

Reading Financial Reports

The most common problem associated with financial reporting is that managers either do not know how to read financial information, or they do not take time to read financial reports and study the underlying information. The financial reporting process is rather pointless if the financial reports are not read or understood.

Therefore CPAs and business owners should make sure that all relevant personnel are receiving accurate financial reports on a timely basis, and that those recipients understand how to properly read the information they are provided. In this spirit, here are a few suggestions for achieving this objective.

Comparison Data

A single amount is not very informative without comparison data.

For example, if you were told that your company's revenues for the period were \$50,000 and the profit margin was 12%, this information alone is not very meaningful. To understand whether these results are positive, neutral or negative one must ask additional questions such as how much were revenues last period? How much did we budget for revenue this period? By how much is revenue growing or shrinking, and what has been the trend over the past year? How much were profit margins last period or last year?

Having an understanding of the importance of using comparative data is an important step to properly reading financial statements, but you must take the appropriate steps to produce reports that provide comparative information.

Benchmarks

Another important source of comparative data is found in industry benchmarks which are compiled and reported by a number of publishers. Some common sources for this type of information are Moody's Industrial Guide, and Standard and Poor's Industrial Guide. Referring to these sources, a doctor could learn that the typical number of days in accounts receivable for a small medical practice is 54 days. This information could be used by a small medical practice to measure the results from their operations to identify financial management areas that need improvement.

Inventory Turnover Ratios¹

The inventory turnover ratio is typically computed by dividing a company's cost of goods sold by its average cost of inventory during the year.

	Sole Proprietorships	Partnerships & LLC's
Furniture & home furnishings industry	5	5.5

¹ BizStats.com

Charting Data

As previously mentioned, the use of comparison data can be very helpful in reading financial information. However, in many cases the use of a chart or graph can make the process of reading comparative financial information easier.

Reports that contain large volumes of numbers tend to be difficult to interpret, while the same data displayed in a chart can be far easier to read.