Catch Errors If You Can: Working With Your Accounting Department

Like a well-oiled machine, business credit can run smoothly when the credit and accounting departments work together during the entirety of a transaction. As credit managers keep their eyes peeled for any signs of distress and ensure payments are collected in a timely fashion, accountants handle the ins and outs of financial statements, setting the foundation of the relationship. Errors in either department, whether big or small, can create problems down the line, essentially leaving the business' fate in the hands of finance departments.

A September study from Massachusetts-based research firm Audit Analytics saw a rise in material accounting mistakes in the first half of 2018, but according to NACM's Financial Statement Analysis course instructors, Toni Drake, CCE, and George Schnupp, CCE, all hope isn't lost as long as credit managers and accountants learn to coalesce and strengthen their give-and-take relationship. Drake, the president of TRM Financial Services in Midland, Texas, and Schnupp, the global credit director for Anixter, Inc. in Glenview, Illinois, teach Financial Statement Analysis I and II, respectively, at NACM's national office in Columbia, Maryland. Schnupp also teaches FSA II at Credit Congress.

"Most credit managers are in one industry, so they're looking at financial statement after financial statement all in the same industry," Drake said. "If there's something that doesn't look appropriate or normal for that particular industry—something that just sticks out and that's not how the rest of the industry is performing—you have to look into that."

"The No. 1 communication is risk between the two departments because risk would be captured by reserves," Schnupp added. "The second-most important piece is the communication of cash, our estimations of cash coming in. This is timely notification of very large wires coming in and reserves and cash coming in. These are key communications between both functional areas that really should be going on every day."

For more than a decade, accountants working for U.S. public companies have been at the top of their game, each year showing less and less material accounting mistakes. A financial item is considered material when there's a possibility the error could impact an economic decision, such as estimated income and earnings trends, according to management consulting and publishing firm Solution Matrix Ltd.'s website. If the impact is deemed "too small," the error may be ignored.

Audit Analytics' latest finding revealed the number of accounting mistakes not only rose during the first half of 2018, but also led to the restating and refiling of several companies' finances. Changes to U.S. tax law, specifically the Tax Cuts and Jobs Act (TCJA) passed in December 2017, were said to have contributed to the rise in errors.

"Errors can be anything from a misapplication of accounting principles to an error in inputs in accounting software or an error in [Microsoft] Excel schedules," Michael Burke, partner at accounting firm UHY LLP, told *The Wall Street Journal (WSJ)* in a September article.

The *WSJ* article revealed results from the study of more than 9,000 U.S. public companies, 65 of which made accounting mistakes that required restating and refiling "entire financial filings to regulators, compared with 60 companies for the same period last year."

In a separate study, completed by business and financial software company Intuit and released in mid-September, the majority of accounting errors were due to inefficient record-keeping. More than half of the 500-plus small- to medium-sized businesses that responded said a lack of accounting software and falling behind on bills contributed to mistakes.

Since the Sarbanes-Oxley Act of 2002 (SOX) was enacted, Schnupp said, accounting rules and policies have undergone "extreme tightening." In the chapter on the Legal Environment of Credit in NACM's *Principles of Business Credit*, "SOX was created and enacted to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for other purposes."

"It's very, very, very detailed," he said. "I could see how [credit managers] might find some issues on the accounting side when a smaller company is preparing certain financials themselves and try to do the best they can. Every once in a while, you may end up finding an error in financial statements on the numbers side or it was booked to the wrong account. That's more the exception than the rule."

Drake said credit managers must have a strong line of communication between the credit and accounting departments. She reiterated the importance for credit managers to thoroughly review financial statements and any accompanying notes.

"Go to your own accounting department and say, 'Explain this to me. Does this make sense to you? Is what this customer is saying something you think could and probably did happen?'" Drake said. "If a credit manager just looks at the surface of a financial statement and at what we call 'the bottom line,' the net income, without considering all the factors that contributed to that, they would probably not get a true picture of that company's financial condition and financial performance."

—Andrew Michaels, editorial associate