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# Finance for the HR Professional

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Deloitte & Touche LLP

October 1<sup>st</sup>, 2009



Audit • Tax • Consulting • Financial Advisory.

# Table of Contents & Timeline

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5- Jargon-Watch	15 min
6- Translating HR Decisions Into Business Decisions: KPI's, Budgeting & Forecasting	30 min
7- Wrap-up	15 min
<b>Total</b>	<b>120 min</b>

# Introduction

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## Jamie Barron

- Accountant!
- Audit Partner
- HR roles with Deloitte
- Works with large and small enterprises

## Jane Jantzi

- **NOT** an accountant!
- Business Development Manager
- Brave soul (works with an entire company **full** of Finance people)
- Works with growth companies, all of whom have HR challenges

## Introduction

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Put up your hand if you love accountants!

Introductory Video:

Seinfeld's opinion on accountants:

<http://www.youtube.com/watch?v=ekp9dmXM7Qs&feature=related>

# Objectives

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At the end of this session, you will:

- ✓ Understand how Financial aspects pervade every aspect of a business, even if you don't want them to!
- ✓ Know how to read and interpret an organization's financial statements: Income Statement, Balance Sheet and Cash Flow Statement
- ✓ Understand how to translate "accounting speak" into real English, no matter how arcane it might sound to you now...
- ✓ Understand how HR decisions greatly affect financial outcomes and key performance indicators (KPI's)
- ✓ Love accountants! No, really, you really really will, I'm quite sure of it...HR people and accountants get along really well....honestly...

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# How Finance Brings Value to the Organization

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"Accounting is difficult to understand and not very exciting". (WHAT?!)

We hear this too often; at the end this section, you should be able to:

- ✓ Describe the relationship between an organization's vision and its operations
- ✓ Understand the value Financial Analysis brings to an organization and the different contexts in which it is used
- ✓ Become familiar with the different financial processes and understand the value of analyzing an organization's past performance and forecasting the future results

# How Finance links Vision to Operations

Finance supports an organization's vision by aligning the strategy with the business operations which are the foundation of that organization



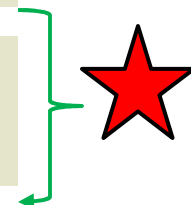
\***Finance processes** include Strategic Planning, Planning, Budgeting and Forecasting, Consolidation, Reporting & Analysis, Managing Accounts Receivables and Payables and Benchmarking Analysis



# What is the Value of Accounting

**AICPA Accounting definition:** The **art** of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are of financial character, and interpreting the results thereof. In layman’s terms, here is what it involves:

<b>External/Legal Reporting</b>	For regulatory purposes and to report a Company’s performance to the market
<b>Management Reporting</b>	For internal management of performance, tracking of sales and costs...
<b>Planning &amp; Budgeting</b>	As input to the strategic plan and to forecast a Company’s performance
<b>Performance Evaluation</b>	<b>As a guide to evaluate a Company’s performance and reward its employees</b>





# What is the Value of Financial Analysis

**Financial analysis** refers to an assessment of the viability, stability and profitability of a business or project

## Value of Financial Analysis:

- Provides the link between strategy, execution and results
- Facilitates informed decision making: strategic and day to day operations
- Creates a framework to achieve and maintain profitability
- Provides backbone to measure and evaluate performance
- Enables monitoring of performance over time and versus competition



# Financial Processes Overview

**Finance processes** use the **Strengths, Weaknesses, Opportunities and Threats (SWOT)** model to analyze the company's past performance in order to plan its future performance accurately



# How Finance Brings Value to the Organization: Review Questions

## 1. How do you define accounting?

### Accounting Definitions

1

The thing you do when you can't be an actor

2

A sure-fire cure for insomnia

3

Something nerdy statisticians cooked up to keep themselves employed

4

An excellent way to entertain guests on Saturday nights when Hockey Night in Canada finishes

5

A really, really, REAALLY interesting thing I cant wait to learn more about!!!

**(OR...)**

# How Finance Brings Value to the Organization: Review Questions

## 1. How do you define accounting?

### Accounting Definitions

- 1 **“The language of business,”** accounting is a system and an art that supports maintaining, reporting, and auditing of the financial results of a business (*Deloitte*)
- 2 System of recording, verifying, and reporting of the value of assets, liabilities, income, and expenses in the books of account (*Wikipedia*)
- 3 The bookkeeping methods involved in making a financial record of business transactions and in the preparation of statements concerning the assets, liabilities, and operating results of a business (*Answers.com*)
- 4 **The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information** (*American Accounting Association*)
- 5 The art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are of financial character, and interpreting the results thereof (*AICPA*)

## How Finance Brings Value to the Organization: Review Questions

### 2. Which of the following are examples of how Finance brings value to the organization:

a. Keeps people busy by constantly asking them for variance explanations

b. Provides the link between strategy, execution and results

c. Keeps bands of wandering rogue statisticians off the streets

d. Provides backbone to measure and evaluate performance

e. Creates reports that provide different answers to the same questions

f. Provides someone for the sales people to get annoyed with other than their bosses

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## **Heart of Darkness: Journey Into The Mind Of An Accountant**

- 6. Financial people are not always the most social folks!**
- 7. Financial people live in a box – some have bigger boxes – you need to figure out how to get in that box with them!**
- 8. The bottom line is everything**
- 9. Finance people think differently**
- 10. Finance people are misunderstood**

## **Heart of Darkness: Journey Into The Mind Of An Accountant**

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- 1. Accountants – they are on the same team as you and they understand the importance of the HR role – once you speak their language a real team can be created with great results**
- 2. Finance professionals are from Venus, HR Professionals are from Mars**
- 3. Finance people love new ideas – as long as the numbers make sense**
- 4. They love acronyms**
- 5. Everything is measured**

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# Financial Statements Overview

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At the end of this section, you should be able to:



Know how to read and interpret financial statements



Understand the impact of business events on the financial statements and how you can influence the results

# Introduction to Financial Statements

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**Financial Statements** are tools which track and measure the financial performance of a company. They are a formal record of the business' financial activities

<b>Objective</b>	To provide information about the financial position of an enterprise that is useful to a <b>wide range of users</b> (owners, employees, investors, banks, government...) in <u>making economic decisions</u> <sup>1</sup>
<b>Accounting Standards</b>	Companies typically report their Financial Statements in accordance with Generally Accepted Accounting Principles (GAAP). Companies in Canada will need to report in accordance with International Financial Reporting Standards ("IFRS") as of 2011
<b>Governance</b>	If a Company's stock or debt is publicly traded, it must submit its FS to the Ontario Securities Commission (TSX listed) in Canada, or US Securities and Exchange Commission (SEC) in the US. The OSC/SEC's mission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation <sup>2</sup>
<b>Matching Principle</b>	GAAP requires the <b>accrual method</b> of accounting, so revenues and expenses are recorded when goods and services are transferred or products sold, irrespective of the actual cash paid or received <sup>1</sup> (e.g. consultant fees expensed when training is delivered)

<sup>1</sup> [www.wikipedia.org](http://www.wikipedia.org)

<sup>2</sup> [www.sec.gov](http://www.sec.gov)

# Financial Statements Overview

There are four standard financial statements under GAAP: Income Statement, Balance Sheet, Cash Flow Statement and Shareholder's Equity.

### Business Events

- Sales
- Purchases
- Expenditures
- Production
- Investments
- Loans
- Cash Receipts
- Payments to Suppliers
- Dividend Payment

### Financial Statements

#### Income Statement

	Successor For the three-month	Predecessor For the three-month
Revenue		
Cost of goods sold <sup>(8)</sup>		
Selling and administrative expenses <sup>(9)</sup> (Note 9)		
Research and development expenses <sup>(9)</sup>		
Depreciation and amortization		
Total operating expenses		
Operating income		
Financial expenses (Note 9)		
Interest income		
Loss (gain) on foreign currency		
Total other expense (income)		
Income before income taxes		
Income tax expense		
Net income		

#### Balance Sheet

	Successor December 31, 2009	Predecessor September 30, 2009
Assets		
Cash and cash equivalents		
Accounts receivable, net		
Accounts receivable from the parent company (Note 14)		
Accounts receivable		
Inventory (Note 4)		
Prepaid expenses and deposits		
Deferred income taxes		
Other current assets		
Property, plant and equipment, net (Note 5)		
Intangible assets, net (Note 6)		
Goodwill		
Other long-term assets		
Deferred debt issue expenses, net of accumulated amortization of \$5,443 (\$4,201 as at Sep. 30, 2009)		
Deferred income taxes		
Liabilities		
Customer liabilities		
Accounts payable and accrued liabilities		
Accounts payable (Note 10)		
Liabilities to be paid to long-term debt		
Deferred income taxes		
Other long-term liabilities		
Long-term debt (Note 8)		
Other current liabilities		
Other long-term liabilities		
Deferred income taxes		
Shareholders' equity		
Common shares		
Preferred shares		
Additional paid-in capital		
Accumulated other comprehensive loss		
Accumulated deficit		
Total liabilities and shareholders' equity		

#### Cash Flow Statement

	Successor December 31, 2009	Predecessor September 30, 2009
Operating activities		
Net income	5,133	22,328
Non-cash items		
Non-cash financial expenses	1,798	-
Depreciation and amortization	14,473	5,927
Stock-based compensation expense	1,330	1,018
Loss on disposal and write-down of assets	11	-
Foreign currency fluctuations	(1,638)	(5)
Changes in fair value of hedge	897	-
Deferred income taxes	1,325	(249)
Changes in working capital items		
Accounts receivable	(9,032)	(5,891)
Accounts receivable from the parent company	(713)	-
Income taxes receivable	5,744	(3,003)
Inventories	1,875	(3,050)
Prepaid expenses and deposits	(2)	(784)
Accounts payable and accrued liabilities	12,167	(3,527)
Income taxes payable	1,853	(2,952)
Cash flows from operating activities	38,981	10,198
Investing activities		
Disposal of short-term investments	-	123,758
Acquisition of property, plant and equipment	(1,298)	(3,184)
Acquisition of intangible assets	(15)	(15)
Cash flows from investing activities	(1,313)	120,559
Financing activities		
Repayment of long-term debt	(2,188)	(132)
Issue of shares	-	190
Foreign exchange gain (loss) on cash held in foreign currencies	(2,188)	36
Foreign exchange gain (loss) on cash held in foreign currencies	(1,195)	368
Net increase in cash and cash equivalents	34,376	131,221
Cash and cash equivalents beginning of period	55,105	175,672
Cash and cash equivalents end of period	89,581	310,893

#### Notes to the Financial Statements

#### Management Discussion & Analysis (MD&A)



# Introduction to the Income Statement

The purpose of the **income statement** is to show managers and investors whether the company increased or lowered its **profit** during the **period** being reported

## Income Statement Objectives

The Income Statement's objective is to help investors and creditors:

- Determine the **past** performance of the enterprise
- Predict **future** performance
- Assess the capability of generating future cash flows<sup>1</sup>

## Income Statement Limitations

Information on an income statement has several limitations:

- Some relevant items are not reported (e.g. brand recognition)
- Some numbers depend on accounting methods used (e.g. LIFO vs. FIFO Inventory)
- Some numbers depend on estimates (e.g. depreciation)<sup>1</sup>

<sup>1</sup> [www.wikipedia.org](http://www.wikipedia.org)

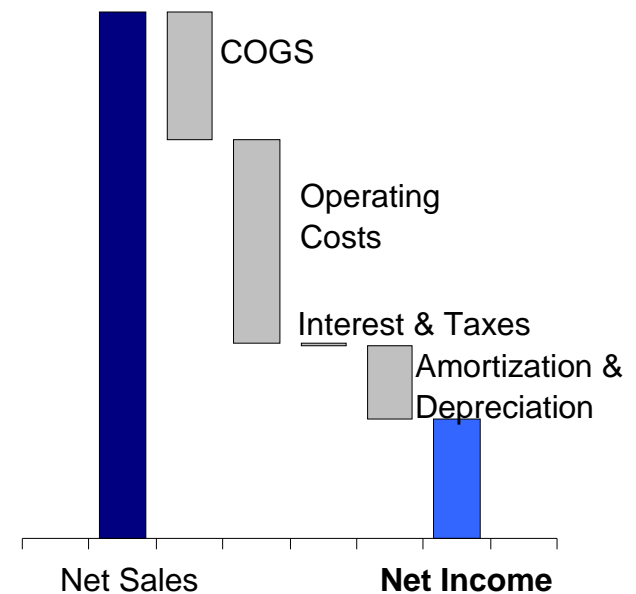


# Income Statement Line Items

The Income Statement, or *Profit & Loss Statement (P&L)*, provides a representative picture of profitability in a given period, usually quarterly or annually

Income Statement	
Line Item	Definition
Net Sales	Sales minus discounts, rebates and returns
COGS	Costs Of Goods Sold
<b>Gross Margin</b>	<b>Net Sales - COGS</b>
Operating Costs	Administrative, Marketing, Selling, R&D, Distribution
<b>EBITDA</b>	<b>Earnings Before Interest, Taxes, Depreciation &amp; Amortization</b>
Interest Expense	Interest Charges for financing activities
Tax Expense	Corporate Taxes paid to government
Depreciation & Amortization	Depreciation: Prorating a tangible asset over its life Amortization: Spread of intangible asset's cost
<b>Net Income</b>	<b>EBITDA – Interest – Tax – Depreciation &amp; Amort.</b>

Company A's FY08 Income Statement



# Company A's Income Statement

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Let's look at a real life example of an Income Statement...

Company example -



# Introduction to the Balance Sheet

A balance sheet is a summary of a company's balances. It is often described as a **snapshot** of what a company **owns and owes** at a **point in time**

## Balance Sheet Objectives

The balance sheet provides details on the actual assets that make up a stock's book value. It helps stakeholders:

- Identify potential liquidity problems
- Measure the degree to which a company is in debt
- Determine how likely the company is to meet its payments
- Evaluate a company and compare it to its peers<sup>1</sup>

<sup>1</sup>[www.wikipedia.org](http://www.wikipedia.org)  
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# Balance Sheet Line Items

The Balance Sheet shows a company's financial position at a specific point in time. It features two basic components of a company's financial picture:

Assets		=	Liabilities + Shareholders' Equity	
Line Item	Definition		Line Item	Definition
<b>Current Assets</b>	<b>Short-term Assets</b>		<b>Current Liabilities</b>	<b>Short-term Liabilities</b>
Cash	Cash in bank accounts		Accounts Payable	Due to suppliers
Accounts Receivable	Owed from customers		Short-term Loans	Purchased from institutions
Inventory	Amount of stock on hand		<b>Long-Term Liabilities</b>	<b>Long-term Liabilities</b>
<b>Fixed Assets</b>	<b>Long-term Assets</b>		<b>Shareholders' Equity</b>	<b>Owners' Claims in Assets</b>
Intangibles	Non-monetary assets including goodwill		Stock	Share of ownership
PP&E	Property, Plant & Equipment		Additional Paid-in Capital	In addition to stock value
Investments	Capital invested		Retained Earnings	Income held by company

- **What you have**
- What the company owns

- **How you got it**
- What the company owes

**Note:** Short-term refers to a period of less than 1 year. Long-term refers to more than 1 year.



# Company A's Balance Sheet

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Let's look at a real life example of a Balance Sheet...

Company example -



# Cash Flow Statement Objectives

The cash flow statement shows a company's incoming and outgoing money (**sources and uses of cash**) during a time period, often monthly or quarterly

## Cash Flow Statement Objectives<sup>1</sup>

The cash flow statement is intended to:

- Provide information on a company's **liquidity and solvency** and its ability to change cash flows in future circumstances
- Provide additional information for evaluating changes in assets, liabilities and equity
- Improve the comparability of different companies' operating performance by eliminating the effects of different accounting methods
- Indicate the amount, timing and probability of future cash flows

**CASH IS KING!!!**

<sup>1</sup>[www.wikipedia.org](http://www.wikipedia.org)



# Cash Flow Statement Stakeholders

The cash flow statement helps internal and external stakeholders make important business decisions

## Cash Flow Statement Stakeholders<sup>1</sup>

People and groups interested in cash flow statements include:

- **Accounting personnel**, who need to know whether the organization will be able to cover immediate expenses
- **Lenders**, who want a picture of a company's ability to repay
- **Potential investors**, who need to judge whether the company is financially sound
- **Potential employees** or contractors, who need to know whether the company will be able to afford compensation

<sup>1</sup>[www.wikipedia.org](http://www.wikipedia.org)



## Cash Flow Statement Line Items

The cash flow statement includes only inflows and outflows of cash; it excludes transactions that do not directly affect cash receipts and payments

Cash Flow Statement Line Items	
Line Item	Definition
<b>Operating Activities</b>	<b>Production, sales &amp; delivery of products &amp; payment collection</b>
Net Income	Net income as reported on the Income Statement
Changes in Working Capital	Changes during the period in Current Assets or Current Liabilities
Depreciation & Amortization	Allocation of Fixed Asset's cost over its lifetime
<b>Investing Activities</b>	<b>Purchase and sale of long-term assets needed to make and sell products</b>
Capital Expenditures	Purchase and sale of fixed assets
Investments	Disposal or Acquisition of investments
<b>Financing Activities</b>	<b>Inflow of cash from investors and outflow of cash to shareholders</b>
Long-Term Debt	Repayment or issuance of long-term debt
Dividends	Payment of dividends to stockholders



# **Company A's Cash Flow Statement**

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Let's look at a real life example of a Cash Flow Statement...

Company example -



# Notes to the Financial Statements

The accompanying notes are an integral part of the consolidated financial statements as they **provide more details** on the various results

Examples of the notes to the financial statements include<sup>1</sup>:

1. Governing Statutes, Description of Business and Basis of Presentation
2. Significant Accounting Policies
3. Recently Issued Accounting Standards
4. Inventories
5. Property, Plant and Equipment

## **...CAN INCLUDE SIGNIFICANT HR-RELATED ITEMS:**

- PENSION EXPENSE
- VACATION ACCRUALS
- SEVERANCE LIABILITIES
- STOCK COMPENSATION
- BENEFIT LIABILITIES



# Management Discussion & Analysis (MD&A)

The MD&A is a section of the annual report in which management discusses numerous aspects of the company, both past and present

## MD&A Objectives

The MD&A provides an overview of the previous periods of operations and how the company performed in that time period. Management will usually also touch on the upcoming year, outlining future goals and approaches to new projects

## MD&A Requirements<sup>1</sup>

The OSC and SEC have strict guidance on the items that need to be included in the MD&A, and they include:

- Impact of accounting policies on results
- Effect on acquisitions and dispositions on revenues
- Impact of changes in sales policies (ex: discounts to customers)

<sup>1</sup>[www.sec.gov](http://www.sec.gov)  
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# Financial Statements Overview: Review Questions

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## 1. What is the difference between net income and net cash flow?

Net income is calculated on the income statement based on the **accrual** method of accounting:

Expenses and revenues are recorded when goods and services are transferred or products sold

Income Statement

Net cash flow is calculated on the cash flow statement based on the **cash** method of accounting:

Receipts are recorded during the period they are received, and expenses in the period in which they are actually paid

Cash Flow Statement

# Financial Statements Overview: Review Questions

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## 2. What is an intangible asset and what influences its value?

Intangible assets are defined as non-monetary assets that cannot be seen, touched or physically measured and include: **patents, trademarks, and goodwill**

Goodwill typically represents the amount of money a company has paid or would pay over book value to acquire another company

The value of intangible assets can be impacted by the availability of a competitive generic product, the loss of goodwill from a lawsuit, the expiration of a patent...

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# Financial KPIs & Analysis

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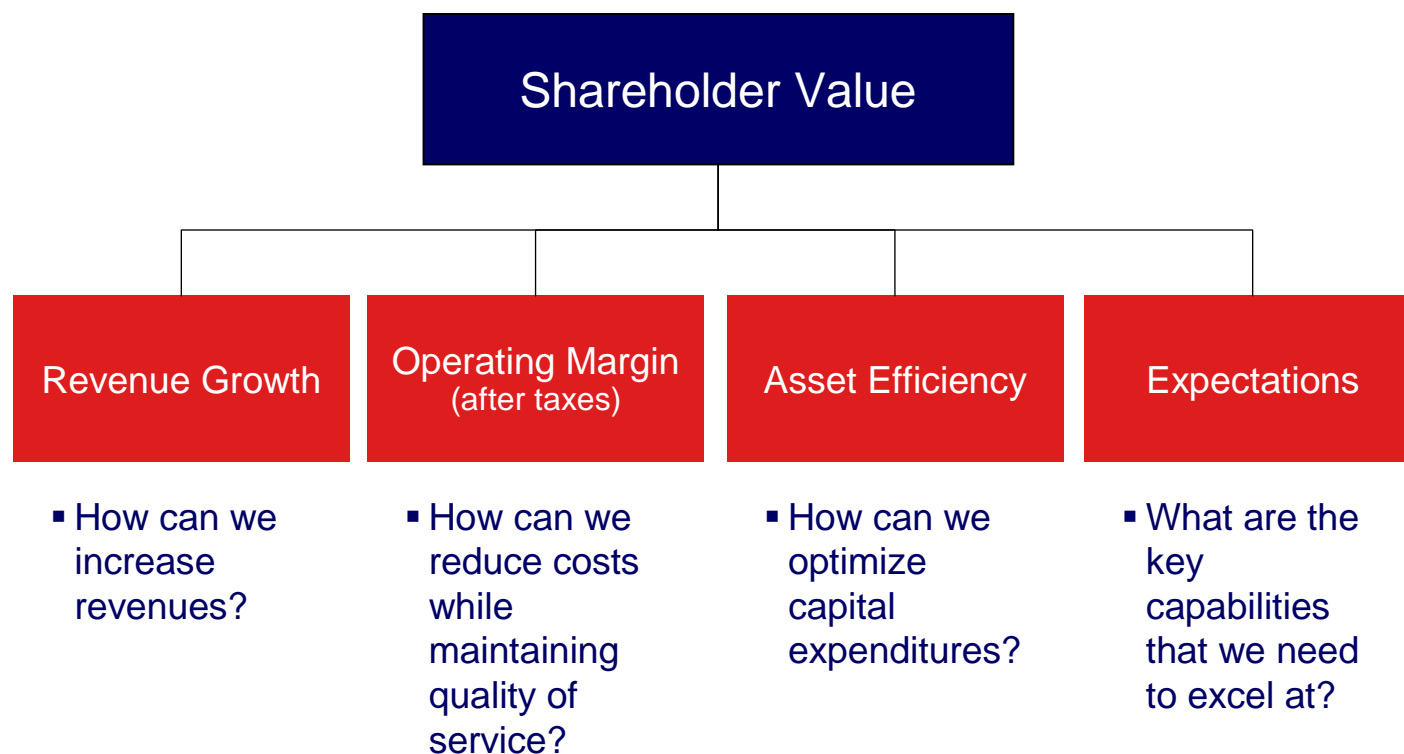
At the end of this section, you should be able to:

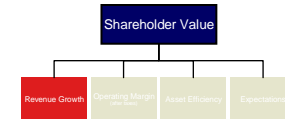
- ✓ Become familiar with Key Performance Indicators (KPIs)
- ✓ Understand how you can improve KPIs
- ✓ Understand the impact of business events on KPIs

# Introduction to KPIs

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KPIs are aligned to the four shareholder value driver categories: Revenue Growth, Operating Margin, Asset Efficiency & Expectations





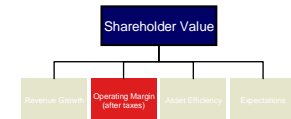
# Revenue Growth KPIs

Revenue Growth represents growth in the company’s “top line,” or payments received from customers in exchange for the company’s products and services (“**sales**”)

Revenue Growth KPI		
KPI	Definition	Desired Trend
Gross Sales Volume	Invoice value of sales before deductions	↑
Sales Deductions	Customer discounts, allowances or returns	↓
Net Sales Volume	Gross Sales Volume minus Sales Deductions	↑
Market Share	Company’s Net Sales / Total Industry or Market Sales	↑

How can **you** improve **Revenue Growth** KPIs?

- Hire experienced and talented sales personnel
- Design effective compensation structures that encourage business growth



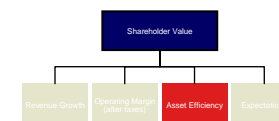
# Operating Margin KPIs

Operating Margin represents the portion of revenues that is left over after taxes and the costs of providing goods and services are subtracted. It is the key measure of operational and tax efficiency

Operating Margin KPI		
KPI	Definition	Desired Trend
Gross Margin	$(\text{Revenues} - \text{COGS}) / \text{Revenues}$	↑
Net Margin	Net Profit After Taxes / Revenues	↑
EBITDA	Earnings Before Interest, Taxes, Depreciation & Amortization	↑

How can **you** improve **Operating Margin** KPIs?

- See Revenue KPI's
- Design cost-effective compensation strategies and structures
- Effectively manage payroll and benefit structures and costs
- Control recruiting and other HR-related costs



## Asset Efficiency KPIs

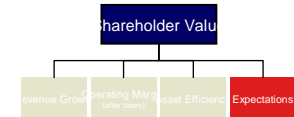
Asset Efficiency represents the value of assets used in running the business relative to its current level of revenues; it is the key measure of investment efficiency

Asset Efficiency KPI		
KPI	Definition	Desired Trend
Working Capital	Current Assets – Current Liabilities	↑
Return on Net Assets	Net Profit / (Fixed Assets + Working Capital)	↑
Inventory Turnover	COGS / Average Inventory	↑
Fixed Asset Turnover	Sales / Average Net Fixed Assets	↑

How can **you** improve **Asset Efficiency** KPIs?

- Create incentive programs aligned with cash flow expectations of the business
- Carefully manage HR-related liabilities
- Create incentive programs which align with KPI's of specific job roles (e.g. Accts Receivable collection)

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# Expectations KPIs

Expectations relates to the confidence shareholders and analysts have in the company’s ability to perform well in the future. It is based on external market factors and on a Company’s ability to deliver its commitments

Expectations KPI		
KPI	Definition	Desired Trend
Performance to Quota	Percentage of individual targets achieved for the period	↑
Employee Turnover	Number of departures / Total number of employees	↓
Vacancies %	Number of vacant positions / Total number of positions	↓

How can **you** improve **Expectations** KPIs?

- Talk to your team to keep everyone motivated and engaged
- Conduct job interviews as early as possible to reduce vacancies
- Ensure the business is rewarded based on performance to quota

# Planning & Budgeting Process

The planning & budgeting process supports a Company's vision by aligning the company's strategy with the business operations



The vision can not be achieved without an efficient process to link its strategy with the business operations that are driving the company's performance

# Importance of Strategy, Planning & Budgeting

By following a comprehensive strategy, planning & budgeting process, a Company will be able to protect its current value, analyze its performance to the plan and develop strategic initiatives designed to add value to the enterprise

## 1 Strategy

- Understand strategic levers
- Articulate strategic enterprise goals
- Perform strategic risk assessment
- Agree on strategic intents

» 3-5 year horizon

» High-level view

» Leadership Group

## 2 Planning

- Develop strategic plan
- Define strategic initiatives
- Develop business cases
- Prioritize and integrate initiatives portfolio

» 1-3 year horizon

» More specific details

» Department Heads

## 3 Budgeting

- Define top down budget guidelines
- Develop bottom up plan
- Develop bottom up initiatives budget
- Incorporate impact of strategic initiatives

» 1 year horizon

» Most detailed view

» All Cost Center Managers

# Importance of Forecasting

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Companies rely on (quarterly) Latest Best Estimate forecasting exercise to:

- Obtain accurate financial & operational projections
- Ensure the supply of cash and inventory meets the demand
- Identify and evaluate risks
- Help management understand what is likely to occur
- Build a consensus

## 4 Forecasting (Latest Best Estimate)

- Perform forecasts on performance drivers
- Identify events that will have an impact on original plan and projects
- Integrate scenario planning & financial forecasts
- Consolidate overall forecast

- » Quarterly – 1 year horizon
- » Detailed-level view
- » All Cost Center Managers

**“66% of companies are unable to accurately forecast earnings for the next quarter, missing the mark by anywhere between 6% and over 30%”**

The Hacket Group Survey, 2008

# Budgeting vs. Forecasting

Identify whether the following statements are related to the Budgeting or the Forecasting process:

Is reactive based on actual events	B	A. Budgeting
Reflects changes to get “back on plan”	B	
Is pro-active based on strategy	A	B. Forecasting
Reflects planned course of action based on current economic conditions	B	
Helps coordinate the organization’s resources	A / B	
Is only beneficial to the Leadership Group	N/A!	

## Table of Contents & Timeline

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1- Training Introduction	5 min
2- How Finance Brings Value to the Organization	20 min
3- Heart of Darkness: Journey Into The Mind Of An Accountant	15 min
4- Financial Statements Overview	20 min
5- Jargon-Watch	15 min
6- Translating HR Decisions Into Business Decisions: KPI's, Budgeting & Forecasting	30 min
<b>7- Wrap-up</b>	<b>15 min</b>
<b>Total</b>	<b>120 min</b>

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Questions?

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