BY ROBERT L. WHIDDON

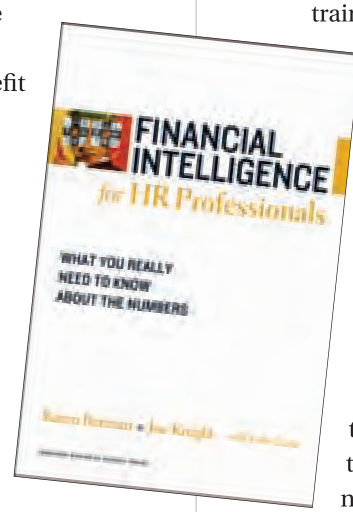
Language arts: New book aims to teach HR conversational finance

JOE KNIGHT

AS BENEFITS BECOME MORE COSTLY, CFOs become more interested. That means HR and benefits people have to brush up on the difference between a P&L statement and a balance sheet.

It is often said that knowledge is power and Joe Knight co-author of the new book *Financial Intelligence for HR Professionals* believes that opening up the books to workers across an organization engenders a more powerful workforce.

It's a timely tome for benefit professionals. As more and more money is spent on health care and other group benefit offerings; executives are increasingly interested in the subject. That means HR and benefits talent will have to be versed in the language of finance to satisfy the heightened interest level. In his book Knight outlines how HR and benefits professionals with a better understanding of finance, can help companies avoid financial peril.



Knight began his career as a financial analyst with Ford Motor Co. and now serves as CFO of SetPoint. He now splits his time between the Ogden, Utah-based automated machinery company and the Business Literacy Institute, which was founded by his co-author Karen Berman. As partners at the BLI, they help companies increase employee financial intelligence. *EBA* Editor Robert L. Whiddon and Knight recently discussed the new book and how a more financially knowledgeable HR professional is a more powerful HR professional.

So what's the book about?

Our book is about teaching non-financial people how to read financial statements, how to do basic analysis and how to understand what the numbers really mean.

Why did you write it and why write it now?

The biggest reason why we wrote the book right now is that we found that if we train and do these classes, people would ask us to recommend a book to them that they could read or pass out and we always struggled. We do not like text books. We don't think they are appropriate for this kind of thing. They are meant for people who want to major in finance or accounting. Some of the basic finance books are too simplistic. We just felt like there was something that was needed in this market.

What letter grade would you assign HR folks given their current financial intelligence?

I would give HR people a C to a C- but let me back up from that. I would give most professionals a C to a C- and even sometimes accounting and finance professionals. I have been surprised, and I don't know if dismayed is the right word, but I've been disappointed in how little most people understand about finance.

In the book you hit on a crucial HR issue and that's the idea that they are a cost center. Talk a little about your thoughts on that subject.

There are a couple of areas where a financially astute HR director or manager or VP could really contribute. First is to figure out ways and come up with metrics as to how the human resource investment in the company is getting a return and figure out [that] ROI. The simplest ratio that we look at is revenue per employee. But there are a lot of other things that an HR executive can do that understood finance.

The other part of finance that an HR executive should understand is how to evaluate projects. A lot of what's done in HR is initiatives and projects. It's also always very difficult to come up with metrics or ways to measure a return on a major initiative or project. I think understanding the basic return on investment analysis tools, which are available in our book would make it possible for them to put more concrete numbers and more objectivity to the things that they are doing. That would justify not only the need for HR, but even more importantly help HR quantify the value of some of the things that they do.

One benefit of bigger finance muscles is the ability to spot bias. Talk about what that is and why it is important.

Something that is actually surprising to a lot of people in HR is that when you look at a financial statement and see that net income or that profit at the bottom of the statement, that number is to some extent theoretical because there are a lot of estimates and assumptions that have to be made to get those numbers right. An HR executive has to understand that those estimates and assumptions can be biased by whoever prepares the report. When I say biased I'm not talking about fraud or dishonesty. I'm just laying out the fact that we in finance and accounting don't have all the concrete numbers and we have to make judgments.

Now if you are an HR executive and you are using my report that I provide to you as a financial analyst it would be wise for you to figure out where those assumptions are. The best way to do that is to understand the statement and ask questions of your financial people.

A notorious example is that of Xerox ... They started booking all of the revenue on the sale of their copier equipment right upfront. When the copier was shipped they didn't amortize part of the sale over the life of the five-year contract in which they were sold. That created a lot more revenue upfront and profitability upfront and made the company's financials look better and more appealing on Wall Street. Ultimately they had to restate more than $3 billion in 2004 to correct the problem.

As an analyst in HR, the problem there would be as the revenue was expanding with this accounting approach — which of course Xerox isn't going advertise, they ended up getting in trouble for that as did their audit firm — what's going to happen there is you're going to make decisions and allocations of resources based on revenue, top-line revenue. If the numbers have been painted or pushed in a certain way you might be hiring people in a situation where you are basing it on a change in the accounting principles not on a true change in the business.

Another example that is even more dramatic for me is the whole WorldCom debacle. Their focus was on a number we call in finance EBITDA — earnings before interest, taxes, depreciation, and amortization. When the telecom industry started to struggle they started protecting their EBITDA by calling expenses assets. That's a very simple explanation, making their profit look artificially higher than it really was. When they were actually losing money in their business, they were showing one, two, three billion [dollars] of profit. The company continued to expand and hire employees in an environment where, in reality, they were losing money.

When the company fell apart, when the company spiraled down into bankruptcy one month after the discovery of the problem there were 20,000 layoffs all over the company. I would argue that those layoffs would not have happened if they had known about their problems initially and not, if you will, cook the books and protect their numbers. The company was expanding and if they had been looking at the numbers correctly they might have had to do some minor downsizing. But certainly 20,000 people would not have lost their jobs in the matter of one week.

These examples are powerful, but I was surprised that there weren't examples of the companies that HR might be more familiar with — major insurance and financial services. Will more financially savvy HR professional do a better job identifying and contracting with those types of companies?

I think first of all that as a savvy shopper of those kinds of benefits you should be aware of the financial standing of the financial institutions you are working with on your 401(k) and your retirement plan and also the financial stability of the insurance carrier that's providing your benefits. These companies are not completely free of problems. You can find smaller companies that are financially weak that appear great because of their pricing. The reason why their pricing is low is because they are trying to add volume, understanding some basic financial ratios, understanding how to look at a statement is very important when you are evaluating these companies.

I certainly would not sign up a company for either financial benefits in terms of retirement or for medical benefits without first looking at their financial statements and doing an evaluation on their financial stability. Nothing could be worse for you as an HR manager than to sign up with a carrier that ends up in financial duress or even bankruptcy when you are counting on them for your medical care.

It's a fascinating book, offering sample financial statements and even some course work. What does a typical corporate engagement with the BLI look like?

An engagement is probably around $15,000 typically for the development of the material and maybe two facilitation courses. It can obviously go up from there. We have some long-term relationships with some companies.

We have actually started doing the finance training for GE … GE University.

PODCAST

Listen to the rest of our conversation with Joe Knight, co-author of *Financial Intelligence for HR Professionals* online at *EBA*'s Raw Bar – eba.podhoster.com.

You do small company engagements as well?

When we do small company consulting, we really focus on three things. One is training. The other two are important as well. The second, is how to develop a system where employees get continuous feedback. If you are going to teach people what the numbers mean you better be able to share the numbers consistently. Finally, and just as important as number two, we also want to make sure that there is a bonus system, objectively calculated from the numbers so employees can see the benefit for themselves for being involved in the numbers and understanding the numbers. **EBA**