



106 Financial Analysis for In-house Counsel

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CLO's Role in Financial Compliance: Trusted Legal Advisor, Advocate & Leader Insights of Michael Fricklas, CLO Viacom Inc.

"The relationship with the financial side of the business is one of the most important relationships a General Counsel has, and developing an open and trusting relationship is fundamental to success," explains Michael Fricklas, Executive Vice President and General Counsel for Viacom. As General Counsel, Fricklas leads by example and spearheads initiatives within the company to develop strong processes for legal support for financial compliance and internal controls. In addition, Fricklas plays a key leadership role within the broader legal community on the critical and related issue of ever-expanding auditor requests for information and the client's (and counsel's) need to preserve the attorney-client privilege and work product protections. Highlighted below are perspectives shared by Fricklas on practices chief legal officers can implement within their companies and how they can strengthen the role of law departments in their company's financial compliance processes and their relationship to corporate governance and brand integrity.

BUILDING TRUST AND EFFECTIVE PROCESSES

"Internal and outside auditors heavily rely on General Counsel and in-house lawyers when certifying the books and financial statements. While our participation in the audit process is increasing, our finance role is not limited to this function. We implement a variety of 'preventive' practices that help build trust and support the integrity in our financial processes, and this reinforces the value and important role lawyers play," shares Fricklas. Among these practices are:

- **Be 'in-the-loop'.** In-house lawyers need to be on top of the latest finance information in the company so that they may proactively help spot issues and ask questions during internal discussions. They should also be involved in the process to help identify legal issues and ensure comfort with external statements by senior management to the investment community. Fricklas notes that his law department and senior management have established practices that help enable the law department to be so familiar with the numbers that they can provide advice on-the-spot, or in advance of company announcements or management's speaking engagements.
- **Establish collaborative relationships with company financial staff and auditors that foster information-sharing with minimal intrusion.** Fricklas believes that, under most circumstances, auditors don't need access to privileged documents, and companies can find an alternative way to support accounting positions without risking the attorney-client and work product privileges. As an example, Fricklas notes that business personnel can focus on fact-based reasons supporting financial positions rather than focusing on advice of counsel since most circumstances will necessarily involve fact-based decision-making as justification for a given course of action.

- **Hire lawyers who are financially literate and provide tools to support continued learning.** In-house lawyers working with inside financial personnel and outside auditors need to stay current on significant accounting rule changes and related financial rules to that they can stay plugged in to the entire set of accounting processes and ask informed questions. But even more fundamental, they need to have a good grasp of how the company's business and finances are connected, which many lawyers don't spend time focusing on. Within the Viacom law department, lawyers attend an internal company 'corporate college,' and appropriate lawyers receive advanced training that supports their relationship with auditors and company financial managers.
- **Communicate with the Board.** In-house lawyers should brief the full Board on significant litigation, and Fricklas attends all meetings of the Board's Audit Committee, including executive sessions of the committee during which outside auditors are not present. There is also an executive session attended only by the Committee and himself as General Counsel.
- **Help structure internal controls processes and certify the process.** At Viacom, in-house lawyers are deeply involved in quarter-end review processes to help ensure the reliability of divisional certifications of financial information submitted to Corporate. Since the role of in-house lawyers focuses on providing assistance and process support, select in-house lawyers working with the business divisions certify their involvement with the process and whether it was followed.
- **Separate facts and legal opinions in internal investigation reports.** Consider preparing separate legal and factual components of any investigation report prepared so that the factual information may be shared with outsiders, including auditors, while preserving legal privileges and protections for the report that contains legal advice and mental impressions.
- **Meet with outside auditors and have open/honest discussions.** Lawyers take the lead in discussing the business impact of legal matters in a manner that does not constitute waiver, including the likely financial impact and the broader operational impacts of legal affairs.
- **Stay involved in the outside auditor inquiry letter process.** The law department should be engaged with their auditor to help identify which outside law firms may have information on material matters and should therefore provide written responses to audit inquiry letters.

LEADING THE WAY TO CHANGE TO HELP PROTECT PRIVILEGE AND BALANCE AUDITOR NEEDS

As noted above, in addition to playing an important leadership role on financial compliance within his company, Fricklas is a leader within the professional and business community more broadly on issues relating to auditor information requests and legal and work product privileges and protections. More specifically, Fricklas leads the General Counsel Working Group, an informal group comprised of general counsel from major public companies within the New York metropolitan area and convened by The New York City Bar (formerly ABCNY). The Working Group has taken a leadership position on how to positively affect productive change in a meaningful collaborative way on the auditor information issue and more broadly on attorney-client privilege issues and corporate governance.

"In the wake of Sarbanes-Oxley, auditors increasingly feel the need to review material that lawyers view as privileged. Auditors are asking to review information relating to opinions on tax

positions, evaluation of litigation reserves, investigative reports, as well as advice on a broad range of other issues in performing their diligence on financial statements. The law on providing this information to auditors is unsettled—with many courts viewing provision of this material to auditors in connection with a financial audit as a waiver, and the additional complex issues of whether the waiver may extend to other materials not specifically provided. As a result, there is quite a lot of discussion among auditors and the companies they audit on how much auditors need to see and whether what they want to see is privileged. This issue bubbled up among our Working Group discussions, and David Brodsky of Latham & Watkins (former General Counsel of Credit Suisse First Boston) offered to work with us to prepare a white paper reviewing these tensions and suggesting solutions,” explains Fricklas.

The White Paper concludes that the audit function “must not be allowed to jeopardize a company’s ability to utilize one of the primary tools it has at its disposal to comply with its corporate governance obligations—its legal counsel.” Specifically, the White Paper proposes that the SEC, PCAOB, the corporate counsel community, and the principal auditors of the vast majority of U.S. public companies should resolve this issue by proposing legislation that would permit companies to provide certain kinds of needed privileged and work product information to auditors without waiving privileges as to others.

The Association of Corporate Counsel’s Board of Directors has endorsed the position in the General Counsel Working Group [White Paper](#), and ACC has also been an active member of the ABA’s Task Force on Attorney-Client Privilege, which recently addressed the issue of privilege waiver in the audit context in a [Report](#) to the ABA House of Delegates.

HEARSAY

Going Global | New To In-house | Ins & Outs
Small Law | The Contractual Cogitator

There’s an old joke about three candidates for an accounting job, each of whom are asked only one question: “What’s two plus two?” The first candidate confidently answers, “Four.” The second candidate hesitatingly answers, “Well, usually it’s four, but it could also be three or five.” The third promptly answers, “What do you want it to be?” Candidate number three gets the job.

We’re relatively certain that they will hear “plain English,” but we also know that they will *listen* to the language of business—accounting.

During a recent contract negotiation, I changed my reasoning for a recommended revision to a termination clause from “You’re accepting too much risk that they can easily terminate this agreement,” to “If they terminate, there’s going to be a profound im-

the legal department’s contributions to the business process have a positive impact on the company’s revenues and its bottom line, be that greater revenues or lesser liabilities. Positive feedback from corporate clients also helps if you need to solicit feedback from your clients at performance review time.

Question Two: Where can you acquire this knowledge?

If you have read this column this far, perhaps you’re not completely skeptical about ASL. You might even feel compelled to seek out ASL resources once you drop this dog-eared copy of the *Docket* into your reference pile. If so, I recommend that you begin your search for materials on the web to determine what is best for you. Below is a list (a very short, very limited list, and not in any particular order), of the financial resources that I use regularly and have found to be the best fit for me:

1. John A. Tracey, *How to Read a Financial Report: For Managers, Entrepreneurs, Lenders, Lawyers, and Investors* (5th ed. 1999).
2. John A. Tracey, *Accounting for Dummies* (2nd ed. 2001).
3. Robert B. Dickie and Philip E. Meyer, *The Lawyers’ Accounting Program: Financial Statement Basics* (1999). The Tracey books are available at any reputable book store, and The Dickie Group offers several financial courses tailored to attorneys (see www.thedickiegroup.com). Lastly, I note that Tracey’s *Accounting for Dummies* has perhaps the greatest therapeutic value: Helping me accept that I am an accounting dummy while simultaneously reinforcing my satisfaction in having chosen the legal profession so many years ago. ■

Have a comment on this article?
Email editorinchief@acc.com.

Mixing Numbers and Lawyers: Accounting as a Second Language (ASL)

BY SEAN VENDEN

Many in-house lawyers, having learned in elementary school that a number can have only one meaning, are disgruntled to realize that mathematics is not accounting. With a brief nod to the old adage “numbers and lawyers don’t mix,” we all have at least a rudimentary mathematical background and need simply to acknowledge that accounting requires a different skill set. Some knowledge of the basic principles of accounting is necessary for a long-term in-house career. That conclusory statement compels at least two questions: (1) Why do I need this knowledge? (2) Where do I get it?

Question One: Why should in-house attorneys have knowledge of accounting basics?

I don’t suggest that you gain a CPA’s knowledge in the generally accepting accounting principles (GAAP), or strive to become a critical asset to your finance department. However, in order to better advise your business clients of legal risks, you should speak their language. Your clients don’t want to hear legalese.

Our negotiating posture quickly went from a fear of losing the contract because of “legal issues” to one of securing revenues. The issue was the same. But by referring to “operating revenues” instead of that onerous termination provision in Section 15(a)(iii)(D), I was able to get my folks to listen to and understand the problem.

Another example involves a vendor. We were unhappy with performance and the vendor was unhappy with our lack of payment in response. Rather than discussing the risks as to how taking a course of action might lead to a legal claim, I said, “Any intentional breach or claim alleging that we breached the contract might require us to establish a reserve.” Message received. Negotiations ensued. A compromise was reached. Business people were happy.

I’ll spare you the other examples and describe another benefit to having this ASL: It helps me quantify the inaccessible “Increase Shareholder Value” performance metric for in-house attorneys. I can point to specific instances where



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SPINRITE INCOME FUND
(\$000S)

REPORTED NUMBERS

	Feb 8 to					
	Dec 31 2005	2004	2003	2002	2001	2000
Net Sales	114,432	71,429	58,703	58,288	60,057	60,970
Cost of Sales	75,739	42,867	40,537	45,885	41,413	42,523
Gross Profit	38,693	28,562	18,166	12,403	18,644	18,447
SG&A (excluding Depreciation & Amortization)	15,061	8,656	8,538	7,843	12,222	9,913
EBITDA	23,632	19,906	9,628	4,560	6,422	8,534
Depreciation & Amortization	5,489	1,327	1,568	1,310	1,029	1,010
Interest Expense	2,860	1,020	478	603	440	400
FX & other (gains)/losses	(549)	338	476	588	(143)	268
EBT	15,832	17,221	7,106	2,059	5,096	6,856
Income Tax Expense	150	4,779	2,302	584	1,918	2,721
Net Income (before non-controlling interest)	15,682	12,442	4,804	1,475	3,178	4,135
Change in Accounts Receivable	9,121	(6,117)	(1,017)	1,548	357	(1,284)
Change in Inventories	(13,161)	(3,517)	1,274	(309)	2,536	(84)
Change in Prepaid Expenses & Other Assets	(49)	(347)	(72)	(4)	39	74
Change in Accounts Payable & Accrued Liabilities	(8,141)	4,812	847	(1,929)	(23)	3,128
Changes in Income Taxes Payable	1,900	1,410	4,656	(2,810)	(751)	(1,519)
Total Cash Inflow/(Outflow) from Change in W/C	(10,330)	(3,759)	5,886	(3,504)	2,158	315
EBITDA	23,632	19,906	9,628	4,560	6,422	8,534
Capital Expenditures	1,272	1,377	661	5,350	3,335	1,209
Estimated Distributable Cash	22,360	18,529	8,967	(790)	3,087	7,325

DIRECT METHOD CASH FLOW STATEMENT

Cash Inflow from Operations:						
Net Sales	114,432	71,429	58,703	58,288	60,057	60,970
Change in Accounts Receivable	9,121	(6,117)	(1,017)	1,548	357	(1,284)
Total Cash Inflows from Operations	123,553	65,312	57,686	59,836	60,414	59,686
Cash Outflow from Operations:						
Cost of Sales	75,739	42,867	40,537	45,885	41,413	42,523
SG&A (excluding Depreciation & Amortization)	15,061	8,656	8,538	7,843	12,222	9,913
Change in Inventory	13,161	3,517	(1,274)	309	(2,536)	84
Change in Accounts Payable & Accrued Liabilities	8,141	(4,812)	(847)	1,929	23	(3,128)
Change in Prepaid Expenses (& Other Assets)	49	347	72	4	(39)	(74)
Total Cash Outflows from Operations	112,151	50,575	47,026	55,970	51,083	49,318
Net Cash Flow from Operations	11,402	14,737	10,660	3,866	9,331	10,368
Required Re-Investment	1,272	1,377	661	5,350	3,335	1,209
Free Cash Flow from Operations	10,130	13,360	9,999	(1,484)	5,996	9,159
Cash Interest Paid	2,891	870	478	603	440	400
Cash Taxes Paid	271	3,201	586	3,163	2,545	4,130
Distributable Cash Available from Operations	6,868	9,289	8,935	(5,250)	3,011	4,629
Proceeds from Asset Dispositions	-	20	-	-	-	5
Costs of Acquisitions in Excess of Financing	-	(3,895)	-	-	-	-
Debt Repayments	(110)	(879)	(829)	(259)	(49)	(272)
Real Distributable Cash	6,858	4,435	8,106	(5,509)	2,962	4,362

Declared Distributions to Unitholders	18,582
Paid Distributions to Unitholders	16,793
Distributions Paid/Real Distributable Cash	245%
Distributions Declared/Real Distributable Cash	271%

Average Free Cash Flow from Operations 2005-2003	9,700	@ 20,299 units =	0.48	per unit
		@ 25,372 units =	0.38	per unit

Average FCF from Operations	7,860
Standard Deviation of FCF from Operations	5,147
Standard Deviation as a percent of Average	65%

Average Real Distributable Cash	3,536
Standard Deviation of Real Distributable Cash	4,807
Standard Deviation as a percent of Average	136%



106: Financial Analysis for In-house Counsel

Robin B. Schwill

ACC's Canadian CCU:
New Challenges/New Solutions

November 18-20, 2007 The Metropolitan Hotel, Toronto, ON

The in-house bar association.™

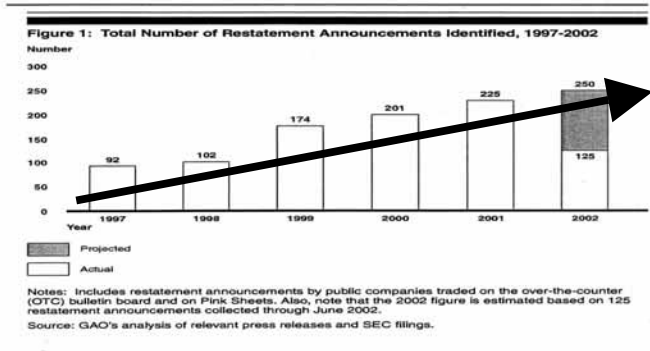
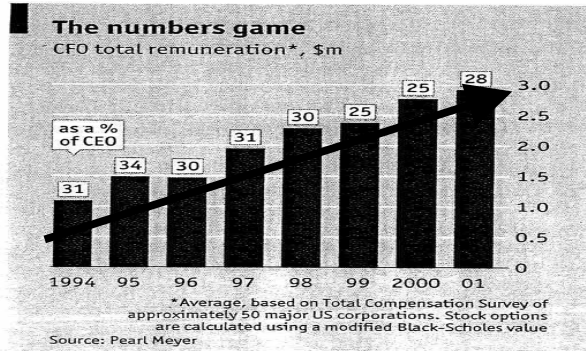




Figure 2: Percent of Listed Companies Restating, 1997-2002

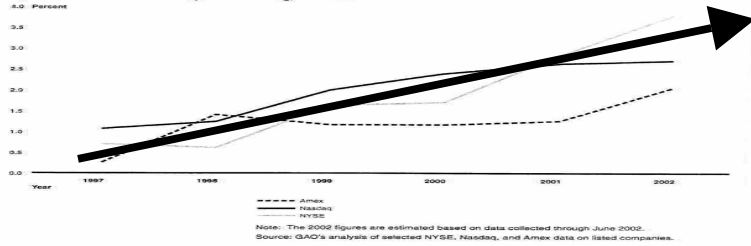
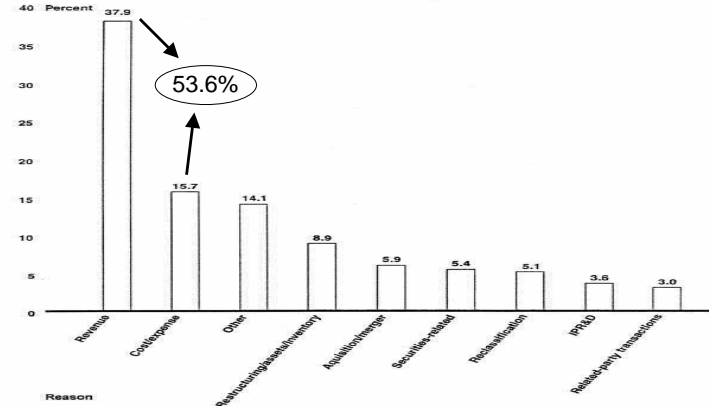
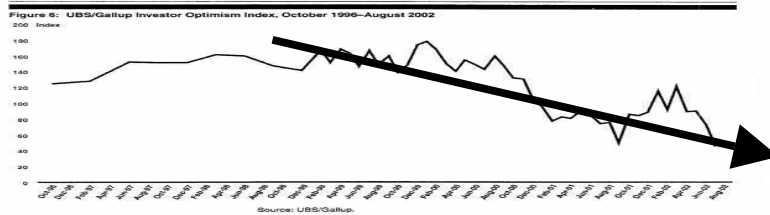


Figure 3: Restatements by Reason, 1997-June 2002



Note: Our database includes announced restatements that were being made to correct previous material misstatements of financial results. Therefore, our database excludes announcements involving stock splits, changes in accounting principles, and other financial statement restatements that were not made to correct mistakes in the application of accounting standards.
Source: GAO's analysis of initial restatement announcements due to accounting irregularities.



The Two Epiphanies

- Accounting presentations are **NOT** objective . . .
 - GAAP is flexible, not rigid
 - Audits only relate to GAAP
- . . . Nor are they **Neutrally Portrayed**
 - management prepared
 - inherent bias to:
 - minimize the cost of capital
 - maximize reported earnings



Underlying Accounting Approach

- Accrual v. Cash Accounting
- The Matching Principle



Transparent Financial Disclosure

- “An effective audit committee takes an active role in overseeing an entity's accounting and financial reporting policies and practices.”
(CICA Handbook)



Financial Transparency Issues

- Earnings Management
- Fictitious & Hidden Assets
- Hidden & Fictitious Liabilities



Earnings Management

- Revenue recognition
- Cost recognition
 - Capitalization
 - Inventory valuation
 - One-time charges



Earnings Management

- Revenues
- Cost of Goods Sold (COGS)
- = Gross Profit
- Selling, General and Administrative Expenses (SG&A)
- Other Operating Expenses (e.g. Research and Development)
- = EBITDA
- Depreciation
- Amortization
- = EBIT
- Interest Expense
- = EBT
- Income Taxes
- = Net Income



Cost Recognition – Capitalization

- EBITDA
- Capitalized Costs
 - Exploration costs
 - Pre-production costs
 - Pre-operating costs
 - Development costs
 - Prepaid marketing costs
 - Deferred leasing costs
 - Deferred financing costs
 - Licensing & Program Costs
 - Practice Management Costs
 - Pension Costs

NBV (starting)
 Less: Amortization
Plus: Cash Spent on Item
 NBV (ending)



Cost Recognition - Capitalization

- Spend \$500,000 this year for production that will commence next year and is estimated to last for 5 years.
- Could expense \$500,000 this year.
- Could capitalize \$500,000 this year and recognize and expense of \$100,000 per year over 5 years to match (?) against revenues.



Basics of Revenue Recognition

- Revenue is booked net of:
 - trade discounts
 - volume discounts
 - returns & allowances
 - claims for damaged goods
 - certain excise & sales taxes



When is a Sale a Sale?

- transfer of significant risks & rewards of ownership
- all significant acts complete
- no continuing managerial involvement in goods transferred
- no effective control of goods transferred
- reasonable assurance regarding:
 - measurement
 - extent to which goods may be returned
 - ultimate collection



Some Key Recognition Issues

- When shipped?
- When customer accepts delivery?
- After return period expires?
- What if price protection is offered?
- Tied Services Offered
 - extended warranties
 - frequent flyer miles
- Licensing Fees
- Franchise Fees



Services and Long Term Contracts

- completed contract method
 - rendering of services completed or substantially completed
- percentage of completion method
 - revenue proportionate to degree of completion
 - total costs need to be estimated (unbilled A/R; Deferred Revenue)
- reasonable assurance regarding:
 - measurement
 - ultimate collection



Recognition Games

- Massaging the Estimates
- Channel Stuffing
- Revenue Swapping
- Bill and Hold
- Paying Myself
- Lumping In non-operational revenue



Massaging the Estimates

- Discount, return and allowance estimates abnormally reduced
- Percentage of completion cost estimates reassessed
- Terms of sale completion re-characterized
 - side letters
 - abnormal purchase order or invoice terms



Channel Stuffing

- Convince customers to over order
- Deliberately over ship ordered goods
- Ship goods not ordered



Revenue Swapping

- Two companies selling same type of goods to each other
- Net cash outflow is zero
- Total assets don't change
- Each books revenue amount



Bill and Hold

- Goods are ordered, made, and invoiced but not shipped until some later date

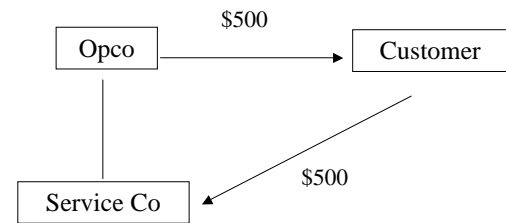


Staff Accounting Bulletin No. 101

- The risks of ownership have passed to the buyer
- The customer must have made a fixed commitment to purchase the goods, preferably in written documentation
- The buyer, not the seller, must request that the transaction be on bill-and-hold basis. The buyer must have a substantial business purpose for ordering the goods on a bill-and-hold basis
- There must be a fixed schedule for delivery of the goods. The date for delivery must be reasonable and must be consistent with the buyer's business purpose
- The seller must not have retained any specific performance obligations such that the earning process is not complete
- The ordered goods must have been segregated from the seller's inventory and not be subject to being used to fill other orders
- the goods must be complete and ready for shipment



Paying Myself



		<u>Dr</u>	<u>Cr</u>
Opco Accounts }	Capitalized Cost	500	
	Cash		500
Service Co Accounts }	Cash	500	
	Revenue		500



Lumping In Non-Operational Revenue

- interest income
- investment income
- gains on asset sales
- foreign exchange gains



Cost Recognition – Inventory Valuation

- Valuation Methods
 - Lower of cost and “market”
 - Net Realizable Value v. Replacement Cost
 - FIFO
 - LIFO
 - Average Cost



Inventories

● FIFO - First In, First Out

Q1	100 units@	\$10 =	\$1,000
Q2	100 units@	\$15 =	\$1,500
Q3	100 units@	\$20 =	\$2,000
Q4	100 units@	\$25 =	<u>\$2,500</u>
			<u>\$7,000</u>

- Sold 300 units during the year.
- Ending Inventory = 100 units@ \$25 = \$2,500
- Cost of Goods Sold = \$4,500
- \$7,000



Inventories

● LIFO - Last In, First Out

Q1	100 units@	\$10 =	\$1,000
Q2	100 units@	\$15 =	\$1,500
Q3	100 units@	\$20 =	\$2,000
Q4	100 units@	\$25 =	<u>\$2,500</u>
			<u>\$7,000</u>

- Sold 300 units during the year.
- Ending Inventory = 100 units@ \$10 = \$1,000
- Cost of Goods Sold = \$6,000
- \$7,000



Inventories

	<u>FIFO</u>	<u>LIFO</u>	<u>Average Cost</u>
Ending Inventory	2,500	1,000	1,750
Cost of Goods Sold	4,500	6,000	5,250
Gross Profit (assuming sales of 10,000)	55.0%	40.0%	47.5%



Cost Recognition - One-Time Charges

- “Cookie Jar” Accounting
 - restructuring charges
 - provisions and reserves
 - One time hit to earnings in quarter/year taken
 - Creates a liability on the balance sheet
 - In future, spend money and reduce liability, not earnings



Cost Recognition – One-time Charges

- Discontinued operations
- Unusual and Extraordinary Items
 - not expected to occur frequently over several years
 - don't typify the normal business activities of the company
 - don't depend primarily on decisions or determinations by management or owners



Earnings Management - Triggers

- Earnings are somewhat short of forecast
- Company is preparing for an IPO
- Earnings are just below the minimum required to earn incentive compensation
- Earnings are above or close to exceeding the maximum beyond which no additional incentive compensation is earned
- Company is close to violating earnings-related financial covenants in existing agreements
- Earnings above or below a long-term trend believed by management to be sustainable
- Earnings volatility is induced by a series of non-recurring items
- A change in top management has taken place
- Large losses associated with restructuring and related charges have been accrued in the past

Source: Charles W. Mulford and Eugene E. Comiskey, *The Financial Numbers Game: Detecting Creative Accounting Practices*, 2002: John Wiley & Sons Inc.



Balance Sheet Presentation Issues

- Not all accounting assets are economic assets
- Not all economic assets are reflected on the Balance Sheet
- Not all accounting liabilities are economic liabilities
- Not all economic liabilities are reflected on the Balance Sheet



Accounts Receivable

- Bill your customers 10,000
 - Gross A/R = 10,000
 - Revenue = 10,000
- Estimate not collecting 5%
 - Allowance for Doubtful Accounts = 500
 - Bad Debt Expense = 500
 - Net Income = 9,500
 - Net A/R = 9,500



Accounts Receivable

Gross A/R (starting)
 Plus: Further credit extended
 Less: Collections
 Less: Write Offs
Gross A/R (ending)
 Less: AFDA (ending)
Net A/R

AFDA (starting)
 Plus: Bad Debt Expense
 Less: Write Offs
AFDA (ending)



Accounts Receivable

	Year 2	Year 1	Change
Accounts Receivable (Net)	19,800	21,000	1,200
Allowance for Doubtful Accounts	2,800	1,500	
Gross A/R	22,600	22,500	(100)
Allowance for Doubtful Account (Beginning)		1,500	
Bad Debt Expense (in Year 2)		2,600	
Write Offs (in Year 2)		(1,300)	
Allowance for Doubtful Account (Ending)		2,800	
Change in Net A/R	1,200		
Bad Debt Expense (in Year 2)	(2,600)		
Cash Effect	(1,400)		
Change in Gross A/R	(100)		
Write Offs	(1,300)		
Cash Effect	(1,400)		



Future Tax Assets

- Estimate of Useable Tax Loss Carry Forwards
- Economic Asset?



Goodwill

- Excess purchase price on acquisitions
 - Purchase price – (fair value of assets – liabilities)
- Written down to “fair value” every year



Other Fictitious Assets

- Capitalized Costs
- Pension surpluses



Hidden Assets

- Operating Leases
- Market value > book value
- IP you created, not bought
- Contingent receivables



Deferred Revenue

- Advanced payment for goods or services
- Owe delivery of goods or services



Future Tax Liabilities

	<u>Accounting</u>	<u>Tax</u>
EBITDA	5,000	5,000
Depreciation	1,000	--
Capital Cost Allowance	--	2,000
EBIT	4,000	3,000
Interest Expense	1,000	1,000
EBT	3,000	2,000
Taxes (40%)	1,200	800
NI	1,800	1,200

Paid 800 in Cash but recorded Income Tax Expense of 1,200
 Difference of 400 equals Future Income Tax Liability



Minority Interest

- Only when ownership is >50%
- Consolidation is required, but don't own 100%
- % of Shareholders' Equity you don't own
- Not money owing



Pension Plan Liabilities

- Defined Contribution v. Defined Benefit
- Defined Benefit Plans in deficit position
 - accrued benefit obligation > fair value of plan assets
 - not what's on the Balance Sheet
- Post Employment Benefits



Restructuring Charges and Other Provisions

- Record a large expense today (and create liability account)
- When costs are actually incurred . . .
- Cash goes down, Liabilities go down;
- No income statement (earnings) impact
- Reversals back into Earnings



Off Balance Sheet Liabilities

- Operating Leases
- Guarantees
- Law Suits
- Purchase Commitments
- Grant Repayment Obligations



EBITDA v. Operating Cash Flow

Cash Inflows from Operations:
Revenues
Change in Accounts Receivable
Change in Deferred Revenue
<hr/>
Total Cash Inflows from Operations
Cash Outflows from Operations:
COGS
SG&A
R&D
Change in Inventories
Change in Accounts Payable
Change in Accrued Liabilities
Change in Prepaid Expenses
<hr/>
Total Cash Outflows from Operations
<hr/>
Net Cash Flow from Operations



EBITDA v. Operating Cash Flow

Net Cash Flow from Operations
- Depreciation Expense
<hr/>
Operating Cash Flow



EBITDA v. Operating Cash Flow

- EBITDA +/- Changes in Working Capital
 - Not necessarily all operational earnings
 - Not adjusted for capitalized costs



Typical Financial Ratios

- Gross Margin = $\text{Gross Profit} / \text{Revenues}$
- Net Margin = $\text{Net Income} / \text{Revenues}$
- DSO (Days Sales Outstanding)
 - $(\text{Average Gross Trade Receivables} / \text{Sales on Trade Credit}) \times 365$
- Inventory Days
 - $(\text{Average Inventory} / \text{COGS}) \times 365$
- Payable Days Outstanding
 - $(\text{Average Trade Payables} / \text{COGS}) \times 365$



Typical Financial Covenants

- Interest Coverage
 - EBITDA/Interest Expense
 - Operating FCF/Cash Interest Paid
- Fixed Charge Coverage
 - EBITDA/Fixed Charges
 - Operating FCF/Fixed Charges
- Debt Coverage
 - Total Debt/EBITDA
 - Total Debt/Operating FCF