

SHARPEN YOUR PENCIL

One of the easiest statements to make in business is "Let's cut expenses." If done prudently, it is more than simply "slicing and dicing" to get to a lower number. Before the cost cutting process begins, it is important to first determine not only what expenses are out-of-line, but also what might be done proactively to improve operational efficiency.

Logical Business Decisions

Expense reductions should always be based on logical, prudent business decisions. Anyone can cut costs and reduce expenses; however, doing so with a poorly conceived plan can have negative rather than positive results. Before the process begins, various expense categories should be compared on a month-to-month, quarter-to-quarter, or year-to-year basis.

In addition to simply comparing dollar amounts, common size income statements should also be prepared. This is a process of converting all dollars to percentages for every number appearing on an income statement.

Comparison Advantages

Comparing both dollars and percentages in an income statement allows the reader (you) to spot anomalies and trends that would normally be difficult to pinpoint if using stand-alone (non-comparison) income statements only. Using a spreadsheet application to compare historical income statements brings attention to both positive and negative anomalies and trends.

When reviewing income statements, it is important to not only view what appears to be abnormal dollars and percentages but to also take appropriate corrective actions, if necessary. Immediate changes should be made to those categories and operational areas that have negative figures and/or trends. Likewise, additional emphasis should be placed in those areas with positive numbers and/or trends. In addition to simply reviewing numbers and trends, this type of review allows you to investigate and understand why various expenses increased or decreased.

Revenue and Expense Narrative Variance Report

A revenue and expense narrative variance report is a report that details in narrative form why major variances occurred in a particular category from the current accounting period compared to a previous accounting period (prior month, quarter, or year). It is an excellent management tool that forces analysis to determine what caused major changes to a revenue or expense account. Additionally, if future research is needed regarding major changes in a revenue or expense account, the task is made much easier with the existence of a narrative variance report.

Summary

A thorough expense review not only determines what expenses can be reduced, but what alternative choices might be made to not only reduce cash outflows but also to improve operational efficiency. Being proactive in business rather than reactive produces positive