The Crucial Monthly Close

Owners need timely and accurate financial statements to best manage their business

by **Dennis Niven**

HOW IS YOUR business doing lately? As an owner, you probably have a sense of how things are going, but is it right? While I have developed a great respect for an owner's "gut feel" over my 40 years of consulting, there are many illusions and counter-intuitive aspects to business that can mislead owners. A common counter-intuitive illusion is that if sales are increasing, things must be getting better. As discussed in the article on working capital, the first in this "Business Education" series, few events can deplete cash in a business as quickly as increasing sales. Owners need a periodic "gut check," and a crucial one is supplied by having timely and accurate financial statements that the owner respects and understands.

To produce financial statements, usually on a monthly basis, an accountant must record transactions for all financial events in a comprehensive manner. While the recording of cash receipts and disbursements might be straightforward, accrual adjustments are not. A monthly close commonly takes three to five days to complete, and that is after the passing of seven to ten days for billings to be completed and for bank statements and invoices to be received. A business owner, then, should expect a good set of financial statements by the 10th or 15th of each month.

Notice that I said "accrual adjustments." Accrual adjustments are made to report sales as earned, and all costs that "match" those particular sales or expire during the month are accrued to determine profit or loss and, perhaps more importantly, where cash came from and where it went. Accrued sales are reported whether or not they have been collected, and accrued expenses are matched with sales for the month whether or not they have been paid. Expenses include cash entries such as payments for material, labor and overhead expenses as well as non-cash entries such as depreciation on long-term assets. Only by matching expense with revenue on the accrual basis can a business owner see through what are often simply the illusions of profitability. Appropriate management steps can then be taken based on this information.

Sales being crucial to the management of a business, owners are anxious to see the results as quickly as possible, especially if they suspect a good or bad month. Accountants, being the meticulous creatures that they are, need the time to make their accrual entries and see that all revenues are reported along with all matching expenses. Data mentioned above are simply not available immediately after month-end, and pressure to get the numbers earlier leads to mistakes, estimates and inaccuracy. While we don't want meaningless financial statements, an accountant's pursuit of accuracy also has a diminishing rate of return. So, what can be done to get financial statements done sooner?

Here are 10 systemic changes that can be made to get statements out sooner:

- Have experienced supervision in place for the accountant during this time. This can be outsourced on an as-needed basis.
- Don't keep the accountant in the dark. The accountant needs to anticipate what entries might be needed to record unusual events.
- Billings can be completed on a timelier basis by those employees responsible for billing. Absences of billing professionals must be covered to avoid delays (in both the monthly close and the cash collection of those billings).

- Expense reports can be required within two days of month-end.
- Accountants can have telephone and email-free days to work the close, and be protected from other "priorities."
- The cut-off for the month can be moved up to the 25th. Bank statements and vendor invoices can cut off earlier, too.
- Email invoices and billings to eliminate several days in transit.
- Expenses can be estimated to save time. Don't sweat the small stuff.
- Have recurring entries and an entries list that the accountant can follow.
- Begin with the budget in mind. Resolve differences with budgets to avoid time-consuming mistakes.

Recognizing the crucial nature of the monthly close is the first step to having timely and accurate financial statements. The ability to better manage the business improves when the statements are reconciled with the owner's gut feel.

Note that the above discussion refers to the *monthly* close. At year-end, methods to accelerate the close are generally not appropriate, as the determination of profit and loss is of particular interest to auditors and IRS agents. A year-end close generally takes more than 30 days to prepare while all material adjustments are made.

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