

Growth Rock News

February 2009

A guide to build durable businesses with rock solid controls

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EDI Basics

- By Kate Spontak

Overview

EDI stands for Electronic Data Interchange. It is simply the computer-to-computer exchange of business documents to facilitate buy and sell transactions between companies. EDI documents use specific computer record formats that are based on widely accepted standards. However, each company may use the flexibility allowed by the standards in a unique way that fits their business needs.

EDI has been around since the 1960's. It was first used by railroad companies in the U.S. long before there was e-commerce or the internet.

Today EDI is used in a variety of industries and is popular with companies in inventory-based industries, such as those in manufacturing, retail and wholesale distribution. When used well, EDI can improve the entire inventory supply chain. EDI can improve efficiencies, lower costs and reduce inventory, while maintaining good controls. In fact, over 80,000 companies use EDI to improve efficiency. Many of these companies require all business partners to use EDI.

Computer-to-computer exchange of information is much less expensive than handling paper documents. Studies have shown that processing a paper-based order can cost \$70 or more, while processing an EDI order costs a dollar or less. EDI requires much less labor. Fewer errors occur because computer systems process the documents.

EDI transactions between

companies flow faster and more reliably than do paper documents. Faster transactions support reduction in inventory levels, better use of warehouse space, fewer out-of-stock occurrences and lower freight costs through fewer rush shipments. Because of the speed in handling purchasing transactions, EDI can be used to support just-in-time inventory management. Paper purchase orders can take up to 10 days from the time the buyer prepares the order to when the supplier ships. EDI orders can take as little as one day.

EDI has improved the efficiency of business communications in many industries. Business documents, such as invoices, purchase orders, and advanced shipping notices, can all be exchanged between companies through EDI.

How EDI Works

Here is an example of how an EDI transaction works. A buyer prepares an order in his purchasing system and has it approved. The order is translated into an EDI document format called an 850 purchase order.

The 850 purchase order is then securely transmitted to the supplier via the internet or through a VAN (Value Added Network).

The buyer's VAN is like an electronic post office that connects with the supplier's VAN. The VANs make sure that EDI transactions are sent and received. The supplier's VAN ensures that the supplier receives the order.

The supplier's EDI system then

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Take Control of Your Fiscal Periods

Nothing strikes the ire of accountants more than finding a financial statement error in a prior period. It happens all too common. The controller/accounting manager goes about the month-end close. Just when he is about to finalize the financial statements, he realizes that the prior period balances do not tie to last month's reported results. He knows the prior balance is wrong, but doesn't know in which month. If he is working on the year-end close, he can choose from one of 11 possibilities. In addition, if the company has subsidiaries, he has to figure out which entity. Exasperated, the controller backtracks to figure out what exactly happened. All the while, the CFO is waiting impatiently for the financial statements. After spending hours re-ticking and re-tying figures, the controller discovers that it was entity XYZ. By accident an A/P clerk posted a vendor invoice to period one!

It is a common problem. Today's accounting system gives users flexibility to post to any period. If users are not careful about fiscal period controls, errors can and will result. Accurate data entry requires transactions to be posted to the right account and period. This is particularly true, if the company uses accrual accounting. For public companies that report quarterly financial information to the SEC, the accuracy of prior period information is paramount. Accounting information has to be correct not only for the current period, but also for prior periods.

Accuracy of accounting postings can be improved by restricting data entry to a single period. About half of the battle is making sure transactions are posted to the right period. To

improve controls over the fiscal period, companies should consider implementing the following procedures:

1. Have a dedicated person, such as the controller, be responsible for closing and opening a fiscal period in the accounting system.
2. Establish clear deadlines when to close a period in the accounting system. Deadlines and cut-off dates can be established for each module, such as accounts payable, accounts receivable and general ledger.
3. Use a checklist to make sure all companies and modules in the accounting system are accounted for and closed properly.
4. Use lock down features to prevent posting to a closed period.
5. Restrict non-authorized users from having the ability to open or close a fiscal period.
6. Have procedures to prevent anyone from re-opening a previously closed fiscal period.
7. Make it clear to everyone that corrections should be made in the current period.
8. If possible, avoid opening too many future periods. Doing so raises the risk that someone may incorrectly post a transaction to a future period.
9. If possible, use an accounting system that has good fiscal period controls.

Some accounting systems have strict fiscal period controls. That is, once a fiscal period is closed, it cannot be re-opened. Before Microsoft Windows, many character-based accounting systems, such as DOS and UNIX, had this key control. A common weakness of accounting systems today is that a closed fiscal

period can be re-opened. An unscrupulous accountant who wants to commit fraud can post a transaction to a prior, closed period by simply re-opening it. In a one-person accounting environment, this problem is difficult, if not impossible, to detect.

Restatement of financial statements can cause headaches. Prior period changes may require amending prior year tax returns. Also, if a company is audited, such changes will create more work for auditors and end up costing the company more money. Even worse, reissued financial statements will look unfavorably on management.

Some accounting systems provide safeguards by allowing users control over which periods to activate/open. This control applies equally to past and future periods. It is seldom necessary or advisable to have unlimited future periods opened. It is just as easy to post incorrectly to a future period as it is to a past period.

For example, a vendor invoice can be posted to the wrong year simply because the year digit was incorrectly entered (e.g., using 2009 instead of 2008). Unlike prior period postings, postings to a future period usually can't be detected until that period becomes the current period.

Managers will be shocked to find errors one year later! To prevent this from happening, it is highly recommended to have as few future periods opened as possible, if any.

Accounting information is only as good as the controls. Having good fiscal period controls helps produce reliable financial statements. Fiscal period controls is both a function of the accounting system and manual procedures.

—GRN (2/09)

EDI Basics...

(Continued from page 1)

processes the order. Data security and controls are maintained throughout the transmission process using passwords, user identification and encryption. Both the buyer's and supplier's EDI applications edit and check documents for accuracy.

Each trading partner has unique EDI requirements. These will include the specific kinds of EDI documents to be processed, such as the 850 purchase order used in the example above, 856 advanced shipping notices and 810 invoices. In fact, almost any business document involved in a purchase transaction can be sent via EDI.

However, each EDI document must be exchanged with each partner in exactly the format they specify. Many partners will have an EDI implementation guide or kit that explains their specific requirements. Maps are required to translate the EDI documents from the trading partner's format into the format that is useable by the receiving party.

EDI capability involves either buying or outsourcing the following components:

1. Software for communications, mail boxing of EDI transactions, mapping and translation.
2. Communication protocols via ASYNC, BISYNC, or internet.
3. Data mapping for EDI documents.
4. Hardware, including a server or PC, communication devices and peripherals.
5. Secured office space and monitored security.
6. Data backups and redundant power.
7. Third-party VAN for ongoing EDI transmissions.
8. Integration with back office systems, including accounting.
9. Personnel training on use of

software and hardware.

If you are a small or mid-sized company and handle only a few transactions a month for a few partners, then outsourcing all of the EDI components makes sense. All you would need is internet access and email. For a fee, the EDI service provider takes care of the first 7 items listed above. You will enter the orders into your order entry system, and then will provide all the information for the outgoing documents to the service provider.

Edisoft Desktop provides similar functionality.

With few transactions you can take the time to enter carefully everything on the incoming order and make sure the information provided for the outgoing invoices is correct.

When your volume increases, or you are doing UCC-128 labels and advanced shipping notices, it is time to bring EDI functions in-house.

When the EDI orders integrate with order entry, accuracy is assured.

When all purchase order information is retained, and information from accounting invoices is mapped directly to fields on the outgoing documents, the document creation process is automated. The same person who once processed five orders a month for two trading partners, can now process five orders a week, for 100 stores or more, from each of 10 trading partners in less time.

Why You Need EDI

More and more customers want suppliers who can reliably exchange EDI documents. Companies are under pressure to reduce

procurement process costs by automating manual processes, such as invoice data entry. As a result, EDI capability is becoming a business requirement.

Suppliers want to develop closer customer relationships. Customer volume increases when buyers can process orders quickly and easily with few administrative burdens.

Both suppliers and their customers find that inaccurate or late B2B documents create expensive exception processes. Suppliers want to preserve good customer relationships. They have worked hard to create business arrangements with customers and want to offer them the best possible service.

Many suppliers want an easy-to-use application that gives them control of their documents and the EDI process. Ideally the application should integrate with the accounting software. For example, incoming purchase orders should post seamlessly to order entry using your inventory codes and customer information, while alerting you of price differences or other discrepancies.

EDI increases efficiency for all businesses. Suppliers reduce costs when the speed and accuracy of both received and sent documents improve. Any company engaged in manufacturing or wholesale distribution should consider EDI solutions.

—GRN (2/09)

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Dishing the Mail

Opening mail seems like a simple task. Its importance on accounting controls cannot be understated. While the process appears simple, many companies don't do it well.

Despite advances in email, fax and other electronic forms of communications, accounting transactions still depend largely on paper based documents sent by mail.

An accountant's nightmare is having mail that is lost or misplaced, is delivered to the wrong person/department or is delivered late. Bookkeeping tasks cannot be done unless documents get to accounting on time.

"An accountant's nightmare is having mail that is lost, is delivered to the wrong place or is delivered late."

For customer payments, it is important that checks are deposited promptly and the customer account updated. Misplacing a customer payment or depositing a payment late can affect cash flow. Some cash strapped companies exist day-to-day based on their cash receipts.

What might be worse is the possibility of losing a customer check. Imagine having to go back to the customer to ask him to issue a stop payment and reissue a check. Picture the grimace on the customer's face. Not only will the customer be reluctant to do this, he will be left with a negative impression.

If word gets out that a company can't get a handle of its cash receipts, unscrupulous customers will catch on and really start to use the hackneyed alibi, "The check is in the mail."

For vendor invoices, the clock

starts ticking when the company receives an invoice. Processing payables accurately and timely is important to maintain and build credit.

People forget that invoices sometimes need to be matched to the purchase order and receiving report before they are sent to managers for review and approval. The matching and approval process takes time.

Thus, there can be a time lag between when the invoice is received and when the voucher package (invoice, purchase order and receiving report) is posted in the accounting system. It is important

that this process goes smoothly.

Otherwise, it's difficult to enter the invoice, so that it can be aged and paid within terms.

Retail or wholesale distribution companies that handle a high volume of inventory purchases can literally shoot themselves in the foot if they do not get a handle on this process. Matching the purchase order, receiving report and vendor invoice can be a major ordeal.

It happens too often that a purchase order, receiving report or invoice is found under a pile of paperwork on someone's desk.

Managers do not realize the damage they do to the company's credit when they are sloppy in handling these documents.

Paying vendors late because invoices are not received and entered timely can result in a lower credit score and affect the company's trade and bank credit. A decline in credit

will negatively affect cash flow and liquidity.

For example, a company's liquidity can be put in peril if a vendor downgrades a company's credit terms from net 30 days to COD. If enough vendors are involved, the change to COD will cause such a liquidity problem that the business effectively shuts down.

To avoid these problems, the following are some tips to help keep track of mail documents and make sure that they are distributed to accounting on time:

1. Have a dedicated person responsible for opening and distributing mail.
2. Use an inbox or folder dedicated to accounting related documents.
3. Use a rubber stamp to mark the date when the document was received.
4. Log all documents/mail received with the date received, sender's name, addressee's name, the department and brief description of contents.
5. Deliver mail daily at a prescribed time.

A good way to be sure mail is sent to the right place is to validate the address when a new customer/vendor is set up in the accounting system. Using a new customer/vendor setup form is a good practice.

It's important to keep in mind that there may be multiple addresses and contact persons, depending on the address type: remittance address, invoice/statement address or general mailing address.

Problems arise when companies have multiple locations. For

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Reconciliation Workpapers

(Continued from the January 2009 Newsletter)

The following article is a continuation of the article that was included in the January 2009 newsletter. In that issue, we discussed why it was important to prepare workpapers and discussed at length workpaper schedules, the first of four workpaper elements. In this issue we continue with a discussion of workpaper indexing, tickmarks and index tabs.

Workpaper Indexing

Given the maze of schedules that are included in a reconciliation workpaper binder, how do users make sense of all those schedules and get at the needed information? It's done through an indexing or page numbering system.

Workpapers should have a logical indexing to accomplish the following objectives.

1. Provide an efficient way to file and retrieve schedules.
2. Facilitate workpaper referencing between schedules.
3. Facilitate management and auditor review.

Indexing is generally organized top-down with summary schedules at the top and more detailed schedules at the bottom.

Using Tickmarks

Tickmarks are symbols used to cross-reference data between schedules and to reference data to external sources. For example, it may be necessary to reference the source of the exchange rate used in a calculation.

The extent of tickmark referencing should be based on the importance of the data. As a general

rule, only important data should be referenced with tickmarks.

Tickmark referencing should be weighted towards financial statements and lead schedules; most of the financial data on these schedules should be referenced. Tickmark referencing should be used less in detailed schedules.

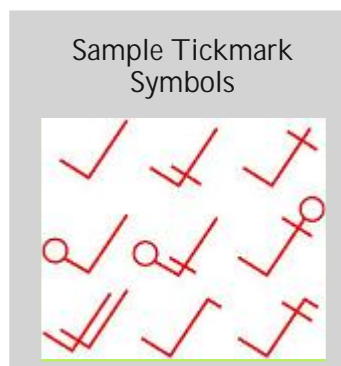
Tickmarks are notable for their color. They are usually in red or blue to make them stand out. When an amount needs to be referenced, a tickmark is placed beside a number on a schedule. A tickmark legend or explanation is placed at the bottom of the same schedule.

There are two types of tickmarks, standard and non-standard.

Standard tickmarks are used for frequently referenced items. Standard tickmarks are typically used for the following referencing:

- Traced to/agrees with general ledger/trial balance
- Footed, cross-footed & recomputed
- Traced to/agrees with prior period workpapers

Instead of providing an explanation for every standard tickmark used, a single explanation page can be used for all standard tickmarks at the beginning of the workpaper binder.



Non-standard tickmarks are used to reference information that is not in the workpapers. When a non-standard tickmark is used on a schedule, a tickmark explanation needs to be provided on the same schedule. For example, to reference an exchange rate for the Mexican Peso used in the calculation of a key financial statement amount, a tickmark can be placed beside the exchange rate. The tickmark explanation can be along the lines of "traced to/agrees with the exchange rate published by the Federal Bank of New York as of 12/31/08."

Binder Index Tabs - Putting It All Together

Workpapers are usually kept in a three-ring binder. It's useful to separate major sections with index tabs for easier access to schedules. Some companies prefer to have a tab for each separate account. This may result in too many tabs. A simpler approach may be to use a standard 8-tab index with the following categories:

1. Financial statements
2. Trial balance and adjustments
3. Assets
4. Liabilities
5. Owners equity
6. Revenue
7. Expenses
8. Other

The examples above serve as a guide only. Companies should develop their own workpaper documentation, indexing and referencing standards. Such standards will improve the quality and timeliness of financial information.

—GRN (2/09)

Financial Ratios - Days Payable Outstanding and Cash Conversion Cycle

Days payables outstanding (DPO) is a working capital ratio. It measures how long it takes for a company to pay its bills. DPO is measured in days and is expressed as follows:

$$\text{DPO (in days)} = \frac{\text{average accounts payable}}{\text{COGS per day}}$$

DPO is seldom used in isolation. It is used with Days Sales Outstanding (DSO) and Days Sales Inventory (DSI) to compute the Cash Conversion Cycle (CCC). The cash conversion cycle is a cash flow and liquidity measure. It is computed according to the following formula:

$$\text{CCC (in days)} = \text{DSO} + \text{DSI} - \text{DPO}$$

CCC measures how many days it takes on average for a company to convert its working capital to cash. In other words, how many days of cash is tied up in working capital.

CCC is the single most important metric to measure a company's effectiveness in managing cash flow and working capital. The goal is to have as low a CCC as possible.

CCC is best used when measured over a period to identify a trend. Also, it is very useful to benchmark a company's CCC against peer companies within its industry. In many cases, the CCC is largely a function of a company's industry. Retail and wholesale distribution companies typically have a large CCC.

CCC represents a funding gap between short-term assets and short-term liabilities that needs to be made up with financing, whether it be owners' capital or bank credit, such

as a line of credit or term loan. Because of this gap, CCC is also commonly referred to as the cash gap.

Typically start up companies will have a larger cash gap than mature companies. Vendors will seldom give favorable trade credit terms initially to a new company. Over time the company closes the gap by obtaining more favorable credit terms.

Improving credit and narrowing the cash gap is largely a function of good controls and effective working capital management. Good companies understand building credit takes time. It requires diligence in managing receivables, inventory and payables.

Some companies close the cash gap by leveraging supply chain technologies, such as just-in-time inventory and EDI. Wal-mart is an example of a company using such technologies to improve cash flow and minimize inventory.

Another important fact about the cash gap is that it tends to get larger as a company grows. This phenomena is not intuitive at first.

A fast growing company has to make large investments in inventory and receivables, which require a use of cash.

Many growing companies are blind to the cash gap. Many realize only too late that cash goes out the door the faster the company grows. Because of this dilemma, a growing company has greater urgency to strengthen controls and improve cash management.

To counteract against the cash gap effect during growth periods, companies can utilize technologies,

Dishing the Mail...

(Continued from page 4)

example, mail for a branch office may be sent first to the administrative or corporate office, which collects and distributes mail to branch offices. In this arrangement, it is easy for a key document to be lost and never entered.

In some cases, the administrative or corporate office records accounting transactions for the branch office. If mail is not sorted properly, transactions can be coded to the wrong branch, subsidiary, department or cost center. Even worse, mail may be lost and the transaction never gets entered.

Financial record keeping can happen only when all source documents are accounted for. Handling and distributing mail is a key control that is often overlooked. Having an orderly process to open and distribute mail is a prerequisite of good controls.

Without a good process, accounting can fall into disarray and cause the company's credit and cash flow to be adversely affected. Financial information will become suspect and management will quickly lose control of its business.

—GRN (2/09)

such as just-in-time inventory or EDI. These technologies are not only for large, mature companies. Such technologies can be equally beneficial, if not more so, for smaller, fast growing companies.

A growing company would do well to mind the cash gap. Doing so will help stabilize cash flow and liquidity during periods of rapid growth.

—GRN (2/09)

Sudoku Puzzle

		4			2	3		
	2		8	4			6	
6		7	5			2		1
9				7		4	5	
	5		9		1		3	
	7	6		3				2
1		9			8	6		3
	3			1	9		7	
		5	3			8		

www.sudoku-puzzles.net

Sudoku puzzle is printed with permission of www.sudoku-puzzles.net.

Sudoku Instructions:

The aim of the puzzle is to enter a number from 1 through 9 in each cell of a grid, most frequently a 9x9 grid made up of 3x3 subgrids (called "regions"), starting with various numerals given in some cells (the "givens"). Each row, column and region must contain only one instance of each number. The solution to the puzzle can be found at the URL link, www.anthillworks.com/resources/sudoku.html.

Quips & Quotes

"If you owe the bank \$100 that's your problem. If you owe the bank \$100 million, that's the bank's problem. "

- J. Paul Getty

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Accounting Calendar February 2009

February Reminders

Remember to file IRS Form W-3 and Form 1098 for 2008 by 3/2/09

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
1	2 Due date to send IRS Forms 1098, 1099, and W-2/G Due date for IRS Forms 940, 941, 943 or 944, if deposits were not made on time	3	4	5	6	7
8	9	10 Due date for IRS Forms 940, 941, 943, 944, and/or 945, if deposits were made on time Due date to report Jan 09 employee tips >\$20	11	12	13	14
15	16 Washington's Birthday	17 Due date for SEC Schedules 13F/G, Form 5 and Form 10-Q for period ended 12/31/08	18	19	20	21
22	23	24	25	26	27	28

Sources:

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