KPI Booklet 2019

March 27

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Back to Basics

Introduction to Management Accounting and its Role in Business

Managers are vital to creating a successful business. They are engaged in three main areas of the business.

Planning, Operating & Evaluating

> *"Managers are vital to creating a successful business. They do so in three main areas.*
>
> *Planning, Operating & Evaluating"*

Planning

Management begins with planning. Planning creates the goals of the business and how these targets are going to be met. The standards that are set can be called "benchmarks" against which results can be measured. We may refer to these standards as KPIs further in this booklet.

Operating

When the business is operating on a day by day basis, managers must make decisions about how to achieve the goals that have already been set. Accounting information allows managers to make decisions on how to set product prices, or whether to buy equipment of expand facilities. These decisions are ongoing and are made primarily on the managers evaluation on whether they fit with the plans that have already been made.

Evaluating

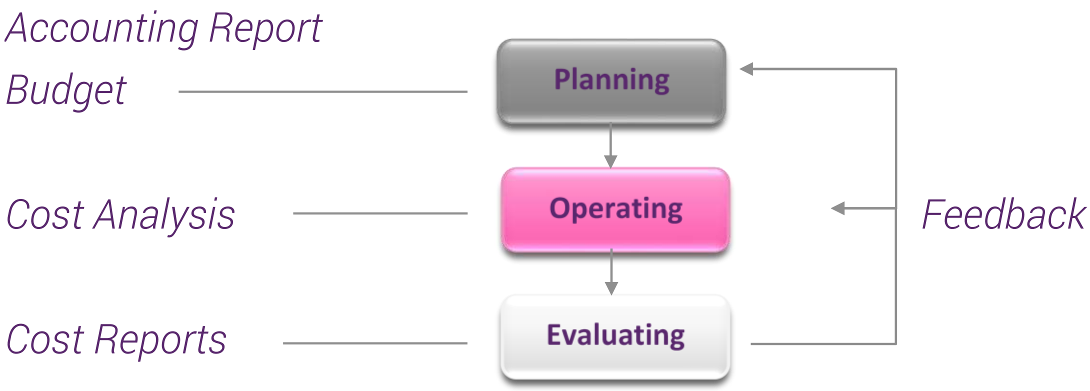
This activity measures actual operations and progress against the standards or benchmarks. Evaluation is designed to continually correct movement away from established goals and to plan for future operational requirements. Evaluation works best when problems are detected quickly, and operational changes are implemented to correct them.

Accounting Support for Management

Accounting systems are designed to measure, record and summarise the economic information of the business for management decision making. The information is then shared with internal users such as individual employees, working groups, managers and business owners.

Activities of Managers and Accounting Reports

Budgets, cost analyses and manufacturing cost reports are examples of management tools that are provided by accounting systems.



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Basic Financial Statements

Profit & Solvency

Profit is the difference between the sales (Revenues) of the business and its total costs (Expenses). Solvency is a business long term ability to pay all its debts as they become due. Both internal and external users can be given access to this type of information.

Profit Calculation (equation format)

Writing out the profit equation can help decision makers to project future profits for their goods and services.

This calculation can answer the following questions:

a) How much profit will the business earn at a given unit sales volume?

b) How many units must the business sell to break even?

c) How many units must a business sell to earn a given amount of profit?

$$\text{Profit (for a given sales volume)} = \left[\text{Selling Price per Unit} \times \text{Unit sales Volumes}\right] - \left[\text{Variable cost per unit} \times \text{Unit sales volumes}\right] - \text{Total Fixed Costs}$$

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Specific KPIs

Every business has their own KPIs that they should monitor. The role of a CFO amongst other things is to give feedback to the internal and external people of the business about how the KPIs are being followed. Also, a CFO may advise on making changes to KPIs in line with projected and actual performance data.

KPIs can be grouped into various headings in which the ratio will reside:

Activity	*Liquidity*	*Performance*
Valuation	*Solvency*	*Engagement*
Revenue	*Team*	

Activity KPIs are based on the activity that takes place in the business.

Example of Activity based KPIs are:

Inventory Turnover Ratio which is the number of times inventory is sold in a year.

$$Inventory\ Turnover\ Ratio = (COGS(Cost\ of\ Goods\ Sold))/(Average\ Inventory\ *)$$

$$*\ Average\ Inventory = (Invoices\ for\ Previous\ Year + Invoices\ for\ Current\ Year)/2$$

Receivable Turnover is the number of times in a year the business collects its accounts receivables.

$$Receivables\ Turnover = (Net\ Sales\ *)/(Average\ Accounts\ Received\ **)$$

$$*\ Net\ Sales = Gross\ Sales\ Less\ Sales\ Returns$$

$$**Average\ Accounts\ Receivable = (Accounts\ Receivables\ Previous\ Year + Accounts\ Receivable\ Current\ Year)/$$

Liquidity KPIs are ones that relate to the ability of the business to meet its liquidity liabilities.

$$Current\ Ratio = Current\ Assets\ (Current\ Assets)/(Current\ Liabilities)$$

The Quick Ratio is commonly referred to as the Acid test where a preferred ratio greater than 1.

$$Quick\ Ratio = ((Current\ Assets - Inventory))/(Current\ Liability)$$

The cash ratio less than 1 is acceptable otherwise it shows an inefficient use of cash resources. Greater than 1 indicates that the business needs more cash to pay its debt.

$$Cash\ Ratio = (Cash + Cash\ Equivalent)/(Current\ Liabilities)$$

Solvency Metrics

Debt to Equity is a measure of how the company can deal with its debts. The ratio is used to evaluate a company's financial leverage. The D/E ratio is an important metric used in corporate finance. It is a measure of the degree to which a company is financing its operations through debt versus wholly owned funds. More specifically, it reflects the ability of shareholder equity to cover all outstanding debts in the event of a business downturn.

$$Debt\ to\ Equity = (Total\ Liabilities)/(Total\ Equity)$$

Interest Coverage is to show how easy it is for interest payment to be made.

$$Interest\ Coverage = (Operational\ Profit)/(Interest\ Expenses)$$

Debt to Asset ratios are helpful in determining how risky companies' position is when it comes to repayment of the debt.

$$Debt\ to\ Asset\ Ratio = (Total\ Liability)/(Total\ Assets)$$

Debtor Days is the number of days that it takes to get paid by your customers.

$$Debtor\ Days = (Trade\ Debtors)/Revenue\ X\ 365$$

Creditor (or payables) days number is a similar ratio to debtor days and it gives an insight into whether a business is taking full advantage of trade credit available to it. Creditor days estimates the average time it takes a business to settle its debts with trade suppliers.

$$Creditor\ Days = (Trade\ Payables)/(Cost\ of\ Sales)\ \ X\ 365$$

Performance and Profitability KPIs give business owners and their managers a very direct view of how their business is performing and how they can make changes that will impact their value going forward.

$$Gross\ Profit\ Margin = (Gross\ Profit)/(Net\ Sales)$$

The operating margin measures how much profit a company makes on a dollar of sales, after paying for variable costs of production, such as wages and raw materials, but before paying interest or tax. It is calculated by dividing a company's operating profit by its net sales.

$$Operating\ Margin = (Operating\ Profit)/(Net\ Sales)$$

Net Profit Margin is one of the best known KPIs. It measures the profit margin on all operations.

$$Net\ Profit\ Margin = (Net\ Profit)/(Net\ Sales)$$

Return on Assets is the amount of profit your assets generate.

$$Return\ on\ Assets = (Net\ Profit)/(Total\ Assets)$$

Return on Equity

$$Return\ on\ Equity = (Net\ Profit)/(Total\ Equity)$$

The Role of Accounting Systems and Measuring KPIs

The beauty of modern-day accounting software is that many of the KPIs that you may want to follow are either hard wired into the system or can be created as a custom report. The below picture is of a demonstration company in Xero. The bonus of cloud accounting is the ease in which you can keep the figures updated so that you and your management team can keep on top of the issues that arise.

Gross profit (loss)	11,956.41	9,795.00	22.1% ▲
Other Income	97.05	0.00	0.0%
Expenses	22,898.32	17,212.99	33.0% ▲
Profit (loss)	(10,844.86)	(7,417.99)	-46.2% ▼
Balance Sheet			
Debtors	16,006.55	10,199.50	56.9% ▲
Creditors	8,965.67	3,691.95	142.8% ▲
Net assets	(16,718.89)	(5,874.03)	-184.6% ▼
Income			
Number of invoices issued	7.0	7.0	0.0%
Average value of invoices	1,818.45	1,399.29	30.0% ▲
Performance			
Gross profit margin	94.0%	100.0%	-6.0% ▼
Net profit margin	-84.6%	-75.7%	-11.7% ▼
Return on investment (p.a.)	778.4%	1515.4%	-48.6% ▼
Position			
Average debtors days	38.7	29.2	32.8% ▲
Average creditors days	11.7	6.0	95.6% ▲
Short term cash forecast	7,040.88	6,507.55	8.2% ▲
Current assets to liabilities	0.4	0.8	-56.1% ▼
Term assets to liabilities			0.0%

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Valuation Metrics

Getting specific about how our business is valued is important especially when you want to achieve finance or sell.

One important KPI is the Earnings per share metric that measures a company's profitability.

Earnings per Share = (Net Income-Preferred Dividends) / (Number of Shares Outstanding)

Engagement KPIs are based on the satisfaction of your customers and the engagement that they have with your business. Surveying customers constantly is how you can create KPIs that really drive client engagement.

Net Promoter Score measures your client's feedback to your business. There are apps that can rate your NPS easily and immediately.

The NPS Calculation

Calculate your NPS using the answer to a key question, using a 0-10 scale: How likely is it that you would recommend [brand] to a friend or colleague.

Respondents are grouped as follows:

Promoters (score 9-10) are loyal enthusiasts who will keep buying and refer others, fueling growth.

Passives (score 7-8) are satisfied but unenthusiastic customers who are vulnerable to competitive offerings.

Detractors (score 0-6) are unhappy customers who can damage your brand and impede growth through negative word-of-mouth.

Subtracting the percentage of Detractors from the percentage of Promoters yields the Net Promoter Score, which can range from a low of -100 (if every customer is a Detractor) to a high of 100 (if every customer is a Promoter).

Example Survey Results

Survey Answers	Type of Client	# of Responders	% of Responses
9-10	Promoter	50	24.390%
7-8	Passives	150	73.171%
0-6	Detractors	5	2.439%
		205	100%

NPS Calculation = 24.390% - 2.439% = **21.951%**

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How does your business rate?

To check how well you are going with your business we have a calculation page that you can complete. If you do not know the answers to these questions, please leave them blank.

Please complete the following formulae and send to Supervision today to get your free appraisal.

(Please fill in the blanks with your current months information)

Net Profit Margin = (Net Profit)/(Net Sales)

1. ____________% = _________________

Return on Assets = (Net Profit)/(Total Assets)

2.____________% = _________________

Net Promoter Score % = Promoter %-Detractors %

3. ________% = ________% - ________%

Average Debtor Days = (Trade Debtors)/Revenue X 365

4. ____________Days = __________________ X 365

To receive your free consultation and business KPI evaluation, please contact us by any of the following options:

Email: info@supervision.com.au

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