CHAPTER 1

CHIEF FINANCIAL OFFICER'S REPORTS

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The chief financial officer must communicate important and accurate financial information to senior-level executives, the board of directors, divisional managers, employees, and various third parties. The reports must be prepared in a timely fashion and be comprehensible and relevant to readers.

The needs of management differ among organizations. Management reports should be sufficiently simplistic in order to enable the reader to concentrate on problems and difficulties that may arise. The reports should not be cumbersome to read through; they should be consistent and uniform in report format. The facts presented should be based on supportable financial and accounting data. The CFO should use less accounting jargon and more operating terminology when reporting to management. Also, the reports should generate questions for top management discussions.

What are prospective financial statements?

Prospective financial statements include financial forecasts and projections. This category excludes pro forma financial statements and partial presentations.

Financial forecasts are prospective financial statements that present the company's expected financial position as well as results of operations and cash flows, based on assumptions about conditions actually anticipated to occur and the management action expected to be taken.

A financial forecast may be presented in a single dollar amount based on the best estimate, or as a reasonable range. However, this range cannot be selected in a misleading way.

In contrast, financial projections are prospective statements that present the company's financial position, results of operations and cash flows, based on assumptions about conditions anticipated to exist and the action

management is expected to take, given the hypothetical (what-if) assumptions.

Financial projections may be most useful to limited users, who seek answers to questions involving hypothetical questions. These users may want to change the scenarios based on expected changing situations. A financial projection may contain a range.

A financial projection may be prepared for general users *only* if it supplements a financial forecast. However, financial projections may not be contained in general-use documents and tax shelter prospectuses.

What should be contained in financial forecasts and financial projections?

Financial forecasts and financial projections may be in the form of either complete basic financial statements or financial statements containing the following minimum items: sales or gross revenues; net income; gross profit; basic and basic diluted earnings per share; income from continuing operations; income from discontinued operations; unusual income statement items; tax provision; material changes in financial positions; and summary of significant accounting policies and assumptions.

Management's intent of preparing the prospective financial statements should be stated. However, there should be a mention that prospective results may not materialize. Also, it should be clearly stated that the assumptions used by management are based on information and circumstances that existed at the time the financial statements were prepared.

What are the various kinds of planning reports that can be prepared?

The CFO can prepare short-term companywide or division-wide planning reports. This includes the forecasted balance sheet, forecasted income statement, forecasted statement of cash flows, and projections of capital expenditures.

Special short-term planning studies of specific business segments may also be prepared. These reports may relate to: product distribution by territory and market; product line mix analysis; warehouse handling; salesperson performance; and logistics. Long-range planning reports may include 5- to 10-year projections for the company and its major business segments.

Specialized planning and control reports may include the effects of cost-reduction programs, production issues in cost/quality terms, cash flow plans for line-of-credit agreements, evaluation of pension/termination costs in

plant closings, contingency and downsizing plans, and appraisal of risk factors in long-term contracts.

Why are information reports useful?

The CFO may prepare information reports for other members of top management. The reports can show and discuss long-term financial and operating trends. For example, the reasons and analytical implications of trends in revenue, production, and costs can be presented over the last three years. Although the format of such reports may vary depending on the environmental considerations and user needs, graphic depiction is often enlightening.

How can reports be used to analyze and control operations?

Reports can be prepared dealing with controlling financial activities and related analytical implications. Analytical procedures include comparing financial and nonfinancial information over time. The reports can highlight the reasons for significant change between prior and current year performance. For example, a sharp increase in promotion and entertainment expense or telephone expense may require investigation. Analytical reports are also used to summarize and evaluate variances from forecasts and budgets. Appraisal of variances may be by revenue, expense, profit, assets, product, division, and territory.

Why are exceptions to the norm significant to note?

Exception reports present detailed enumeration of the problems and difficulties faced by the business over a given time period. Such reports might zero in on internal control structure inadequacies or improper employment of accounting or auditing procedures in violation of generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS). Exception reports should be automatically outputed by the computer when a red flag is posted, such as when a customer's balance exceeds the credit limit.

What should the board of directors know?

The board of directors is usually concerned with overall policy matters, general trends in revenue and earnings, and what the competition is doing. It is also interested in short-term and long-term issues. Relevant information in reports directed to the board of directors include company and divisional performance reports, historical and

forecasted financial statements, status reports applicable to capital expenditures, and special studies.

What special occurrences should be reported?

Special situations and circumstances may occur requiring separate evaluation and study. For example, it may be necessary to identify the cause for a repeated decline in profitability of a given product, service, or territory. There may be a need for a feasibility analysis of whether to open a new store location or plant. Other reports may be in connection with union negotiations, commercial contract reviews, pension plan administration, bonus plans, and product warranty issues. It is essential that the reports contain narrative and statistical analyses of the decision with graphic presentations as needed.

What reports may segment managers find useful in decision making?

Reports prepared to assist divisional managers in evaluating performance and improving operating results include: dollar sales and volume; profitability by product line, service, project, program, and territory; return on investment and residual income; divisional contribution margin, segment margin, and short-term performance margin; actual and budgeted costs by cost center; cash flow; labor and plant utilization; backlog; and comparisons of each division's performance to other divisions within the company and to competing divisions in other companies.

The CFO should determine whether current reporting may be improved. In one case, the author consulted with a company in which a maintenance and repair department manager prepared reports focusing solely on machine downtime. The reports concentrated on expenditures for repairs due to equipment breakdowns. Instead, the author recommended that the focus of attention should be on improving the productivity of manufacturing facilities. Hence, it is more constructive to look at uptime (machine usage) rather than downtime and to allocate resources accordingly. A machine uptime index may be computed. The production cycle period may also be analyzed. This is the time between the receipt of an order and delivery to the customer, which should be monitored on a regular basis.

How can reports be directed to improving quality?

Reports can be prepared with the view of improving the quality of goods and/or services while controlling

costs. What is the cost-effectiveness of contemplated quality improvements? Of course, there is a trade-off between better quality and increased costs. Attention should be directed to curing defects that cause project delays. Cost considerations include overtime, rework, scrap, and capital outlays. The reports should concentrate on the accumulated costs of actions that promote quality. The costs include material inspection, quality control, preventive maintenance, and sampling. The CFO should also consider the increased costs associated with poor-quality products and/or services, such as warranties, promotional expenditures to improve the company's image, and legal liability settlements.

What types of information might interest employees?

Reports can be directed toward the interests and concerns of employees and contain this information: revenue and/or profitability per employee; revenue relative to employee salaries; assets per employee; profit margin; sales volume or service hours; investments made to directly or indirectly benefit employees; explanation of changes in benefit programs (e.g., health insurance, pension plan); percentage increase in salaries, fringe benefits, and overtime; dividends relative to wages and number of employees; corporate annual growth rate; comparison of employee salaries to that of competing companies and industry averages; real earnings after adjusting for inflation; analytical profit and cost information by responsibility center; assets by business segment; future prospects and problems in the company, industry, and economy; breakeven point; actual and expected production; employee safety; compliance with federal, state, and local laws pertaining to employee working conditions; sources of financing; nature and type of assets held; and overall financial health of the company. (See Exhibit 1.1.)

GOVERNMENTAL REPORTING

The CFO may have to prepare reports to federal, state, and city governmental agencies. Antitrust laws, environmental protection laws, pension laws, product liability laws, pollution laws, laws governing international trade and commerce, and tax laws are but a few of the myriad reports with which the company must contend. Penalties may be assessed for failing to file reports on time.

	Total Amount	Amount per Employee	Costs per Dollar of Receipts
The Business Received			
From customers for merchandise or services performed			
Interest			
Dividends			
Total amount received			
Business Expences Incurred:			
For raw materials, supplies, and other expences			
Depreciation			
Taxes			
Total expenses			
Residual for salaries, dividends, and reinvestment in the company			
This was divided as follows:			
Paid to employees (excluding officers) as salaries			
Paid for employee fringe benefits			
Total			
Executive salaries			
Executive fringe benefits			
Dividends to stockholders			
Reinvested in the company for expansion			
Total division			

Exhibit 1.1 ABC COMPANY STATEMENT OF REVENUE AND EXPENSE FOR EMPLOYEES FOR THE YEAR ENDED DECEMBER 31, 20XX

What does the New York Stock Exchange want to know?

The listing application to the New York Stock Exchange contains an agreement to provide annual and interim reports including financial statements and disclosures. The reports are filed on a timely basis because the information they contain may have a material influence on the market price of stock, bond ratings, and cost of financing.

REPORTING UNDER THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 has had a significant impact on CFOs and their reporting responsibilities. It has changed how public companies are audited, and has made adjustments to the financial reporting system. The Act has also created a Public Company Accounting Oversight Board (PCAOB) to enforce professional standards. In

addition, it has increased corporate responsibility and the usefulness of corporate financial disclosure. CFOs must personally attest to the truth and fairness of their company's disclosures. These provisions and requirements are promulgated under the Act as it applies to CFOs:

- CFOs cannot engage in any action to fraudulently influence, coerce, manipulate, or mislead the independent auditor.
- CFOs must certify in the annual report that they have reviewed the report and that it does not include untrue statements or omissions of material information.
- CFOs must establish and maintain internal controls to ensure proper reporting.
- CFOs are prohibited from falsifying records.
- Pro forma financial data in any report filed with the Securities and Exchange Commission or in any public release cannot include false or misleading statements or omit significant information needed to preserve the integrity of the financial data.
- The company's audit committee is responsible for the selection and oversight of the auditing certified public accounting firm.
- An independent audit committee is required.
- No insider trading is allowed during pension fund blackout periods.
- Significant off-balance sheet transactions, arrangements, obligations, and other relationships must be disclosed. Disclosure must be made on material aspects related to financial condition, liquidity, resources, capital expenditures, and components of revenue and expense.

OTHER REPORTING

Many groups compile statistics on business performance, such as trade associations, state commerce departments, federal bureaus and agencies, and credit agencies. Questionnaires and reports of a wide scope are received and completed.

The CFO's role in reporting information cannot be understated. Besides the ability to formulate relevant financial and nonfinancial data, the CFO must be able to effectively and efficiently communicate to management, employees, government, investors, creditors, and other interested parties. Financial reports should be submitted in a timely way so that up-to-date information is available for decision-making purposes.