



Financial Adviser

Michael S. Neubauer, CPA, MBA, is a supervisor at McGill, Power, Bell & Associates, LLP, a regional certified public accounting firm with offices in Erie and Meadville. His area of specialization is the manufacturing niche. Neubauer serves as the treasurer for the Erie Chapter of the Pennsylvania Institute of Certified Public Accountants and is also the treasurer of the Presque Isle Partnership.

Troubled Businesses: Find Out Before It's Too Late

A business that is facing financial hardships such as a shortage of cash does not find itself in this situation overnight. Normally, the situation has progressed over a number of months or even years. The key is to be able to recognize the warning signs of an unhealthy business before it is too late to correct the root of the problem.

A shortage of cash, when not recognized in the early stages, typically results in insolvency, or the inability to pay debts. The inability to pay debts as they are due, coupled with either a voluntary or involuntary petition, is the very definition of bankrupt.

The problem that many companies face is that management tends to neglect the early warning signs, such as a decrease in sales, increased operating expenses, or inefficiencies, and treats them as short-term problems that will eventually correct themselves. This often perpetuates the problem and leads to financial inflexibility.

Utilize Available Resources

Aside from a general feeling that your business is in decline, there are other tools that can be used to identify a business that is headed for financial failure; specifically a qualified CPA and your financial statements. Analytical procedures, similar to those performed in an audit of financial statements, can be applied to evaluate the overall health of the company's finances. Using your financial statements, one can calculate ratios in the areas of profitability (are profits being made at an acceptable rate?), liquidity (is the company able to pay short-term debts as they are due?), and efficiency (are the resources of the company being employed efficiently?).

For a more in-depth analysis, an analytical tool known as the

Z-Score can be used to assess the probability of bankruptcy. Edward I. Altman designed the Z-Score using five financial ratios, four of which can be derived from a company's internal financial statements, with one ratio employing market value (for public companies) or book value (for private companies). Each ratio is computed, multiplied by a specific coefficient, and then added to determine the Z-Score.

Get a Clear Understanding of Your Z-Score

The Z-Score can be adapted to predict bankruptcy for both manufacturing and nonmanufacturing entities (utilizing distinct coefficients and benchmarks). Once computed, the Z-Score must be interpreted. For instance, a manufacturer with a Z-Score of less than 1.23 has a high potential for bankruptcy, whereas a manufacturer with a score greater than 2.9 has a low potential for bankruptcy. A score that falls between 1.23 and 2.9 falls into a zone that cannot be classified with reliability. For a nonmanufacturer, different benchmarks and coefficients are employed to adjust for the differences that arise when comparing a manufacturer to a nonmanufacturer.

The Z-Score is not 100-percent accurate; there is no known magic trick that can predict the future. However, the Z-Score is a powerful analysis tool that can be used to evaluate your company's financial health. Consulting with a reliable CPA can assist you in pinpointing the warning signs of financial stress before it is too late to make the necessary changes that will allow your company to prosper. *

For more information on troubled businesses, bankruptcy, or Z-Score calculation, contact Michael Neubauer at McGill, Power, Bell & Associates, LLP at 814/453-6594 or mneubauer@mpbcpa.com.

