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FINANCE TOOLS

Tips for Using Waterfall Charts

(Quick Code 061501)

Controllers seeking an effective, simple way to present budget vs. actuals in reports and meetings for nonfinancial managers should try waterfall charts.

This handy finance tool fills the bill for Kristin Tesch, Controller at ESP International, a global and domestic supply chain company headquartered in Cedar Rapids, IA, which specializes in developing seals, rubber products, plastics, and cast and forged metal products for the OEM market.

"My main role includes general monthly financial reporting, sales forecasts, cash flow forecasts, and high-level analysis," explains Tesch, who has been in her position for four years and worked in public accounting for six years prior to joining ESP. "Since we are an employee-owned company, we are an open book when it comes to many aspects of our financials. We communicate overall consolidated financial results to our managers, who share information with their teams. Employees in our organization like knowing how their actions and responsibilities impact our share price, which in turn impacts their personal retirement accounts."

WHAT IS A WATERFALL CHART?

A waterfall chart is actually a special type of Excel column chart. "It is normally used to demonstrate how the starting position either increases or decreases through a series of changes," explains Ekaterina Bespalaya, a writer for AbleBits.com.

"The first and the last columns in a typical waterfall chart represent total values," she explains. "The intermediate columns appear to float, and show positive or negative change from one period to another, ending up in the final total value. As a rule, these columns are color-coded for distinguishing positive and negative values."

"A waterfall chart is also known as an Excel bridge chart since the floating columns make a so-called bridge connecting the endpoints," adds Bespalaya. "These charts are quite useful for analytical purposes. If you need to evaluate a company profit, determine product earnings, or make an inventory or sales analysis, a waterfall chart in Excel may be just what you need."

For complete instructions on how to build a waterfall chart in Excel, go to https://www.ablebits.com/office-addins-blog/2014/07/25/waterfall-chart-in-excel/#what-is-waterfall-chart.

At-a-Glance Reporting

To present financial results in reports and meetings, Tesch relies on visual aids that are easy to use and to interpret. "We use waterfall graphs to show our budget versus actuals. This provides an easy and quick way for our managers and others to see our results without having to read through a long narrative text containing a lot of numbers," she explains. "We use them for monthly, quarterly, annual, and year-to-date reporting if needed."

Color coding allows Tesch to clearly depict at a glance any variances between budget and actuals. "Where one column ends, the next one in the row starts. In the following exhibit, line items that are performing worse than budget appear in black. Areas that did better than budget appear in light gray," she explains.

The following exhibit, which is created with a simple Excel spreadsheet,

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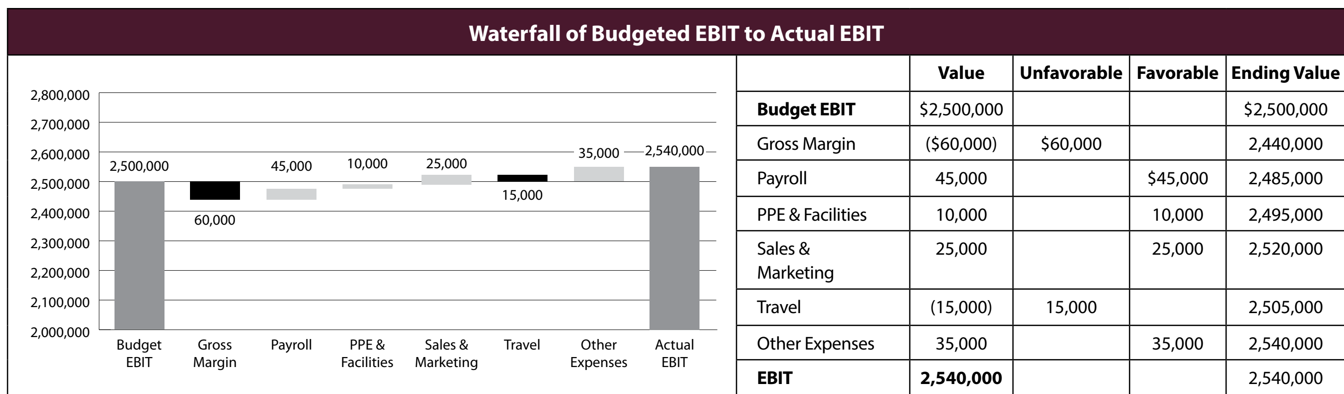
Waterfall of Budgeted EBIT to Actual EBIT



	Value	Unfavorable	Favorable	Ending Value
Budget EBIT	$2,500,000			$2,500,000
Gross Margin	($60,000)	$60,000		2,440,000
Payroll	45,000		$45,000	2,485,000
PPE & Facilities	10,000		10,000	2,495,000
Sales & Marketing	25,000		25,000	2,520,000
Travel	(15,000)	15,000		2,505,000
Other Expenses	35,000		35,000	2,540,000
EBIT	**2,540,000**			2,540,000

breaks down results for Budget EBIT, Gross Margin, Payroll, PPE and Facilities, Sales and Marketing, Travel, Other Expenses, and Actual EBIT.

"The waterfall chart walks people through the financials so they can see which aspects of our operation are overperforming and which are underperforming," Tesch notes. For example, in the exhibit it's easy to see at a glance that Payroll, PPE and Facilities, Sales and Marketing, and Other Expenses are performing better than anticipated while Gross Margin and Travel are performing worse.

Pinpointing Challenges and Areas for Improvement

"The waterfall chart is also helpful for reporting on different sales strategies," says Tesch. "We can show that one location is down while another is performing well. Then we can look at various factors, such as how challenging the market is in a particular area, to get to the bottom of why the area might be underperforming and how we can turn things around."

Tesch also uses waterfall charts to present financials to the company's board such as the breakdown of EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) and sales, benefits, and facilities costs. "If some expenses are higher than expected for the month but sales were in excess of our budget, we can use the positive sales data to buffer some of the impact of certain things that haven't been performing," she points out. "The charts are a great starting point for us to talk about sales activities for certain customers, new projects, and business and sales dollars for new businesses."

Tips for Success

Tesch provides these tips for controllers who would like to use waterfall charts:

1. Explain the charts to first-time users. "The first time you present a waterfall chart to management, the board, or another nonfinancial audience, it's a good idea to provide a simple explanation on how to read the chart," Tesch suggests.

2. Get the formulas working well. "Take a bit of time to get all the formulas and elements you use to create your data working well to ensure the accuracy of your chart," she says. "Once I have all the calculations, it's quick to show the 'overs' and 'unders.' We do our charts in Excel, feeding in data from our financials automatically so we don't have to manually draw it in. We use four different bar graphs to create one waterfall chart."

3. Use different colors. "Using different colors for bad vs. good and ups and downs makes it easier for the users to interpret the information," she says.

4. Include a summary. "Present the charts along with a monthly summary of activities," Tesch advises. "Put bullet points on some of the variances that are referred to in the write-up as there are likely to be questions on large variances. Provide some explanation but don't make it too long and complicated. People may want to discuss items at more length, and that's fine. You just don't want to overwhelm them with information."

"The waterfall appears at the end of our monthly financial report, but we find that people often flip to the chart first because it provides a quick snapshot," Tesch points out. "We have discovered that our managers and board members find the charts to be user friendly and helpful." ❑

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Tips for Stronger Narratives *(Quick Code 041505)*

CASH MANAGEMENT

Three Keys to Optimizing Your Cash Flow

(Quick Code 061502)

By Mircea Stanciu, Finance Controller, BIC

One major objective for any company is optimizing cash flow—and having cash available in the right amount and at the right time.

Your sales may be growing nicely—and the company may be profitable—but if cash is not readily available, discounts and investment opportunities may be missed. Not only do these lost opportunities drive profits down, they threaten growth and profitability.

To ensure that cash flow is optimized and growth and profitability can be sustained, controllers need to place proper focus on cash management. These steps help in this effort:

1. Measure and benchmark. Good cash management starts with measurement. One of the most popular ways of measuring cash is monitoring liquidity ratios.

For example:

- *Standard liquidity* (short-term assets/short-term liabilities); and
- *Quick liquidity* (cash and equivalents/short-term debt).

By benchmarking these key performance indicators (KPIs) against industry averages, historical results, or forecasted values, the controller can identify potential problems.

2. Understand the factors that affect cash. It is not possible to achieve cash optimization without understanding the factors that affect cash. The International Accounting Standard 7 (IAS 7) outlines three cash-generating activities: operating cash flow, financing cash flow, and investing cash flow. Understanding these cycles means understanding the complex connections between cash, profit (or loss), and balance sheet activity.

- ***Operating cash flow*** requires a tactical approach, as it relates to cash generated by the usual day-to-day activities. It is calculated as operational profit (with some adjustments for depreciation, amortization, etc.) minus working capital changes within a certain period of time (AR, AP, inventory, etc.). If, for example, the AR levels are higher in 2015 than in 2014, while operating profit and all the rest of the working capital items remain unchanged, it would mean that 2015 cash would be comparatively lower.
- ***Financing cash flow*** refers to funds raised to finance short-term or long-term company objectives. Financing cash can be positive one year, as the company raises funds (loans or equity), and can be negative the year after, as the company repays the loan or repurchases shares.
- ***Investment cash flow*** refers to cash outflows generated by long-term investments, or inflows generated by selling long-term assets.

The sum of these three cash-related activities should be positive and the focus should be on the operating cash flow. Controllers should measure and track the various KPIs that take these activities into consideration.

Ideally, net cash from operations should cover investment cash outflow. But when this is impossible and opportunities cannot be lost, then financing is necessary. Even when a company's debt/equity ratio is healthy, if loans are chosen to finance investments, the interest level is important to consider, as it may consume a significant part of the operational cash flow, therefore creating cash risks.

3. Take a strategic approach to decisions about cash activities. The potential optimization process could involve decisions concerning all cash activities. Assuming that the company is generating negative operational cash flow (low operational profit and/or increasing investment in working capital), the easiest and quickest solution would be attracting positive finance cash flow, (e.g., contracting a loan or issuing share capital).

Because the company Gearing Ratios (debt/equity) may not allow a further loan increase, the focus should become the operational cash optimization itself, meaning optimizing the two main factors affecting it: operating profit and working capital.

One interesting cash problem can occur when inside entities are growing very fast (requiring increasing working capital), while margins (percent of sales) are

low. In such cases, if it is not possible to get loans (perhaps because the company is still in start-up status), the only possible variant might be to increase share capital. Otherwise, if working capital solutions are also limited, the accelerated growth will finally suffocate the respective entities as a cash crisis strikes.

Optimize Cash Before Problems Arise

The cash optimization process cannot start when cash flow problems are already visible. The optimization must start in advance, using cash flow forecasts to predict potential future problems. That way, your company has time to take the necessary actions.

When producing a cash flow forecast, the P&L and the balance sheet forecasts, as assumptions, must be crystal clear. Cash is a result of profit and balance sheet movements; therefore it is vital that any discrepancies in cash (actuals vs. forecast) are traced back to discrepancies in actual vs. forecasted P&L and balance sheet.

The bottom line: Cash is the lifeblood of every organization. No matter what industry they are in, companies have three major financial objectives: growth, profitability, and liquidity. A perfect balance among these objectives is required for stability as well as expansion. Growth and profitability are not sustainable as long as cash is bottlenecked. This is why you must remain ever vigilant when it comes to measuring, managing, and optimizing cash flow.

Editor's Note: As Finance Controller, Central and Eastern Europe, Mircea Stanciu manages financial affairs for eight of BIC's business clusters comprising 38 geographical areas. He has been working as a finance professional for 18 years, owned an accounting and tax consulting practice for 10 years, and has completed the Association of Chartered Certified Accountants (ACCA) program. ❑

COST CONTROL

Six Mid-Year Cost Management Tips for Better End-of-Year Results

(Quick Code 061503)

By Mike Sbrocco, Director of Finance/Controller, Junxure

Controllers whose companies' fiscal years are synced with the calendar year need to take a careful look at finances this month. If the company is not hitting its revenue forecast or if spending is over budget, action is clearly needed now to ensure that goals will be met at year-end.

Here are some steps controllers can take to assess and manage costs at mid-year:

1. Make sure proper invoice approval protocols are in place and being followed to the letter. It is important to make sure all invoices are being reviewed and approved by the departments responsible for buying the goods/services. Raise the appropriate questions to ensure that invoices aren't just getting automatically rubber-stamped with an approval.

2. Ensure that department heads have a clear understanding of their budgets. Depending on the size of the company, most department heads have responsibility for their areas' budgets. Mid-year is a good time to check in with department heads to caution them about out-of-compliance spending and discuss any variances between budget and actuals. (You should be meeting with department heads to review their budgets on a regular basis as a matter of course.)

3. Scrutinize expenses. If your company is not hitting its revenue forecasts, then expenses should naturally be reduced. Start by looking at the biggest recurring expenses and work your way down the line to see if there is any room to make adjustments.

In addition to looking at current recurring monthly expenses, look into future expenses (either planned one-time expenses or new recurring expenses) and see if there is a way to make adjustments. For example, your company may have budgeted at the beginning of the year to add a new employee in August; however, if revenue is tight in June, you can raise the question of whether the hiring can be pushed out one to three months as a cost-saving measure.

4. Scout for cost-saving opportunities. When it comes time to find cost-saving opportunities, hunt

for them on your own or partner with department heads to identify them. Sometimes this is as simple as saying, "We budgeted $5,000 for telephone expense each month and you are only spending an average of $4,000 per month, so we are going to reduce your budget by $1,000 each month for the second half of the year." Other times it is more difficult and a conscious effort needs to be made to identify cost savings.

POSSIBLE MANDATED CUTS

To cut costs (depending on how the company is structured and who has final say on the budget), you might be able to mandate changes. For example, you might:

- Change the purchasing process so all new purchases go through a more rigorous review;
- Enforce the elimination of all non-essential expenses; or
- Cut out all nonessential travel for the second half of the year and only authorize travel that is directly tied to revenue generation.

Warning: Cost-cutting measures can seriously impact morale, so it is important to weigh the benefits of the cost savings against the potential impact on morale. In other words, think twice before you recommend canceling the annual company picnic!

5. Review products and services to see if there is a more cost-effective solution that you can switch to. Don't be afraid to go back to vendors and let them know that your company is trying to cut costs and see if there is anything they can do to assist you with this effort. A good business partner will work with you and offer suggestions.

6. Communicate and enlist the support of management/staff. Getting everyone in the organization to understand the importance of cutting costs—and buy into the belt-tightening measures—is important. Communicate the benefits of hitting financial goals and the consequences of not hitting the goals. Then track progress and communicate the results so those involved can see that their efforts are making a difference.

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7. Put together a cross-functional budget committee. If the company does not have a formal budget committee, consider putting together a group that represents a good cross section of the company. Brainstorm different ideas that will help the company cut costs. The committee might consider offering nonmonetary rewards or incentives for those who are successful in cutting costs.

Weigh Cost-Cutting Measures Carefully

Cutting costs is usually a last resort, so make sure you've exhausted all possibilities for generating additional revenue *before* starting down the path of cutting costs.

Of course, if cutting costs is critical to the success of the company, then make it a priority. Ensure that the proper people have oversight of their respective areas, give them clear direction, set the expectations, and hold them accountable. ❑

PAYROLL COMPLIANCE

How to Handle Taxation of COBRA Benefits

(Quick Code 061505)

By Raeann Hofkin, CPP

The Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA) requires employers to provide temporary continuation of group health coverage to past employees, their spouses, former spouses, and dependent children when this benefit would otherwise be lost due to events such as termination of employment. In some cases, an employer may choose to pay the COBRA premiums for a former employee as part of a severance package.

When an employer pays for the coverage, taxability of such payments comes into question. Determining taxability depends on how the employer pays for the premium.

What the IRS Says

According to the Internal Revenue Service (IRS), if the employer gives money to pay the premiums with no restrictions or proof that the payment was used to pay the COBRA premium, then the reimbursement is

fully taxable as wages. However, if the employer pays the premiums directly to the insurance company—or actually only reimburses the individual for the actual payment once a receipt is provided—then the reimbursement is considered nontaxable.

It is important to note that self-insured group health plans are subject to nondiscrimination requirements. These nondiscrimination rules prohibit discrimination in terms of plan eligibility as well as benefits provided under a self-insured group health plan. Therefore, any subsidized group health plan coverage for former employees should be evaluated in light of these requirements.

IMPLEMENTING REIMBURSEMENT ARRANGEMENTS

The following tips will assist companies in maintaining compliance while implementing COBRA reimbursement arrangements:

1. Structure the arrangement as a reimbursement for premiums that are actually paid by the individual, who is then required to submit a receipt.
2. Decide if the reimbursement will be capped as of a point in time or will increase if/when premiums increase with a new plan year.
3. Have a written policy for more formal arrangements that details which ex-employees would be entitled to the reimbursement arrangement.

COBRA Payments for New Hires

In other situations, an employer may hire a new employee who has COBRA coverage available from a former employer. Under the same approach described earlier, whereby the employer pays for a former employee's premium, payments to new hires can also be excluded from taxable earnings.

Note: For there to be a tax-free reimbursement, the employer *must obtain appropriate documentation* that the premium payment was actually made. If the employer provides a payment with no required proof that the payment is being used to pay for the COBRA premium, regardless of whether the medical or dental premiums were paid, that payment would not qualify as a tax-free premium reimbursement.

Taxability is not the only consideration that new employers should consider when making COBRA payments for another employer.

Put It in Writing

It is highly recommended that the new employer create a written statement clearly explaining that it is reimbursing the COBRA payment for the past employer. The written statement should:

- Include specific terms,
- State when the employer will take over the payments,
- State for how much and how long the employer will reimburse the premiums,
- Explain what documentation is required in order for the employee to be reimbursed,
- Note whether the employee is allowed to continue on the COBRA coverage until the benefit has been exhausted,
- State when the new employee will be qualified to join the current employer's plan (there could be as much as a 60-day wait before coverage is offered).

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(Quick Code 051506)

Key Points to Keep in Mind

The COBRA clock does not start over if the employee terminates employment with the new employer before enrolling in the new health plan. The payments being made are part of another employer's health plan, which the new employer was simply reimbursing as part of an agreement made during the hiring process.

Furthermore, expense payments or reimbursement of COBRA payments for the employee's insurance premiums may be excluded from wages only if those payments are made under an accountable plan. This means that there must be documentation proving that the payment was used for COBRA reimbursement.

It is recommended that the employer pay the insurance provider directly per the provider's invoice. If the employer is reimbursing the employee for an out-of-pocket expense, then the employee must substantiate that expense with an invoice, receipt, or other documentation. In other words, if the payment to the employee is intended to reimburse insurance costs but the individual doesn't substantiate the expense, the payment should be treated as taxable wages. ❑

TAX & REGULATORY COMPLIANCE

Respond Correctly to 'B' Notices and Avoid Penalties

(Quick Code 061504)

Companies that receive "B" Notices from the Internal Revenue Service (IRS) must respond in a timely and appropriate manner to avoid costly penalties. The IRS sends B Notices—technically referred to as CP2100 or CP2100A notices—in the spring and/or fall to payers (companies/organizations) that filed 1099 forms containing errors earlier in the year.

"The IRS sends filers a list of 1099 errors that prevented the matching of payee data against IRS records," explains Marianne Couch, Esq., cofounder of COKALA, a tax advisory services firm. Common errors that will attract a B Notice include mismatches between payee name and TIN (taxpayer identification number), missing TINs, and TINs that were not issued to anyone.

All the 1099 forms that are that are subject to backup withholding are covered under the B Notice rules, including B, DIV, INT, K, MISC, OID, and PATR.

According to Couch, there are several key compliance issues regarding B Notices that payers need to keep in mind:

There Are Actually Two B Notices

First B Notice. "Payers must send the *first* B Notice and a Form W-9 to a payee with a 1099 error after they've received the first CP2100 or CP2100A Notice from the IRS with respect to this payee's account," Couch explains. The purpose of this first B Notice is to inform the payee of the problem and ask the payee to send the payer a correct name/TIN combination.

"In the first B Notice letter, the language is written by the IRS," Couch points out. "The payee must respond with a complete, accurate Form W-9 signed under penalty of perjury."

Second B Notice. "Payers must send the *second* B Notice to a payee if they receive a second CP2100 or CP2100A Notice from the IRS listing that payee within a three-calendar-year period," Couch says. The text of the Second B Notice is different from that of the first B Notice. The second B Notice tells the payee to contact IRS or the Social Security Administration (SSA) to obtain the correct name/TIN combination the payee should be using on their W-9 form.

The IRS writes the language for the second B Notice letter. The mailing of the second notice does *not* include a Form W-9. The payer must receive a copy of the SSA- or IRS-issued validation of the payee's name/TIN combination after sending the second B Notice. "The payee must obtain government documentation of the payee's correct name and TIN, which can be either an SSN (on a Social Security card) or EIN (employer identification number per IRS Letter 147C)," Couch points out.

Following the 'Two in Three Years' Rule

Generally, a payer does not have to send a B Notice to the same account more than twice within three calendar years. "IRS counts multiple B Notices sent in the same calendar year or relating to a single tax year as one notice," Couch says. "For example, the Fall 2014 list is related to Tax Year 2013; the Spring 2015 list also relates to Tax Year 2013.

If a payee on the fall list who the payer processed with a first notice letter appears again on the spring list, the payer can disregard the spring appearance.

"Since the payer just sent the B Notice letter a couple of months prior, and since the list relates to the same tax year, the payer does not need to contact the same payee again, unless this same payee appears again on the Fall 2015 list, which will pertain to the file sent to the IRS in 2015 for tax year 2014," Couch explains.

Observing Deadlines for B Notices

"Payers have 15 business days from the date of the CP2100A or CP2100 Notice, or the date on which they received it (whichever is later), to send a B Notice to a payee," Couch says. "For incorrect TINs, the payer only has to send a B Notice to a payee whose name/TIN combination and account number on the payer's records agrees with the combination that IRS identified as incorrect."

Payers do not necessarily need to contact every payee listed on the B Notice list. "However, payers do need to research the list to determine which payees must be contacted and how many times those payees have appeared on the notice," Couch says.

"Payers that companies do *not* need to contact include those whose 1099s are processed by a third-party administrator," Couch points out. "However, payers must make sure their third-party administrators timely

and properly process the list, otherwise the payers will be held responsible. Other payees that do not require contact include payees who are fiduciaries, payees whose payments were not reportable on a 1099, and payees for whom there is no record in the system of ever having been paid. Payers also do not need to send B Notices if the error was made on their end—for example, if someone in AP, while keying in the payee information, transposed digits or misspelled the name provided on the Form W-9."

Keep this in mind: The B Notice list is generally six months to one year behind your tax-year filing. "Assume that information in your files that differs from the information on the list is the correct information," Couch advises. "You have corrected it between the time you sent the original file and the time the IRS sent the list."

Avoiding Penalties

By processing the B Notices timely, payers get any filing penalties that arise from inaccurate or incomplete 1099s waived. "Payers must write penalty waiver letters to the IRS explaining their B Notice processing procedures and providing evidence of backup withholding when required," Couch explains.

"Before sending out B Notices to payees, payers that receive lists should call the IRS to make sure they did not receive the B Notice list in error," she adds. "It is also a good idea to call the IRS Enterprise Computing Center at (866) 455-7438 each spring and fall to verify whether a B Notice list was sent. They may need authorization from the payer organization in order to provide the payer with the information, but this way you can make sure that any list sent is processed in a timely manner."

Couch explains that notices proposing penalties for 1099 errors are sent out in August; payer organizations have 45 calendar days from the date on the notice to respond. "Respond with a letter requesting a penalty waiver," she advises. "This letter must explain all the errors for which penalties are proposed using language from the 'reasonable cause' regulations found in IRC § 6724." She adds that a proposed penalty notice resembles a B Notice list, but payers can tell the difference because the proposed penalty notice proposes an assessment of monetary fines, so there will be a dollar amount referenced in the letter.

Penalties are calculated as follows: $100 per 1099 error; or $30 if a corrected 1099 was filed within 30 days of the original due date; or $60 if a corrected 1099 was filed later than 30 days from the due date but before August 1. The maximum penalty ceiling recently increased from $250,000 to $1.5 million. "The penalty for intentional disregard of the requirements also increased from $250 to $260 per item for failure to file correct information returns, and the same increase from $250 to $260 for failure to furnish correct payee statements," Couch says.

Editor's Note: Marianne Couch, J.D., is a nationally known advisor and author on U.S. federal and state tax information reporting compliance. She recently delivered a webinar for IOFM on CP2100 B Notices and TIN solicitations. More resources to help payers handle B Notices include: IRS Publication 1281, "Backup Withholding for Missing and Incorrect Names/TINS," http://www.irs.gov/pub/irs-pdf/p1281.pdf and IRS Publication 1586, "Reasonable Cause Regulations and Requirements for Missing and Incorrect Names/TINs," http://www.irs.gov/pub/irs-pdf/p1586.pdf. For questions on Notice 972CG or the TIN listing, call the Information Returns Branch Centralized Call Site at 1-866-455-7438 (from outside the United States, 304-263-8700), Monday through Friday 8:30 to 4:40 PM Eastern time. ❑

SUPPLY CHAIN LEADERSHIP

The Role of Finance in Supply Chain Management

(Quick Code 061507)

The controller and the finance department are critical links in a company's supply chain. As such, they can play a strong role in ensuring cost-effective supply chain management, says Keith D. Dabbs, MBA, CMRP, APM, Senior Manager of Procurement and Sourcing at Riverside Health System, a healthcare company that has earned awards for supply-chain management excellence.

"The controller's awareness of the supply chain enhances the company's financial performance," says Dabbs. "According to the Association for Healthcare Resource & Materials Management (AHRMM), there are five elements in the supply chain process: sourcing, inventory, distribution, utilization, and payment. In the sourcing phase, for example, a company evaluates a supplier, determines a price, creates a contract, and ultimately makes the purchase. In the inventory section, the company receives the items and verifies the purchase within their purchase order system and item master

file. In the payment section, the company pays for the product or service and satisfies the accounts. Finance and the controller must play an integral part in each of these elements."

Tips for Controllers

According to Dabbs, there are eight steps controllers can take to ensure that they and their teams are strongly supporting their organizations' supply chains:

1. Understand the process through which goods and services are obtained. Invite people from procurement to talk to finance about their process. Provide a list of questions ahead of time, including queries you hear from your staff concerning any aspect of the procurement process.

2. Conduct audits and inventories. "This is one of the best ways to learn about potential discrepancies and possible credits owed," says Dabbs. "For sourcing and inventory, most commonly, auditing is an efficient way to verify or confirm that pricing is accurate and reflects what is in the company's contract and item master file, and what is on the invoice."

"In addition, conducting a physical inventory is a proven method for finance to learn what the organization's assets are. Establishing a solid physical inventory process will bring together the purchasing, receiving, and invoice payment functions to the point where, when followed stringently throughout the period, the act of performing the inventory becomes more streamlined and efficient. A benefit of the physical inventory process is the opportunity to learn about purchasing metrics such as carrying costs, inventory turn rates, and inactive/obsolete goods," Dabbs explains.

3. Capture costs through the accounting process. "As goods and services are purchased, not only is it important to capture costs through the accounting process, it is also important to assist the supply chain team with reporting or providing data," Dabbs says.

4. Ensure matching. "Payment for goods and services is the last link in the supply chain. In an efficient supply chain, a vendor's invoice should match all criteria for rapid payment. The price, description, unit of measure, and quantities should all reflect what was ordered and received," he points out.

"This area is one that gives the controller an opportunity to work with sourcing and provide information on the status of invoice payments and develop the business relationship in general. Through this exchange, sourcing will have the ability to better negotiate with incumbent vendors for goods and services, or explore other vendors—in a sense, starting the supply chain cycle over again," Dabbs explains.

5. Establish clearly defined cost centers and expense codes. "Ensure that all departments within the company are aware of the establishment of new cost centers and changes to existing cost centers," he advises. This way, people will know the proper billing codes to use for purchases and it will be easier to track and control purchasing activity.

"Also, regularly review expense codes for accuracy and update or change them if necessary. They should also routinely generate reports for departments summarizing their purchasing activity to help keep them on track," Dabbs recommends.

6. Facilitate the budget process for all departments. "Proactively send out financial reports in anticipation of the budget preparation period," Dabbs suggests. This will help ensure that department heads are well educated about the state of company finances, and what is expected of them and their departments regarding purchasing and spending activity for the new period.

"Also, provide a resource person from finance to assist department managers during budget season," Dabbs adds. Send an e-mail informing them that a person is available to answer their questions, meet with them in groups and individually, and assist them in coming up with budgets that will allow them to meet their needs and goals while staying within the proper spending parameters.

7. Share data and reports on an ongoing basis. "Work with your departments to determine what specialized reports would be beneficial for them in managing their areas' purchasing and spending throughout the year," Dabbs advises. "Make it clear that you and the finance department are available to provide general support and recommendations all year long."

8. Meet regularly with purchasing/procurement. "Encourage purchasing to meet with you on a regular, ongoing basis to review invoice payment statuses and other data related to purchasing and spending activities," he says.

"Controllers can help break down the silo mentality that arises between functional areas in companies," Dabbs notes. "When communication, positive relationships, and a general understanding of roles exist between finance and purchasing, this will forge strong links in the company's supply chain." ❑

PROCESS IMPROVEMENT

Improving Reconciliation and Accrual in the Monthly Close

(Quick Code 061506)

When monthly close time rolls around, time is of the essence; controllers can't afford to let anything get in the way of a timely and accurate close. Yet, there are common challenges that can hinder the efficiency of the close process.

"Two of the biggest challenges in my monthly close process are bank reconciliation and booking of accruals (revenue as well as expense)," says Shabbir Kapadvanjwala, controller at Sargenti Architects, P.C. (Paramus, NJ). "An untimely flow of information and a large amount of data contribute to these problems."

Wayne Spivak, Interim Portfolio Company CFO, Relativity Capital, L.P., offers some suggestions to help:

1. Do your bank reconciliations daily. "A business can have as few as a dozen entries to reconcile or hundreds and even thousands. It is always preferable to handle large chunks of data in smaller sets," Spivak points out.

"Reconciling cash on a daily basis has become much simpler since the advent of programs that can read statement information directly from the bank and accounting systems that can interface with those programs," he says.

"It takes me only minutes a day to reconcile my bank account because my accounting system will match up checks, deposits, and miscellaneous debits and credits with entries in my accounting system, await my acceptance or edit, and in the case that my system never knew about the transaction, create an entry on the fly," he says.

"If you wait till the end of the month to reconcile—when you get your monthly bank statements—you will have to check all the transactions at once during the close process," he points out. "However, if you reconcile daily or weekly, you'll have only a fraction to deal with during the close process, which is much more manageable. Another big advantage to doing your bank reconciliation daily is that you can catch fraud immediately, not days or weeks from the date of transgression."

2. Book job costing accruals on a weekly basis rather than monthly. This step helps avoid last-minute time crunches.

"Booking of accruals presents some of the same problems as bank reconciliations," Spivak notes. "Either you bunch them up and enter them at one time (hopefully remembering all of them) or you take care of the accruals as they come up, making sure to document each entry should there be a question later on from an internal or external source such as a vendor, customer, or auditor. This is a preferable approach."

With job costing information, every transaction entered should be appropriately tagged to the correct project. "Timely postings of financial transactions will speed both the reconciliation of the job, as well as reconciliation of your trial balance," says Spivak.

3. Stay on top of delays. When it comes to accruals for revenues and expenses, "you should always know ahead of time if a revenue or an expense may have a delay," advises Spivak. "You should also have a good concept of the estimate of delayed expenses or revenue so you can execute the appropriate transactions."

"Remember, accruals are good-faith estimates," he continues. "It's okay if you are off, but with all transactions, make sure that the estimate is *documented* so that if there are questions later on you are armed with the information you used to create that accrual. ❑

THE BOTTOM LINE

Spivak explains that the close process will be less trouble-prone if you take the following steps:

- Follow GAAP
- Use good internal controls
- Pay attention to detail
- Continuously tune and retune the close process
- Automate functions that are repetitive and bridge multiple systems to eliminate duplicating work

"If you prepare your month-end close by doing pieces of the close all month long, you will increase accuracy, decrease the days involved in the close process, and reduce stress, as you won't have a huge deadline for financials looming over you," Spivak says.

METRICS

Linking KPIs With Business Strategy

(Quick Code 061508)

By Regis Quirin

In most organizations, the accounting or finance group is responsible for assembling a series of reports after month-end and after the accounting close. The reports are assembled and distributed to senior managers to provide them with a clear understanding of the state of the business.

An effective reporting package should include four items: an Income Statement, Variance of Actual to Plan, Production and Financial Forecast for the Balance of the Year, and a Scorecard with Key Performance Indicators (KPIs).

The first three reports in the package present economic and production information, while the last report provides metrics associated with company objectives and department-specific initiatives.

BENEFITS OF KPIs

Key performance indicators deliver benefits like the following:

- Quickly show senior management the measurable progress that has been made toward the achievement of company strategy;
- Provide a fast way to explain variances in income statements;
- Make it easy to link departmental contributions to strategy attainment, which aids in performance measurement and management;
- Allow nonfinancial individuals to understand the organization's success at achieving goals and strategies by tracking how the KPIs change over time.

As a general rule, the KPIs provide information about the organization's success from a strategy perspective (i.e., financial, operational, and risk/compliance).

Aligning KPIs With Strategy

KPIs should be part of every department's initiatives and be closely aligned with the company's annual business plan. When the business plan is produced, supporting strategies must be formulated, vetted, and approved among the senior managers.

At the department level, initiatives must then be developed that foster the attainment of the company's overall business strategy. In turn, KPIs are established to measure the success of the initiatives.

Common strategies with corresponding key performance indicators include the following:

The strategies presented here are basic and need to be adjusted based on each organization's specific business model. Also, if the product or service sold includes multiple steps, it is appropriate to include KPIs for each step; the key performance metrics can take the form of values and/or ratios.

Controllers can play a valuable role in establishing KPIs across the organization and helping management at all levels to ensure that strategies will attain the desired financial results in support of the company's business goals (growth and profitability).

To develop a KPI scorecard, take the following steps:

1. Identify a dozen or so important activities the team can accomplish that will contribute to the strategic objectives or compliance obligations of the business.
2. Group the variables in a logical order, such as Production, Operations/fulfillment, Post-purchase Customer Care, Audit, and Compliance.
3. Set targets and tolerance ranges.
4. Benchmark against your top competitors and add benchmarks for each KPI on your scorecard. This will help in tracking how you are performing vs. the desired performance level.

Once established, the KPIs can be presented to senior managers during regular financial reporting for their review. The KPI report should always include an explanation of why you fell short of, or exceeded, the targeted KPIs. After a few months you will be able to see how the company is trending.

A Few Caveats

Be careful about creating KPIs that, if maximized, could cause problems in another area. As soon as you place a number on a table and publish it, the responsible individuals will do all they can to improve the value and reach the target that is set.

For example, time to complete a process has a very large impact on customer satisfaction. Intuitively, shortening the time element will have a positive impact

Strategies, Initiatives and KPIs		
Company Strategy	**Department Initiative**	**Key Performance Indicator**
Increase Employee Satisfaction	Companywide Human Resources Human Resources	% Respondents Satisfied or Extremely Satisfied from Employee Surveys Headcount Employee Attrition
Increase Customer Satisfaction	Companywide	% Respondents Satisfied or Extremely Satisfied from Customer Surveys
Increase Profit Margin	Sales	Profit/Units Sold
Improve Credit Quality	Sales	Ensure Client Credit Files contain all executed documents and background checks
Reduce Seriously Delinquent Accounts Receivable	Sales	90 Day + AR/Total AR
Execute Targeted Marketing Campaigns	Marketing	# of Programs Return on Marketing Investment %
Contain and Control Costs	Operations	Personnel Expense/Units Sold Non-Personnel Expenses/Units Sold
Improve Vendor Compliance	Compliance	Vendor Costs Vendor adherence to Service Level Agreements (SLA)

on satisfaction, except when quality is reduced. If you are going to track time, you should also track error rates or rework required. If time declines and rework also declines or at least stays the same, then you're on the right track.

Another issue that can occur is when financial people hide behind the metrics. When asked a question, a person responds with the metric, which is appropriate at first. However, especially with ratios, you must understand the ingredients of the ratio.

For example, if a KPI is "90 Day + AR/Total AR" and if the ratio declined (a good factor), did 90 Day Collections improve (which is what you want) or did Total AR increase (which is what you do not want)? Do not just look to the ratio without understanding the significance of the numerator and denominator that generated the metric. There is no replacement for understanding the numbers cold.

Editor's Note: Regis Quirin is a financial executive with 23 years of corporate experience, including four years at the New York Stock Exchange, 14 years at JP Morgan Chase, and five years at GMAC ResCap. Since January 2000, Quirin has worked with small and medium-sized entities including joint ventures, start-up entities, and established businesses. ❑

COMPENSATION

A Look at U.S. Controllers' Salary Trends

(Quick Code 061509)

Controllers seeking the latest information on salaries in their profession can find the answers in the most recent *Global Salary Survey* released by the Institute of Management Accountants (IMA).

This annual survey examines trends in compensation of accounting and financial professionals around the world, as well as other factors related to job satisfaction.

Raef Lawson, CMA, CPA, CFA, Ph.D., professor-in-residence and vice president of research and policy at IMA, is one of the co-authors of the study, along with Denis Desroches, a research associate for IMA.

"While finance and accounting professionals, on the whole, experienced modest gains in compensation during 2014, those in controller-related positions generally did not experience, on average, an increase in compensation," reveals Lawson. "Plant controllers were the only category with an increase in average compensation" (see Exhibit 1).

"These results reflect the overall stagnation of wages in the U.S. economy, as well as an anemic economic recovery," says Lawson.

Findings on Age and Experience by Gender

"While there was no difference between men and women in terms of years of experience at the Corporate Controller level," says Lawson, "differences do exist for the other levels, with women who are Divisional Controllers or Plant Controllers tending to have more experience than men in the same position and having less experience than men when it comes to being Assistant Corporate Controllers" (see Exhibit 2).

Gender Compensation Gap

"The *Salary Survey* found a continuation of a gender compensation gap, with the average salary for women being 84.2 percent of the average salary for men. This gap exists at all controller levels, with the gap being smallest for Plant Controllers and larger for more senior positions," says Lawson (see Exhibit 3).

Findings on Certification

IMA's salary surveys have consistently shown the benefits of certification. "For example," Lawson notes, "the premium that Certified Management Accountants (CMAs) earn over non-CMAs increases as the level of responsibility increases. This may be because the skills covered by the CMA body of knowledge are increasingly needed as one advances up the career ladder," he suggests.

"We also see that the percentage of controllers who are CMAs increases with level of responsibility, indicating that the certification may be seen as a way of gaining necessary skills and advancing one's career," he explains (see Exhibit 4).

Editor's Note: Similar increases would be expected as a result of controller-specific certifications as well, like IOFM's Certified Professional Controller (CPC) certification.

Responses to the *Global Salary Survey* included a total of 3,729 responses coming from 81 countries across the globe. For the complete *Global Salary Survey* results, go to http://www.imanet.org/resources-publications/research-studies-and-resources/salary-survey. For information on how to attain the CPC certification, go to http://controller.iofm.com/cpc-certification. ❑

Exhibit 1. Controller Salaries and Compensation

	Average Salary			Average Total Compensation		
Position	2014	2013	Percent Change	2014	2013	Percent Change
Corporate Controller	$109,526	$136,635	-20%	$131,047	$183,631	-29%
Assistant Corporate Controller	87,456	98,333	-11%	101,381	129,967	-22%
Divisional Controller	115,390	123,787	-7%	141,548	152,814	-7%
Plant Controller	96,568	90,717	6%	109,718	99,054	11%

Source: *Global Salary Survey*, Institute of Management Accountants (IMA)

Exhibit 2. Controller Age and Experience by Gender

	Average Salary			Average Years of Experience		
Position	Male	Female	All Respondents	Male	Female	All Respondents
Corporate Controller	47	47	47	22	22	22
Divisional Controller	45	52	47	20	25	22
Assistant Corporate Controller	41	38	40	16	12	14
Plant Controller	45	48	46	19	24	20

Source: *Global Salary Survey*, Institute of Management Accountants (IMA)

Exhibit 3. Gender Compensation Gap

	Average Base Salary			Average Total Compensation		
Position	Male	Female	Female as a % age of Male	Male	Female	Female as a % age of Male
Assistant Corporate Controller	$72,500	$98,526	81.9%	$78,145	$117,630	66.4%
Corporate Controller	94,708	119,039	79.6%	107,569	146,277	73.5%
Divisional Controller	95,554	123,622	77.3%	126,306	147,530	85.6%
Plant Controller	90,718	98,017	92.6%	97,475	113,273	86.1%
All Controllers	$92,207	$113,548	81.2%	$106,253	$136,812	77.7%

Source: *Global Salary Survey*, Institute of Management Accountants (IMA)

Exhibit 4. Salary and Compensation for Certified vs. Non-certified Controllers

		Average Salary			Average Total Compensation		
Position	Percent CMAs	Non-CMA	CMA	CMA Premium	Non-CMA	CMA	CMA Premium
Corporate Controller	56%	$91,709	$124,126	35%	$103,291	$153,983	49%
Divisional Controller	50%	108,033	121,789	13%	123,149	158,737	29%
Assistant Corporate Controller	46%	87,264	89,976	3%	96,943	108,861	12%
Plant Controller	43%	93,823	98,876	5%	105,519	113,350	7%

Source: *Global Salary Survey*, Institute of Management Accountants (IMA)

You can view all of these articles plus videos, tools, and resources at our member website: controller.iofm.com

NEWS BRIEFS

Quick Code 061510

GET READY FOR INTEREST RATE HIKES

A recent survey reveals that finance leaders are expecting interest rates to climb and are planning their management strategies accordingly. In its *2015 Survey of Business Conditions*, Tatum, a financial and technology services firm, polled both internal CFOs at Tatum partners and external CFOs.

The survey asked respondents—all high-level finance executives—about the likelihood of the Federal Reserve raising interest rates up to 3.125 percent by the end of 2017. More than half of Tatum's internal CFO partners (54 percent) said interest hikes are likely, and nearly three-quarters (71 percent) of external CFOs agreed.

The survey also asked how finance leaders planned to change financial management strategies, capital structure, business investment levels, and cash investment management in response to rising interest rates. Their companies' plans include the following:

- Accelerate capital investments;
- Dial back on longer pay-back projects;
- Expand debt levels to take advantage of better rates and availability;
- Replace debt with equity; and
- Reduce debt levels.

More than two-thirds of CFOs said they foresee no change to their pricing structure and cash investment management.

Survey results are available for download at http://www.tatum-us.com.

PROPER TECHNOLOGY NEEDED BEFORE IMPLEMENTING A 'RECURRING REVENUE MODEL'

The recurring revenue model, pioneered by telecommunications service providers, is being adopted by an increasing number of organizations to beef up revenue and improve their customers' experiences with products and services, reports Ventana Research.

The recurring revenue business model involves billing transactions based on a prior agreement or contract (auto-renewals and/or subscriptions are examples of the recurring revenue model).

The most significant challenge organizations reported lies in integrating systems with sales force automation; ERP; and contracting, billing, and accounting systems.

Only one-third of organizations are satisfied with the existing systems they use to support recurring revenue, and most respondents indicate that their lack of satisfaction is due to functionality, flexibility, and lack of integration issues.

"There are still area to address regarding the systems support of recurring revenue processes," reveals Ventana. Training, improved analytics, and systems improvements will enable more successful implementations.

REVERSE SALES AND USE TAX AUDITS

As those familiar with the myriad sales and use tax laws are well aware, it is very easy to overpay sales or use tax. The rules are complicated and constantly changing, and there can be turnover of the personnel handling the function. That's why some organizations hire outside experts to come in and identify refund opportunities. These same experts will pinpoint potential areas where there may be exposure. In both of these cases, the organization can take one of two approaches: sort it out now by filing for a refund or paying excess taxes owed, or simply fix the problem to ensure future compliance.

Many providers handle reverse audits for a percentage of the savings, which is a similar arrangement as a payment recovery audit or VAT reclaim service. An organization that undertakes a reverse sales and use tax audit benefits in several ways. In addition to the improved cash flow, you also receive training and recommendations to improve compliance so that mistakes can be avoided in the future. ❑

THE CONTROLLER'S CALENDAR

Order to Cash (OTC) Summit, June 17-19, Fairmont Chicago Millenium Park, Chicago. For more information, go to www.iofm.com/order-to-cash.

IOFM's *Controller's Conference & Expo,* September 9-11, The Westin O'Hare, Chicago, IL. For more information go to www.iofm.com/controllers-conference

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