

DallasBusinessBlog

Numero loqui sibi. Tu quid isti dicunt?

by EDITOR on AUGUST 24, 2012

By: Ron Pyke

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The numbers speak for themselves. But do you know what they are saying?

Those of you that know me know two things about me: First, I don't know Latin. And second, I have a very practical approach to the accounting and finance issues faced by privately owned companies.

Yet, some of the business owners I meet believe that I have performed magic with their numbers. That is not totally true. What I have done is help them to understand what their numbers are saying.

For instance, I frequently come across business owners who want to calculate their current ratio. The formula seems simple enough: current assets divided by current liabilities. But what if you do not have the correct numbers to make the calculations? What if you draw a conclusion that you are doing much worse than your competitors, but you are not making an apples to apples comparison?

There can also be issues with the underlying information that goes into the calculations. For instance, one of the components of current assets is inventory. If your inventory balance includes obsolete and overvalued items then your current ratio will most likely be misleading. So be careful with the conclusions that you try to draw. My practice is to not only run calculations and draw conclusions but to dig deeper to make sure the results are based on accurate up-to-date information.

So what should your current ratio be? Well, I am going to hedge by saying that depends. Which direction is your current ratio trending? Has it gotten below 1.0? What is your industry standard, or better said is: How are your competitors doing? Have you cleaned up your books so that the calculation provides meaningful information? Well, then the answer is you want it to be at least 1.0. That means you have the resources (current assets) to pay your current obligations (current liabilities). In my opinion, anything less than 1.0 will require you and your team to spend too much time trying to figure out how to get everyone paid.

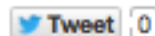
So, do I work magic? Well, that is in the eye of the beholder. I simply know that taking a practical look beyond the surface numbers is vital to obtaining accurate conclusions and that monitoring key performance indicators on a timely basis can help you make important decisions before outside forces make those decisions for you.



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Ron Pyke can be reached at: RPyke@B2BCFO.com

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