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Musings

#60: You must be a Pseudo-Accountant
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Even if you are not from the finance department, you must be comfortable reviewing financials and understanding the numbers. This is not something that you can just blindly depend on finance to do. The numbers are the ultimate report card of the business. Despite the craziness of Silicon Valley, if a business cannot drive enough revenue to cover its expenses and deliver profits, it does not have value. In fact, the level of profits and the return on the shareholders equity need to exceed those of safer alternatives. The numbers tell you if you are creating value by growing revenue and free cash flow.

If you somehow left college or grad school without taking financial accounting, take it now. You must understand GAAP and debits / credits. You need to know how the three statements: income statement, cash flows and balance sheet interact with each other. You need to review the footnotes of audits which often provide hidden treasures of information.

There are two components to good financial management: (1) accounting and (2) financial, planning and analysis (FP&A). Simplistically, the accounting side is keeping score by booking entries. You should close your books every month and get a GAAP compliant set of financials within a couple weeks of month end. Instill the discipline of having the close done by the 15th of the following month and don't let it drag. You should also have audits done every year as a matter of good governance.

FP&A is where you do your analyses and especially your projections. You should have a rolling four quarter set of projections (all 3 statements). This basically involves building a model that gets updated every month so you have visibility on where you are going. Without forecasts, you are always talking yesterday's news when reviewing financials and cannot be managing forward.

Key to the model will be the assumptions and these should be highlighted on the first page and easily changed so you can see how key metrics drive results. Remember you want to look at YoY (year over year) growth rates of all key revenue and expense lines as well as the common size income statement showing margins. Revenue should be growing faster than every expense line thus giving you increasing margins and faster growing profits.

The invention of excel has been great but dangerous. Underneath this model will be formulas developed by your FP&A staff that they could get wrong. I recommend you literally get out a pencil and calculator and spot check some of the numbers. You can't just assume they got it right. My experience is this tactile activity can also help with comprehension. You should also play with the assumptions and see if the resulting changes in the forecast make sense.

I would make your lead finance executive present the numbers every month to the team in an M,D&A style reviewing top trends and drivers. Often folks in these fields are less comfortable presenting so make them get up in front and do it publicly to help develop this game. You might also assign other executives to present the numbers to ensure their comprehension and develop their finance skills.

Be safe. Work hard.

Jml

Second Thoughts

To have economic growth over the long term, you need population growth. The U.S. is headed for trouble unless we start having more babies (Heather and I did our share). According to the WSJ: *the total fertility rate—a snapshot of the average number of babies a woman would have over her lifetime—ticked down to 1.7 in 2019, a slight decline from the previous year and another record low. In almost all years since 1971, that rate has been below the level of 2.1 needed for the population to replace itself, without accounting for immigration.*

Love this which was posted in sub Reddit by University of Chicago student: