SIGNATURE ANALYTICS

Do you know your numbers?

A guide to what successful businesses should expect out of their finance and accounting department.

Knowing Your Numbers eGuide

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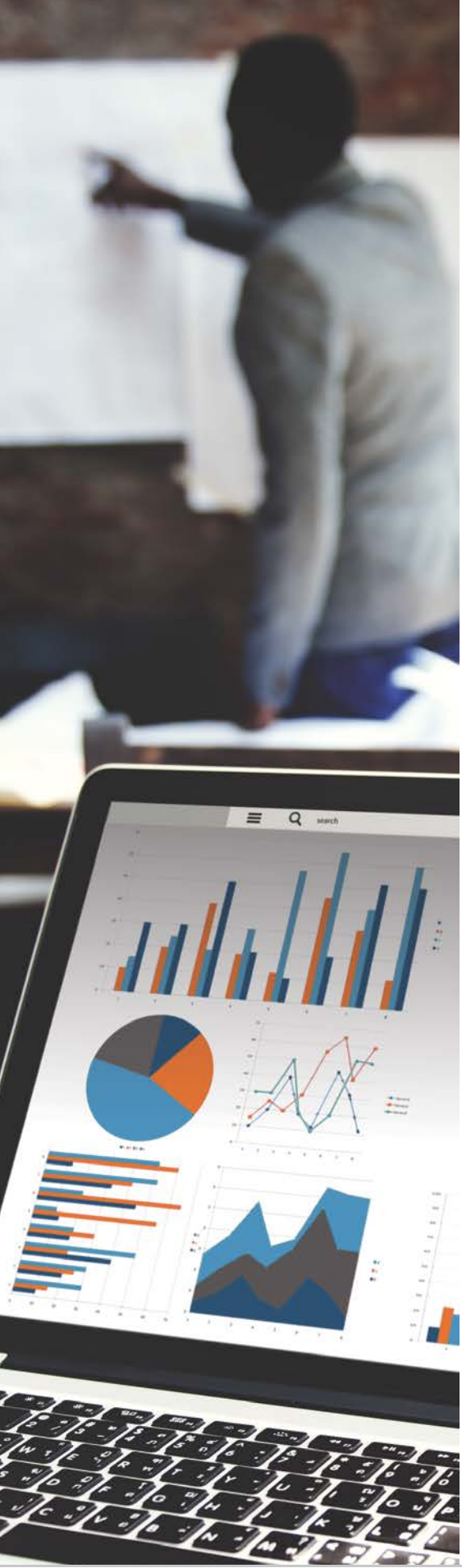
A guide to what successful businesses should expect out of their finance and accounting department.

You **can't manage** what you **don't measure**. Too often, we don't have accrurate, relevant, or timely information or simply don't know how to assemble it.

This guide will discuss what business owners should do to ensure they develop the right reports and metrics to **improve** their business performance and **achieve** their goals.



Make **Better** Decisions with More **Accurate** Information

Foundation of Good Information

When San Francisco's Millennium Tower opened in 2009, the flashy 645 foot-tall, reinforced concrete structure was designed to resemble a translucent crystal.[1] From former NFL players to VCs, and tech powerhouses, the lavish multimillion-dollar condominiums had piqued the interest of the city's financial elite.

Within just a few years, cracking along the basement walls had not only become noticeable, but they were also spreading. By 2016, residents of the award-winning tower received notices that the structure was sinking into the mud and beginning to tilt. The culprit? The stability of the foundation.

Like any centuries-old building, a solid foundation is key to long-lasting prosperity, which is the same for any business. A business built upon a weak foundation is akin to constructing a building on sinking ground. Similar to how a structural engineer ensures a building doesn't collapse, a business owner must ensure the company's stability by discovering the elements for establishing, building, and maintaining a foundation of good information. If you ignore the components that are critical to creating a robust foundation, and even the most acclaimed infrastructure can fail.

People

A solid foundation starts with your team, so it's critical to have the right people in the right role with the appropriate expertise for the task.

Many companies fall into the trap of promoting low-skilled employees into positions where they have no training, education, or experience to effectively meet expectations. For example, they promote a bookkeeper to take on more challenging and complex accounting and reporting functions without any oversight or supervision. While the bookkeeper is excited about the increase in compensation and responsibility, they lack the proficiency and knowledge to perform the new tasks.

The opposite side is hiring high-level employees and having them perform tasks that they are overqualified to do. For example, hiring a controller who performs a significant amount of data entry. This action leads to low job satisfaction and high turnover, and as a result, attracts mediocre talent to the role and leaves companies to question why they don't get what they need from their accounting team.

Most small and medium-size businesses fall into these traps because they don't need full-time resources for each role. That is where a fractional finance and accounting firm can support the business by bringing in the appropriate resources at the proper level for the time it takes to do the work. As the company grows, it will eventually make sense for the company to hire full-time internal employees to serve its needs and achieve the best value.

Structure

Similar to how an office building, sports arena, and a house are each structured differently based on their purpose, the way you track your financial information depends on the specific goals you've set for the business. The foundation of the structure of your financial information is called the General Ledger.

The general ledger provides a complete record of financial transactions over the life of the company. The ledger holds account information that is needed to prepare financial statements and includes accounts for assets, liabilities, owners' equity, revenues, and expenses.[2]

In other words, the general ledger contains all the buckets you are going to use to track the financial aspects of your business. It's important to think through the drivers of your business in relation to your goals when the general ledger is being set up. Why? Your General Ledger encompasses all the company's transaction data, which is needed to produce the income statement, balance sheet, and other essential financial reports.

For example, a company planning to expand into multiple geographies will want to set up its general ledger to be able to track revenue and expenses by location to understand trends and results. The same is true for a product company wanting to track each SKU separately to understand profitability by product.

Proper structure of information is critical for future analysis and understanding. If all your data is in generic buckets, like revenue, you won't be able to report on the drivers and issues in your business efficiently, nor with any real consistency.

Process

"The average embezzler [is] a small-business, middle-aged employee who works in the accounting and finance department." -Inc.[3]

Accounting touches every part of your business. The typical business loses 5% of annual revenues or an average of $120,000 to fraud.[4] So, while an inefficient accounting team creates inefficiencies across your business, inefficient processes, or a lack of processes altogether allow unscrupulous people to steal from you. Defined processes not only severely reduce the risk of fraud but improve overall efficiency.

Newer businesses will frequently have limited or unwritten processes. However, processes should evolve as the company grows. Without processes in place, business owners will see a lack of accountability among the team. Though cash flow is the lifeblood of businesses, we often see inefficiencies with invoicing and collections. How difficult is it to get an invoice to a customer? What happens when a customer doesn't pay within the terms? Whose job is it to pick up the phone to make that call to them?

Processes ensure timeliness and consistency. A good process ensures that invoices are followed-up with some form of communication confirming that the client received the invoice, that it has been put into the system, and that they have received all the documentation backup in order to get paid.

Are the right processes in place to drive the success of your organization and protect you against fraud?

Technology

Everything from your accounting software to your CRM and how your HR payroll is managed, should be aligned with your business approach and future strategy. The utilization of current technologies and accounting systems maintains efficiency and creates scalability within a company.

Not all accounting software is created equal. Just because it tracks transactions, enables you to cut checks, and is affordable, doesn't mean it's the right fit for your business. Before investing in a new tool, find software that integrates with your current applications. Many small and midsize businesses use accounting software like QuickBooks, Netsuite, Sage Intacct, and Xero. While all are good accounting systems, some software is better suited for specific industries and circumstances over others. Also, if you are using a very old version, consider upgrading to the current version to gain access to great new features and benefits.

In addition to good, up-to-date accounting software, there are some great tools that help streamline your accounting. For example, Bill.com[5] allows small and midsize businesses to receive, route, and pay invoices electronically while integrating with other popular accounting software, including QuickBooks. So if your accounting team is still manually printing and inputting transactions, it's time to evaluate modernizing the technologies your business has in place.

Whichever accounting software and tools your business purchases, the key is to ensure they all sync and work together to drive efficiency and save you time and money.

You **Can't Manage** What You **Don't Measure**

Key Reports to Manage a Business

With the right people doing the right job, accurate information in the proper structure, and efficient processes in place, you can start consistenly creating **A**ccurate, **R**elevant, and **T**imely (ART) financial reporting.

Accurate means that the information you are looking at is correct, and you trust it. Easy right? That's not always the case. We often find that due to a lack of processes, controls, and structure, data validation for history and current financials is a necessary step in our approach to working with clients.

Relevant means receiving reporting that makes sense for the business and not just canned reports from the accounting system that might look important but doesn't really tell you anything insightful or actionable. This type of reporting often includes information from other systems like CRM, operations, marketing, and HR. We often see canned reports when we first engage with a client that does not make valuable decisions for the company.

Timely means getting the information relatively soon after the end of the period. That may be the 5th business day, the 15th business day, or any other time frame that works for your business. We have spoken with many business owners who hadn't seen a financial report for over three months, and as a result, causing them to make bad decisions due to the lack of information. When was the last time you saw your financial reports?

Key reports that are critical to managing your business:

Income Statement

The income statement reports a business's financial performance over a specific period. It's tempting to want to break out every expense in the income statement, but at the end of the month, the single line item noting the $10 spent on parking doesn't contribute to the bigger picture. A 5-page income statement printed from QuickBooks is a sign that you need to reevaluate how your income statement is structured.

The income statement should show the results of your business, helping identify key areas of concern, and where to focus efforts. All expenses should be allocated at the appropriate level into the correct accounts, allowing you to identify any significant fluctuations.

Balance Sheet

The balance sheet provides a good idea of your company's financial strengths and weaknesses, showing cash position, assets, accounts receivable, inventory, and who the business owes (line of credit, credit cards, payables, accrued expenses, or long-term debt).

Are you thinking about financing your company? Lenders look at a business balance sheet, so business owners need to understand and be able to articulate the details of the balance sheet in relation to the health of the company.

Cash Flow Forecast

Because cash is king, all businesses should have a cash flow forecast. Starting with how much money is in the bank, a rolling weekly cash flow forecast should then be broken down into what is due that week, including incoming cash flows (receivables) and expenses such as rent, payroll, and office expenses. This section should have loan payments and equity distributions broken out.

Why is having a cash flow forecast so important? Because even a profitable, growing business can go bankrupt if they fail to manage their cash flow. For example, a company with $50,000 cash in the bank is expecting an additional $50,000 in accounts receivables to be paid that week. If their expenses (accounts payable) are more than $100,000, the company will show negative cash flow. If only $20,000 of the expected $50,000 in accounts receivables are collected that week, difficult choices will need to be made on accounts payables. This is why it's important to have a cash flow strategy in place.

We recommend that businesses build a cash flow forecast report at least 13 weeks out, then update it weekly. Having visibility into the future helps manage your week, along with your cash flow actions. This report will help you know that you need to get financing significantly sooner than if you were watching your bank account balance. It can be used as a model to make decisions and understand the effects of buying more inventory or equipment. Using a cash flow forecast report when adding new clients can help to illustrate the impact of growth on your cash.

Budget

A budget is a financial plan, or document, over a specified period of time. Many companies don't create a budget at all or create an annual budget and then put it away until the next year. Building a budget is useless if it's not put into action. Instead, create a budget that allows your business to compare actual performance to expected performance.

Creating a budget forces you to think about how revenue comes in (cyclical vs. noncyclical) when expenses occur, and what you need to do to achieve the results and goals. It is a great exercise to ensure you have your arms around your business and allows you to plan and be proactive versus reactive.

Flux and Trend Analysis

Understanding how account balances can vary from month-to-month, quarter-to-quarter, and beyond can be incredibly insightful into the numbers of a business.

Flux analysis, sometimes called Fluctuation or Variance Analysis, is this type of process. It will include dollar and percentage changes and will indicate why the numbers of the account are different between the two periods of time compared.

Insights that come from this analysis are powerful, as they expand on what forecasting and budgeting already illustrate. When monitored consistently, this process can be one of the most effective ways to mitigating and managing risks. Most accounting teams will skip this process altogether as it takes some time. However, at Signature Analytics, our team uses FloQast software to help with Flux Analysis so that you always receive the most insights into your companies numbers.

Trend Analysis is another way to collect valuable information from the business that can provide insight into any trends, inconsistencies, or seasonality over a period of time, but 12 months is most common.

Ideally, using Trend Analysis, there will be specific patterns that stand out and that can be rectified through a particular course of action. Some of the patterns that might stand out may include declining sales, unusual expenditures of certain line items, or expense reports with fraudulent claims. Any of these points of analysis can be incredibly beneficial to a business, and the information found can help determine where the company needs to make adjustments.

Avoid Making the **Wrong Decision** with **Bad Data**

Metrics & Analytics

Because it's easy to fixate on the bottom line, business owners put less consideration into what inputs are needed to generate outputs. Understanding the difference between metrics that measure inputs versus metrics that measure outputs is key to making the bigger picture happen.

For example, if a company's goal is to make $15 million dollars in revenue this year, what inputs will help accomplish this output? A company may consider hiring more salespeople or increasing the number of sales calls made per day.

How does a company know what additional inputs will help them reach their output goals relating to overall business objectives? At this point, this is where having useful data is critical.

A good key performance indicator (KPI) should act as a compass, guiding your business down the right path toward your strategic goal. Tracking KPIs will give you a better understanding of the sustainability and trends within your business and keep a close handle on the financial health of your business.

As a business owner, it's essential to understand the metrics being measured, how to calculate them, and why they're important. Whether the objective is acquiring more capital to grow the business, further developing the company for the next generation to take over, or selling the company, each metric should matter to the business' overall objective.

We have created several **best practices** to keep in mind when developing **key metrics** for your business:

- Each business is unique and there are **no magical metrics**
- Metrics should **tie to the ultimate objective** of the business owner or CEO
- Metrics should be **meaningful, measurable, manageable,** and **repeatable**
- Focus on a **few key metrics** versus pages of metrics
- Do something with them

Having good data enables business owners to dig into problems and solve them. If you have access to good data, you can do the analysis to understand trends, results, operational efficiency, and more.

For example, if your business is a service company, then understanding utilization is very important. With the right data, you can look at utilization by the client, the employee, the office, or by title, etc. This allows you to understand the details of your business for a specific period or over time and to find the source of the problem, enabling you to solve it.

Another example:

Cost of Goods Sold (COGS) should be tracked at the product level. For instance, a medical device manufacturer might track the COGS for an immunology testing kit versus their autoimmune testing kit.

If the gross margin for their immunology testing kit is 55%, but the autoimmune testing kit's gross margin is 75%, the biotech company needs to research the cause of the margin difference. Knowing margins by product line beyond the company's overall revenues allows for smarter business decisions to be made and the right questions to be considered.

Beyond understanding individual product lines, understanding total COGS for a company's brands can lead to better decision making. Perhaps a brand's margins are healthy, but the company is losing market share. In this type of scenario, the company has the option to reduce prices to support the overall brand. Or perhaps a money-losing brand is bringing down the profits of the entire company. If the costs of that brand cannot be reduced to bring the margin to acceptable levels, it might be time to divest that extended brand and focus on the brands that positively contribute to the company's goals.

With the **right information**, businesses can **make decisions** critical to the health of the business **quickly and efficiently.**

We recommend that companies focus on 3-5 key metrics at a time. As your business and your goals evolve, the metrics you are measuring should be updated and changed to remain aligned with your needs.

Having a **strong foundation** of information in place ensures business owners develop the **right reports** using the **right metrics** and make the **right decisions** to achieve their goals. From good information, your business will continue to **improve** and **achieve ongoing success**.

Let us ask you one final question:
do you know your numbers?

When deciding **which metrics tie to the ultimate objective** of your business, it may be beneficial to seek advice from industry experts to ensure you **don't waste time and money.**

Contact Signature Analytics and Ask the Experts

Phone: (888) 284-3842 / **Email:** info@signatureanalytics.com

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