

Financial Reporting

Financial reporting is done according to man-made rules

- Communicates financial information to interested parties
- Tracked via "accounting" processes
- Accounting processes are man made!
- Financial Accounting Standards Board (FASB) develops/modifies Generally Accepted Accounting Principles (GAAP)



Objectives



- ◆ Demonstrate how an agency/brokerage makes money and reports this information to interested parties
 - “Profit” versus cash
- ◆ Review the basic financial statements (income statement, balance sheet, statement of cash flows)
 - Define revenues and expenses
 - When to MATCH
 - How to RECOGNIZE
 - Define assets, liabilities and equity

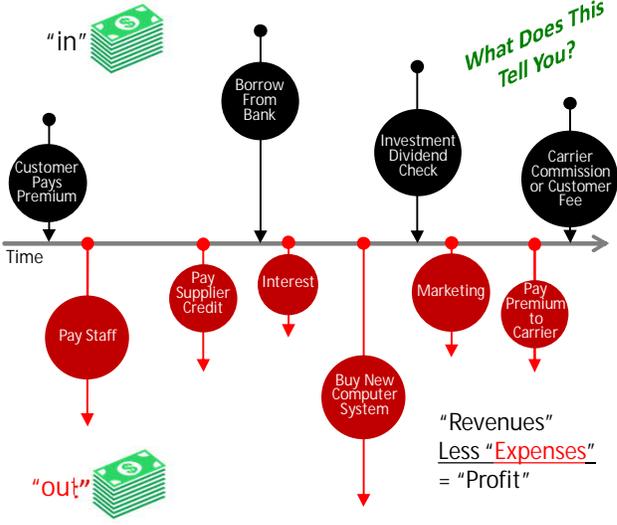


Cash doesn't tell the whole story!

Cash Does Not Tell You...

1. “Profit”: Revenue from sale of products less all expenses associated with making, selling and operating the business.
 - Can't count borrowed money or money put into the business by the owner as revenue.
 - Long-term investments shouldn't be deducted all at once.
 - Income and expenses need to be recognized & matched at time of sale, not when cash actually changes hands.
 - Premiums are not “revenue”.
2. Financial Condition
 - Cash on hand
 - Money owed or due
 - What you own (assets)

Net Cash Flows = **(\$53,253)**



“Revenues”
Less “Expenses”
= “Profit”



There are 3 main financial statements

- **Income Statement (P&L)**
 - A summary of a business' sales revenues and associated expenses over a specified period
 - Reports the net income (profit) or loss for the period
- **Balance Sheet**
 - A summary of a business' financial position on a given date that shows what the business owns (Assets) and who owns it (Liabilities & Owner's Equity)
- **Cash Flow Statement**
 - A summary of a firm's actual cash receipts and cash payments during a period of time



The Income Statement (P&L) reports "profit" and "loss"

Compares revenue and expenses for a given period

Movie of financial health & success



Business Profitability



Financial Reporting

**An example of an
Income Statement (P&L)**

**Income Statement
January 1, 202X - December 31, 202X**

Common size analysis (see % of commissions & fees column) expresses all numbers as a percentage of total commissions & fees (the useful way to compare performance between companies or from period to period).

		% of Commission & Fees		
REVENUES				
Total Commissions and Fees	7,049,007	100.0	Avg \$5MM Agency	
Contingents	576	0.0		Source: The Partners Group 2017
Investment/Misc. Income	17,523	0.2		Contingent 4-6%
Total Other Income	18,099	0.3		
GROSS REVENUES	7,067,106	100.3		
Less Outside Commission Expenses	<u>102,309</u>	<u>1.5</u>		
NET REVENUES	\$ 6,964,798	98.8		
EXPENSES				
Compensation Expenses			70.9 (incl. benefits)	58%
Total Compensation	4,552,729	64.6		
Selling Expenses			4.3	
Total Selling Expenses	399,420	5.7		
Operating Expenses			17.0	
Total Operating Expenses	859,593	12.2		
Administrative Expenses			3.8	
Total Administrative Expenses	454,636	6.4		
TOTAL EXPENSES	6,266,377	88.9		
PRE-TAX PROFIT	\$ 698,420	9.9	12.0	
Taxes	<u>279,368</u>	<u>4.0</u>		
NET PROFIT	\$ 419,052	5.9%		17-20% Private, and 25% Public
EBITDA	\$ 1,069,694	15.2%		
ROS (Net Profit/Net Revenues)		6.0%		

Source for \$5MM agency averages: Marsh, Berry & Company 6/2017



Profit is not always the same as Cash!

Differences

- “Profits” subtract depreciation & amortization (a non-cash expense)
- “Profits” ignore cash expenditures on new capital or L-T “investments” (the expense is capitalized)
- “Profits” record income and expenses at the time of sales, not when the cash exchanges actually occur
 - Written vs. earned premiums
 - Paid out losses vs. reserved losses




Customer segments aren't equally profitable

	BOP	Mid Market: General	Mid Market: Value-Added	Specialty 1	Specialty 2	Specialty 3	Specialty 4
Revenue							
Commissions	\$ 194,939	\$ 628,172	\$ 1,161,113	\$ 449,751	\$ 73,712	\$ 411,144	\$ 146,663
Contingents	8,016	25,829	47,743	18,493	3,031	16,906	6,031
Fee Income	1,234	3,978	7,353	2,848	467	2,604	929
Total Revenues	\$ 204,189	\$ 657,979	\$ 1,216,209	\$ 471,092	\$ 77,209	\$ 430,654	\$ 153,622
Compensation Expenses							
Producer Payroll	\$ 11,438	\$ 176,300	\$ 321,953	\$ 129,644	\$ 19,839	\$ 116,219	\$ 39,188
Service Payroll	191,662	163,612	151,023	35,086	11,633	19,393	34,630
Payroll Benefits	34,730	58,125	80,879	28,169	5,382	23,190	12,623
Total Compensation	\$ 237,830	\$ 398,036	\$ 553,854	\$ 192,899	\$ 36,853	\$ 158,801	\$ 86,442
Contribution Profit	\$ (33,641)	\$ 259,943	\$ 662,355	\$ 278,194	\$ 40,356	\$ 271,852	\$ 67,180
Profit per Customer							
	\$ (66)	\$ 594	\$ 1,640	\$ 2,964	\$ 1,297	\$ 5,241	\$ 725
Average Premium							
	\$ 3,111	\$ 13,633	\$ 25,826	\$ 28,236	\$ 18,453	\$ 48,264	\$ 10,871
Total Premium							
	\$ 1,595,072	\$ 5,966,368	\$ 10,433,236	\$ 2,650,032	\$ 574,225	\$ 2,503,693	\$ 1,007,004
CSI							
	8.20	8.26	8.03	8.05	7.88	7.66	8.14

More detail on profitability leads to better insights...



The Balance Sheet reports what the business owns and who has funded it

What the company owns and who owns it

Snapshot of financial health



Accurate for a specific date

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$



Example of a Balance Sheet (as of Dec. 31, 202X)

ASSETS		LIABILITIES & EQUITY	
Cash	\$ 1,423,004	LIABILITIES	
Investments	357,408	Accounts Payable - Insurance	\$ 1,803,247
Accounts Receivable - Insurance	1,617,843	Accounts Payable - Other	20,363
Accounts Receivable - Other	71,315	Accrued Expenses and Taxes	198,034
Prepaid Expenses	46,512	Short-Term Debt/Current Portion L-T Debt	26,340
Other Current Assets	<u>14,611</u>	Other Current Liabilities	<u>71,272</u>
Total Current Assets	3,530,692	Total Current Liabilities	2,119,257
Building/Improvements	228,444	Long-Term Debt	500,466
Furniture/Fixtures	616,566	Deferred Compensation	<u>118,258</u>
Other Fixed Assets (e.g. Motor Vehicles)	104,031	Total Other Liabilities	618,724
Less: Total Accumulated Depre.	<u>(189,929)</u>	TOTAL LIABILITIES	2,737,981
Total Fixed Assets	759,112	EQUITY	
Covenant/Renewal Lists/Goodwill	1,879,038	Capital Stock (Common and Preferred)	95,783
Less: Total Accumulated Amort.	<u>(339,557)</u>	Paid-In Capital	654,419
Total Intangible Assets	1,539,481	Retained Earnings	<u>2,742,622</u>
Total Other Assets	401,520	TOTAL EQUITY	3,492,824
TOTAL ASSETS	\$ 6,230,805	TOTAL LIABILITIES and EQUITY	\$ 6,230,805

Assets = Liabilities + Owner's Equity



Cash Flows are tracked in a separate report

Cash Flows from Operating Activities	
Net Income	\$ 421,835
Depreciation & Amortization	142,119
Increase (decrease) in Accounts Payable	(9,091)
Increase (decrease) in Accrued Exp/Other Current Liabilities	(12,394)
Increase (decrease) in Deferred Compensation	0
Decrease (increase) in Accounts Receivable	(787,011)
Decrease (increase) in Prepaid Exp/Other Current Assets	48,672
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$ (195,870)
Cash Flows from Investing Activities	
Decrease (increase) in Investments	(49,213)
Decrease (increase) in Fixed Assets	(5,569)
Decrease (increase) in Intangible Assets	0
Decrease (increase) in Other Assets	0
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	\$ (54,782)
Cash Flows from Financing Activities	
Distributions	0
Increase (decrease) in Short-Term Debt/Current Portion L-T	(100,004)
Increase (decrease) in Long-Term Debt	(26,340)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	\$ (126,344)
Net Increase (decrease) in Cash	(376,996)
Cash at Beginning of Year	1,800,000
CASH AT END OF YEAR	\$ 1,423,004



