



Finance for the Non-Financial Manager

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Publisher: McGraw Hill
Copyright year: 2003
ISBN: 0-07-141377-4

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Counting the Beans

- Managers need to understand the rules of accounting and the boundaries of proper finance well enough to avoid getting into trouble as they aggressively try to achieve their goals.
- The financial department really has two fairly distinct jobs to perform in most companies: managing the company's financial resources ("Finance") and recording and reporting all its financial transactions ("Accounting").
- The standard format for recording and reporting financial transactions is outlined in guidelines, or rules, called *Generally Accepted Accounting Principles (GAAP)*.
- One of the greatest challenges for management is to balance the two primary responsibilities of the financial department-to safeguard the assets of the company by properly accounting for them and monitoring their use and to organize information from transactions and present it so managers can function more effectively.

The Structure and Interrelationships of Financial Statements

- Financial reports must be reasonably accurate, formatted in a relevant way, and delivered in timely fashion to be useful for helping managers make decisions about the company. For each ARTistic (Accurate Relevant and Timely) attribute, there is a trade-off between the degree of perfection and the cost of achieving it.
- The balance sheet is a snapshot of the financial condition of a company as of a point in time, while the income statement and the statement of cash flow tabulate all the transactions that have occurred during a period of time, i.e., between two balance sheet dates.
- The chart of accounts is an organized list of all the kinds of transactions that typically occur, so that transaction totals can be meaningfully grouped, summarized, and reported in financial statements.
- Accounting transactions are recorded in a balanced way, with each transaction affecting the scales equally, to ensure that the transaction has been recorded completely and correctly. If the

scales are always in balance, the balance sheet will always be in balance.

- Assets always equal the sum of liabilities and equity. Put another way, assets minus liabilities always equal stockholders' equity or owners' equity. As a result, increasing assets without increasing liabilities by a like amount increases equity. This is achieved in its simplest form when the company makes a profit.
- The accrual method of accounting is the standard for nearly all companies. Under the accrual method, transactions are recorded when an economic event has occurred, such as a customer buying a product or the company purchasing supplies. The results of these transactions are recorded, in general, as soon as the commitment to enter into the transaction occurs, not when cash is received or paid for the commitment, which might be much later.

The Balance Sheet: Basic Summary of Value of Ownership

- The balance sheet is the report of the company's financial condition at a certain moment. It will provide valuable information about the success of the company's cash management practices, its history of profitability, and the adequacy of its invested capital. Often the most valuable information it provides is simply showing the right questions to ask.
- *Current assets* and *current liabilities* are closely related. Current assets are very liquid and should be able to be converted into cash within a 12-month period. Current liabilities, in turn, must be repaid with that same 12-month period, usually from the cash raised out of the conversion of current assets. The difference between the two is called *net working capital*.
- A large amount of accounts receivable may look good on the balance sheet, but their collectibility is the most important issue, and that's not always apparent by simply looking at the total. Look at "Allowance for bad debts" and the customer-by-customer details to better understand the true quality of this balance.
- Inventory represents a constant management challenge and a relatively high-risk area for losses unless inventory management practices are solid. There are lots of ways inventory can cost a company money, including deterioration, obsolescence, and breakage.
- Accounts payable is the largest source of day-to-day financing for most companies. Delaying payment can provide temporary relief for cash-strapped companies, thus causing accounts receivable collection problems for their creditors.

The Income Statement: The Flow of Progress

- Don't get confused by the wide variety of line item labels on income statements. The labels are attempts to adapt to top management preferences or unique aspects of one company or industry compared with others. Look for the common thread, e.g., marketing is marketing, even if the label is a little different.
- Don't get tempted by accounting tricks. Remember that sales belong in the periods in which they were earned and completed, not necessarily where they look good.
- There are a few really key numbers on any income statement: sales, gross profit, operating income or EBITDA, and net income. These are the numbers that are most often used to measure profit performance by everyone who has an interest in the company.
- The income statement is the most familiar measure of a company's performance over a period of time. Its value increases substantially if it's compared with a benchmark, such as a budget, prior month, or prior year. The comparison enables you to better judge the company's perform-

ance.

Profit vs. Cash Flow: What's the Difference – and Who Cares?

- Cash flows throughout every company in an endless process that converts cash to operating assets and expenditures and ultimately back to cash again. The secret is to manage the process so that there's more cash at the end than at the beginning. The management challenge is to know how well you're succeeding at that when a company is operating normally, with many cash cycles occurring at the same time.
- Net cash flow is never the same as net profit; managers must track both to be well informed about the financial condition of their company. The best way to do that is to ensure that monthly financial reports are prepared that show both measures-cash flow and net profit.
- Managers in fast-growing companies always need more working capital to support growth. They should consider every opportunity to conserve cash for future growth by such means as financing large purchases and arranging backup lines of credit before they're needed.
- Businesses routinely take on obligations that require large amounts of cash, such as building inventories and extending credit to customers. Much of that investment is a necessary cost of doing business; however, keep in mind that every dollar invested in inventories and accounts receivable is at risk of loss before it again becomes cash.
- A forecast of estimated cash flow six to 12 months into the future is an excellent tool for management. It gives managers time to make decisions and arrange alternative sources that can prevent surprise cash shortages.

The Cash Flow Statement: Tracking the King

- The statement of cash flow fills a critical information need: it analyzes all the reasons that net income didn't produce an equal increase in cash in the bank. It's by far the easiest way to get that information.
- Cash is needed to finance customer purchases on credit. If accounts receivable is growing faster than sales, it's a cash drain for the company. This is often the largest cash requirement a growing company will have, and it cannot be ignored without risking impairment of essential working capital.
- Inventory is the second largest consumer of cash, and cash invested in inventory takes the longest time to be converted back into cash again. If inventory is growing faster than sales and expected future sales are not increasing correspondingly, the company may be wasting its cash and risking future losses on liquidation of old inventories.
- Investments in the company, purchases of assets, borrowing, and other activities to finance company operations and growth are activities that usually involve significant amounts of cash. They are most easily seen and tracked in the statement of cash flow.

Critical Performance factors: Finding the "Hidden" Information

- Critical performance factors (CPFs) are tools for tracking key indicators of success in a business. They're best accompanied by a benchmark or standard against which they are measured. They must be computed separately, because in most cases they don't appear on the basic financial statements.

- CPFs are most effectively used when a company identifies its most sensitive areas in sales, operations, and finance and establishes goals or standards for each area to be improved. Common financial CPFs include measures of financial strength, profitability, liquidity, and leverage. Key operational CPFs include relevant productivity indicators. Key sales CPFs should include sales backlog and sales force performance.
- Trends tell us what a single piece of data can never tell us-what the future might look like. The trick is to capture the right CPFs and to present them in six to 12 periodic readings, so that it becomes easier to see where they are going and whether action should be taken to encourage or counter that trend.

Business Planning: Creating the Future You Want, Step by Step

- The term "business plan" is really a generic label. It's important to determine the purpose of the plan, its intended readership, and what is expected of its readers, in order to know the kind and depth of material that it should contain.
- We all plan some of our activities, but the more complex the business activities to be managed, the more important to have a plan to guide them. If a plan is needed to manage a business activity, it should be in writing, to ensure it provides clarity, a roadmap to the desired end result, consistent communication of what is to be done, and the means to empower those who will carry it out.
- Goals must be crafted with care to be effective in driving performance. SMART goals encompass the key characteristics that make them most likely to succeed-or at least most likely to produce a clear and mutual understanding of what was expected and what was delivered. (Specific Measurable Attainable Relevant Trackable)
- Strategic plans are typically long-term (three to five years) and broad in their description of the goals to be achieved. Operating plans are usually short-term (one year) and more detailed in their description of the work. Strategic plans guide the operating plans. Operating plans guide the day-to-day activities that get work done. A realistic operating plan should define the goals the company wants each department to achieve and it should also outline the challenges they must overcome in order to reach the goals and how they will be met, for the plan to be both believable and achievable.

The Annual Budget: Financing Your Plans

- Every budget development cycle should begin with an estimate of the revenues the company can expect to earn. While this may first be announced as a management goal, it's critical for the sales department to accept as its own whatever sales budget is adopted. That usually occurs when it is directly involved in the revenue budget development process. There's always a good reason to spend money. Budget developers and approvers must always keep in mind the operating goals of the company for the period under review and not allow a "good reason» to permit a budgeted expenditure that's not in the best interests of meeting the company's goals.
- The budget preparation process is a trial-and-error process, because we're bringing together information from diverse sources to work toward a company goal. The chances of hitting that target on the first try are slim, so managers should simply expect to rework the budget at least once and accept the frustration of repeating their efforts, because a good budget is worth the work.

- Flexible budgets are an excellent tool for organizations with outcomes and costs that can vary widely. They are used when management wants to create a budget that does not reward the under spending that typically accompanies underproduction. A flexible budget enables adjustment of cost budgets to the level that would be expected at various levels of productivity, thus permitting measurement of efficiency at the actual level of activity. Remember the three magic questions for getting the most benefit from budget variance reports:
 - Why did it happen?
 - What immediate action should we take?
 - What are we learning that will make the next budget a better management tool?
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Recommendation: A welcome gift for entrepreneurs.

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Many CEO's find themselves asking "What now?" to sensitive situations that only an experienced former CEO can understand. Frumi is brought in to solve problems and often remains to work with you, as your confidante and secret weapon. She has an uncanny knack of getting to the heart of your corporate climate and maximizing your team's performance, profitability and sustainability.

To schedule a free ***Break From the Pack to Success*** consultation email

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