How To Write Financial Reports That Really Make a Difference

Patrick M. Gray and Richard R. Dubois

Do your financial reports really make a difference in managing the business? Good ones do. But many have only indecipherable numbers and statistics of doubtful use. The authors offer a concise guide to writing reports that top management can act on.

Every chief financial officer (CFO) would like, and should expect, the company's monthly financial report to help top management make a difference in managing the business. But many reports have only indecipherable numbers and a slew of financial statistics of doubtful use. The analysis, if any, is fairly standard and all too familiar. It doesn't explain what has happened and why—the bare minimum requirement of any report. A good report should have information that top management can *act on*. In many reports, the most critical elements—the prospective implications for the company, and alternative decisions and action plans—are absent. The monthly financial report should help management, board members, investors, bankers, and advisors communicate with each other. Fortunately, changing an ineffective report into a useful one is not that hard. Doing so may actually save a great deal of time and effort, in both preparing and using the report.

For a handy summarized list of report Dos and Don'ts, see **Exhibit 1**.

GENERAL GUIDELINES

Financial reports should be highly individualized. You must tailor them to the nature of the readers and the organization. However, we believe that the following guidelines are equally applicable to virtually all circumstances.

1. Know the readers. The overriding guideline for preparing an effective monthly financial report is that you must gear it to the needs of the readers. Preparers, usually under the direction of the CFO, must recognize that most readers are not accountants. Preparers need to ask readers what they want and need to know—and then must deliver this information to their "customers." Following this one

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Exhibit 1
Some Dos and Don'ts for Writing Financial Reports

Do	*Don't*
General Guidelines	
1. Know your readers, tailoring the report to their needs.	1. Write a narrowly focused report based on what you, individually, think is important.
2. Assign one individual overall responsibility for preparation, including quality control.	2. Assemble a report from various sources without one individual ensuring consistency and quality.
3. Establish standards of presentation and content in conjunction with your readers.	3. Prepare a report without clear objectives and standards that meet your readers' expectations.
4. Create a process to make preparation efficient and timely.	4. Recreate the report from scratch every month.
5. Periodically re-evaluate and improve the report's contents and preparation process.	5. Assume an effective and efficient report will stay as such indefinitely.
Presentation Guidelines	
1. Establish an organized, easy-to-read format.	1. Provide information without regard to structure and flow.
2. Be concise by including only what's important to your readers.	2. Include information because it's available and might be of interest to someone.
3. Be consistent such that readers become familiar and comfortable with the report.	3. Repeatedly change the look of the report.
4. Be timely.	4. Allow individuals' schedules or late information to delay the report—plan for such occurrences.
Content Guidelines	
1. Focus only on matters that are critical to the business (and your readers).	1. Detract from what's important by including and analyzing what isn't.
2. Provide forward-looking information and analysis.	2. Concentrate on historical information without explaining its future ramifications.
3. Integrate the analysis and perspectives of every discipline.	3. Rely exclusively rely on financial personnel to provide analysis.
4. Analyze the key indicators—what they mean currently and in the future.	4. Provide boilerplate explanations of what transpired without analyzing why and what the ramifications are.
5. Be correct—follow GAAP.	5. Reduce GAAP standards from those followed at year-end.

simple rule—in establishing standards for the report, in preparing its contents, and in presenting it—will significantly improve the usefulness of your report.

2. Assign responsibility. One individual, usually the CFO, should be responsible for preparing the report if it is to be an efficient and effective process. The preparer must gather the data, including information from other departments. He or she must also perform quality control by assuring the integrity and internal consistency of the report. This is done by coordinating, reviewing, and editing sections submitted by other departments.

3. Follow standards. A common reason why so many financial reports are substandard is that preparers have no standards by which to critique their product. It is precisely for this reason that preparers must consider and work with the readers to establish specific standards of presentation and content that satisfy their requirements.

Standards for your financial report could relate to presentation and content and such standards as length, form and nature of charts, limited use of insider jargon, and so forth. We have attempted to articulate certain guidelines for presentation and content in this article. Further, an example which follows provides a standard format that should be useful.

4. Establish a process. Once you set standards for the report and construct a model, the report will require substantially the same inputs each month. Preparing the report is, therefore, conducive to developing an automated process that allows the report to be prepared efficiently each month. This will also aid in maintaining the desired standards of preparation and content and, perhaps more importantly, in consistently producing the report in a timely manner.

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Let's look at the way it should be done. For example, one company that we advise closes its books on the seventh business day after month-end. At that time, all of the standard charts and graphs used in the report are automatically updated. They are electronically distributed to each of the department heads (manufacturing, marketing, and so on), the president, and the CFO. The department heads electronically submit their contributions to the CFO (primarily analysis) on the ninth day. The corporate controller adds summary financial statements, downloaded from the company's financial systems, on day ten. The CFO reviews and edits the entire package, typically twelve pages and automatically in final report form, by the twelfth day. Finally, the president, who has been writing his one-page letter, adds it, usually within one day. Then the CFO's secretary distributes bound reports, both internally and externally, on day thirteen or fourteen. All those involved are aware of their responsibilities and the information flow is automatic. Every company can adopt a similar process fairly easily.

5. Seek continual improvements. In order to maximize the usefulness of the report on an ongoing basis, the preparer must periodically request feedback from readers. After all, businesses continually change; the report must be dynamic if it is to keep pace and maintain its relevance. Similarly, you will achieve efficiency improvements only if the process for preparing the report is periodically challenged—and, consequently, improved.

In the case of the company depicted above, it has eliminated three days from the monthly timetable over the last two years. This efficiency improvement occurred at the same time that certain graphs were redesigned, and certain emerging businesses were integrated and added. The improvements were largely a result of increased experience and efficiency of the contributing personnel, as well as increased automation.

PRESENTATION GUIDELINES

Presentation of the monthly report must, first and foremost, consider the reader. For instance, if the report is to be used only by internal management in an informal, closely-managed organization, a brief, informal memorandum with attached summary financial information might suffice. Such a report probably would be inappropriate, however, if it were disseminated to investors and bankers or if the organization were highly decentralized in nature. Bearing this premise in mind, some of the presentation guidelines to follow are as follows:

1. Format. Many reports are not particularly easy to use because they are not well organized or divided into manageable parts—they are not "user-friendly." Depending on the needs of the readers and the organization, the format of a good report can take many forms. However, we believe that there should generally be four main sections:

1. President's letter;
2. Management's discussion and analysis (MD&A);
3. Key statistics; and
4. Financial statements.

We will deal with each of these in more detail later.

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2. Be concise. Most financial reports are too long; we've seen upwards of fifty pages of numbers alone. Except in the largest and most complex organizations, if the monthly report cannot be summarized in ten or fifteen pages, the preparer should rethink its contents. The analysis should be to the point, and the key statistics should be only those that drive the business. Otherwise, the report will be wasting a great deal of time both for the preparer and the readers. Correct grammar adds to the quality of the report as well, and is particularly important when the report will be shared with external investors, advisors, and so forth.

3. Be consistent. Once readers become accustomed to the format and style of a report, it is more efficient to remain consistent. A report that constantly changes its look will waste an inordinate amount of the readers' time, as they try to decipher it. As the earlier example shows, a consistent format saves time in preparing the report as well. Obviously, changes will be required as the business changes. Each change in the report should represent an improvement. However, changes can be kept to a minimum in most situations if the report is structured well and has readers' input in the first place.

4. Be timely. Financial reports, no matter how informative and insightful, quickly lose their relevance. In fact, report timeliness is one way many report users evaluate the effectiveness of a company's management. For right or wrong, report timeliness can leave the impression of either a proactive or reactive management, managing ahead of or behind the curve.

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Our view is that a monthly report should be available no later than twenty calendar days following the close of business. Certainly a report issued thirty days after month-end is of diminished utility. Irrespective of our view, however, timeliness must be one of the standards established in connection with the users at the outset. If the right process is put in place—one of continual improvement—it will be possible to shave days off that starting point, as the earlier example illustrates.

CONTENT GUIDELINES

Once again, and at the risk of being obvious, the contents of the report—what to include, as well as the level of detail and analysis—need to be tailored to individual circumstances. If, for instance, the only readers are extremely "hands-on" managers, it would generally be appropriate to assume a high degree of knowledge. If, on the other hand, the primary readers are the company's bankers, more detailed analysis would probably be appropriate.

1. Focus on important matters. There are probably no more than ten or fifteen key statistics that tell the reader how the business has performed and, more importantly, what can be expected. Again, these should be the statistics that the reader is most interested in—and, not coincidentally, those that drive the business.

Many of these statistics are most easily digested as graphs or charts. Once a model is created, a personal computer with a laser printer can produce a graph or chart almost instantaneously. For instance, trends and comparisons of quantitative statistics, such as orders, backlog, cash flow, sales, income, and even productivity measures, are much easier to understand and analyze if you display them graphically. Some statistics, however, such as those relating to product quality and the technical status of important research projects, may best be presented in narrative form. For example, a small reduction in a product's quality can have serious implications, and its significance might be lost in the scale of a bar chart.

2. Focus on the future. Successful businesses are always looking ahead. Similarly, a good financial report should be projecting forward, analyzing and interpreting what has happened primarily for its effects on the business in the future. The best monthly financial reports that we have seen incorporate key statistics and trends that interrelate current and future (estimated) data—for instance, employees, capacity, or operating expense levels with orders or market share with past and future budgeted advertising expense. Even more important, however, is the need for the analysis to deal with these issues. For example, a report might say that if orders continue to be so favorable, the company will experience capacity issues by the third quarter and management therefore must now consider options A, B, and C. That seems easy. But the vast majority of financial reports would say something like, "Orders continue to be strong due to the economic upturn." Keep in mind that historical information is useful only if it is used to project and manage the future.

3. **Involve all functions.** Although the CFO should generally be primarily responsible for the monthly financial report, the effectiveness of the report will suffer considerably if other functions—research, manufacturing, marketing, sales, and so on—do not contribute to the analysis of results. A narrowly focused report prepared from the financial perspective tells only part of a company's story. Even the most experienced and operationally-involved financial manager cannot duplicate the perspective brought by other functions. And it is critical that the decision makers, regardless of their backgrounds, receive analysis from each of these perspectives. As our earlier example illustrates, obtaining input from other functions is not difficult or time-consuming if orchestrated properly. And this will add a great deal of insight and breadth to the report.

4. **Provide analysis.** Many financial reports fail to adequately explain what happened, why it happened, what it means for the company's outlook, and how the company may be able to alleviate the problem or capitalize on the opportunity. Management's discussion and analysis needs to cover each of these bases. The MD&A needs to draw key trends, comparisons, and indicators out of the key statistics presented (usually in chart/graph form), and fully explain what they mean for the business. The president's letter must then sift through the analysis, and articulate the president's succinct view of the state and prognosis for the business, taken as a whole. It should focus on the company's strategic plan—what the results indicate in terms of performance versus the plan, and what initiatives are in place or being considered to manage the business toward achieving the plan.

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5. **Be correct.** With any financial report, the information must be correct. All financial information should be prepared in conformance with generally accepted accounting principles. Even the most difficult accounts, such as deferred taxes and foreign currency translation, should be reasonably estimated. Readers must assume that the financial information is fairly stated. Substantial year-end adjustments that affect previously reported periods greatly diminish the value of interim reports and, in the extreme, can lead to wrong business decisions.

A SAMPLE REPORT: ABC CORPORATION

Finding a monthly financial report which specifically illustrates all of these guidelines is difficult, particularly since companies keep their information private. ABC Corporation is a fictional company. We have assembled ABC's October monthly report from our cumulative experience, in order to demonstrate how the guidelines add value to a report. We should add that ABC is a smaller company that shares its monthly financial report with key investors and its bankers.

ABC's report includes the four main sections referred to earlier:

1. President's letter—an overview of the president's views on the state of the business.
2. Management's discussion and analysis (MD&A)—an analysis of the key statistics that drive the business.
3. Key statistics—a summary, usually presented primarily in charts and graphs, of the key monthly and year-to-date statistics that drive the business.
4. Financial statements—summary income statement, balance sheet, and statement of cash flows.

Let's look at each of these in turn.

1. President's letter. Readers are busy people. No matter how well written and presented a report is, they tend to read the beginning to get the report's flavor, or skip to the end for the conclusion. The president's letter, therefore, should contain enough information to inform the reader, while motivating him or her to read more of the report.

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The purpose of the president's letter is not to summarize the remainder of the report, but to provide the president's views of the state and progress of the company. It also gives his or her vision for the future in the context of, and based upon, the information and analysis contained in the report.

An excerpt from ABC's president's letter may read as follows: "The results for October indicate that the Company continues to perform well in all key areas. Orders, revenue, and profit were 98 percent, 102 percent and 110 percent of plan, respectively. The positive profit performance is attributable to improved product yields resulting from the successful redesign of our manufacturing process. This trend should continue and is critical to maintaining our competitiveness in the current environment. Although orders were fairly strong in the context of the trends in the industry, there is cause for concern because the product mix appears to be swinging to lower-volume, higher-priced products. Though this trend should correspond to higher profits in the near-term, we are currently reviewing its impact on and the flexibility of our long-term personnel and plant capacity strategies..."

2. Management's discussion and analysis. MD&A is the crux of the monthly financial report. See **Exhibit 2** for an excerpt of the analysis that describes ABC's new order and manufacturing activities

Exhibit 2
Management Discussion and Analysis

New Orders	*Manufacturing*
New orders for October were 2% below plan. This is markedly better than the 5%-6% decline being experienced generally in the industry and is attributable to the success of our Christmas promotional campaigns as well as our improved delivery speed and product quality. We experienced a trend in September's and October's orders toward our higher priced, low volume products and are currently reviewing market data to better understand whether this buying trend is market-driven or the net result of our various promotional programs. As a consequence, we are developing a new "low-end" strategy to revitalize orders of those products. Our expectations for the remainder of the year are that orders should track both October's and our year-to-date results (approximately 2% below plan).	Manufacturing results improved significantly compared to plan as illustrated by improved yield and favorable variances from standards. The improved performance was attributable to achieving the efficiencies of our redesigned manufacturing process faster than anticipated. The extra retraining time spent during the summer (which adversely affected our yields at the time) has returned significant benefits over the last two months as production ramped up for the Christmas season; headcounts and costs are down, while yields, quality and delivery speed are up. Product shifts have caused some disruption in production planning and some adverse overhead variances; however, these inefficiencies were offset by labor efficiencies associated with the shift to higher priced products. A longer-term shift of this nature could help alleviate our expected future capacity constraints. Our expectations are that yields for the remainder of the year and throughout the "slower" winter months should remain at or above the 97% experienced in October.

during the month. Such an analysis is common, but when it is presented in this manner, it gives the reader a clear picture of business trends and expectations.

3. **Key statistics.** This section of the report contains several charts and graphs. The graphs in ABC's report show amounts at month-end, monthly and cumulatively for key items that drive the business. In ABC's case, they include: sales, orders, backlog, operating income, cash usage, gross margins, operating expenses, inventory, headcount, capital expenditures, warranty failure rate, general and administration expenses, marketing expenses, research and development expenses, manufacturing yields, and manufacturing expense. Not all of the graphs appear, but **Exhibit 3** provides some examples.

4. **Financial statements.** The financial statements summarize

Exhibit 3
Sample Charts of Key Statistics

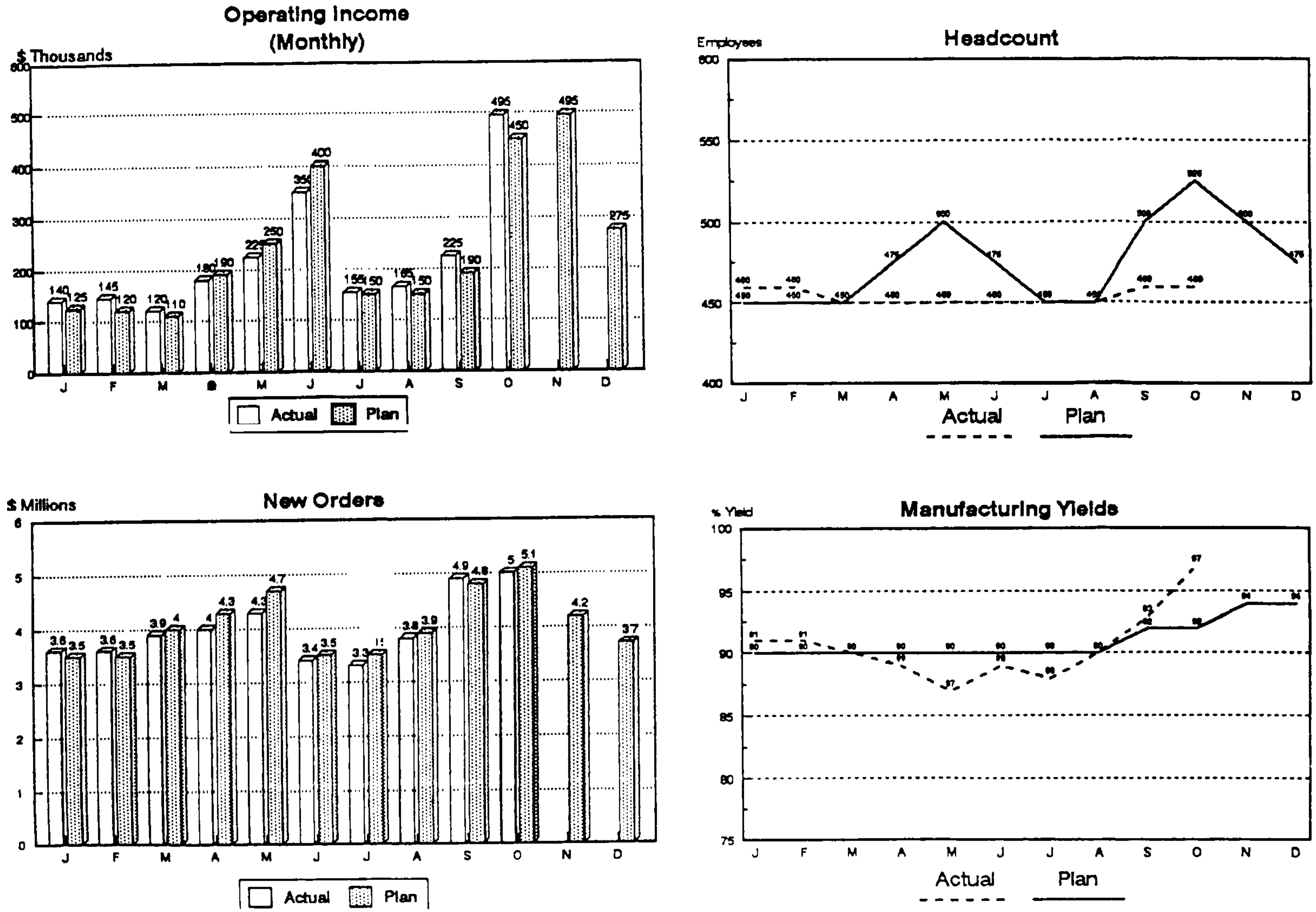

Exhibit 4
Sample Income Statement

Financial Statements

ABC Corporation Income Statement

October 1992

(in thousands of dollars)

	October	
	Actual	*Variance from Plan*
Sales	$4,904	1.9 %
Cost of sales	2,431	(3.2)
Gross margin	2,473	7.5
Operating expenses:		
Research and development	294	(2.0)
Marketing and sales	1,341	10.6
General and administrative	343	0.3
Total operating expenses	1,978	6.6
Net operating income	495	11.5
Interest income (expense)	51	(15.0)
Other income (expense)	6	100.0
Income before income taxes	552	9.5
Income taxes	199	9.3
Net income	$ 353	9.6 %

and confirm the trends discussed and displayed graphically in previous sections. Actual amounts are compared with planned results. The statements should not be too detailed. The income statement in **Exhibit 4**, for example, has a few line items and statistics, such as percentage changes from plan, to facilitate the readers' understanding. It can also include year-to-date information.

Accountants often are reluctant to place the financial statements last, as they view them as important. However, most readers are not accountants and understand analysis and charts better than financial statements.

COST-BENEFIT

Before closing, it is useful to consider whether the time and effort required to prepare an effective monthly financial report are justified by the benefits derived by the readers. As the earlier examples were meant to demonstrate, the answer is certainly yes. But the cost/benefit relationship is affected by a great many factors, and is optimal only when the report is tailored to the specific needs of the readers and the circumstances of the company. For example, take the case of a decentralized and geographically dispersed organization, with a number of external users of the monthly report. It will require a very different report from a closely managed organization that uses the report for internal purposes only. Said differently, only if the report is "user-driven"—that is, targeted to provide the information needed by the readers of the report—will it be effective and efficient. Only then will it provide the right people with the right information to make business decisions in a manner that uses their valuable time most productively and efficiently.

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REPORTS THAT REALLY MAKE A DIFFERENCE

For many companies, the monthly financial report is one of the primary recurring means of communicating with its board, investors, bankers, and advisors. A financial report that follows the guidelines suggested above, as illustrated by the example of ABC Corporation, will be a more useful and efficient management tool. It will really make a difference. Decision makers will get the information they need to run the business in a focused, insightful, and timely manner. Report preparers will save time by efficiently targeting their efforts on only those areas of most significance. ◆