

It's more than just numbers

FINANCIAL STATEMENTS AND THE DETAILS

What are the goals of a business?

- Make a profit
- Remain in a healthy financial position
- Make good use of cash flow

What is a Financial Statement?

- It is the three part story of the financial health of a business.

Financial Statements Include:

- The BALANCE SHEET, also known as "The STATEMENT of FINANCIAL POSITION."
- The INCOME STATEMENT also known as "The STATEMENT of PROFIT and LOSS" and
- The STATEMENT of CASH FLOW also known as "The STATEMENT of WORKING CAPITAL".

Financial Statement Stakeholders+

- Management
- Potential Investors
- Lenders
- Creditors
- Vendors
- Employees (Yes, Employees)

The three types of Financial Statement Reports are:

- Audited Financial Statements
- Reviewed Financial Statements
- Compiled Financial Statements

What is an "audited" financial statement?

- An audit is the highest level of financial service a CPA can provide.
- The purpose of having an audit is to provide financial statement users with an "opinion" by the auditors on whether the financial statements are prepared in accordance with the proper financial reporting framework. An audit enhances the degree of confidence that intended users, such as lenders or investors, can place in the financial statements.
- The auditor obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, and whether the misstatements are free from error or fraud.+

Routine and important Audit Procedures

- Inquiring of management and others to gain an understanding of the organization itself, including operations, financial reporting and known fraud or error
- Evaluating and understanding the internal controls
- Performing analytical procedures as expected or unexpected variances in account balances or classes of transactions
- Testing supporting documentation of account balances or classes of transactions
- Observing the physical inventory count
- Confirming accounts receivable and other accounts with a third party

What is a "reviewed" financial statement?

- A review engagement is conducted to provide limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with the financial reporting framework.
- A review differs significantly from an audit. Review engagements provide less assurance to the reader of the financial statements because the CPA does not perform many of the audit procedures.

The broad review procedures required to be performed by the CPA are:

- Written representations from the management regarding the accuracy of all information given to the CPA
- Actions taken at owners or directors meetings.
- Inquires as to the accounting practices and principles used by the business
- Procedures for recording and accumulating financial information

What is a "compiled" financial statement?

- In a compilation engagement, the objective is to assist management in presenting financial information in the form of financial statements only.
- There are no assurances that material modifications should be made to the financial statements to be in conformance with acceptable financial reporting frameworks.
- The CPA will not express an opinion or provide any assurance regarding the financial statements.+

Balancing Report Needs to Cost

- It is important to find the proper balance between the cost of the CPA's service and the level of assurance the users of financial statements require.
- As a general rule, larger companies and more detailed transactions will require more financial assurance.
- Remember, as always, "Time is Money"
 - Audit
 - Review
 - Compilation

Types of Audited Financial Statement Opinions

- UNQUALIFIED
- QUALIFIED
- ADVERSE

Audit Opinions

Unqualified or "Clean" opinion. This type of opinion will contain language such as "the financial statements present fairly in all material respects" and "in conformity with generally accepted accounting principles (GAAP) in the United States."

Qualified opinion. If an auditor is unable to render an unqualified opinion, a qualified opinion may be issued. Several reasons that opinions maybe qualified include scope limitations and departures from GAAP. +

Adverse opinion. If the auditor concludes that the that the financial statements are not fairly stated, and the departure from GAAP is too significant, then an Adverse opinion must be issued. ++

Determining the Cost to Benefit Relationship

- The level of annual financial reporting that a small or middle size business presents is typically dictated by its banking agreements and users of its financial statements.
- In order to save costs, many business owners will ask their bank for permission to submit "Reviewed" as opposed to "Audited" financial statements for their annual reporting.
- The lending market is very competitive on business loans and the additional cost of an audit represents ¼ point of additional interest on the loan cost.+

Financial Statements as a Tool for Business Evaluation

- A recent survey indicated that over 50% of privately owned businesses will have a succession or liquidity event in the next 5 years.
- There is an increasing percentage of businesses that are owned by persons 55 years and older.
- Private equity firms are aggressively pursuing acquisitions and have a lot of buying ability in their pockets.
- Strategic buyers are challenged with the prospects of organic growth.+

The Potential Impact of Reviewed Versus Audited Financial Statements.

- Due Diligence Period: When a buyer or investor is interested in the purchase of a business, there is a process of due diligence related to the quality of earnings of the seller.+
- The extent of the due diligence procedures typically increases with more sophisticated buyers and sellers.
- Due diligence adjustments for private equity and strategic buyers reveals that sellers of businesses who presented "reviewed" financial statements had significantly more negative adjustments to earnings as compared to companies with "audited" financial statements.++

The Effects of Due Diligence Adjustments

- Due diligence adjustments average approximately 10% of EBITDA when purchase price has been based on reviewed financial statements.+
- Example: For a business generating \$2M of EBITDA, that is an negative adjustment of \$200K. If you apply an average transaction multiplier of 6 times EBITDA, that results in a decrease of \$1.2M in purchase price that may have been identified earlier or all together if audited financial statements had been prepared.++

Letter of Intent (LOI) signing

- A business letter of intent outlines the intent of one party relative to another; in business transactions it can be the initial proposal to the other party. While generally not binding, it can help clarify the points of the major points of a deal.
- Business owners need to understand that after a LOI is signed, there is a shift in negotiating leverage from the seller to the buyer as the due diligence begins.++
- A business should present audited financial statements two to three years before a liquidity event.++

Benefits of Audited Financial Statements

- Good Financial Discipline. The audit process focuses on the best practices and compliance with current accounting standards.+
- Fraud deterrent. An audit is not designed to detect fraud. However, the auditor's presence and examination acts as a fraud deterrent.
- Comfort to stakeholders. There is a higher degree of confidence in your financial reporting and how the business is managed when reviewed by auditors.
- Improve the business. The audit should provide ideas that help business owners improve performance.
- Accelerate transaction timelines. Quality financial reporting will help avoid delays when pursuing a transaction.++

Financial Statement Footnotes! Understandable?

- Footnotes are vital to the understanding and clarification of the:
 - Income Statement+
 - Balance Sheet (Statement of Financial Position)++
 - Cash Flow Statement+++

What are footnotes for?

- Typical annual reports contain more than the basic three financial statements.
- Footnotes provide the detail to fully explain the three financial statements+
- Generally, a reference is made to the footnotes in the main body of the other three documents.
- The accompanying footnotes to the financial statements are an integral part of these statements.++

Footnotes are necessary for adequate disclosure in financial reports.

- Proper and full disclosure is everything in Financial Reports

Footnotes are of two kinds.

- First: the main accounting methods used by the business are identified and briefly explained. For instance, the particular accounting method used to determine the company's cost of goods sold and its ending inventory is identified. The accounting methods should be consistent from reporting period to reporting period.
- Example:
 - Inventories are valued by the LIFO (last in, first out) method. The value of inventories on LIFO basis represents approximately 85 % of the total current cost.+
 - If the FIFO (first in, first out) method is used, inventories can be significantly higher than reported for the three years presented.++

Additional Disclosures in Financial Statement Footnotes:

- Depreciation methods
- Method of consolidation for parent and subsidiaries corporations
- Intercompany dealings are explained and eliminated
- Affiliations with less than controlling interests

The Second type of Footnotes

- Provides more detailed disclosure with adequate explanations.+
- Details about the company's employees' retirement and pension plans are also disclosed in footnotes.
- The list of footnotes is a long one; and a very necessary and detailed responsibility of management.++

Management Discretion in Writing Footnotes

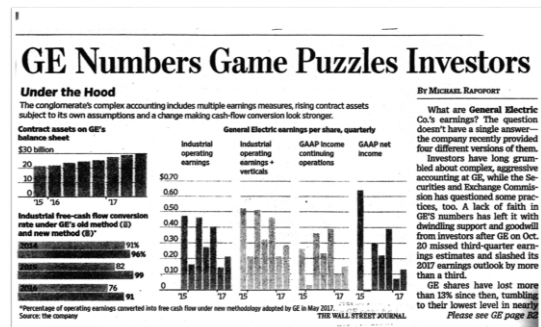
- Management must rely on experts to help convey proper and correct disclosure in the footnotes.
- Experts are Chief Financial Officer, Legal Counsel, outside CPA auditors and similar experts.
- Management has discretion and flexibility on how candid to be and how much detail to express in each footnote.
- How much information are Stakeholders entitled to? Difficult to determine at best.+

Clear, Opaque, or Cloudy Footnotes?

- How clear and precise are footnotes required to be?+
- Footnotes are required, but the rules do not demand clear and concise explanations such that the average financial reader can always understand them.
- Stockholders and creditors cannot expect management to detail their bad decisions.
- It is somewhat the readers responsibility to dig into the details provided in the footnotes to find and understand their purpose.++
- Generally, audited financial statements have more inclusive footnotes.

Financial Statement Fraud and Misstatements

- Potential litigation exists when business interests are transferred
 - Fraud is intentional or
 - Misstatements are negligent
- There is a Cottage industry of "forensic accounting" after the fact
- A prudent buyer should request audited financial statements to ensure value received
- A prudent seller should invest in audited financial statements to limit potential liability



GE

Continued from the prior page
The stock is now down more than 30% from its peak in the first quarter of 2015, when GE's share price peaked at \$22.45, down 12% from its peak in the first quarter of 2014.

13%
Dow Jones Industrial Average
as of Oct. 20

problems," said John Bach, Deutsche Bank analyst, who has been critical of GE over the quality of its earnings and disclosure. "It is hard to see how the company can build from whatever the book does mean to us, but we have been in a position for some time to see what the company is doing to fix it."

The SEC has focused on GE's use of off-balance sheet vehicles to reduce debt and improve its financial ratios. The company has used a series of trusts to hold its debt, which has allowed it to reduce its reported debt levels. The SEC is now looking at how these trusts are structured and whether they are being used to hide debt from investors.

The JBS Saga... From bad to worse

By Leesa Zalesky

High-stakes game of chicken...

On October 6, a federal judge in Brazil froze \$500 million in assets belonging to J & F Investimentos, the primary holding company of the Batista family, which is the founding and controlling owner of JBS SA, the world's largest meatpacker and cattle feeder. The asset freeze was related to a new

investigation into what the court said were alleged "tax irregularities" involving false invoices created to effectively siphon off and launder millions of dollars used to bribe hundreds of politicians and regulators over nearly a decade. Billionaire brothers Wesley and Joesley Batista of the JBS SA family, who are currently being held in jail in Brazil related to insider trading charges, admitted their roles in the political bribery scandal in a plea bargain agreement with prosecutors last May. Twelve days after the court froze Batista assets in the deep freezer, JBS SA fired back by announcing that it was shutting down operations at seven slaughter plants in the state of Mato Grosso do Sul. A spokesman for the family said the court-ordered asset freeze had brought "legal insecurity" to its operations in Brazil's second-largest cattle-producing

...Cont. on pg 5

WESTERN AG REPORTER

Thursday, October 26, 2017

JBS
cattle available.
On October 19, just one day after the Batistas announced the plant shutdown, the court blocked and granted an injunction filed by the Batistas to release their frozen assets... Watching all this unfold was like being a spectator at a 14-day O.K. Const. shoot-out.

JBS SA names new chairman & elects new members...
One day after the court released Batista assets, JBS SA

informed investors through a securities filing that Jeremy O'Callaghan had been elected to the post of JBS SA chairman. O'Callaghan was previously the investor relations director for a decade at JBS and will replace Tarek Farhat, who has been moved into a "global advisor" position with the company while retaining his board seat at the company's U.S. subsidiary, Pilgrim's Pride. During the meeting when O'Callaghan was selected as the new chairman, the JBS SA board unanimously elected four new members to the board (see side bar) Jose Batista, the 84-year-old father of the now-jailed Joesley and Wesley Batista, remains JBS SA's CEO, a position he gained during a controversial JBS SA board meeting in September and which appointment development bank BNDES, a 21% stakeholder in JBS, is now challenging.

Born in Ireland, O'Callaghan immigrated to Brazil in 1979, joined the Brazilian meat industry in 1983, developing global trade strategies for

the Brazilian beef industry. He joined JBS in 1996 to develop its department of international businesses and then moved into the position of Investor Relations Officer where his responsibilities included representing the JBS SA relationship with CVM, Brazil's securities regulator, and developing and expanding JBS relationships with local and international investors and stakeholders.

On October 18, the Irish Times reported that Brazil's securities regulator, CVM, has opened an investigation into O'Callaghan, in which he is accused of violating his duty to inform markets by not expartiating JBS managers and controlling shareholders related to the plea bargain signed in May by Batista brothers Wesley and Joesley along with other company executives. CVM also claims O'Callaghan disclosed the plea agreement in an inappropriate manner by not using an associated "material fact form" to highlight important information from the company for investors.