

# MAKING MORE **Time**

## FOR **EFFECTIVE FINANCIAL ANALYSIS**

*It's a great way to add value to your company.*

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**Time.** No one has enough of it—especially financial professionals. We come to work each day with the best of intentions but never seem to get everything done that we want to do. And the things we put off are usually the activities that are proactive and that could help our companies the most. For example, we complete reports and go through monthly processes at the expense of doing analysis—the work where we can really add value.

In financial transaction departments that process payroll, accounts receivable, and accounts payable, process improvement activities are the added value. Balance-sheet mining and cash flow maximization (in addition to process improvement activities) add the value in accounting departments that record journal entries and reconcile accounts.

When you think about it, many required financial activities—filling out a journal entry, completing a tax form, reconciling an account, paying a vendor—don't add value to a company. But they're extremely important because when they aren't done correctly they can reduce a company's value, hurt its reputation, or increase its legal

risk. Therefore, we financial professionals should strive to perform these activities as efficiently as possible so we can be free to do more analysis and more process improvement. It's the creative work that really adds value.

How do we go about reducing the time spent on these activities and increasing the time spent on financial analysis and consulting? First, we must change the way we think and open our minds to approaching things differently. Then we should analyze the way we spend our time to understand where there are opportunities for change. Finally, we need to change our behaviors and implement new tools to help us do more with less—less time that is.

Let's take a look at some ways to do this.

### **CHANGING OUR THINKING**

Financial analysis is much more an art than a science, involving an “educated gut feel” that develops over time. Effective analysis involves getting comfortable with 80% of the information to make decisions and letting go of the rest. Once we do this, we eliminate unnecessary tasks and save time. Yet this is hard for most financial profes-

sionals to do. We want things to tie to the penny. We want to have all the answers before we go into a meeting. But does that last penny really matter in an analysis, and was it a good use of our time finding it?

A recent book called *Blink* by Malcolm Gladwell supports this idea. It's about "thin slicing," or the concept that we can make many decisions with a fraction of the information we collect to make the decision. It offers several illustrations where, with the right information, we can draw conclusions quickly without needing a lot more information.

A good example in the book describes how Cook County Hospital in Chicago (now John H. Stroger, Jr. Hospital of Cook County) learned a better way to diagnose heart attacks in the emergency room. Every day about 30 patients would come into the ER, worried that they were having a heart attack. As you might expect, patients with chest pain are resource intensive because they require more medical professionals' attention, more testing equipment, and more hospital beds than most other patients. Yet even with all of this attention, it was difficult to determine whether someone really had a heart attack. In addition, different doctors using the same diagnostic data would often draw different conclusions. With limited bed space and a need for quality improvement, something had to be done.

Cook County decided to implement a decision algorithm developed by a cardiologist named Lee Goldman. After extensive computer modeling, Goldman discovered that the diagnosis of whether someone was really having a heart attack could be made from just four factors: (1) the results of an electrocardiograph, (2) the pain felt by the patient is unstable angina, (3) there is fluid in the patient's lungs, and (4) the patient's systolic blood pressure is below 100. Each combination of these risk factors followed a different path down a decision tree, which guided emergency room professionals to the best treatment options. This new method proved to be more accurate than previous methods and required fewer resources. It also suggested that extra information wasn't only unnecessary, but it was sometimes dangerous because it might lead doctors to the wrong conclusion.

Making decisions and drawing conclusions quickly or with less information doesn't work for everything. We wouldn't want to draw quick conclusions on a Sarbanes-Oxley audit—we would want our conclusions based on well-tested facts. But certainly there are other things we do that are unnecessary or that could be done more effectively.

How do we determine what information is needed and

what isn't and the best way to spend our time? One way is to wait it out and let years of experience take effect. Most highly effective CFOs are good at spending their time on only the most relevant tasks and at making decisions quickly with little information. But a more accessible way is to analyze how we spend our time by doing a "Time-Spent Analysis."

## ANALYZING OUR TIME

A Time-Spent Analysis is a spreadsheet that categorizes the time we spend in a typical year. In addition to our time, it ideally includes the time of others in our department who have similar responsibilities. Table 1 illustrates a Time-Spent Analysis for a fictitious financial analysis department. The tasks are categorized into four major types: (1) Administrative and Personal, (2) Routine and Reporting, (3) Forecasting and Budgeting, and (4) Projects and Analyses. Both individuals work for the same manager and have estimated the time they spend on various tasks in each of the categories. They have similar responsibilities supporting different product lines within their company. Summarized at the bottom is the amount of time they spend in each category.

We can glean several observations by analyzing the data in Table 1. Overall, Eli spends more time at work each year. But is it effective? He spends more hours and a higher percentage of his time on Routine and Reporting activities, while Peyton spends more time on Projects and Analyses. Further, in Forecasting and Budgeting, Peyton spends more time on the value-added activities of planning, collaboration, and analysis, while Eli spends more time just entering data. Finally, in the Administrative and Personal section, we can see that Eli doesn't have enough time for personal development. He works 100 hours of overtime each year but isn't spending his time as effectively as Peyton.

Yet the analysis doesn't end with the conclusion that Peyton is more effective than Eli at adding value to his finance department. These individuals, or anyone doing a Time-Spent Analysis, also should ask the following questions:

- ◆ What opportunities do we have to develop **best practices**? Peyton spends less time doing Routine and Reporting activities to support his product line. Sharing his methods with Eli should provide some insights on how to be more effective here.

- ◆ What activities can be **eliminated**? By comparing the reports and analyses done for each product line, Peyton and Eli might learn that they're doing some unnecessary work. The two should ask others if they need the

reports they are producing for them. Can they eliminate the reports or produce them less often?

◆ What can be **automated** using spreadsheets, databases, macros, etc.? Eli and Peyton should think about the processes they use to complete these tasks. Although he spends less time compiling and entering numbers during the budget process, Peyton still spends 400 hours per year on this activity and could probably automate it further to free up time for more analysis (which he enjoys the most).

Starting with the areas where we spend most of our time will yield the best results. In addition to identifying best practices, tasks to be eliminated, and process improvements through automation, we can also use the Time-Spent Analysis to assist in transitioning jobs when someone leaves the department and another person takes their place.

Before we go further, it's important to make a few points about completing a Time-Spent Analysis. First, it isn't a time tracking tool with the objective of accurately identifying every hour spent during the year—we aren't going to bill a client based on this. The tasks identified should be the major tasks we perform during the year, and the hours should be estimates—in the spirit of learning to draw conclusions with less information. Second, the Time-Spent Analysis is most effective when it's completed incrementally. In other words, work on it for a little while, then set it aside for a day. Revisiting it briefly several times over a period of days will yield a better product.

Completing a Time-Spent Analysis and using it to look for improvement opportunities is an investment in time. Nevertheless, it's an investment that will bear fruit. And it's even more effective when combined with a couple of behaviors that will help us make decisions with less information: practicing the judgment of materiality and taking a "Top-Down" approach to analysis.

## CHANGING OUR BEHAVIOR—MATERIALITY

Knowing when we've reached a point where spending more time on an analysis won't provide enough benefit to continue is understanding materiality. It's amazing how many people understand this concept but don't practice it at work. They continue to seek more information when they already have enough, trying to research something to the penny or understand that really small variance. A good illustration of materiality is how we tell time. If someone asks us what time it is, we typically say, "It's about 2:30." We don't say "It's 2:28 and 42 seconds." In addition, most of us don't know how much cash we have on us to the penny, but we usually know whether we have enough to buy a coffee or a new iPod. The point is we

**Table 1: TIME-SPENT ANALYSIS**

	PEYTON	ELI
<b>ADMINISTRATIVE &amp; PERSONAL</b>		
Staff Meetings	50	50
Other Meetings	65	65
Training & Development	40	10
Vacation & Holidays	160	160
<b>Total Administrative &amp; Personal Hours</b>	<b>315</b>	<b>285</b>
<b>ROUTINE &amp; REPORTING</b>		
Financial Reporting	300	420
Statistical Reporting	50	100
Month-End Close	280	375
Account Reconciliations	80	100
<b>Total Routine &amp; Reporting Hours</b>	<b>710</b>	<b>995</b>
<b>FORECASTING &amp; BUDGETING</b>		
Planning	250	200
Compiling and Entering Data	400	550
Kickoff and Strategy Meetings	75	50
Review and Analysis	50	20
<b>Total Forecasting &amp; Budgeting</b>	<b>775</b>	<b>820</b>
<b>PROJECTS &amp; ANALYSES</b>		
Ad Hoc Reporting & Analysis	120	20
Analysis of Potential Acquisitions	20	10
Analysis of New Products	60	20
Analysis of Staffing Proposals	30	20
Competitor Analyses	50	10
<b>Total Projects &amp; Analyses</b>	<b>280</b>	<b>80</b>
<b>SUMMARY</b>		
<b>Administrative &amp; Personal</b>	315	285
<b>Routine &amp; Reporting</b>	710	995
<b>Forecasting &amp; Budgeting</b>	775	820
<b>Projects &amp; Analyses</b>	280	80
<b>Total Annual Hours (standard: 52 X 40 = 2,080)</b>	2,080	2,180
<b>SUMMARY: HOURS AS PERCENT OF TOTAL</b>		
<b>Administrative &amp; Personal</b>	15%	13%
<b>Routine &amp; Reporting</b>	34%	46%
<b>Forecasting &amp; Budgeting</b>	37%	38%
<b>Projects &amp; Analyses</b>	13%	4%

**Table 2: ADMINISTRATIVE EXPENSE RECONCILIATION**

(\$ in 000s)

2006 Administrative Expenses	\$ 40,000
Annual Salary Increases	\$ 4,100
Payroll Tax Increases	\$ 200
Increase in Travel	\$ 100
Consultants for IT Project	\$ 1,000
New Billing System	\$ 1,200
Cleaning Service Price Increase	\$ 20
Telephone Service Price Increase	\$ 32
New Product Advertising Campaign	\$ 840
Office Supplies	\$ 7
Higher Printing Expenses	\$ 35
Postage Increase	\$ 15
Other	\$ 1
2007 Administrative Expenses	\$ 47,550

already have enough information to make relevant decisions about time or our spending. We are practicing materiality in our daily lives and don't even realize it. Now we need to practice it more at work.

Consider the Time-Spent Analysis from Table 1. Perhaps Eli is taking longer to complete his Financial Reporting tasks because he's taking them to a level of unnecessary detail. Consider one of his analyses in Table 2. He's doing a comparison of administrative expenses for the CFO by identifying every difference he can find until he has only \$1,000 remaining, which he calls "Other." Peyton has decided to help Eli. He has a better approach, which is shown in Table 3. This analysis is in \$ millions rather than in \$ thousands. First, the Payroll Tax Increase is a function of higher salaries, so Peyton suggests just displaying the difference in the summary account Salaries and Related rather than looking at the detail accounts. Second, Increase in Travel, Cleaning Service Price Increase, Telephone Service Price Increase, Office Supplies, Higher Printing Expenses, Postage Increase, and Other are all relatively small amounts and round to \$100,000 or less in this exercise. Therefore, they should be combined in the "Other" category for this analysis. The result is an analysis that has only five "material" items identified rather than 12 items that include "immaterial" items. In this case, the CFO doesn't want the detailed items. He wants only those that provide the key differences between the years—the biggest opportunities for

**Table 3: ADMINISTRATIVE EXPENSE RECONCILIATION**

(\$ in millions)

2006 Administrative Expenses	\$ 40.0
Annual Salary and Related Increases	\$ 4.3
Consultants for IT Project	\$ 1.0
New Billing System	\$ 1.2
New Product Advertising Campaign	\$ 0.8
Other	\$ 0.2
2007 Administrative Expenses	\$ 47.6

potential improvements. A higher level of detail might be warranted if the analysis were for a cost center manager. The key is that we must know our audience.

There's a subtlety in Table 3 that you may have noticed: The numbers don't foot. They add to \$47.5 million, not \$47.6 million. Does this bother you? If so, you should try to let go. You know that it's the result of rounding and isn't relevant to decision making. And if it bothers the CFO, perhaps he shouldn't be the CFO!

### USING A TOP-DOWN APPROACH TO ANALYSIS

The practice of Top-Down Analysis is to take a big-picture view of things *first*. Start with the most important analytic, and work down to lower levels of detail (but only on paths that are necessary to understand the analytic). When an answer becomes clear, *always* come back to the top. Consider an example where a company has 10 divisions, and each division has 10 products with profit targets. Some analysts might look at performance results for all 100 products. The most efficient approach, however, would be to select only the divisions that have material product profit variances and then drill down to the product level in them. In other words, look only at the divisions that have material variances. Now, might some key variances be missed where significant positive and negative growth variances exist for products within the same division? Perhaps. But if the division manager is delivering overall, does it really matter how he or she does it? Again, we must learn to let go sometimes.

Another example of employing a Top-Down Analysis approach involves working with financial statements such as income statements. Table 4 shows a simple operating income statement for an insurance company. Anyone asked to identify the most important number on the page would reply "Operating Income." Now ask yourself, "Is

this the *first* number I look at when analyzing an income statement?” For many people, the answer is “no.” They start with the revenue numbers at the top and work their way down to operating income. The problem is in the design of the income statement. When income statements developed as a financial tool many years ago, the order of line items was dictated by the order of additions and subtractions needed to get to the final number, or “bottom line.” Today, with spreadsheets and financial software, we aren’t held to a specific order. So why not change it? Table 5 shows a “Top-Down” income statement. The most important number is at the top. Each next level of important numbers has its own sections with the details beneath them. Any financial statement or analysis can be designed this way. The key is to start at the top of this new income statement and work our way down each section from the most important numbers to the least important.

Using a Top-Down Analysis approach has some advantages. First, it saves time since we’re only looking at the important numbers, variances, etc. Second, it’s easier to focus on one thing at a time rather than several. Big-picture thinking leads to Top-Down Analysis. The key is not getting lost in the detail.

## IT’S TIME TO CHANGE

In his book *The World Is Flat*, Thomas L. Friedman makes the point several times that things that are transaction based can often be done more cost effectively overseas. Fortunately, the role of financial professionals is changing from a transaction focus to a more strategic focus. It’s refreshing to see that our leadership at the Institute of Management Accountants (IMA®) has recognized this and is moving us in this direction. As financial professionals, we need to transform ourselves to add more value to our companies.

Remember, follow these steps to become a more valuable financial resource to your company and to make more time for effective financial analysis:

- ◆ First, change your way of thinking, and open your mind to doing things differently by getting comfortable making decisions with less information.
- ◆ Second, use a Time-Spent Analysis to analyze the way you spend your time and understand where you have opportunities for change.

**Table 4: COMPARATIVE INCOME STATEMENT—INSURANCE COMPANY**

	ACTUAL	FORECAST	VARIANCE
Premiums	\$10,750	\$10,000	\$ 750
Administrative Service Fees	\$ 1,100	\$ 1,000	\$ 100
<b>Total Revenue</b>	<b>\$11,850</b>	<b>\$11,000</b>	<b>\$ 850</b>
<b>Cost of Benefits</b>	<b>\$ 8,400</b>	<b>\$ 8,000</b>	<b>\$ 400</b>
<b>Gross Margin</b>	<b>\$ 3,450</b>	<b>\$ 3,000</b>	<b>\$ 450</b>
Selling Expenses	\$ 800	\$ 750	\$ 50
Administrative Expenses	\$ 1,600	\$ 1,500	\$ 100
<b>Total Expenses</b>	<b>\$ 2,400</b>	<b>\$ 2,250</b>	<b>\$ 150</b>
<b>Operating Income</b>	<b>\$ 1,050</b>	<b>\$ 750</b>	<b>\$ 300</b>

**Table 5: TOP-DOWN COMPARATIVE INCOME STATEMENT**

	ACTUAL	FORECAST	VARIANCE
<b>Operating Income</b>	<b>\$ 1,050</b>	<b>\$ 750</b>	<b>\$ 300</b>
<b>Gross Margin</b>	<b>\$ 3,450</b>	<b>\$ 3,000</b>	<b>\$ 450</b>
<b>Total Revenue</b>	<b>\$ 11,850</b>	<b>\$ 11,000</b>	<b>\$ 850</b>
Premiums	\$ 10,750	\$ 10,000	\$ 750
Administrative Service Fees	\$ 1,100	\$ 1,000	\$ 100
<b>Cost of Benefits</b>	<b>\$(8,400)</b>	<b>\$(8,000)</b>	<b>\$ (400)</b>
<b>Total Expenses</b>	<b>\$ 2,400</b>	<b>\$ 2,250</b>	<b>\$ 150</b>
Selling Expenses	\$ 800	\$ 750	\$ 50
Administrative Expenses	\$ 1,600	\$ 1,500	\$ 100

◆ Third, change your behaviors, and implement some new tools that help you do more with less. Understand and practice the techniques of Materiality and Top-Down Analysis.

Now is the time for all of us to shift the focus of our finance organizations from transaction processing to value-added analysis. ■

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