

Your Financial Statements are Misleading

I am a big believer in accurate and timely financial statements. I started my career as a CPA performing audits of financial statements to ensure their accuracy. I strongly believe in using financial statements as a tool to run the business on a daily basis. But if we're not careful and do not fully understand what financial statements do and do not show, we are apt to head in a wrong direction.

I often ask clients "*What is your greatest asset?*" Having been well trained by their accountant, I generally hear answers such as inventory, buildings, equipment or accounts receivable. I will tell them that I don't think their answers are correct, upon which they will often pull out a copy of their balance sheet, look at it and show me the largest number. I tell them that this may sound strange coming from someone trained as an accountant, but their greatest asset does not appear on their balance sheet. It's a limitation of our traditional accounting systems.

With that statement, the clients will often look puzzled for a moment, smile as they understand, and then tell me that what I'm probably talking about are their people -- their employees. And I would share with them that they are right -- but it's not just the employee's bodies, or their hands or even their brains that are the most important assets. Most important is what I call the *spirit* of our people.

Every day your employees walk in the door filled with creativity, initiative, a sense of responsibility, a desire to accomplish something and to make a difference with what they do. It's this spirit that leads to passion.

So many times we don't think about this spirit of our people because it's not on our financial statements. There is no line item on the balance sheet for people or their passion. But I can tell you that when employees become passionate about what they do, you will have found the greatest asset – the greatest resource – your business can ever have. Your role as a leader is to tap into that spirit and properly harness that passion for everyone's benefit. We'll talk more about how to do that a little later.

While we're on the subject of financial statements, let's move for a moment from the balance sheet to the profit & loss statement. What is the greatest cost your company has every month? The typical answer is salaries & wages, materials for another large item on their income statement. Once again, I believe their financial statements, although accurate, may be misleading.

Without ever looking at their financial statements, I can tell you that the greatest cost most any company has is not on their income statement. Their greatest cost is *opportunity cost* – the cost of lost opportunities – good employees we did not retain or did not hire in the first place, passion of our employees we did not tap into, sales we did not make, new customers we did not reach, new products we did not introduce, and new markets we did not go into. We tend not to think about these costs because they do not

appear on our financial statements. Our traditional accounting systems only record historical transactions. Nowhere in our accounting system do we record lost opportunities. But I firmly believe these lost opportunities are the greatest cost to your business every day.

Having said that, now let me reaffirm that your financial statements are a critical tool for operating your business. They must be accurate. They must be timely. They must be set up properly so that they are not simply creating historical archives but are working as real-time decision-making tools to help you and your entire team run your business better. As business consultants we spend a great deal of time working with clients to make sure that their *accounting system* is working hard for them as a valuable *information system*.

But even the best data is worthless if you don't use it properly. Simply keep in mind as you use your financial reports that your greatest assets and your greatest costs are not listed on the pages.