Assignment 2

Restated Financial Statements and Ratios

Unit code:	**ACCT11059 – Accounting, Learning and Online Communication**
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Step 1: Chapter 4 - Ideas, reflections and reactions

Not long after starting to read chapter four of the study guide, I realised that my superficial knowledge of accounting that I referred to in assignment one was indeed worse than I thought. The mention of the many acronyms to follow was not that disconcerting; however, the ratios they represented were. My immediate concern was that I had never encountered these ratios in my twenty-nine years as a senior manager.

Moreover, my four hundred and fifty dollars per hour accountant of sixteen years never presented any of these ratios to me as an analysis of my business. The company had invested several million dollars in plant and equipment, a multi-million-dollar turnover, and twenty-seven employed staff. My initial question was: 'was my business too small for this type of analysis or was my accountant depriving me of his best service?'.

In assignment one, I revealed that I am a Certified Practicing Business Broker (CPBB). I was curious to revisit my CPBB training material to see if any of these ratios were examined, chiefly because business brokers are concerned with assessing a firm's value and these ratios are intended to assist with that function. I was discouraged when I realised there was no mention of these ratios at all.

In my opinion, there is a disconnect between accountants and business brokers when determining the value of a firm. Primarily, we are looking at the enterprise from two different positions. An accountant uses detailed financial analysis to determine the value of the business whereas the business broker considers the financial data to determine a likely selling price. I am beginning to wonder if this difference only occurs at the small business level.

I could relate to the discussion about people's imagining about things that have not yet happened. My experience is that most business owners forecast a better result than they achieve, making me sceptical about forecasts. I am beginning to understand the broader importance of accounting for business. It is much more than keeping a record of the past and complying with legislative requirements.

The concept of restating financial statements to help make it easier to understand a firm's past makes sense to me though before reading this I could not understand why you would undertake this exercise. Understanding why and understanding what I am seeing are two different things. Ryman Healthcare's restated statement of changes in equity, as shown in

Table 4-4 of the study guide, does not impress me as being easier to understand than the original. I hope this is a matter of having some practice during the next stages of this assignment.

I found the concept of Free Cash Flow (FCF) interesting because it shows the relationship between investment in operating assets and the value of a firm under the Discounted Cash Flow (DCF) model. FCF is something I wish my accountant had calculated for my business in his assessment of my planned asset purchases. The analysis my accountant presented was usually a forecast profit and loss statement and a cash flow forecast, which would only show the impact of the investment on profitability and cash flow. The example given of Ryman Healthcare's investment of some three hundred and seventy million dollars in a building program of new retirement villages and rest homes is good although I am unsure how you would determine how much you should invest by using this model. Is this what you mean by saying FCF is a measure of transfer of value rather than the creation of value?

I understand the concept of opportunity cost and your example of buying property in Yeppoon two years ago paints a good picture. The question this raised for me was that of the relationship between leveraged capital and opportunity cost. Is the opportunity cost reduced if you borrow against the property to buy Ryman Healthcare shares?

Your analogy of a Kinder Surprise was a terrific explanation of why it is important to look beneath the outer layers to see what is happening, in particular, how this relates to identifying value created or destroyed by the company's operating activities.

My understanding of the various ratios discussed in the latter pages of chapter four is limited after reading over them a few times. I expect I will gain a better understanding by calculating and considering each of the ratios in some of the upcoming stages of assignment two.

Summary

The key concepts and questions I have from reading chapter four are summarised as follows:

Key concepts:

- Looking at the past as a way of predicting the future.
- Restate financial statements to make it easier to understand the past.
- Free Cash Flow is a model to show the relationship between investment and the value of a firm.
- Capital can only be invested in one thing at a time.
- A firm's operating activities are usually where value is added or destroyed.
- Look beneath the outer layers of the firm to see what is happening on the inside.
- The statement of changes in equity shows how the income statement and balance sheet interconnect.

Questions:

1. Are the ratios discussed in this chapter only suitable for the analysis of large companies or are they applicable to small to medium size enterprises as well?
2. Why are these ratios ignored in the Certified Practicing Business Broker training material if they are indicators of a firm's value?
3. Is the value of a business determined by financial analysis alone or is what it could be sold for also relative?
4. Does a different valuation methodology apply to large business and small business?
5. Is Free Cash Flow modelling on its own a satisfactory method of determining how much to invest in operating assets?
6. What effect does leveraged capital have on opportunity cost?