

What is financial window dressing?

Financial managers can do certain things to increase or decrease net income that's recorded in the year. This is called profit smoothing, income smoothing or just plain old window dressing. This isn't the same as fraud, or cooking the books.

Most profit smoothing involves pushing some amount of revenue and/or expenses into other years than they would normally be recorded. A common technique for profit smoothing is to delay normal maintenance and repairs. This is referred to as deferred maintenance. Many routine and recurring maintenance costs required for autos, trucks, machines, equipment and buildings can be delayed, or deferred until later.

A business that spends a significant amount of money for employee training and development may delay these programs until the next year so the expense in the current year is lower.

A company can cut back on its current year's outlays for market research and product development.

A business can ease up on its rules regarding when slow-paying customers are written off to expense as bad debts or uncollectible accounts receivable. The business can put off recording some of its bad debts expense until the next reporting year.

A fixed asset that is not being actively used may have very little current or future value to a business. Instead of writing off the un-depreciated cost of the impaired asset as a loss in the current year, the business might delay the write-off until the next year.

You can see how manipulating the timing of certain expenses can make an impact on net income. This isn't illegal although companies can go too far in massaging the numbers so that its financial statements are misleading. For the most part though, profit smoothing isn't much more than robbing Peter to pay Paul. Accountants refer to these as compensatory effects. The effects next year offset and cancel out the effects in the current year. Less expense this year is balanced by more expense the next year.