RYE
RURAL YOUTH
ENTREPRENEURSHIP

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The Signs

REBOOT
MODULE

1 The Signs

"One good thing about being young is that you are not experienced enough to know you cannot possibly do the things you are doing"

Gene Brown

We know the top fifteen causes of business failure, so now let's look at the symptoms in an attempt to assess the level of trouble your business is in.

Symptoms of a failing business include:

1. Cash flow difficulties such as frequent difficulties in paying wages or suppliers continually calling about getting paid.
2. Low morale of employees.
3. Your banker calling your loan.
4. Flat or decreasing sales.
5. Continually in crisis management.
6. No strategy for the business.

Are you in the Zone of Insolvency?

While there is not a clear-cut test for insolvency, a corporation or business can be said to be in the zone of insolvency if its liabilities exceed its assets (balance sheet insolvency) or it is unable to pay its debts as they come due (equitable insolvency).

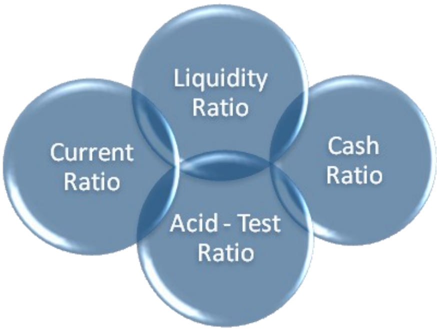
Your financial statements, specifically your most recent Balance Sheet, will help you assess this. It is essential, however, that you are confident that your financial statements are accurate. This can be one of the biggest problems with a business experiencing difficulties.

How do you know if your financial statements are accurate?

Most businesses in difficulty have poor financial reporting systems. A business may lack accurate information in three critical areas: profits, costs and cash position. Without good budgetary controls, you never know how profitable you are, or even if you are operating above or below your break-even point. Now is the time to review your financial statements - perhaps with the assistance of an accountant with experience in financial analysis.

Here are a few key areas to check over to ascertain if a more detailed audit of your books is necessary.

KEY AREAS	Y	N
Have you overvalued inventories?		
Have you overvalued receivables? Check the accuracy of the company's financial statements as a starting point.		
Are expenses accurate?		
Do sales (on the Income Statement) seem accurate?		



Liquidity Ratios

The financial stability of a company can be tested in many ways. One of the quickest ways to see just how well a company is performing is to use financial ratios. In accounting, the term liquidity is defined as the ability of a company to meet its financial obligations as they come due. The liquidity ratio is a computation that is used to measure a company's ability to pay its short-term debts. There are three common calculations that fall under the category of liquidity ratios. The current ratio is the most liberal of the three. It is followed by the acid ratio, and the cash ratio.

Current Ratio

The current ratio indicates a company's ability to pay its current liabilities from its current assets. This ratio is used to quickly measure the liquidity of a company. The formula for the current ratio is:

Current Ratio = Current Assets ÷ Current Liabilities

Current assets are those assets that are expected to turn into cash within one year. Examples of current assets are cash, accounts receivable, and prepaid expenses. Current liabilities are those debts that are expected to be paid or come due within a year. Examples of current liabilities are accounts payable, payroll liabilities, and short-term notes payable.

Look at the following example:

Company X has the following information listed on its balance sheet:

Current Assets = £40,000
Current Liabilities = £20,000
Current Ratio = Current Assets ÷ Current Liabilities
Current Ratio = £40,000 ÷ £20,000, then the Current Ratio = 2 or 2 to 1

What does this mean? When interpreting the current ratio of Company X, you can see that for every £1 in current liabilities, the company has £2 in current assets. A current ratio that is better than 1 to 1 is considered good. The higher the ratio, the better the financial position of the company.

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Acid Ratio

This Acid Ratio is also referred to as the quick ratio. The purpose of this ratio is to measure how well a company can meet its short-term obligations with its most liquid assets (those that can be quickly turned into cash).

The formula for calculating the acid ratio is:

Acid Ratio = (Cash & Cash Equivalents + Short-Term Investments + Accounts Receivable) ÷ Current Liabilities.

Cash and cash equivalents refer to such things as cash on hand, current accounts and savings accounts. Short-term investments are any investments that will mature within 90 days.

Company Y has the following information listed on its balance sheet:

Cash & Cash Equivalents = £20,000
Short-Term Investments = £5,000
Accounts Receivable = £10,000
Inventory = £15,000
Current Liabilities = £25,000

Acid Ratio = (£20,000 + £5,000 + £10,000) ÷ £25,000
Acid Ratio = 1.4 to 1

If you have discovered that your business is in the Zone of Insolvency, it is recommended that you seek competent legal advice. You can be held personally liable for your business decisions. Of particular concern is something called Fraudulent Conveyance of Assets.

What does Fraudulent Conveyance of Assets mean?

This is also known as fraudulent transfer; a transfer of a debtor's property made within two years before the filing of the bankruptcy petition for which the debtor received little or no consideration while the debtor was (or was rendered) insolvent. Fraudulent conveyances also include transfers made with actual intent to hinder, delay, or defraud creditors. In this context, fraudulent does not refer to a criminal fraud, but rather means only that the transfer has placed the assets out of the reach of creditors. Fraudulent conveyances may be reversed by the bankruptcy court. This is a major concern of lenders who do not want payments from the borrower or a guarantor to be rescinded.

If you are in the Zone of Insolvency you must be very careful in this area as it can lead to criminal prosecution.