By the Numbers

The Need for Financial Information

Almost everyone has a need for gathering and organizing financial information. If you want to buy something, you need financial information to determine whether or not you can afford it. If you want to create a personal budget, you need financial information to know exactly how much money you're making and spending. When you're filing your taxes, you need financial information to ensure you complete your return accurately.

Businesses need to gather and organize their financial information, too. Read on to learn more about the types of financial information businesses use as well as how they use it!

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Objectives

A Describe useful financial information.

B Describe the uses of financial information in business.

Make It Meaningful

Financial information is any record or data related to an individual's or business's financial activities. Think about your personal financial information. It might include records of:

- Credit card transactions
- Bank deposits and withdrawals
- Loans (school, car, house, etc.)
- Wages/Salary
- Bills (rent, utilities, wireless, etc.)
- Investments, savings accounts, and other **assets**

Can you think of more examples of personal financial information? (There are several free online resources for keeping track of your personal financial information. Check out www.mint.com, for example!)

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Businesses must keep track of quite a bit of financial information as well. Here are just a few examples of financial data that a typical business generates:

- **Accounts payable** records
- **Accounts receivable** records
- Receipts
- Sales invoices
- Corporate credit card transactions
- Loan documents
- Expense reports
- Income statements
- Records of other assets

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Can you think of more examples of a business's financial information?

Accounts payable are debts a business owes (e.g., a bill for having new carpet installed). Accounts receivable represent money that is owed to a business (e.g., an outstanding sales invoice for a customer who bought raw materials from the company).

Make it work

Imagine a big desk piled high with papers—receipts, bank statements, pay stubs, bills, etc. That's a lot of financial data! However, in its current state, it isn't very useful. The data need to be gathered and organized in a way that makes sense and is useful.

Data and Information

Don't let the terms "data" and "information" confuse you. Data are raw facts and figures. Information is knowledge or facts presented in a usable form. However, many people tend to use the two terms interchangeably.

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Make it useful

What makes financial information useful? The following four criteria are common standards for achieving this goal:

Useful financial information is understandable. Have you ever purchased a product that required assembly—and then realized that the instructions were printed in a foreign language? Unless you had some very detailed photos to go by, the instructions probably weren't of much use to you. That's because they weren't understandable!

Financial information must be understandable, not just to the people who prepare it, but to everyone who needs to use it. Accountants and others in the field of finance may have in-depth knowledge of financial data, but their reports will be seen by managers, employees, investors, etc., who may not be as skilled in the finer points of financial interpretation. For this reason, useful financial information is presented in ways that are understandable, both in the language used and in the layout and format of the report.

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Useful financial information is relevant. A good definition of **relevant** is "appropriate to the situation at hand." Let's say you're trying to determine whether or not you can afford to buy an iPad. While you're checking your bank account's balance, your sister mentions that she still has birthday money left and is thinking about purchasing an iPad herself. You're happy for your sibling, but her financial information doesn't help you with your decision. It's *irrelevant*.

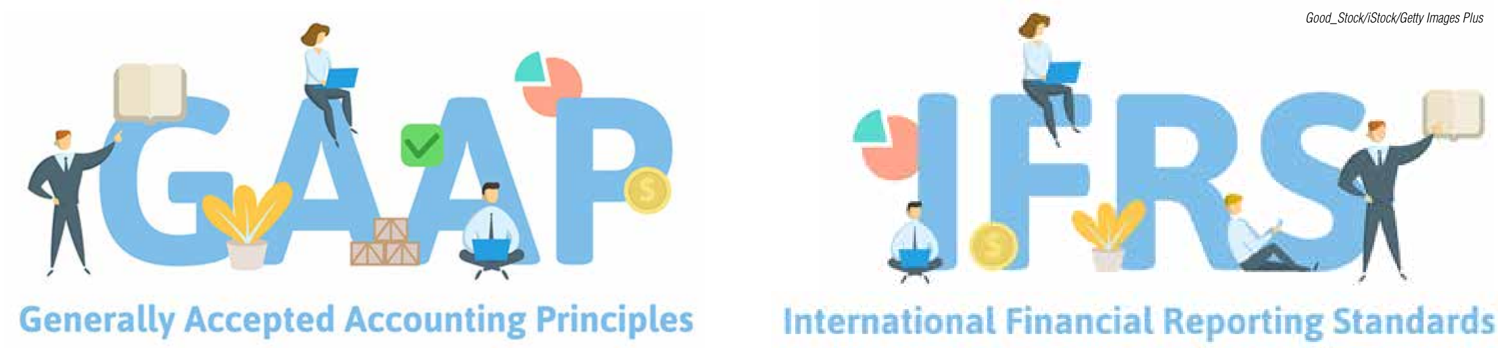
With so much financial data available within a business, it can be difficult to distinguish what's relevant from what's irrelevant. The people who receive financial information need it to be applicable to their purposes. For example, a business deciding whether to hire new employees may need to analyze a different set of financial data than potential investors determining whether a company will provide a good **return** on their money. Various reports are prepared with this in mind.

In addition to being applicable to its audience, relevant financial information is also *timely*. This means that it's up to date and provided to its users in time to take needed action. In many situations, outdated financial information is useless. Fortunately, advances in information technology have made keeping financial information current a much easier task.

Useful financial information is reliable. When a user receives financial information, s/he should be able to safely assume that the information is accurate. This means that the information is not only error-free but is also *complete*. Let's say your friend sends you a text inviting you to a concert. He tells you where the concert is, what time it starts, and where he'll meet you. This is all accurate information; however, since he hasn't told you what *day* the concert is, the information is incomplete. It isn't usable until you get all the data you need. The same goes for a business's financial information.

Another characteristic of reliable financial information is **neutrality**. Neutral means impartial or unbiased. Financial reports should focus on the numbers, not how they'll be interpreted or analyzed by those who receive them. It might be tempting to present financial data in a way that makes the company look better (or worse, depending on the circumstances), but biased information is not reliable or useful. In addition, it's unethical to attempt to influence users of financial information. Financial information must stick to the facts!

Reliable financial information also conforms to specific standards accepted in the U.S. and around the world. It wouldn't be good if businesses made up their own rules and procedures for processing financial information! Think of it in these terms: What if every teacher in your school used a different grading scale? An "A" in one class might be a "B" in another. This would make your transcripts very difficult to interpret! That's why a set of standards is necessary. No matter what standards a business chooses to use, it's important to remain consistent and let users know what system has been selected.



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▲ The GAAP and IFRS are standards for U.S. and international accounting. There are some similarities between the two, but there are also important differences.

Useful financial information is comparable. Users must be able to compare current financial information to past financial information. If they can't, it's impossible to see what financial changes have occurred in the business, either positive or negative. The same principle applies to your own life in many ways. For example, if you don't have access to your basketball stats from last season, how can you know if you've done any better this year? Or, what if last season's stats were recorded using a completely different method or format? That would also make the comparison quite difficult.

A business's financial information should also be comparable to data from similar businesses. Potential investors want to see how one company stacks up against another company in the same industry. Comparability is another reason that businesses conform to accepted standards—it provides **consistency** that benefits everyone.

The Gray Zone

By now, you should understand why financial information is so crucial for businesses. From helping reduce expenses to planning business expansion, financial information helps companies grow and thrive. Because of its sensitive nature, financial information should be carefully safeguarded by all who use it. It's not always clear, however, just how careful an employee should be when dealing with financial information. Consider Mary, a manager at a public accounting firm. While away on a business trip, Mary received an email containing sensitive company financial data. She accidentally downloaded and viewed the documents on a public Wi-Fi network. Can you think of any reasons why Mary's behavior might be risky? Is this a breach of security that deserves punishment?

Treat it right

Even within the same set of standards, there may be more than one acceptable way to "treat" (record and organize) a piece of financial information. Let's work through a couple of examples.

You work for a marketing firm as a graphic designer. You make a $15 payment to a website that offers officially licensed sports graphics for 10 cents each. The company receives your money in one lump sum, but it will provide its service to you over a period of time (however long it takes you to download 150 graphics). The expenses involved in providing the service to you cost the company around $3. So, that's $15 coming in and $3 going out. However, the $3 doesn't go out at the exact same time the $15 comes in. The company can spend your money immediately if it wants to, but it must determine how to keep track of the expenses involved in providing the service to you so that they don't become lost or hidden. There may be more than one acceptable accounting method for tracking these expenses, but the important thing is to do it the same way every time.

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▲ Consistent treatment of financial information is important no matter the size of the company. Establishing consistent processes can save lots of time and money in the long run.

You have a summer job babysitting your neighbors' two children. At the beginning of each week, your neighbor gives you $100 in cash for the kids' weekly expenses (pool, ice cream, etc.). It is your job to keep track of what you do with that $100. You might keep a little notebook where you jot down each expense. Or, you might put $20 in five different envelopes marked for each day of the week. However you treat the financial information, you should be consistent and careful so you don't lose track.

Make sense? Can you think of different ways you might "treat" a piece of your personal financial information?

Summary

Financial information is any record or data related to an individual's or business's financial activities. To be useful, financial information must be understandable, relevant, reliable, and comparable. Every business must choose a set of standards to conform to. Consistency is key—even when there is more than one acceptable way to "treat" a piece of financial information, the business must use the same method each time.

TOTAL RECALL

1. List four examples of financial information.
2. Explain why financial information should be easily understandable.
3. What does it mean for financial information to be relevant?
4. Why is it important for financial information to be reliable?
5. Describe what makes financial information comparable.

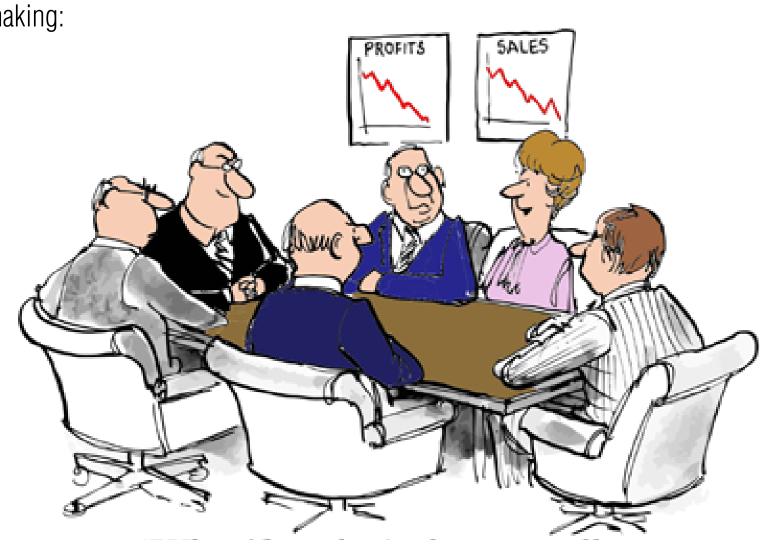
Put It to Good Use

You should now have a better understanding of financial information and its importance. Next, let's look at some of the ways that financial information is put to use.

Business decision-making

Knowing how to keep a business running smoothly is the most important use of financial information. Businesses rely on it when making decisions and figuring out their current and future actions. Here are a few examples of how financial information aids in decision-making:

Reducing expenses. Businesses examine financial information to see how they are spending money and where cuts could be made. For instance, a business determines that its sales team is spending a lot of money taking clients to dinner. The business could cut costs by limiting how much salespeople can spend on client dinners.



"What if we don't change at all ... and something magical just happens?"

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▶ The use of financial information in decision-making is crucial to a business's success. Simply hoping that things will get better doesn't have a great track record.

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Check out Brian Carey's blog post "Six Ways To Reduce Your Business Expenses Right Now." You can find it here: http://blog.intuit.com/money/6-ways-to-reduce-your-business-expenses-right-now/.

Increasing sales. If a business wants to increase sales, it might look at its financial information to determine whether the company can afford to spend more money on promotion. A buy-one, get-one-free offer, for example, may boost sales, but the promotion makes sense only if the business can afford to give away the extra products.

Boosting profits. A company's sales may be strong, but that doesn't necessarily mean that it's making as much profit as the business needs. If profits are low, a business may analyze financial information to see if prices are too low or costs are too high. Once this is known, the business may decide to increase prices or look for ways to reduce costs.

For example, you're earning money for spring break by making and selling jewelry. You've made a lot of sales, but because the materials you use for your jewelry are so expensive, there's not much profit. After looking at your finances, you realize that if you start using less-expensive materials for the jewelry, you'll make more money.

Making purchases. From time to time, businesses make big purchases—buildings, equipment, vehicles, etc. Businesses use financial information to determine what they can afford as well as the best way to finance the purchase. For example, financial information may show that the company has enough available cash to purchase a new delivery van outright, instead of using credit and paying interest.

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◀ Not every piece of financial information needs to be weighed evenly in decision-making, but a company must have as much information as possible before deciding which is the most useful.

Creating and adjusting budgets. It is difficult to manage a business's finances without using a budget. Businesses look at financial information to determine how much money they have available as well as how to allocate it. Financial information can also help adjust budgets as necessary. Perhaps one department is consistently going over budget, while another department is under budget. Having this information would help modify the budget appropriately.

Managing debt. Many businesses carry some debt, and that's OK as long as they manage it properly. One type of debt may be a loan the business took out so that it could buy a piece of equipment. If the equipment enables the business to produce more and increase its profit, the business may look at its financial information and decide to use some of its extra cash to pay off the debt early.

Planning business growth. Most businesses want to grow. And, growth can come in many forms—developing a new product, expanding into a new market, hiring more employees, etc. Growth should create more income for a company, but it costs money to get started. When planning its strategies, businesses use financial information to determine what they can afford and how to finance it. For example, a bike shop wants to extend its evening and weekend hours. Before this happens, the shop will have to review its finances to determine whether it can afford to pay extra wage and utility expenses that result from longer hours.

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▲ Using financial information from the past or present to make decisions for the future can be challenging. A major aspect is weighing the potential risk against the potential gain.

Entering into legal agreements. Businesses use financial information to ensure that their legal agreements have acceptable prices and payment terms. Let's say a business hires an IT consultant to update its network and all its computers. The business will use financial information to determine what it can pay the IT consultant and when. If these terms are acceptable to the consultant, the business and the IT consultant would sign a legal agreement outlining their agreed-upon terms. If the consultant won't accept the terms, the business may have to negotiate further.

Monitoring ongoing business activities and strategies. Businesses use updated financial information to monitor their day-to-day business activities and assess how well their strategies are working. They do so by looking at the differences between what they expected to happen and what actually happened. Let's look at an example:

A restaurant decided to boost its profits by increasing prices on several menu items. Two months later, profits remain about the same. The financial information reveals that sales have dropped slightly since the price increases. This is not what was expected to happen! After studying the differences between projected and actual profit, the business recognizes that, in the long run, increasing prices will hurt its profits. The restaurant decides to lower prices and look for ways to reduce costs instead.

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Checking up on the competition. Businesses don't just look at their own financial information. They also examine competitors' financial information to determine how well their companies are performing in comparison to their competition. They may also analyze another company's financial information to see if the business is worth **acquiring** (buying).

Summary

Financial information is important for use in business decision-making. Businesses use financial data to decide how to reduce expenses, increase sales, boost profits, etc.

TOTAL RECALL

1. What types of decisions does financial information help businesses make?

Make It Pay!

Think about your place of employment. If you're not working right now, consider your personal financial information. What are some decisions being made right now at your business or in your personal life? Perhaps the frozen-yogurt shop where you work is considering opening a new location, or perhaps you're thinking of purchasing a car.

What types of financial information are important for making these decisions?