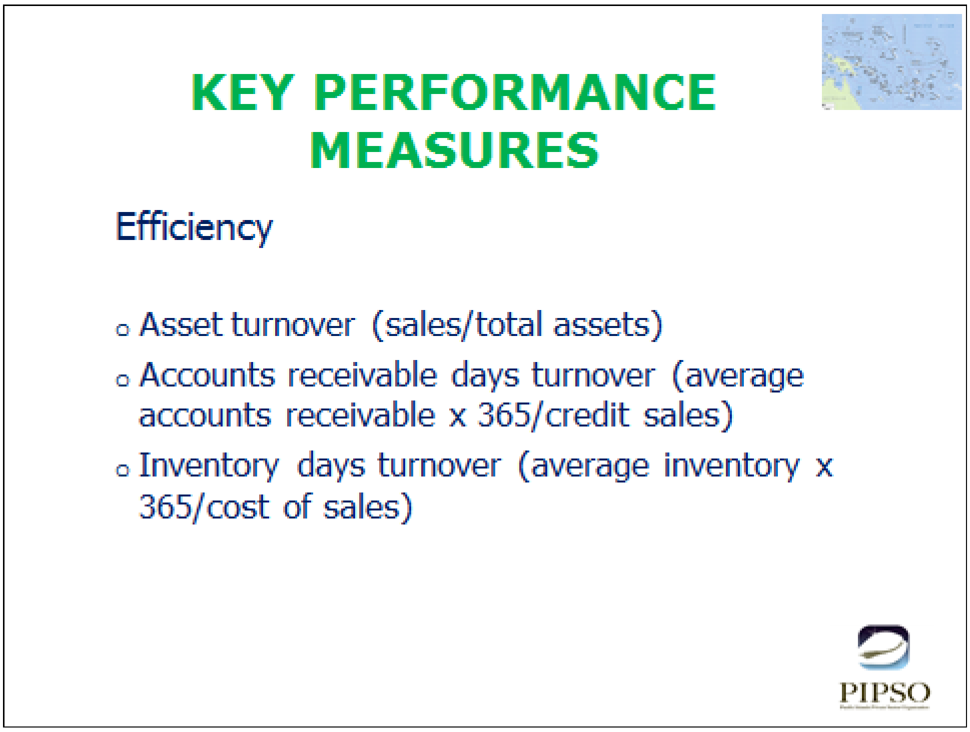
This is a measure of access to cash to meet obligations as they fall due based on the expectation that short-term assets provide the funds to meet short-term obligations. It is calculated as the sum of the $ value of all current assets divided by the sum of the $ value of all current liabilities. The higher this ratio is the better.

Often a ratio of three is considered by banks as adequate, but there may be different industry standards.

Quick ratio (also called the liquidity ratio)

This ratio measures the immediate access to funds to meet impending obligations. It is considered a better measure by some of access to cash quickly.

To calculate this ratio we deduct the value of inventories or stock from the current assets. This recognises that to sell stock quickly may realise less than full value as it may require significant discounting. In addition, it is normal to deduct bank overdraft from the obligations as this is a come & go banking facility & not repayable in the short-term. The higher this ratio is the better. Banks often seek a ratio in excess of one.



Efficiency ratios

These ratios measure the efficiency with which a business is using its assets, in particular its current assets, & liabilities. The ratios both use information from the income statement & the balance sheet. For a small business that is meeting its obligations on time as they fall due the asset ratios are more useful.

Asset turnover

This ratio measures the annual sales as a percentage of total assets. There are large differences in this ratio based on the asset requirements of a business in different industries.

Businesses that are asset intensive, e.g. construction & heavy engineering, might have a low ratio, whilst others that do not require large investment in assets, e.g. professional service providers, hair dressers, lawyers & accountants, would have very high asset ratios. These latter businesses invest more in human resources than physical ones. The higher this ratio is the better after allowing for industry standards.

Debtor(or accounts receivable) turnover

This ratio measures the number of days it takes on average to collect the accounts receivable. It is a measure of the efficiency of the debtor collection practices of a business. There is more than one way to calculate this ratio as follows.

1. Average accounts receivable (opening balance plus closing balance divided by 2) multiplied by 365 days divided by annual credit sales.
2. Accounts receivable (end of period) multiplied by 365 days divided by annual credit sales.

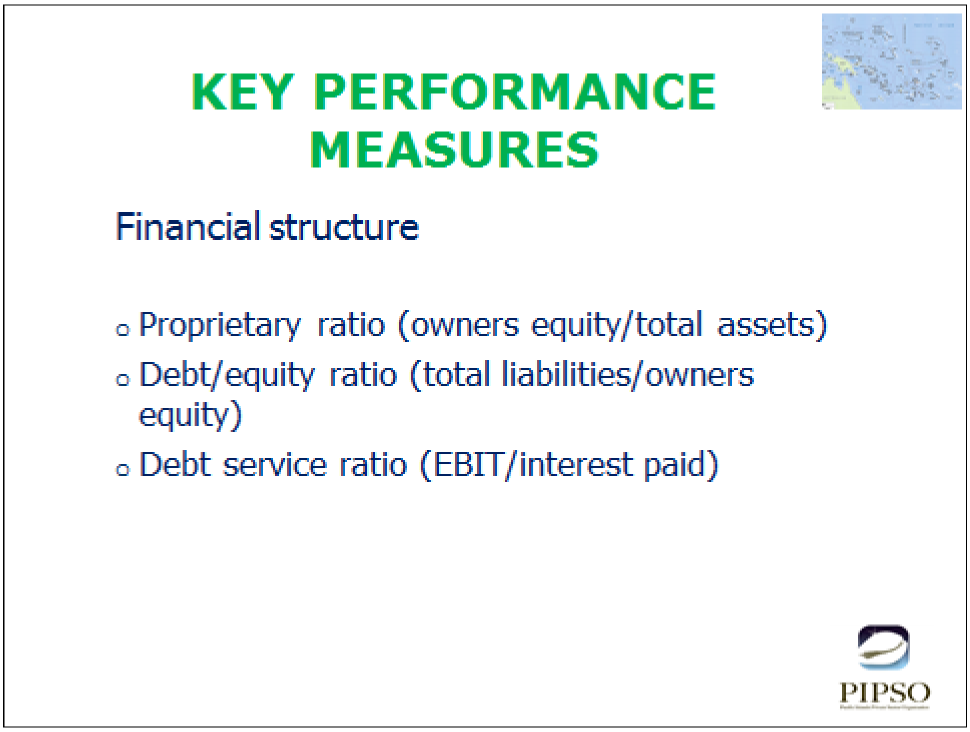
Both methods give an answer that is in days; average days to receive cash from credit sales. Method 1 averages accounts receivable over the period of the sales & is, therefore, a slightly better estimate, but both are useful. The lower this ratio is the better.

Inventory turnover

This ratio indicates how long it takes to sell the goods the business has for sale, i.e. how long goods sit on the shelf. As for debtors, there are two ways to calculate this ratio as follows.

1. Average inventories (opening balance plus closing balance divided by 2) multiplied by 365 days divided by cost of goods sold.
2. Inventories (end of period) multiplied by 365 days divided by cost of goods sold.

Both methods give an answer that is in days; average number of days before inventory is sold. Method 1 averages inventories over the financial period & is, therefore, slightly less biased, but both are useful. The lower this ratio is the better.



Financial structure ratios
These ratios measure the financial position of the business & therefore generally do so relying only on the balance sheet. Debt servicing, however, requires information from the income statement &perhaps the balance sheet. These are measures of gearing, i.e. the amount of debt a business is carrying.

Proprietary ratio

This ratio measures the proportion of equity in the business to finance its total assets. A high ratio means that little debt is used in the business & a low number means that a high proportion of debt is used to finance the business assets.

From the point of view of an investor or a lender a high ratio is evidence of a more risk averse attitude to debt finance. Different businesses are able to carry higher levels of debt due to the stability of their cash flows, but for any business the lower this ratio is the less gearing risk it is accepting.

Debt (or liabilities) to equity ratio

This ratio measures the proportion of liabilities to equity within a business if the ratio exceeds 1 then there are more liabilities than equity financing the total assets of the business. If less than 1 there is more equity than liabilities financing the business assets. This is a variation of the proprietary ratio & measures the same relationship between assets, liabilities & equity in the balance sheet.

A low number means that the business is risk averse. What is a good or bad number requires further investigation in conjunction with other financial performance measures.

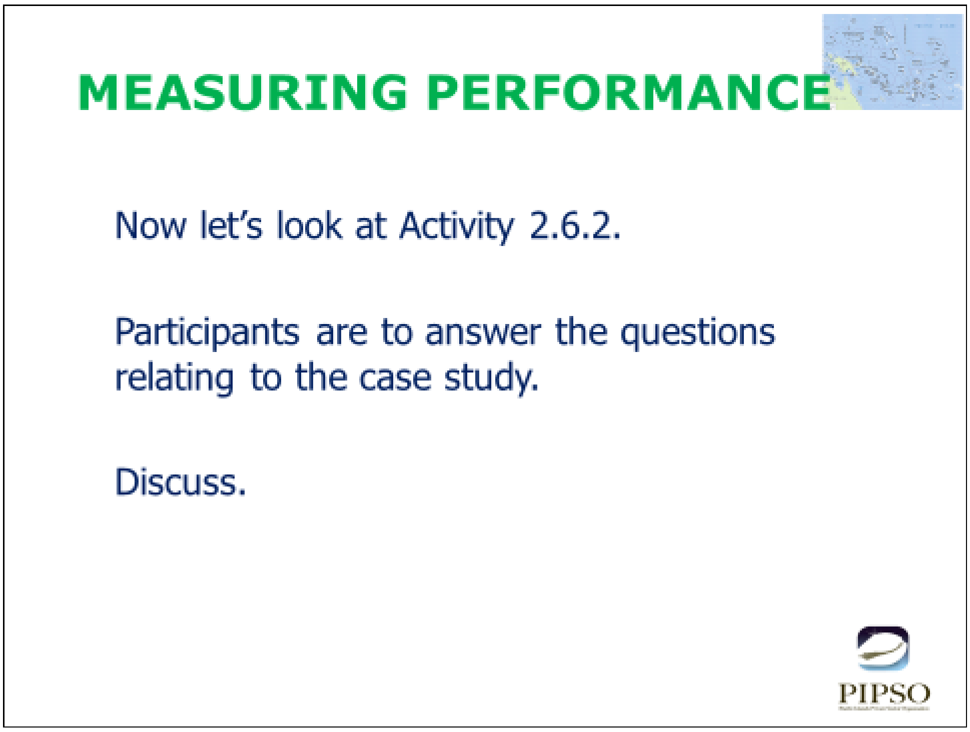
A bank will generally consider a ratio of over 1.5 as high for commercial land & buildings, possibly too high. For private residences a bank will usually accept a higher ratio.

Debt service ratio

This is a ratio used by all banks & other commercial lenders to determine the ability of a business to meet its interest obligations to lenders as they fall due. Divide business earnings (net profit after tax) less tax payable, less the interest paid to lenders/debtors by the amount of interest paid to lenders/debtors. A cash estimated version also deducts depreciation & amortisation.

Clearly the higher this number the more able a business is to meet its interest bearing debt obligations. A result of 3 times cover for interest is normally preferred by lenders as evidence of a sound capacity to pay.

USING PERFORMANCE MEASURES – AN EXAMPLE



ACTIVITY 2.6.2

CASE STUDY

Appliance Makers Ltd - Makers of Fine White Goods

The company, Appliance Makers Ltd (AML), was incorporated on 2 January 2008. Financial reports for the years ended 30 June 2008, 2009 & 2010 are attached.

As is apparent from the detailed financial reports that follow the company has been very profitable & is rapidly growing. AML has paid dividends since its first full year of operations.

The following statistics highlight the rapid growth of the business:

	2008	2009	2010
Total sales	165,500	636,800	751,600
Net operating revenue	136,622	469,000	583,000
Net profit before tax	53,090	148,468	255,643
Current assets	187,681	248,421	145,908
Total assets	347,612	458,572	787,244
Total liabilities	138,979	133,281	305,003
Shareholders equity	208,633	325,291	482,241

During 2012 AML took out financial accommodation from its bankers.

Activities

1. Using the financial information provided, calculate the ratios highlighted.
2. Answer the following questions about AML.
    a. Would you like shares in this company?
    b. Why did the company borrow funds?
    c. Has it borrowed enough?
    d. What are its strengths & weaknesses?

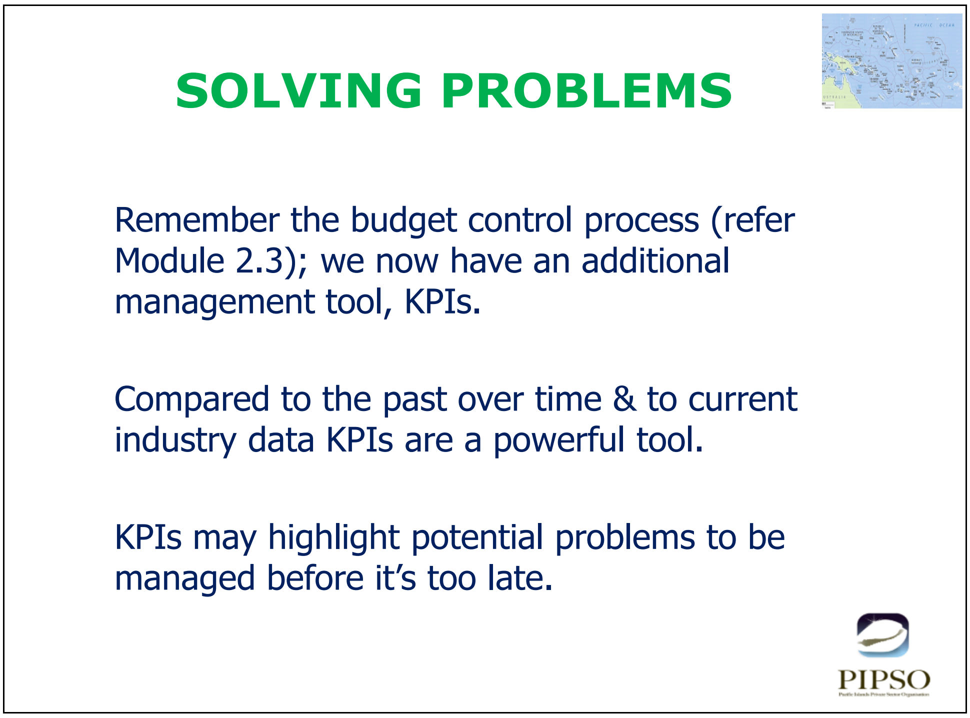
Number of shares on issue	9,500	9,970	9,970
Liquidity			
Current	2.15	2.30	
Quick	1.74	1.80	
Activity			
Stock (days)	73.8	49.7	
Av collection period (days)	46.9	28.4	
Profitability			
Gross profit margin	54%	51%	
Net profit margin (before tax)	32%	23%	
Net profit margin (after tax)	22%	16%	
Return on net worth	18%	32%	37%
Shareholder performance			
EBIT ($)	46,701	140,739	240,357
Earnings per share ($)	4.92	14.12	17.95
Dividend per share ($)	-	1.52	2.21
Leverage			
Long term debt to equity	32%	8%	
Total debt to equity	67%	41%	
Debt to operating cash flow	3.44	0.89	1.17
Interest times cover	7.31	18.21	15.72

NOTE FOR FACILITATOR

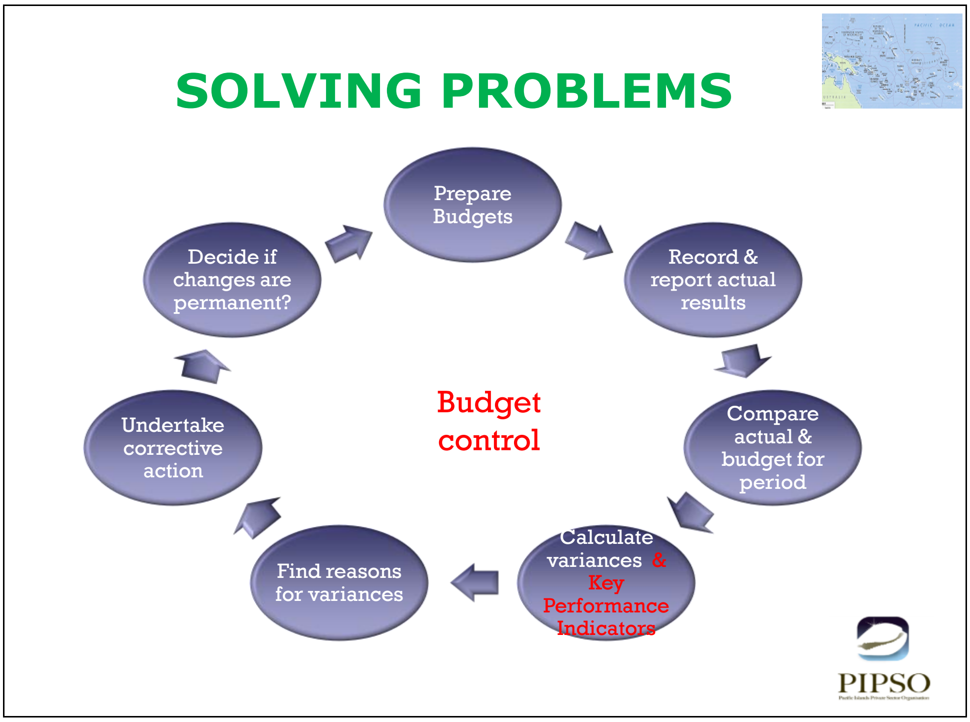
This is a large activity & if time is short provide the calculations to participants in order to focus their attention of the recent events rather than the calculations.

APPLIANCE MAKERS LTD - MAKERS OF FINE WHITE GOODS							ACTIVITY 2.6.2
INCOME STATEMENT		**Y/E 30 JUNE 2008**		**Y/E 30 JUNE 2009**		**Y/E 30 JUNE 2010**	
		$	$	$	$	$	$
	Sales		165,500		636,800		751,600
	Less Cost of goods sold		75,448		312,600		354,600
Gross profit			**90,052**		**324,200**		**397,000**
	Add Other operating revenue		46,570		144,800		186,000
Net operating revenue			**136,622**		**469,000**		**583,000**
Less **Other operating expenses**							
	Selling & distribution expenses	21,576		155,832		160,332	
	General & Administration expenses	55,567		156,971		151,739	
	Financial expenses	6,389	83,532	7,729	320,532	15,286	327,357
Net operating profit before tax			**53,090**		**148,468**		**255,643**
	Income tax expense		15,927		44,540		76,693
Net profit after tax			**37,163**		**103,928**		**178,950**
BALANCE SHEET		**AS AT 30 JUNE 2008**		**AS AT 30 JUNE 2009**		**AS AT 30 JUNE 2010**	
Assets	**Current assets**						
	Cash on hand	102,669		135,702		5,986	
	Accounts receivable	41,650		53,319		72,154	
	Inventory	30,512		54,600		62,968	
	Other	12,850	187,681	4,800	248,421	4,800	145,908
	Non-current assets						
	Plant & equipment	138,080		231,200		282,777	
	Less: Accumulated depreciation - plant & equipment	-3,249	134,831	-45,049	186,151	-81,041	201,736
	Land & buildings		0		0		415,600
	Intangibles						
	Patents		25,100		24,000		24,000
Total assets			**347,612**		**458,572**		**787,244**
Less **Liabilities**	**Current liabilities**						
	Bank overdraft					10,711	
	Accounts payable	35,700		27,282		34,022	
	Current tax liabilities	15,927		44,540		76,693	
	Provision for dividends	15,200		22,000		40,877	
	GST payable	353		10,299		39,000	
	Accrued expenses	6,000	73,180	3,700	107,821	3,700	205,003
	Non-current liabilities						
	Bank loan - secured	40,799		25,460		100,000	
	Other long term loans	25,000	65,799	0	25,460	0	100,000
Total liabilities			138,979		133,281		305,003
Net assets			**208,633**		**325,291**		**482,241**
Shareholders Equity	Share Capital		190,000		199,400		199,400
	Retained profits - Opening balance	0		37,163		125,891	
	Add Net Profit (after tax)	37,163		103,928		178,950	
	Less dividend	0	37,163	-15,200	125,891	-22,000	282,841
			208,633		**325,291**		**482,241**

SOLVING PROBLEMS



Key performance indicators are particularly useful for comparisons over time. They reveal trends, favourable & unfavourable. They can also be used to compare with competitors or industry information. They highlight strengths & weaknesses.

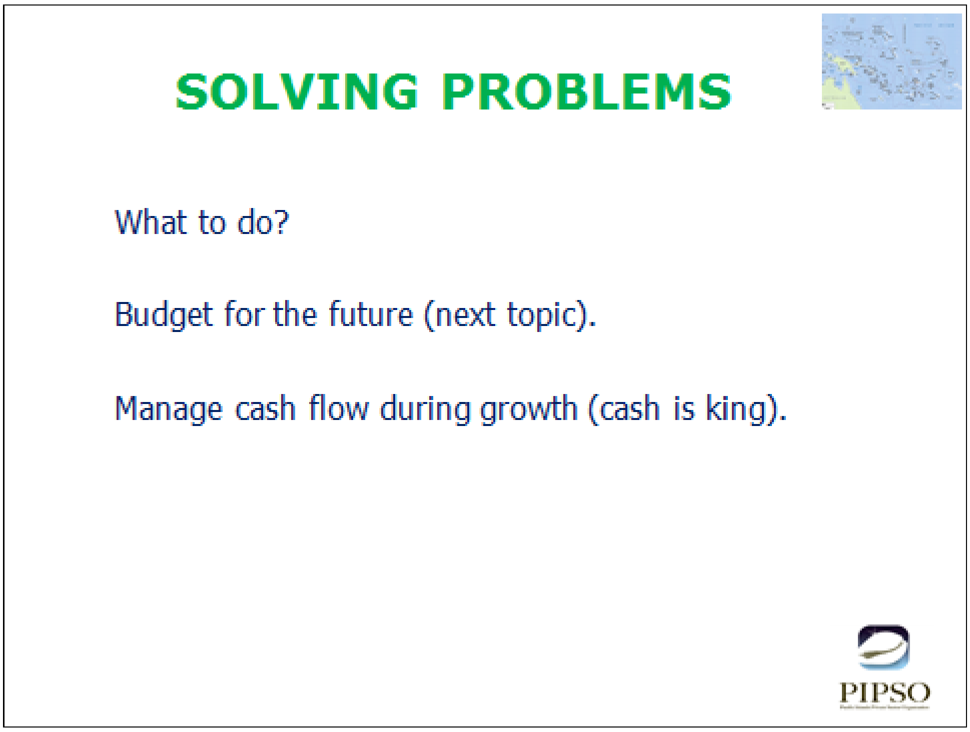


When looking at performance using variances from budget, it can be very useful to compare your results with prior years & external information. The results of these comparisons may not always give the same answers, e.g. while sales might be down on budget in the current year, performance indicators may still be positive when compared with the industry due to a cyclical decline in the marketplace. What might be called for when planning for next year may be the recognition of a change in the market, not budget under performance.

Some reasons for poor performance may include:

- Declining gross profit margin:
    - Excessive price markdowns & discounts
    - Price increases by suppliers
    - Out of date stock
    - Stock shrinkage, e.g. Theft
    - Poor stock recording & control
- Declining net profit ratio, excluding the above:
    - Lower sales volume
    - Selling price reductions
    - A rise in operating expenses
    - Specific cost increases, e.g. Advertising, wages
    - Inefficient use of resources, e.g. Wastage
- Rising gearing ratio:
    - Increases in borrowings (e.g. Overdraft)
    - Asset growth funded by debt
    - Sale & aging of fixed assets
    - Capital withdrawal
    - Dividends in excess of current profit
- Slower debtor turnover
    - Poor debt collection practices
    - Change of staff in accounts receivable
    - Lack of a clear credit policy
    - Reflects customersexperiencing difficulties
- Slower inventory turnover
    - Poor buying
    - Change in consumer tastes
    - Aging or dated inventory
    - Ineffective marketing
    - Turnover in sales staff agents

A good business owner or manager should be able identify the specific reasons for variances. Without this corrective or growth plans cannot be put in place.



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ANSWERS TO ACTIVITIES

Activity 2.6.1

FINANCIAL STATEMENTS QUESTIONS

SECTION A: TRUE OR FALSE

6. Depreciation is deducted from the value of the asset being depreciated. F
7. Total assets less total liabilities equal working capital. F
8. In a double entry system, only rarely are debits not equal credits. F
9. The Balance Sheet contains all the items not included in Profit & Loss statement, except the net profit or loss. T
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d) $34,000

Question 4

If assets increased by $10,000 and liabilities decreased by $4,000, and there was no additional capital or drawings for the year, the net profit would be:

a) $6,000
b) $14,000
c) $10,000
d) $4,000

Question 5

An overstatement in the closing stock would cause next year's opening stock to be

a) Overstated and next year's profit being overstated
b) Understated and next year's profit being overstated
c) Overstated and next year's profit being understated
d) Understated and next year's profit being understated

Question 6

The opening stock is $50,000. If purchases are $185,000, cost of goods sold is $180,000 and sales are $225,000, closing stock would be

a) $5,000
b) $10,000
c) $55,000
d) $280,000

Question 7

Accrued Revenue is classified as

a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 8

Revenue Received In Advance is classified as

a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 9

Prepaid Expense is classified as
a) Assets
b) Liabilities
c) Revenue
d) Expense

Question 10

Which of the following is not classified under current assets?
a) Inventory
b) Accounts Receivable
c) Accrued Revenue
d) Land & Buildings

Question 11

If a business forgets to adjust for an accrued expense, then
a) Assets will be overstated
b) Revenue will be understated
c) Liabilities will be understated
d) Both a) and b)

Question 12

If closing stock is understated, what is the effect on net profit?
a) No effect
b) Increase profit
c) Decrease profit
d) Additional information is required

SECTION C: COMPREHENSIVE QUESTION

What is the final balance of the following accounts as at 30 June 2013?
1. Inventories $11,092
2. Wages $12,189 ($11,729 + $460)
3. Insurance $2,296 ($2,826 – 530)
4. Interest on bonds $200 ($5,000 x 12% / 3)
5. Accumulated depreciation $8,472 ($3,322 + $5,150)
6. Rent received $1,922 ($2,082 - $160)

ACTIVITY 2.6.2

CASE STUDY

Appliance Makers Ltd - Makers of Fine White Goods

Answers

	Y/E Jun 2008	Y/E Jun 2009	Y/E Jun 2010
Number of shares on issue	9,500	9,970	9,970
Liquidity			
Current	2.56	2.30	0.71
Quick	2.15	1.80	0.43
Activity			
Stock (days)	73.8	49.7	60.5
Av collection period (days)	45.9	27.2	30.5
Profitability			
Gross profit margin	54%	51%	53%
Net Profit margin (before tax)	32%	23%	34%
Net Profit margin (after tax)	22%	16%	24%
Return on net worth	18%	32%	37%
Shareholder performance			
EBIT ($)	59,479	156,197	270,929
Earnings per share ($)	3.91	10.42	17.95
Dividend per share ($)	-	1.52	2.21
Leverage			
Long term debt to equity	32%	8%	21%
Total debt to equity	67%	41%	63%
Interest times cover	9.31	20.21	17.72

1. Would you like shares in this company?
   There is no correct answer. Participants answers will be based on their personal attitude to risk. If they accept:
   High risk – YES it's high return, medium risk – YES/NO may oscillateor low risk - NO
2. Why did the company borrow funds?
   a. To finance the purchase of a property for $415,000, plus working capital until the business generates sufficient cash from operations.
   b. It has almost certainly provided the property as security for the funding arranged
3. Has it borrowed enough?
   a. We cannot make absolute statements from the information available, just have expectations based on the financials & that recent finance has been arranged.
   b. Term Loan has increased by only $74,540.
   c. A bank overdraft has been arranged, with a current outstanding balance of $10,711. Any other accommodation is not revealed as at 30 June 2010.
   d. As the bank has provided finance recently, it is likely that the overdraft limit plus any undrawn portion of fixed term loan is sufficient to meet current working capital needs.
   e. We can reasonably assume that AML has borrowed sufficient as the bank has

allowed them to make a discretionary dividend payment that they may have objected to.

4. What are its strengths & weaknesses?
   1. **Strengths**
      a. *Profitability*
         i. Gross profit & net profit margins are very healthy
         ii. Profit margins are still growing
         iii. Return on shareholders funds is also healthy
      b. *Gearing*
         i. Gearing rises from a minimal level to a more expected level for a profitable & growing business
         ii. This is not problem regardless of the form of borrowing
         iii. Barring a major unforeseeable adverse event the company looks healthy
      c. *Tax*
         i. Given the strong cash flow, tax does not represent a harsh financial burden
         ii. Debt will be cheaper than equity to finance growth as interest is tax deductible"
      d. *Impact on management control*
         i. There is no immediate impact on management control due to AML's financial strength
         ii. Control will only become an issue if an adverse event occurs
   2. **Weaknesses**
      a. *Liquidity & Activity*
         i. Should company have cancelled dividend this year?
         ii. Current ratio is weak at 0.71
         iii. Liquid ratio is also very weak at 0.43
         iv. Activity indicators are deteriorating, in particular stock turnover, needs to be watched
         v. This is only risk &should be managed via monthly budgeting & control until sufficient cash generated"
   3. **Other issue**
      a. *Matching investment & funding term*
         i. Property purchase is a long term investment
         ii. Lenders has probably sought mortgage security
         iii. Sufficient funding should be medium term to match investment
         iv. Current profitability & cash flow indicate that loan may be repayable within several years
         v. Working capital requirement should be covered by overdraft as cash flow is very strong
         vi. Projected interest cost is not high given the relatively high current earnings ratios"