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Financial Reporting Checklist

"Fifteen Measures to Superior Reporting"

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Financial Reporting Checklist
"Fifteen Measures to Superior Reporting"

By J. Carlton Collins

You've probably read a thousand financial statements in your lifetime, and scoff at the idea that there could more to it than you already know. In this session, accounting systems expert J. Carlton Collins challenges the status quo by providing some surprising insights to that all important process of reading, analyzing, and dissecting financial reports and statements. In this session, Mr. Collins provides his fifteen rules for preparing, delivering, reading and analyzing financial statements and reports.

The Whole Point is Financial Reporting

Financial Reporting is the most important function of an accounting system. According to the Intermediate Accounting textbook written by Keiso and Weygandt, ***"the primary objective of an accounting system is to summarize detailed transactional data into useful reports that management can use to run their business"***. Many businesses seem to miss this point as financial statements and reports are rarely produced, distributed and read on a continual basis. I believe that it is the job of the CPA to implement a financial reporting system that accomplishes the following:

1. Ensure that the company's accounting system produces accurate financial reports.
2. Ensure that the appropriate reports are produced on a daily, weekly, and monthly basis.
3. Ensure that those reports are distributed to the appropriate personnel.
4. Ensure that the appropriate personnel understand how to read the reports.
5. Ensure that the appropriate personnel are reading the reports and using the information.

Too often businesses produce financial reports only after year end, far too late to allow executives to monitor manage the business. There is great information in those reports, and an informed management team will make better decisions.

Achieve The Best Reporting Possible

Given the above importance of producing financial statements and reports, it is not enough to merely produce a few summary reports. To achieve the best possible results, a wide variety of reports must be produced to meet a wide variety of information needs. Accordingly, the checklist below is intended to help you achieve the best possible financial reporting for your company or client.

1. One Number, By Itself, Is Almost Meaningless

If I told you that I spent $266,548 on Contract labor last month, could you tell me whether that was good or bad? No you couldn't. You would probably follow by asking "How much did you expect to spent? Oh, a budget? Sure, we have a budget and we expected to spend $293,200 on Contract Labor. From these two numbers you could deduce that we were under budget and that is a good.

You might also ask me how much did you spend last month on Contract Labor, or the same month last year? Oh, historical amounts. Sure I can tell you that we spent $234,562 last month on Contract Labor and $214,036 the same month last year. Based on this new information, you might deduce that Contract Labor costs are up dramatically this month compared to historical numbers.

The next time you find yourself producing a single column financial report, rethink your decision. Adding historical and budget comparison data could make the report far more meaningful. Consider the two examples below.

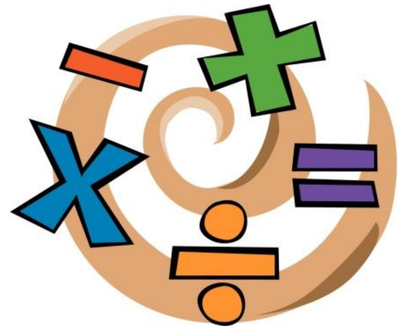
Expense:	Actual
Automobile Expense	38,765
Bank Service Charges	940
Conference Registration Fees	4,000
Contract Labor	266,548
Contributions	12,825
Dues And Subscriptions	60,511
Equipment Purchase	3,710
Equipment Rental	1,344
Hardware Purchase	39,501
Insurance	116,970
Marketing Giveaways	11,849
Memberships	900
Miscellaneous	210,103
Office Supplies	68,618
Online Computer Services	57,897
Outside Services	3,915
Partner Salary Draw	1,720,000
Postage And Delivery	12,612
Printing And Reproduction	435,751
Rent	132,134
Repairs	1,913
Software Purchase	9,117
Federal Taxes	5,000
State Taxes	2,000
Total Expenses	3,216,923

Less informative

Expense:	Actual	Budget
Automobile Expense	38,765	27,100
Bank Service Charges	940	1,000
Conference Registration Fees	4,000	3,400
Contract Labor	266,548	293,200
Contributions	12,825	9,000
Dues And Subscriptions	60,511	55,700
Equipment Purchase	3,710	3,900
Equipment Rental	1,344	500
Hardware Purchase	39,501	40,300
Insurance	116,970	131,000
Marketing Giveaways	11,849	13,400
Memberships	900	900
Miscellaneous	210,103	205,900
Office Supplies	68,618	83,000
Online Computer Services	57,897	73,500
Outside Services	3,915	3,400
Partner Salary Draw	1,720,000	1,548,000
Postage And Delivery	12,612	11,100
Printing And Reproduction	435,751	492,400
Rent	132,134	146,700
Repairs	1,913	2,200
Software Purchase	9,117	11,300
Federal Taxes	5,000	4,400
State Taxes	2,000	1,400
Total Expenses	3,216,923	3,162,700

More informative

2. Difference Reporting



Displaying comparison data is helpful, but such comparisons should also be accompanied by "Differences" to make it easier for the reader to comprehend, absorb and analyze the data. In the example below, columns have been added to show the differences between actual amounts compared to budget and historical amounts.

Expense:	Actual	Budget	Last Month	Same Month Last Year	Actual to Budget Difference	Actual to Prior Month Difference	Actual to PY, Same Month Difference
Automobile Expense	38,765	27,100	37,214	21,951	11,665	1,551	16,814
Bank Service Charges	940	1,000	705	733	(60)	235	207
Conference Registration Fees	4,000	3,400	5,320	1,200	600	(1,320)	2,800
Contract Labor	266,548	293,200	234,562	214,036	(26,652)	31,986	52,512
Contributions	12,825	9,000	9,875	8,730	3,825	2,950	4,095
Dues And Subscriptions	60,511	55,700	77,454	71,853	4,811	(16,943)	(11,342)
Equipment Purchase	3,710	3,900	2,968	3,120	(190)	742	590
Equipment Rental	1,344	500	693	585	844	651	759
Hardware Purchase	39,501	40,300	48,586	36,270	(800)	(9,085)	3,231
Insurance	116,970	131,000	83,049	151,960	(14,030)	33,921	(34,990)
Marketing Giveaways	11,849	13,400	12,086	17,554	(1,551)	(237)	(5,705)
Memberships	900	900	999	603	-	(99)	297
Miscellaneous	210,103	205,900	178,587	142,071	4,203	31,515	68,032
Office Supplies	68,618	83,000	58,326	89,640	(14,382)	10,293	(21,022)
Online Computer Services	57,897	73,500	61,371	61,005	(15,603)	(3,474)	(3,108)
Outside Services	3,915	3,400	6,788	9,800	515	(2,873)	(5,885)
Partner Salary Draw	1,720,000	1,548,000	1,685,600	1,654,770	172,000	34,400	65,230
Postage And Delivery	12,612	11,100	9,585	13,320	1,512	3,027	(708)
Printing And Reproduction	435,751	492,400	483,684	384,072	(56,649)	(47,933)	51,679
Rent	132,134	146,700	169,132	142,299	(14,566)	(36,998)	(10,165)
Repairs	1,913	2,200	2,085	2,816	(287)	(172)	(903)
Software Purchase	9,117	11,300	6,655	9,040	(2,183)	2,461	77
Federal Taxes	5,000	4,400	4,550	3,256	600	450	1,744
State Taxes	2,000	1,400	1,760	1,512	600	240	488
Total Expenses	3,216,923	3,162,700	3,181,635	3,042,196	54,223	35,288	174,727

You might think that this tip is obvious, however I see comparison financial statements and reports displayed all the time with no such comparison calculations. Without the difference calculations, the reader is forced to make mental calculations in their head which takes more time and is more prone to error.

Let's remind ourselves that the goal of producing financial reports is to help management make decisions to manage the company.

3. Difference Percentage Reporting

In some cases numerical data is more informative than percentage data; however in other cases just the opposite is true. Why not provide both? It is helpful to display differences as both a numerical and percentage amount. Remember the goal is to make it easier for the reader to comprehend, absorb and analyze the data. Consider the following data:

Expense:	Actual	Budget	Diff	Diff %
Automobile Expense	38,765	27,100	11,665	43%
Bank Service Charges	940	1,000	(60)	-6%
Conference Registration Fees	4,000	3,400	600	18%
Contract Labor	266,548	293,200	(26,652)	-9%
Contributions	12,825	9,000	3,825	43%
Dues And Subscriptions	60,511	55,700	4,811	9%
Equipment Purchase	3,710	3,900	(190)	-5%
Equipment Rental	1,344	500	844	169%
Hardware Purchase	39,501	40,300	(800)	-2%
Insurance	116,970	131,000	(14,030)	-11%
Marketing Giveaways	11,849	13,400	(1,551)	-12%
Memberships	900	900	-	0%
Miscellaneous	210,103	205,900	4,203	2%
Office Supplies	68,618	83,000	(14,382)	-17%
Online Computer Services	57,897	73,500	(15,603)	-21%
Outside Services	3,915	3,400	515	15%
Partner Salary Draw	1,720,000	1,548,000	172,000	11%
Postage And Delivery	12,612	11,100	1,512	14%
Printing And Reproduction	435,751	492,400	(56,649)	-12%
Rent	132,134	146,700	(14,566)	-10%
Repairs	1,913	2,200	(287)	-13%
Software Purchase	9,117	11,300	(2,183)	-19%
Federal Taxes	5,000	4,400	600	14%
State Taxes	2,000	1,400	600	43%
Total Expenses	3,216,923	3,162,700	54,223	2

In this example, take a look at the difference column. Immediately Partner Salary draws catch your attention because it is a whopping $172,000 over budget. However, the $844 overage for Equipment Rental barely catches your attention. However, when you analyze the Difference Percentage column, you immediately see that Equipment Rental is 169% over budget. The point is that you should consider both – look for actual amounts that grossly exceed your budgets in term so amounts and percentage differences, and concentrate more of your analytical efforts on these amounts.

4. Budgeting & Revised Budgets

I used to view the budgeting process as a wasteful little chore that caused everybody grief and provided little benefit. But that view was based on bad budgeting – of course if you don't do it right, poor budgeting is a big waste of time. However, if done correctly, budgeting can be one of the best measures you can take to help manage and run your business. Presented below is a checklist to help you ensure that budgeting is performed correctly in your organization.

1. **Integrated** – Your budget system should be integrated with your accounting system, and not maintained in an outside budgeting system such a an Excel workbook. This ensures that the accounting system can then produce the necessary budget-to-actual comparative financial reports on a regular basis.

2. **Stratified** - Budgets should be well-stratified (or categorized multiple ways). For example, budget data may be categorized by month (or reporting period), by segments (such as departments, locations, funds, etc.) and by projects or programs.

3. **Revisions** – As conditions change, your initial budget may be rendered obsolete. For example, an epic disaster such as a hurricane or tsunami may have a tremendous impact on a charitable organization's donations and expenditures, rendering old budgets obsolete. In such instances, it is prudent to generate revised budgets to follow for the remainder of the year. Economic conditions can change multiple times throughout the year and they often do. For this reason it is more realistic to consider the budgeting process to be an ongoing process, rather than a one-time event which occurs at the beginning of each year.

4. **Reporting** – Budget amounts should flow easily to, and be included in financial reports. Your accounting system should produce a wide variety of comparative reports such as "actual-to-budget" comparisons, "budget-to-prior-year-budget" comparisons, and "actual and budget to budget-revision" comparisons. These reports should also present differences in amounts and percentages, by row; and should be available across separate segments such as departments, divisions, funds, etc).

5. **Roll Up** – Budgets should be created by levels, and rolled up into various levels of reporting. For example, a world-wide charity with hundreds of locations would typically maintain separate departmental budgets for each location; by state, region, and country. The accounting system should allow the entity to roll up all actual and budgetary data to produce reports by location, state, region, and country.

6. **Statistical Amounts** – It is often useful for an organization to budget non-financial amounts in addition to financial amounts. Non-financial amounts are commonly known

as “statistical amounts”. As examples, a homeless shelter might budget the number of residents they expect to serve, or the number of meals they expect to provide; an association might budget the number of new members they expect to recruit; a charity might budget the number of magazine subscriptions they expect to sell.

7. **Variable Budgeting** – Associated with the ability to track statistical data is the ability to produce variable budgets – budgets that adjust themselves automatically based on certain levels, such as statistical data. For example, as a charitable organization sells more light bulbs, the organization’s revenues and expenditures adjust automatically based on the number of light bulbs sold.

8. **Budgeting Activities** – In addition to budgeting financial and statistical amounts, some budgeting systems allow for the budgeting of specific activities, campaigns, and capital projects.

9. **Tools** – To aid in the budgeting process, it is helpful for the system to provide user tools for inputting budget data. For example some systems enable the user to input one amount for the first month, and that amount can then be automatically replicated, or increased by a fixed percentage or amount, to fill in the remaining months.

10. **Balance Sheet Budgeting** – In addition to budget revenues and expenditures, many not-for-profit organizations find it necessary to budget balance sheet items such as cash and receivables as well.

11. **Import from Spreadsheet** – Microsoft Excel is the world’s most popular tool for creating budgets and therefore a good budgeting system will support the importing of data from this environment.

5. Per Unit Budgeting and Per Unit Reporting

In many instances, it may be helpful to also display financial information based on the "Per Unit" cost. This is because revenues and costs can vary from one month to the next due to volume. As volumes fluctuate, the process of comparing actual numbers to budget or historical numbers can be completely meaningless. However, the process of comparing actual Per Unit Revenue and Costs to Budgeted or Historical Per Unit Revenue and Costs can provide meaningful insights into your data. Listed below are a few industries in which volume can fluctuate widely from one month to the next depending upon many factors.

Manufacturer – Per Units Produced
Dentist – Per Number of Visits
Doctor or CPA Firm – Per Hours Billed
Airline – Per Number of Passengers Served
Builder – Per Number of Houses Constructed
Swimming Poll Cleaner – Per Number of Swimming Pools Cleaned
Hotdog Restaurant – Number of hotdogs served

This type of "Per Unit" revenue & cost accounting analysis can be revealing and informative. Consider the example below in which the Per Unit columns show which line items are askew when analyzed on a per unit basis.

Expense:	Actual	Budget	Same Month Last Year	Actual Per Unit	Budget Per Unit	Same Month Last Year Per Unit	Actual to Budget Difference Per Unit	Actual to Same Month Difference Per Unit
Automobile Expense	38,765	27,100	21,951	2.67	1.96	1.81	0.71	0.86
Bank Service Charges	940	1,000	733	0.06	0.07	0.06	(0.01)	0.00
Conference Registration Fees	4,000	3,400	1,200	0.28	0.25	0.10	0.03	0.18
Contract Labor	266,548	293,200	214,036	18.38	21.25	17.69	(2.86)	0.69
Contributions	12,825	9,000	8,730	0.88	0.65	0.72	0.23	0.16
Dues And Subscriptions	60,511	55,700	71,853	4.17	4.04	5.94	0.14	(1.77)
Equipment Purchase	3,710	3,900	3,120	0.26	0.28	0.26	(0.03)	(0.00)
Equipment Rental	1,344	500	585	0.09	0.04	0.05	0.06	0.04
Hardware Purchase	39,501	40,300	36,270	2.72	2.92	3.00	(0.20)	(0.27)
Insurance	116,970	131,000	151,960	8.07	9.49	12.56	(1.43)	(4.49)
Marketing Giveaways	11,849	13,400	17,554	0.82	0.97	1.45	(0.15)	(0.63)
Memberships	900	900	603	0.06	0.07	0.05	(0.00)	0.01
Miscellaneous	210,103	205,900	142,071	14.49	14.92	11.74	(0.43)	2.75
Office Supplies	68,618	83,000	89,640	4.73	6.01	7.41	(1.28)	(2.68)
Online Computer Services	57,897	73,500	61,005	3.99	5.33	5.04	(1.33)	(1.05)
Outside Services	3,915	3,400	9,800	0.27	0.25	0.81	0.02	(0.54)
Partner Salary Draw	1,720,000	1,548,000	1,654,770	118.62	112.17	136.76	6.45	(18.14)
Postage And Delivery	12,612	11,100	13,320	0.87	0.80	1.10	0.07	(0.23)
Printing And Reproduction	435,751	492,400	384,072	30.05	35.68	31.74	(5.63)	(1.69)
Rent	132,134	146,700	142,299	9.11	10.63	11.76	(1.52)	(2.65)
Repairs	1,913	2,200	2,816	0.13	0.16	0.23	(0.03)	(0.10)
Software Purchase	9,117	11,300	9,040	0.63	0.82	0.75	(0.19)	(0.12)
Federal Taxes	5,000	4,400	3,256	0.34	0.32	0.27	0.03	0.08
State Taxes	2,000	1,400	1,512	0.14	0.10	0.12	0.04	0.01
Total Expenses	3,216,923	3,162,700	3,042,196	221.86	229.18	251.42	(7.32)	(29.56)

6. As a Percentage of Sales Reporting

Many industries do not produce units or measure units that may be used as a basis for calculating Per Unit Revenue and Costs; however, their Sales may still fluctuate widely enough from one month to the next as to make month to month comparisons rather meaningless. In this case, it may be meaningful to use a “Percentage of Sales” calculation to analyze and compare costs from one month to the next.

For example, the financial report below displays financial data as well as “Percentage of Sales” calculations. Further, the final four columns calculate the percentage amount by which budgeted and prior month “Percentage of Sales” calculations differ from actual “Percentage of Sales” calculations. These changes are then highlighted by “Data Bar Formatting” to help the reader quickly identify those actual “Percentage of Sales” line items that fluctuate significantly from budget or prior month “Percentage of Sales” calculations.

Sales	4,182,000	3,950,150	3,634,227					
Expense:								
Automobile Expense	38,765	27,100	21,951	0.93%	0.69%	0.60%	0.24%	0.32%
Bank Service Charges	940	1,000	733	0.02%	0.03%	0.02%	0.00%	0.00%
Conference Registration Fees	4,000	3,400	1,200	0.10%	0.09%	0.03%	0.01%	0.06%
Contract Labor	266,548	293,200	214,036	6.37%	7.42%	5.89%	-1.05%	0.48%
Contributions	12,825	9,000	8,730	0.31%	0.23%	0.24%	0.08%	0.07%
Dues And Subscriptions	60,511	55,700	71,853	1.45%	1.41%	1.98%	0.04%	-0.53%
Equipment Purchase	3,710	3,900	3,120	0.09%	0.10%	0.09%	-0.01%	0.00%
Equipment Rental	1,344	500	585	0.03%	0.01%	0.02%	0.02%	0.02%
Hardware Purchase	39,501	40,300	36,270	0.94%	1.02%	1.00%	-0.08%	-0.05%
Insurance	116,970	131,000	151,960	2.80%	3.32%	4.18%	-0.52%	-1.38%
Marketing Giveaways	11,849	13,400	17,554	0.28%	0.34%	0.48%	-0.06%	-0.20%
Memberships	900	900	603	0.02%	0.02%	0.02%	0.00%	0.00%
Miscellaneous	210,103	205,900	142,071	5.02%	5.21%	3.91%	-0.19%	1.11%
Office Supplies	68,618	83,000	89,640	1.64%	2.10%	2.47%	-0.46%	-0.83%
Online Computer Services	57,897	73,500	61,005	1.38%	1.86%	1.68%	-0.48%	-0.29%
Outside Services	3,915	3,400	9,800	0.09%	0.09%	0.27%	0.01%	-0.18%
Partner Salary Draw	1,720,000	1,548,000	1,654,770	41.13%	39.19%	45.53%	1.94%	-4.40%
Postage And Delivery	12,612	11,100	13,320	0.30%	0.28%	0.37%	0.02%	-0.06%
Printing And Reproduction	435,751	492,400	384,072	10.42%	12.47%	10.57%	-2.05%	-0.15%
Rent	132,134	146,700	142,299	3.16%	3.71%	3.92%	-0.55%	-0.76%
Repairs	1,913	2,200	2,816	0.05%	0.06%	0.08%	-0.01%	-0.03%
Software Purchase	9,117	11,300	9,040	0.22%	0.29%	0.25%	-0.07%	-0.03%
Federal Taxes	5,000	4,400	3,256	0.12%	0.11%	0.09%	0.01%	0.03%
State Taxes	2,000	1,400	1,512	0.05%	0.04%	0.04%	0.01%	0.01%
Total Expenses	3,216,923	3,162,700	3,042,196	76.92%	80.07%	83.71%		

7. Industry Metrics & Benchmarks

Another approach to comparing data is to compare actual results to financial benchmarks of similar companies of similar sizes. Consider the following true story that occurred in 1998.

In 1998 I was installing a new accounting system for a southeastern aluminum products company. During the installation I noticed that its days-in-inventory level had risen from 72 and 75 days in 1995 and 1996, to 143 and 152 days in 1997 and 1998 respectively. Perplexed, I visited the local library to consult Moody's Industrial Guide where I looked up the typical days in inventory for a company of that size and in that SIC code. This guide confirmed that average days in inventory for a company of this nature was 76.2 days.

At that time, the company's inventory level was valued at $4,635,000, but a simple math calculation revealed that the inventory level should have been closer to $2,323,600 (4,635,000 / 152 * 76.2). Indeed for the previous two years the company's inventory was approximately $2,238,200 high compared to similar companies. At the time the company's interest rate on its' inventory note was 12.5% which means that the company had paid interest of $559,600 just to carry the additional inventory.

One of the reasons that management failed to detect the excess inventory was because no one was monitoring financial ratios. A manager told me that he was aware that inventory levels had increased along with sales and he assumed—incorrectly, as it turned out—that inventory was increasing in proportion to increases in sales. An investigation revealed that the company's new purchasing agent who had been hire two years earlier simply over ordered inventory so that the they would not run out. This made the project managers within the company very happy as they did not have to deal with inventory arriving just in time in order for them to meet their deadlines.

The manager then explained to me that not only did the company needlessly spend $559,600 in excess interest in order to carry the extra inventory, but in fact the company had already broken ground on a new $4,000,000 warehouse which they now determined was not really needed.

There are many sources for obtaining financial benchmark information, and in many cases you may have to pay for that information. A few example sources for benchmark information are listed below:

Moody's Financial Metrics Key Ratios by Rating and Industry: 2009

http://www.bizminer.com/reports/samples/industry-financial.pdf

Financial Ratios: Turnover:	2005	2006	2007	2008	2009
Cash Turnover (X)	15.21	12.85	14.17	12.80	12.38
Current Asset Turnover	6.21	5.01	5.06	5.49	4.21
Fixed Asset Turnover	14.25	10.15	9.33	8.70	9.41
Inventory Turnover (X)	57.03	50.26	60.47	70.22	59.48
Receivables Turnover (X)	19.79	13.55	12.23	17.13	10.53
Total Asset Turnover (X)	3.81	3.01	3.06	3.02	2.50
Working Capital Turnover (X)	24.64	19.74	12.07	10.95	78.50

http://benchmark.kpilibrary.com ($20 per month)

http://www.finlistics.com/BenchmarkingTopDownArticle.html

8. Ratio Analysis

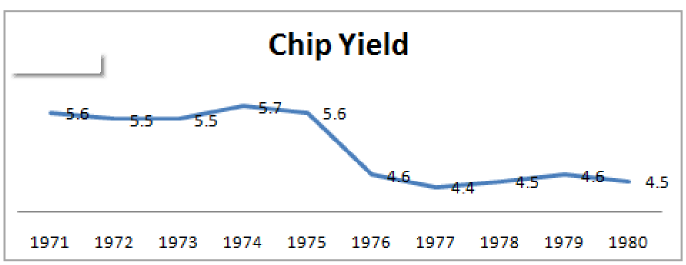
In many companies, ratio reporting appears to be a lost art form. However, ratios can be very revealing, especially if monitored over time. You can find a good listing of the various financial ratio calculations commonly used in the Wikipedia at this address:

http://en.wikipedia.org/wiki/Financial_ratio

If time permitted, I would probably cover numerous ratios, show you the formulas and explain what they each mean. However, as CPAs, you already know about ratios. My key point is that it's time to start using them. I am deeply saddened to find that virtually none of the accounting software products out there actually calculate financial ratios – BusinessWorks is one of the few. Instead I will provide you with this true story from 1981:

In 1981 I took an internship with ITT Rayonier where it was my job to use Arthur Anderson's Transaction Flow Analysis (TFA) technique to trace the flow of documents in the accounting systems of pulp mills. I was assigned to the pulp mill in Jesup, GA – (Yes I spent a whole summer in Jesup, GA, commuting each day from Saint Simons island).

During my work I calculated the chip yield for the previous 10 years. The chip yield is calculated by dividing the tons of paper that is produced by the pulp mill by the tons of pulp wood that are delivered to the pulp mill. The results showed that the chip yield had fallen as shown in the chart below.



I called my supervisor in Connecticut and reported the findings, and he told me *"Carlton, there is a reason for that and if you don't do anything else this summer, I want you to find it an explanation".* I spent the next several weeks looking for answers, however no one I talked to could explain the variation. Finally, one hot summer day I walked across the mill yard and interviewed a seasoned worker who knew the answer. The older gentlemen worked the scales and weighed each train car as it came in to deliver pulpwood. It was his job to record the weight of the train car full of pulpwood, and then subtract the stenciled weight on the side of the rail car to determine the total amount of pulpwood received.

For nearly five years this gentleman had noticed when the empty trains came back across the scales, the stenciled weight on many of the railroad cars was understated. That meant that he was reporting too much pulpwood had been delivered. For example, he would weigh a railcar in at 66 tons, and then subtract the stenciled weight of 23 tons to calculate the amount of pulpwood received (43 tons). However, the railcar actually weighed closer to 26 tons, which meant that the pulp mill was over paying for 3 tons of pulpwood that they never actually received. The scale worker had saved notes on the nearly 250 offending railcars. I was able to use his notes to recalculate the true amount of pulpwood received and the chip years calculations returned to normal. ITT Rayonier was able to go back to the supplier and collect approximately $250,000 in overpayments from that supplier.

This story underscores the importance of calculating key ratios over time, and analyzing them for consistency. The actual ratios you calculate will vary depending upon the nature of your company, but at a minimum I recommend that you calculate the following ratios with regularity:

1. Days in accounts payable
2. Days in accounts receivable
3. Days in inventory
4. Gross profit margin percentage
5. Current ratio
6. Quick ratio
7. Debt to equity

9. Event Triggered Reporting (Alarms)

All businesses should ideally employ a team of accountants dedicated exclusively to reviewing the company's books and financial statements continuously in order to identify potential problems. For example, if cash balance drops below a certain level, if profit margin percentages dip dangerously low, or if sales taper off suddenly, warning bells should be sounded and management should be alerted quickly so they can initiate corrective measures. Historically, this process has been out of reach for most companies, as manual accounting systems required the need for hundreds of continuous boring calculations, which rendered such a solution unreasonable.

However, with the advent of the computer, the evolution of application software, and the addition of e-mail, today's accounting systems can perform hundreds of business calculations continuously, comparing the results against pre-set conditions in order to identify emerging problems or trends. Once identified, these business alerts can be sent to the appropriate management personnel through e-mail, fax, or even a mobile phone. This type of reporting is known in programming circles as "Event-Triggered Reporting," "Alarms," or "Alerts." In business circles, this type of reporting is known as "Management by Exception." By any name, this type of reporting is being heralded as the most useful type of reporting on the planet today—and thanks to advancements in technology, this solution is now widely available to all businesses.

Six Advantages of Event-Triggered Reporting

Event-triggered reporting holds many advantages over the more traditional type of reporting, which typically involves the production of periodic financial statements and reports—usually thick, voluminous stacks of financial statements and reports. A summary of key advantages of event-triggered reporting is presented below.

1. **Immediate Reporting** - Event-triggered reports alert the appropriate personnel to emerging financial conditions as they occur. For example, if profit margins slip, the CFO is notified of this event immediately—often within a few seconds. The more traditional monthly reporting approach might mean the CFO receives this information in report format several weeks later, and even then there's the chance the CFO won't notice this particular event simply by perusing the financial statements.

2. **Continuous Monitoring** - Even the most diligent of employees will grow tired of constantly computing ratios and measures in search of significant observations or signs of trouble. However, an automated accounting system does not get bored—it can calculate numbers without tiring.

3. **Filtered Information** - The traditional approach of producing and circulating detailed financial reports often inundate management with mountains of information which they

must wade through in order to ferret out useful information. This process can be tedious and time consuming. By contrast, event-triggered reporting only provides people the information they need to act upon.

4. **Efficiency** - Event-triggered reporting helps people work more efficiently. For example, assume a customer's purchases decline for a given period. Traditionally, the sales manager might sift through a 400-page sales report in order to identify a customer with declining activity. Such laborious tasks are often set aside or even discarded. An event-triggered reporting system instantly notifies the sales manager whenever activity for a given customer slips. The sales manager need only act on the information—mountains of paperwork are thereby avoided, or at least reduced.

5. **Benchmarking** - When it comes to accounting, no single number is useful. To be useful, it must first be compared to another number. For example, knowing a company has 80 days worth of inventory is virtually useless. You must also fill the blanks to questions such as:

   • What was the number of days in inventory last month? Last quarter? Last year?
   • What is the avgerage days in inventory for a company of our size and industry?
   • What is our budgeted days in inventory?

   Once a manager knows the days in inventory had been averaging 70 days over the past year, the industry average is 65 days, and the budgeted amount is 72 days, a call to action to reduce the current 80 day amount is evident. Event-triggered reporting is about comparing current financial conditions with benchmarks—hence, all information produced by this reporting process is concise and beneficial.

6. **Targeted Feedback -** Event-triggered reports typically send notifications to only those people who should be privy to the information. While the CFO may be copied on all event triggered reports, the sales manager may see only those notifications relevant to his or her job. Likewise, the president may be copied on notifications pertaining to sales, cash, and profits, but may not be bothered with notifications indicating a particular inventory item needs to be re-ordered.

Not Just Looking for Trouble

One might assume event-triggered reporting might focus on looking for potential problems and troubling trends, and indeed, event-triggered reporting is well-suited for this goal. However, event-triggered reporting can be just as useful for identifying positive events as well. For example, a sales manager might want to be alerted when a customer has earned a new discount threshold. In this occurrence, the sales manager might receive the following e-mail message from the alerts system:

Attention Sales Manager: Please call Julia Stevens and congratulate her for purchasing $50,000 this calendar year and earning an extra 1 percent discount on all future purchases. Her telephone number is 555-0100.

Think how much easier your job could be if your accounting system kept you well informed of key events such as this. Other examples might include notification of an employee who achieved a perfect attendance record for the year, sales representatives who have exceeded their goals, or a collections manager who has set a new record for the lowest days in accounts receivable.

Unlimited Business Alerts

An unlimited number of possible alert conditions exist that might help a company better manage its customers, vendors, employees, and resources. All companies would most likely want to monitor typical benchmarks, such as cash levels, current ratios, days in inventory, accounts receivable, and accounts payable. They would also employ this solution to keep an eye on profits, interest rates, and sales levels as well. However, the accounting system can also alert companies about particular inventory items whose quantity are running low, customers who are paying too slow, or even employees who have exceeded their vacation and sick time quotas. The creative CFO can set up hundreds of pre-set parameters in just a few hours, and thereafter, the accounting system will constantly compare these conditions to actual results without fail for years to come.

Sage ACCPAC Pro ERP, for example, not only monitors custom events, but it can alert mangers by sending them e-mails. As you would expect, many high-end accounting products—the so-called beginning enterprise resource planning (ERP) products, such as Epicor, offer event-triggered reporting. However, this high-end feature also can be found in an entry-level product, Peachtree Complete. Its alarms automatically monitor amounts related to account balances, customers, vendors and employees.

For accounting software packages that don't provide event-triggered alarms, a third-party solution often is available. For example, the CleverPath Portal (formerly known as Forest & Trees) from Computer Associates can extract data from a host of accounting software packages, spreadsheets and other databases. In addition, the software can send you a text message if it spots a potential problem. Likewise, the Cisco Agent can perform similar actions.

10. Accuracy

Of course this should go without saying, but financial statements and reports should be accurate. It seems ridiculous to mention this to a bunch of CPAs, however too often I encounter companies whose financial statements and reports are not accurate, and the readers of those statements know it. As a result, the financial statements and reports are not properly used to manage the business. To help ensure accuracy, follow these steps:

Monthly Entries - Make sure that someone is assigned to enter the necessary journal entries each month. Make sure that they are entered correctly. Write up notes and explanations directing the bookkeeper as to the correct process. For example, explain the monthly loan payment amount must be debited against the interest expense and outstanding loan accounts each month in differing amounts according to the amortization schedule.

Review – Make sure that someone knowledgeable is assigned to review the financial statements and reports each month for errors. Create a list of key steps to take such as preparing a bank reconciliation, performing a physical inventory count, spot checking key balances, comparing actual amounts to budgeted amounts and investigate any significant discrepancies.

Errors – As errors are identified, take time to determine what caused the error and train that person responsible so that the error does not recur.

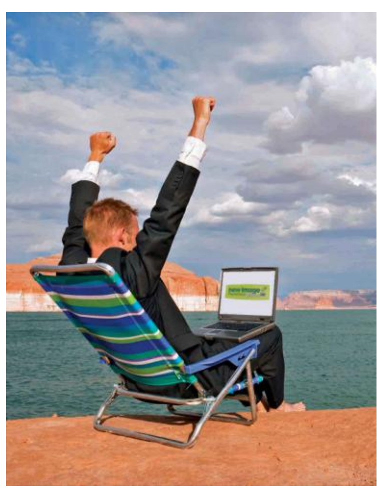
11. Regular Reporting

Financial statements and reports should be issued on a regular basis – daily, weekly, monthly, quarterly and annually. It has been my experience that often the bookkeeper will sit on information believing that it is their job to protect the privacy of all information. This is incorrect. Just the opposite is true, it should be the bookkeeper's job to produce and deliver financial statements and reports on a continual and recurring basis. Both QuickBooks and Peachtree provide a tool that allows the bookkeeper you to print a batch of reports with a single click. As the CPA, you should make sure that these batches are set up properly.

12. Electronic Reporting

If possible, it is best to deliver electronic financial statements and reports via encrypted e-mail rather than to produce paper based reports for the following reasons:

a. Paper reports take time to print.
b. Paper reports must be delivered, faxed, or mailed.
c. Paper reports use paper.
d. Paper reports use toner.
e. Paper reports result in wear and tear on your printer.
f. Paper reports require you to go get paper, store paper, and load paper.
g. Paper reports require you to go get toner, store toner, and load toner.
h. Paper reports must be filed away in a drawer or filing cabinet.
i. Securing paper reports in binders takes time.
j. Report binders cost money.
k. Storing report binders full of reports takes up storage space.
l. Paper reports must later be moved to an archive room.
m. Ultimately paper reports must be shredded.
n. Paper reports cannot be copy and pasted into other applications such as Word.
o. Paper reports make what-if analysis impossible without reentering the data.
p. Paper reports make it impossible to generate a chart without re-entering the data.
q. Paper reports are harder and more expensive to secure than electronic reports.
r. Paper reports are more difficult to share with others.
s. Paper reports are far more difficult to back up.
t. Paper reports are impossible access remotely.
u. Paper reports do not allow the user to drill into details by double clicking a number.
v. Paper reports do not provide search tools to make it easy to locate an account.
w. Electronic reports can be accumulated conveniently in a single folder for easy access.



13. Automated Delivery

If possible, it is best to have the accounting system automatically generate and deliver electronic financial statements and reports via encrypted e-mail at regularly scheduled intervals. The benefits are as follows:

a. This eliminates the need for a bookkeeper to spend countless hours generating and delivering reports.
b. This enables readers of those reports to learn to expect and rely on various financial reports at regularly scheduled intervals, rather than wonder when if ever the reports are forth coming.

Some accounting systems provide the ability to schedule financial statements and reports to be delivered automatically at regularly scheduled intervals. For example, you could schedule the Detailed Aged Receivables report to be delivered each Tuesday and Friday at 10:00 am to the president, CFO, AR Clerk, and Sales Manager. As examples, both Microsoft Management Reporter and Crystal Reports (with the **Navarre Report Scheduler** Add-on) provide the ability to schedule the delivery of each and every report.

14. Timely Delivery

Financial statements must be delivered timely. By the 10th day of the following month, before information grows stale. Many companies receive accurate financial statements once a year, well after the end of the year – too late to be used in the decision making process.

Financial reports should be delivered daily, weekly or month depending upon the company and various factors. For example, I would recommend that inventory re-order reports be delivered twice a week or even once a day in an effort to best manage inventory.

The trademark of a well-run company is a continuous effort to produce and deliver deep rich financial statements and reports on a continuing basis.

15. Customize The Financial Statements and Reports

Virtually every accounting system on the planet provides tools which allow you to customize your financial statements and reports to your specific needs. Financial statements and reports should be customized to include all of the pertinent information. Recipients should be asked to help review the financial statements and reports for missing info.

In particular, statistical information such as units of sales can be added to enhance the reports. Many accounting systems allow the users to create new data fields which can also flow to the financial statements and reports for enhanced reporting. In QuickBooks, these added data fields can be used to filter reports as well.

The key point is that the seasoned CPA should do more than simply rely on the canned reports to meet the needs of the company. They should fully utilize the tools to ensure that the reporting is the best it can be.

In addition, there are several small tips that you should keep in mind when producing financial reports as follows:

a. Well labeled report titles should appear on each page.
b. Each page should be numbered using the "Page # of ##" format.
c. The Calibri and Aerial fonts make numbers easier to read.
d. Financial reports containing numerous zeros should suppress those zeros.
e. In Excel, use the "Accounting Format" with the "Single" and "Double" Accounting underlines to achieve the look and feel that CPAs prefer.
f. In Excel use the new "Spark Line" feature to help depict trends.
g. In Excel use the "outlining" exploding and condensing.
h. In Excel use "Superscripting" partially in your cell to referencing footnotes.

16. Training Users to Read and Understand Financial Statements

It is not enough to merely produce and deliver the financial statements and reports. The recipients of those financial statements and reports should know how to read and understand them. This is a delicate matter, for you don't want to insult the recipient by questioning their ability to read the report. Nonetheless, you should sit down with recipients and point out key numbers and indicators to look for when examine each report.

In conclusion, the Bureau of Labor and Statistics inadequate that poor record keeping is the number two leading cause of business failure. The whole point of record keeping is to produce summarized financial reports for management to use to manage the business. Don't become a statistic. Use the above mentioned financial reporting tips to make your financial reporting effort produce the best possible results.

Bio for J. Carlton Collins, CPA

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J. Carlton Collins, CPA is a Certified Public Accountant with experience in technology, tax, auditing, accounting systems, financial reporting, and bond financing. He is an author, lecturer, and technology & accounting systems consultant. He has published books, articles, and web pages and is the author of the monthly technology Q&A column for the **Journal of Accountancy**. As a public speaker, Mr. Collins has delivered more than 2,000 lectures in 44 states and 5 countries addressing more than 500,000 CPAs and business professionals. As a consultant, Mr. Collins has assisted 275+ large and small companies with the selection and implementation of accounting systems. Mr. Collins has a Bachelor's degree in Accounting from the University of Georgia, is a 25+ year member of the American Institute of CPAs and the Georgia Society of CPAs, and is also a licensed realtor.

Summary of Selected Positions, Awards & Accomplishments:

1. Honored as one of the CPA Industries Top 25 Thought Leaders by **CPA Technology Advisor Magazine**
2. Author of the monthly Technology Q&A column for the Journal of Accountancy.
3. Recipient of the AICPA's Lifetime Technical Contribution to the CPA Profession Award.
4. Chairman of the Southeast Accounting Show - the South's largest CPA event.
5. Recipient of the Tom Radcliff Outstanding Discussion Leader Award.
6. Named "Top Ten CPA Technologists" by Accounting Technologies Magazine (multiple years).
7. Named "Top 100 Most Influential CPAs " by Accounting Technologies Magazine (multiple years).
8. Has personally delivered over 2,000 technology lectures around the world.
9. Recipient of the Outstanding Discussion Leader Award from the Georgia Society of CPAs.
10. Lead author for PPC's Guide to Installing Microcomputer Accounting Systems.
11. Has installed accounting systems for more than 200 companies.
12. Chairperson of the AICPA Technology Conference.
13. Recipient of the ACCPAC Partner of the Year Award.
14. Determined by SAP to be one of the country's "Top Ten Most Influential ERP Systems Consultants".
15. Has delivered keynote and session lectures at dozens of accounting software conferences.
16. Sworn in as a Certified Public Accountant on September 18, 1985.
17. Member of the American Institute of CPAs since 1985.
18. Member of the Georgia Society of CPAs since 1982.

As an auditor, Mr. Collins has audited businesses in the areas of health care, construction, distribution, automobile dealerships, insurance, manufacturing, and general business. Mr. Collins' tax experience includes corporate, individual, partnership, fiduciary, and estate tax planning work. In the area of finance, Mr. Collins has prepared (or assisted in preparing) feasibility studies and financial forecasts for nearly 300 projects seeking more than $3 billion in startup capital. Mr. Collins is familiar with bond issues, Medicare and Medicaid reimbursement, and conventional financing matters. In 1992, Mr. Collins contributed and demonstrated more than 500 pages of suggested design improvements to the Microsoft Excel development team of programmers - and many of those improvements are found in Excel today.

At the University of Georgia, Mr. Collins was elected President of the Phi Eta Sigma Honor Society, was initiated into the BIFTAD Honor Society, served three years in the Judicial Defender/Advocate program, and was a member of Alpha Tau Omega fraternity. At Glynn Academy High School, Mr. Collins was Senior Class President, Class Valedictorian (1 of 6), and received a principle nomination to Annapolis Naval Academy. Mr. Collins has been married for 27 years and has two children. He devotes his leisure time to family, travel, tennis, fishing, snow skiing, and riding motorcycles (both dirt and street). Mr. Collins is president of his homeowners association, participates in the Gwinnett Clean and Beautiful program, and volunteers for Cooperative Ministries food drive.

Because I had an extra page left in this book, I'll throw in a few jokes and quotes to brighten your day. Enjoy!

- I'm so poor I can't even pay attention
- I have enough money to last me the rest of my life...unless I buy something.
- It's so simple to be wise. Just think of something stupid to say and then don't say it!
- I'm searching for fun and happiness that does not involve food or money...
- We make a living by what we get, we make a life by what we give.
- Count your age with friends but not with years.
- Never play leapfrog with a unicorn.
- Friction can be a drag.
- When I want your opinion, I'll remove the duct tape.
- Light travels faster than sound. That's why some people appear bright until you hear them speak.
- Football is a combination of two of America's worst elements: Violence and committee meetings.
- I haven't spoken to my wife in years; I don't like to interrupt her.
- My fake plants died because I did not pretend to water them
- Never let a computer know you're in a hurry.
- I totally take back all those times I didn't want to nap when I was younger.
- I planned to surprise my wife with a new centerpiece for the table...but the taxidermist was closed.
- I have kleptomania, but when it gets bad, I take something for it.
- For every action, there is an equal and opposite government program.
- Even free advice costs more than it used to.
- Love is holding hands in the street. Marriage is holding arguments in the street.
- I always try to hold hands with my wife...because if I let go she'll start shopping!
- My back goes out more than I do.
- An Adult is a person who has stopped growing at both ends and is now growing in the middle.
- The journey of a thousand miles ... begins with a broken fan belt.
- I'm getting serious about exercising - I've moved my TV set much farther away from my refrigerator.
- A Freudian slip is when you say one thing but mean your mother.
- While in the army, Will never liked the phrase "Fire at will".
- Studies have shown that you can live longer by having more birthdays.
- My wife keeps saying that I don't listen to her...or something like that.
- My life goal is to be filthy stinking rich...well, 2 out of 3 ain't bad.
- A child of five would understand this. Send someone to fetch a child of five.
- Warning: Dates in Calendar are closer than they appear.
- Because of these hard economic times, I have started selling furniture on the side. The trouble is, it is my own.

Carlton's CPE Prayer

Now I lay me back to sleep.
The speaker's dull; the subject's deep.
If he should stop before I wake,
Give me a nudge for goodness' sake.