



# Counting the Beans: How Critical Is Good Financial Information, Anyway?

The members of every generation believe the business environment in which they work is tougher than ever before. Today we are no exception. Those who follow us will likely be no exception. Well, guess what? Everybody's right!

## Managing a Company in Today's Business Environment

As business gets more competitive, more global, more technologically driven, it gets easier for others to compete with you. It gets harder to be successful by just doing OK. It gets harder to launch a good product and enjoy the benefits of your innovation for a long time without serious competition. And, yes, it does get tougher to make a living. So what was good enough for our parents to be able to get by and make a "good living" isn't good enough today. You may have read that many of us will fail to achieve the relative standard of living that our parents did because of that tougher world out there. Of course, if you've

## 2 Finance for Non-Financial Managers

been alive for the past 10 or 15 years, you also know that there are unprecedented opportunities to create new wealth, new products, new companies, and new fortunes that never before existed. It's unlikely that our forefathers could have imagined fortunes being made, and lost, as quickly as they were in the '90s.

So it's hard to argue that times are more challenging now. The question is: what can you do about it? The answer: not much about the times, but a lot about how you prepare for them. And that's what this book is all about.

When I was a young boy, my father owned and ran a small grocery store that supplied the neighbors with their daily household needs, long before supermarkets killed the mom-and-pops that then existed in every neighborhood. When school was over, I went to the store to help out, because mom and dad were both working there. My first job was opening cases of packaged goods, pricing the packages, and stocking the shelves. Then I packed groceries and delivered them to customers, sometimes after taking their order over the phone and personally filling it. (Yes, that was how many small stores did business back then.) Then I graduated to cutting meat in the fresh meat department. By the time I was in junior high school, I was checking out customers, opening the store in the morning, and finally running the store when my parents went on a rare vacation. By the time I was in high school, I had run every aspect of a small business, including opening and closing the cash register and doing the bookkeeping at the end of the day.

In today's business terms, I had worked in shipping/receiving, warehousing and inventory control, production, sales, delivery, billing and collection, accounting, and management.

Uncommon today? Yes, and yet that diverse background is exactly what is being demanded more and more of today's up-and-coming professionals. Managers in companies large and small, including directors, vice presidents, and general managers, are finding their particular specialties aren't going to carry them to the finish line as they might once have.

Their first clue might have been the arrival of the personal

computer. Senior managers and company executives a generation ago were challenged by their lack of knowledge of this new tool, no matter how firmly they knew their own particular areas of expertise. The young professionals coming into the business often made their bosses look old-fashioned with their mastery of this impressive and intimidating technology. Soon, as we discovered, those young professionals had children, whose computer acumen after being on the planet for only a few years made even their savvy parents sit up and take notice. And so it goes.

Now, as we are learning, finance and accounting are having an impact on many companies in ways never before thought of by managers outside the financial department. The accounting scandals of 2002 showed that financial incompetence, or carelessness, or simply lack of integrity, could wipe out the efforts of thousands of loyal, hard-working employees. The report card, it seems, has become more important than it ever was when we were in school.

Today we're finding out that we need to know how to read a report card so we can just keep our jobs, let alone advance in our careers. Boards of directors now need to delve into the reports they have routinely received for years to a degree never before contemplated. They need to understand financial terminology and accounting methods they might previously have taken for granted. CEOs now need to be completely aware of what their people are doing and the financial ramifications, because they will no longer be able to credibly say they didn't know. And finally, managers within a company, whether large or small, are going to need to understand the rules of accounting and the boundaries of proper finance well enough to avoid getting into trouble just because they were aggressively trying to make their goals. As for those who aspire to become managers, they might not even get started up the ladder until they can demonstrate this kind of knowledge. So you see, it touches everyone.

Now, it's all well and good to say that accounting scandals will make everyone learn more about finance and accounting, but is that the only reason to know this stuff? Of course not!



**Budget** A projection of the detailed income and expenses that we estimate will occur in a future period, usually prepared on a month-to-month basis for up to a year. Each kind of income and expense is listed, along with the amount each line is expected to add to or subtract from the profit for the period.

Consider the new manager who is asked to prepare a budget for his or her department.

How do you begin your budget? Well, how about sales? Do you start with what you hope you can sell? What you're sure you can sell? What you sold last year or last month?

What will management believe?

OK, if that's too confusing, maybe you should start with expenses. What do you need to spend? What you spent last year or last month? What you hope you can get approval to spend? Do you actually know what it will really cost?


Just knowing where to begin is a challenge. And then how do you decide how much money or staffing you'll need to reach the goals you want to achieve or that your boss wants you to achieve?

Whew! Why can't Finance just do this for you?

And the truth is, of course, they really can't. Oh, sure, Finance can prepare something that looks like a budget and in many companies that's what happens. But then it's not really your budget; it's theirs. And if you miss the target they set, well, it's not really your problem, now, is it? Yet as managers we know that each department knows its unique needs and capabilities better than anyone else. And we know from Management 101 that a goal must be accepted—better yet, owned—by the people who actually will do the work, for there to be a strong commitment to achieving it. And that, simply put, is why each department within the organization must do its own budget and, therefore, why its managers must learn to budget effectively. And, yes, you will need to be able to answer, at some level, all the questions I've raised above. Happily, Chapter 10 in this book will help you do that.

## The Role of the Finance Department

The Finance 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"). Many of today's mid-sized and smaller companies don't establish separate Finance and Accounting departments within their organizations. A company might instead have a chief financial officer who performs or oversees the finance functions for the company and oversees the company's accounting activities. Larger companies will usually be fairly precise about their organization and are likely to have distinctly separate departments reporting to the CFO.



**Chief financial officer (CFO)** The job title of the executive who is in overall charge of all the financial department activities in all large companies and most mid-sized ones. Smaller companies might instead place their financial department under a vice president for finance or even a controller, depending on how they define the responsibilities of these people.

### Finance

The Finance Department can be an accumulation of diverse functions, depending on the company. It may oversee such areas as insurance and risk management, contract administration and pricing, internal auditing, investor relations, and more. But at a minimum, Finance will likely be responsible for treasury activities, often under an executive carrying the title of treasurer or vice president for finance. His or her role will likely include cash management, bank relations, investments, and everything having to do with making sure the organization has enough cash to do its job and has all its cash busily working or productively invested.

Major activities like mergers and acquisitions, attracting investors to a company seeking outside capital, and internal management of public stock offerings—all traditional roles of Finance—will usually fall within the Finance Department's



### **Don't Judge the Executive Book by Its Cover**

While we have tried to give you a general idea of what job titles might do which jobs, these are generalizations that do not apply to every company, and maybe not yours. Some companies are more liberal than others in granting titles. Still others might employ little-used titles such as “director of finance” or “vice president of administration” or even “manager of accounting” to indicate the head financial executive in their organization. It's best to obtain an organization chart or ask someone in Human Resources or the Finance Department when determining exactly who does what. It could save you embarrassment or, even worse, getting the wrong information.

responsibility. A company that decides to take its stock to the public marketplace for the first time—in an initial public offering (IPO)—will almost always place the coordination role for that transaction in the hands of the Finance Department.

### **Accounting**

The accounting job is typically done by the Accounting Department, led by an accounting manager, controller, comptroller, or similar title. These folks record all the transactions that occur as the company does its business and then prepare reports that help them, company management, and outside constituencies understand the financial impact of those transactions.

The accountants maintain the accounting software, process all the paperwork that documents transactions that have occurred, and record them into the company's general ledger. Most of these transactions are recorded in dollars and cents, or the appropriate foreign currency for operations outside the U.S. Some transactions keep track of other units of measure besides currency, such as the number of pieces of inventory in the warehouse, the number of vehicles in the company fleet, and so on.


Of course, keeping records of financial transactions tucked away in some computer serves no one unless we can get access to the information when we need it. So, from all those transaction records the accountants are able to prepare a vari-

ety of reports. Some are for people outside your company, like the government, your bankers, investors, and stockholders. But most important to running the company are the reports the accountants prepare for company managers, for it is those reports that managers use to understand their compa-

ny's financial past and make decisions about its financial future.

As you will learn later in this book, or as you may already have discovered the hard way, the readability of those reports is a huge factor in their value. Put another way, it's hard to use a report you can't understand, no matter how valuable the information it contains.

That, unfortunately, is the way some managers view the basic financial reports their companies' computerized accounting programs typically produce. (We'll discuss these reports in depth in Chapters 3 and 4.) Managers often have good reason to feel that way, it seems to me, because these basic financial reports were designed primarily for use by outsiders! Their purpose is to give a snapshot of a company's financial condition to people outside the company—bankers, government regulators, stock analysts, investors, and others who have no direct role in running the company. While that may be true, these reports still provide an essential summary of the company's monthly or quarterly operations in a standard format that is consistent and familiar, thus making them more credible and useful. They also serve as the basis for more tailored and typically more useful reports, which we'll discuss later on in this book.



**General ledger** The principal accounting record into which all transactions of the company are recorded and summarized. The general ledger is the record from which information for the basic financial reports is drawn. It varies greatly in appearance. These were once huge books maintained with carefully handwritten entries, but nearly all general ledgers today are produced by computer software.

## GAAP: The “Rules” of Financial Reporting

The standard format for recording and reporting financial trans-



Smart Managing

**You Don't Get What You Don't Ask For**

Some accounting departments produce reports that they never distribute outside their department, because no one has ever asked for them. These reports, perhaps produced as part of a standard computerized process or to serve a limited purpose in Accounting, might contain information you have been trying to collect on the back of an envelope for months. If they don't know you want it, they're not likely to go looking for you when it's printed. Ask what kinds of reports are produced that don't get distributed, just in case there is a gem hidden in that file cabinet. Of course, this also applies to reports that aren't printed but are accessible through your computer network.

actions is outlined in guidelines, or rules, called *Generally Accepted Accounting Principles* (GAAP). These guidelines are published by the accounting profession (with some gentle help from the U.S. government). They are intended to be the foundation upon which report readers can gauge a company's progress, compare one company or one accounting period with



**Generally Accepted Accounting Principles (GAAP)**

A set of rules, conventions, standards, and procedures established by the Financial Accounting Standards Board for reporting financial information.

another, and generally judge the financial effectiveness of its management efforts.

As we've seen, it doesn't always work out that way, but that's not necessarily because the rules are flawed. The job of creating

comparable accounting and reporting standards for businesses as widely varied as those operating today can be a daunting task for the folks who set the standards. The objective of each accounting rule is to record a transaction so that it makes economic sense for the company and for readers of the company's reports. Yet to achieve that objective, accountants in two dissimilar companies might need to record the same transaction differently.

We will devote a fair amount of time in this book to helping



### Are All Fords Created Equal?

Two companies purchase identical Ford Taurus automobiles. Company A will use its vehicle for occasional corporate visitors, so it's expected to last about five years. Company B will use its vehicle as part of its fleet of taxis, so it's expected to last about 18 months. Over which of the following periods of time would an accountant depreciate or expense the purchase?

1. five years
2. 18 months
3. three years (an average)
4. different lives in different companies, based on their actual useful life in those companies

The choice will affect the profits of any company that buys cars. The choices that companies must make to reflect their particular realities might lead to confusion and misstatement. However, setting one absolute rule for all companies would create different confusion, perhaps greater. Thus arose the concept of generally accepted accounting principles, rather than absolute rules. These principles have been the basis for reasonable estimates and unreasonable abuses for many years, with the abuses getting a lot more press as this is written.

Incidentally, the answer is 4.



you understand how to read and use these primary financial statements, prepared in accordance with GAAP. We will also discuss other, special-purpose reports that company management may find more useful for internal purposes. Our comments will in all cases assume the use of GAAP, except where we specifically note exceptions.

## The Relationship of Finance and Accounting to the Other Departments

The Finance Department in every company has in theory two primary areas of responsibility:

- To safeguard the assets of the company by properly accounting for them, instituting internal controls to prevent their misuse or loss, and generally monitoring their proper use. In this role, Finance becomes something of

## 10 Finance for Non-Financial Managers

a policing activity, making sure others don't damage the company through their actions.

- To organize all the data that it collects from company transactions and to present that data in a form that everyone in the company can use to more effectively manage their own functions and the company as a whole. In this sense, Finance provides information to help other departments—its customers—do their jobs.

While these functions should generally carry equal importance to the management of a company, they are not always carried out with equal enthusiasm by financial departments. In some companies, financial departments are more recognized for assertive policing than for serving the users of financial information. Policy constraints and procedural labyrinths seem to be the predominant preoccupation of these accountants, to the frustration of many outside the Finance Department. Yet, in other companies, the strong direction of operationally driven management can result in a financial department that is totally occupied with servicing a continuous flow of requirements for ad hoc information, at the expense of the protection function. In these companies, folks outside of Finance get their needs met, but auditors and others outside the company may be concerned about the safety of the company's assets and the efficient use of its resources.

In a perfect world, then, these functions would be balanced in a way that serves the best interests of the company's owners. A financial department that implements adequate internal controls and then enforces them with appropriate levels of enthusiasm would have time and resources to serve the reasonable information needs of the enterprise as well. However, in reality, finding this balance is one of the most challenging management jobs in the company.

## Manager's Checklist for Chapter 1

- ❑ 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.