
COMMUNICATE OR DIE!

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Let me be as frank and blunt as possible to start this book, keeping in mind that the following statement is coming from an accounting and financial professional that has spent the better part of his entire career, almost 40 years, primarily “crunching numbers” (for lack of a better term) and on occasion, writing a book or two.

Writing a financial report cannot be achieved unless you can effectively communicate. Period!

When I mean communicate, I mean it in the broadest sense possible as communication skills extend far beyond what a typical financial or accounting professional may view as representing essential communication skills such as simply stating that 2 plus 2 equals four. What you will quickly learn from this book is that in order to effectively communicate, you must be able to speak, listen, observe, write, read, calculate, educate, lead, interpret, analyze, and direct, all equally well, and be able to package and present your financial report and deliver it via a story to your target audience in a format that they can understand, trust, and believe.

As you work through this book, a primary goal will be to find the proper balance between helping you (in the role of producing a financial report) understand how to prepare best in class financial reports as well as assisting you (in the role of student attempting to learn more about financial reports and financial statements) to expand and improve your knowledge of accounting and financial concepts and topics.

To start, I'll warn you that I tend to emphasize using acronyms to remember key concepts, so out of the gate keep in mind the acronym FIK, which stands for fundamentals, interest, and knowledge. That is, you must have the proper *f*undamentals to write and communicate (e.g., can you structure a sentence?), have an appropriate level of passion and *i*nterest in the subject matter

(nothing more painful than reading content that the author has limited interest in), and have advanced *k*nowledge in the subject matter (to ensure your target audience understands the financial report and the conclusions you're drawing).

To help you navigate the book, I have prepared this simple summary of the book's structure that covers the how, who, what, where, and why of preparing financial reports:

- ♦ Chapter 1, How to Communicate Financial Information: To start, I dive into the subject matter of How to Write a Financial Report, focusing on strategies, techniques, etc. that are essential to the process of communicating financial information in financial reports. Further, I expand on the “how” to communicate concept by diving deeper into a simple but powerful acronym CART (covered in Chapters 4 and 5). This stands for providing Complete, Accurate, Reliable, and Timely financial reports.
- ♦ Chapters 2 and 3, Who Are You Communicating Financial Information To?: Next up, I then turn the book's attention to gaining a better understanding of your target audience, both between external users of financial reports and information and internal parties such as board members, the management, and others. If you don't have a clear understanding of who you are communicating to, not only do you run the risk of having your financial report get lost in translation but more importantly, you may be preparing financial reports that contain vital and confidential financial information that falls into the wrong hands.
- ♦ Chapters 6 through 10, What Financial Information Are You Communicating?: An entire section of the book has been dedicated to gaining a better understanding of what financial

information you will be communicating by providing a thorough understanding of the big three financial statements (i.e., the income statement, balance sheet, and statement of cash flows), why developing best in class financial forecasts should always be a priority, and closing out our discussion on revisiting the importance of gaining a handle on how financial statements and financial information are connected.

- ◆ Chapter 11, *Where Does Financial Information Come From?*: In this chapter, I move my attention to gaining a better understanding of where critical financial information comes from that will be presented in a financial report. Simply put, I spend some time helping you as a reader understand basic concepts associated with accounting and financial reporting systems, basic accounting principles and concepts, and other critical information.
- ◆ Chapters 12 through 15, *Why Are You Communicating Financial Information?*: Finally, I cover the subject of why you are communicating financial information. Of course, this should

be obvious as any type of business, organization, governmental entity, etc. needs to ensure it has CART financial reports on which to base sound economic decisions. In these chapters I offer real-life examples of different internal and external financial reports, as well as tips and tidbits on making sure your financial statements are more effective in delivering the Why!

Finally, I would like to mention that throughout this book, I sometimes will use the phrases of financial information and financial reports interchangeably. To be clear, financial information really represents the source accounting and financial data that needs to be communicated in a financial report. Or thinking of it differently, you cannot produce a reliable financial report without having quality financial information and vice versa; having quality financial information unto itself does not mean a business will have access to a reliable financial report. Both are highly connected and are dependent on one another, but it is important to not confuse these two concepts as one does not automatically produce the other.

Remember the Basics

To master the art of preparing the most effective financial reports, you will gain a new appreciation of just how important developing communication skills is and why, in all the books I've written by myself and/or in partnership with my late father, five critical concepts should be kept in mind at all times:

- ♦ **Accounting – Art vs. Science:** Accounting is just as much an art form as it is a science. I, along with my late father, have driven home this concept, time and time again, in the books we've published including our sister book to *How to Write a Financial Report*, *How to Read a Financial Report* (10th edition), *Accounting for Dummies* (7th edition), and others. As you will discover reading this book, writing a financial report is often even more of an art form than having to apply generally accepted accounting principles (i.e., GAAP) to produce financial statements. Examples will be provided throughout this book.
- ♦ **Financial Report Range:** The concept of a financial report is extensive, broad, and extremely diverse. Financial reports range from something as big and complex as preparing an annual financial report for a publicly traded company such as Microsoft (most recent, 83 pages for 2023) read by thousands of external parties to something as small and simple to understand as an e-commerce company selling products online and trying to understand how much they can spend on advertising and promotional expenses (one page of information, read by two executives). Which brings me to the third critical concept.
- ♦ **Financial Report Audience:** Similar to understanding just how broad the range of financial reports is, the audience for financial reports is even broader. Financial reports are read by all types of parties, ranging from some of the most sophisticated financial professionals in the country to small business owners, managers, sales professionals, staff, lenders, lawyers, students, etc., etc., etc. that are on the opposite end of the technical spectrum. That is, these parties are not experts in financial and accounting matters and as such, need to be treated in a completely different manner (when financial reports are prepared) than the top financial minds and experts spread across the financial centers around the world. Translation – you better be keenly aware of and know your target audience for the financial report (a topic covered throughout this book). A much deeper dive on this topic is provided in Chapter 2, “Target Audience ‘E’ – External Users.”
- ♦ **Never Assume:** Being direct as possible again, assumption is the mother of all f-ups. Don't just assume that after you've produced a financial report that you deliver old school via paper or new school in an electronic file, your job is done. This represents an absolute fatal error as after a financial report is produced, delivered, and discussed, you will almost always need to

respond in a follow-up fashion that encompasses verbal discussions, listening attentively, reading feedback, observing reactions, etc. For example, if you provide a financial report to a party that is not professionally trained in the field of accounting and finance, assuming that this party understands the financial report and its primary financial message or critical output, without discussing the financial report with them, often represents a significant mistake. To combat this potential problem, direct discussions should be held with the target audience to walk through the financial report (line by line if needed), help educate the party(s) as to the structure and findings of the financial report, and confirm that they understand the output. From a factual standpoint, confirming without a doubt that you provided a financial report to the target audience and discussed it with them is always a much better path to pursue than assuming the target audience received, read, and understands the financial report.

- ◆ ***Always the Storyteller:*** As a storyteller, you must remember to be confident, credible, focused, and clear when communicating

financial information. Just as important, the financial story presented must flow in an easy to follow and efficient manner that includes using the proper report format, structure (i.e., ensure the report conclusion is easily identified), level of detail, information, and data and is delivered with a style that is effortlessly digested. To expand on the concept of being an effective storyteller, I'm often drawn to a quote from the movie *Caddyshack* that Judge Smails delivers – “It's easy to grin when your ship comes in and you have the market beat, but the man who is worthwhile is the man who can smile when his shorts are too tight in the seat.” The reason I offer this quote is to remind everyone about the critical importance of delivering bad, challenging, and difficult news (as part of the financial reporting process). It's even more important than being the hero when providing good news. Mastering the art of communicating difficult news (and providing possible solutions) is a skill set that very few have, and which is desperately needed. Always provide full disclosure (to the right parties), especially with bad news.

It Always Helps to Speak the Language

If you're heading to France or Italy, it goes without saying that you should brush up on the basics of French and Italian as, let's face it, being able to communicate in the local dialect can really improve your trip's experience. Same goes for accounting and finance; if you can at least master some basic terminology and begin to speak the "language," you will be well ahead of the game. This section of the chapter covers two buckets of terminology, basic and advanced.

Basic Terminology

Basic terminology is primarily associated with communicating the results of financial statements (from an accounting perspective), with a heavy weighting toward the income statement. Below, I've provided a sampling of the most commonly used basic accounting and financial terminology (which I will use frequently through this book):

- ♦ **Top Line:** A company's net sales revenue generated over a period of time (e.g., for a 12-month period).
- ♦ **COGS or COS:** Pronounced like it is spelled; stands for costs of goods sold (for a product-based business) and costs of sales (for a service-based business). COGS or COS tend to vary directly (or in a linear fashion) with the top-line sales revenue.
- ♦ **Gross Profit and Margin:** Sometimes used interchangeably, gross profit equals your top line less your COGS or COS. The gross margin (a percentage calculation) is determined by dividing your gross profit by the top line.
- ♦ **Op Ex:** Is a broad term that is short for operating expenses, which may include selling, general, administrative, corporate overhead, and other related expenses. Unlike COGS or COS, Op Ex tends to be fixed in nature and will not vary directly with the top-line sales revenue.
- ♦ **SG&A:** Selling, general, and administrative expenses. Companies may distinguish between Op Ex and SG&A to assist parties with understanding the expense structure of its operations in more detail.
- ♦ **Bottom Line:** A company's net profit or loss after all expenses have been deducted from net sales revenue. Being in the "black" indicates that a net profit is present and being in the "red" indicates that a net loss was generated.
- ♦ **Breakeven:** The operating level where a company generates zero in profit or loss as it "broke even." Or, conversely, it is the amount of sales revenue that needs to be generated to cover all COGS/COS and Op Ex.

- ◆ **Contribution Margin:** You may hear companies reference the term *contribution margin*. What this generally refers to is the profit generated by a specific operating unit or division of a company (but not for the company as a whole). Most larger companies have multiple operating units or divisions, so the profit (or loss) of each operating unit or division is calculated to determine how much that specific unit or division “contributed” to the overall performance of the entire company.
- ◆ **Cap Ex:** While Op Ex is associated with the income statement, Cap Ex stands for capital expenditures and is a calculation of how much a company invested in tangible or intangible assets during a given period (for equipment, machinery, new buildings, investments in intangible assets, etc.).
- ◆ **YTD, QTD, MTD:** These are simple and stand for year to date, quarter to date, or month to date. For example, a flash report may present QTD sales for the period of 10/1/20 through 11/15/20 (so management can evaluate sales levels through the middle of a quarter).
- ◆ **FYE and QE:** These two items stand for fiscal year-end and quarter-end. Most companies utilize a fiscal year-end that is consistent with a calendar year-end of 12/31/xx (which would make their quarter-ends 3/31/xx, 6/30/xx, 9/30/xx, and 12/31/xx). Please note that several companies utilize FYEs that are different than a calendar year-end to match their business cycle with that of a specific industry. For example, companies that cater to the education industry may use a FYE of 6/30/xx to coincide with the typical operating year for schools or colleges (which tend to run from 7/1/xx through 6/30/xx).

Advanced Terminology

Advanced terminology tends to be centered in references to financial concepts that are focused on cash flows, forecasts, projections, and financing topics (i.e., raising capital such as securing loans or selling equity in a company). With that said, here’s a summary listing of advanced terminology to reference.

- ◆ **EBITDA:** This is one of the most used (and abused) terms in finance today and stands for earnings before interest, taxes, depreciation, and amortization. A shorter version that is also used frequently is EBIT or earnings before interest and taxes. The reason for EBITDA’s popularity is that capital sources want to clearly understand just how much earning a company can generate in the form of operating cash on a periodic basis. EBITDA strips out interest, taxes, and depreciation and amortization expense (both noncash expenses) to calculate what is perceived to be a company’s ability to generate internal positive cash flow (which is widely used when evaluating the value of a company and its ability to service debt).
- ◆ **Free Cash Flow:** FCF is closely related to EBITDA but takes into consideration numerous other factors or adjustments such as the need for a company to invest in equipment or intangible assets on a periodic basis (to remain competitive), the required or set debt service the company is obligated to pay each year (for interest and principal payments), any guaranteed returns on preferred equity, and other similar adjustments. FCF can be a highly subjective calculation based on the estimates and definitions used by different parties.

- ◆ **YOY and CAGR:** YOY stands for a year-over-year change in a financial performance (e.g., sales change for the current 12-month period compared to the prior 12-month period). CAGR stands for compounded annual growth rate and represents a financial calculation that evaluates a financial performance over a number of periods (e.g., sales increased at a CAGR of 15.5% for the five-year period of 2016 through 2020).
- ◆ **Sustainable Growth Rate:** This calculation estimates a company's maximum growth rate it can achieve by using internal operating capital (i.e., positive cash flow) only. When a company exceeds its sustainable growth rate, external capital such as loans or equity from new investors may need to be secured to support ongoing operations.
- ◆ **Debt Service:** Total debt service includes both required loan interest and principal payments due over a period of time.
- ◆ **B2B and B2C:** A company that sells primarily to other businesses is B2B (business-to-business) whereas a company that sells primarily to consumers is B2C (business-to-consumer).
- ◆ **Burn Rate and the Runway:** A burn rate is generally used for newer businesses or starts-up that have not achieved profitability and are “burning” a large amount of cash. The burn rate calculates the amount of cash burn a company is incurring over a specific period, such as a month or a quarter. If a company has a burn rate of \$250,000 a month (before generating any sales), then an investor could quickly calculate that this company would need \$3 million of capital to support it for one year. The runway calculates how much time a company has before it runs out of cash. In our example, if the company has \$1 million of cash left and is burning \$250,000 per month, it has a remaining runway of four months.
- ◆ **TTM and FTM:** TTM stands for trailing twelve months and FTM stands for forward twelve months. These figures are often used by parties to help understand a company's annual operating results that are not in sync with its FYE (e.g., how much sales revenue was generated for the period of the QE 9/30/19 through the QE 6/30/20, 12 months of operating history). TTM and FTM can be especially useful when evaluating companies that are growing rapidly or have experienced a recent significant change in business.

Throughout the remainder of this book, I will reference these concepts frequently so you may want to bookmark this section to help refresh your memory as needed. There's no harm in reading and re-reading this section of Chapter 1, as when you're swimming with the financial sharks out in the open water, there's nothing worse than becoming the “chum” (or chump) and looking overmatched when you can't even understand basic accounting and financial terminology.

A Friendly Reminder About the Era of Technology

As I write this book and prepare it for distribution with my publisher, I would be remiss if a discussion on technology was not included. And oh, what a world of high technology we live in as over the past two decades, we've graduated from the web and internet, to data mining/big data and the cloud, to all the promise associated with the Metaverse to the latest buzz words, yes, artificial intelligence ("AI"). So with this in mind, I would offer you these pieces of advice as it relates to the interface, or some may refer to it as more of a collision, of financial reporting and technology.

- ◆ Significant risks and dangers are present when using artificial intelligence to produce a financial report. The first question that you must ask is do you, as the author (of the financial report), even understand the output and conclusion drawn? If you trust and rely on the output generated, your target audience that trusts you will rely on it. As such, the entire information flow runs the risk of becoming polluted if AI incorporates what it deems as facts into the financial report that lead to an incorrect conclusion. I'm not debating that AI can be a useful resource or tool. It certainly can be but in the same breath, AI must be controlled, understood, and managed to produce CART financial reports.
- ◆ Furthering our discussion on AI, you must ask another important question related to if AI is even producing an appropriate response or output in the financial report. If you are not

educated and/or familiar with the financial topics of primary importance in the financial report, how would you know if AI is producing accurate information? My point here is that relying on AI, without having a complete and thorough understanding of the issues, can be a fatal error.

- ◆ Moving past AI, I would note that accounting and ERP systems (enterprise resource planning systems) range from relatively simple platforms such as QuickBooks to extremely complex ERP systems, such as SAP/Oracle. From easy-to-use platforms such as QuickBooks (but a platform that lacks proper controls so financial transaction recording risks tend to be elevated) to complex systems that require far more knowledge and technical experience, these systems are great but if they are not properly implemented, managed, and controlled, the risk of DIGO (data in, garbage out) can be significantly increased.
- ◆ And just to complicate this matter further, it's worth chewing on this concept. Most companies utilize multiple data sources and systems that feed into their ERP systems and flow through to financial reporting. It is important to remember that invaluable financial data and information comes from not just an accounting or ERP system, but data and information located elsewhere such as customer relationship management systems (CRM), third-party payroll providers, and proprietary database management systems, just to name a few. It's incredibly

important to manage the flow of digital financial information, from multiple sources, with proper policies, procedures, and controls to avoid the often fatal virus of DIGO (data in, garbage out).

There is simply no way I can cover the topic of technology and its impact on financial reporting and financial analysis in just one section of this chapter, let alone an entire book. There are just too many moving parts, elements, and facets associated as technology has without question infiltrated just about every aspect of accounting

and financial information systems (not to mention our entire lives). Rather, what you need to remember about technology and its influence in financial reporting comes down to two key concepts. First, technological advancements have greatly improved financial reporting and analysis, and should be viewed as a critical tool to improve the efficiency and accuracy of financial reporting. Second and in the same breath, never, ever rely solely on technology to produce financial reports. You should always complete a thorough review of any financial report, whether produced with the assistance of technology or not, prior to distributing to the intended audience.

A Final Word About This Book

For those of you anticipating/expecting a technical book designed around how to write a financial report in a step-by-step fashion, such as preparing an annual report for a publicly traded company, drafting an audit report for a private company, or preparing a 10-K for a company that is required to provide periodic information to the Securities and Exchange Commission (i.e., SEC), I'm sorry to disappoint you as this is not the book's primary objective. While I will reference a wide range of standard financial reports throughout the coming chapters (often used as examples), the book's real goal is to educate you, as a reader, with understanding how to more effectively communicate critical financial and

operating information, data, and results to a broad range/target audience in the most efficient manner possible.

In summary and a thought to keep in mind with not only reading this book but in your day-to-day professional career, if a financial report looks, smells, feels, tastes, reads, etc. like BS, then it probably is BS. If a financial report is logical, defensible, understandable, easily digested, and draws appropriate conclusions, then you've done your job and have helped produce valuable internal company intellectual knowledge and property that will benefit your company in more ways than you can imagine.

