Questions that reveal hidden weaknesses in financial controls

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"Profit & peace"

That's how one interim CFO from Cerius Executives summed up the role of a Chief Financial Oficer. On the surface, these ideas go hand in hand; but what if you came to realize that at your company, they are mutually exclusive? If your peace of mind is derived strictly from knowing your company's profit, are you missing some hidden gremlins in your financial closet? We asked several Cerius interim CFOs what questions they ask to uncover signs of weakness—early in the game, before they morph into monsters that may devour resources and hinder prospects for future growth or M&A opportunities.

What you'll get from this white paper:

- Key finance activities for CEO/ CFO decision making
- Primary cost and profitability triggers
- The role of strategic planning for profitability

International cooperation

This white paper is a contribution of SMW's partner Cerius Executives from USA.

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How long does it take to close your books? Do you get a good variance analysis of results at closing?

What's normal? Closing your books gives you a good measure of where you are. "If you're getting them closed in seven to 10 business days, congratulations – that's average. But two to four days is within the upper quartile of best practices," according to best practices.

How long is too long? "It shouldn't take a month," he added. "The goal is to spend as little time as possible so the finance team has more time to support management in decisionmaking."

As a CEO, what can I do to move our company forward? Put a high value on getting the financial statements closed so they're as current as possible.

What about variances? Ask yourself if you're getting a good month-to-budget analysis. Compare your results with the same month last year or to the previous month. Review the numbers, then ask your finance team to explain any diferences. "A surprising number of people don't do that. The variances will tell a story. It may be in a language that's foreign to the CEO, but it is the CFO's job to translate it."

Is a timely close of the books truly important? If you think your company is too small to worry about this, or that you're large enough to justify taking more time than the average, think again. "Size of the company really has very little to do with it," our CFO explains. "The systems and processes should be in place to get the books closed on a timely basis."

KEY TAKEAWAYS

- Time matters. The longer it takes to close your books, the less useful your financial statements will be.
- Operate in "real time" as much as possible. Get information quickly enough to make timely decisions while they can still make an impact.
- Have data at your fingertips. Having reliable data available for decision-making is an indication of your discipline and the quality of your systems—factors that are especially important when seeking outside capital.

Do you utilize cash flow reporting? What about budgeting and forecasting? How accurate are all these metrics?

If you do an internet search on “13-week cash flow,” you’d be instantly rewarded with hundreds of results. Why? It’s considered a best practice, according to our financial experts.

Why 13 weeks? That’s the length of one quarter. A 13-week rolling cash flow allows you to see your cash on hand, usage, receipts and disbursements. Then you can update it the following week.

One Cerius interim CFO points out, “This gives you a very good indication of where you are. It’s also one of the first things I do when I’m called in to help companies in trouble.”

But guess what? “If companies did this all the time, even when things are going well, they could avoid getting into trouble in the first place,” he added.

KEY TAKEAWAYS

- Finance is a key support player. If your finance team isn’t being diligent about cash flow reporting, budgeting and forecasting, it’s not providing the CEO necessary support.
- Glitches can be warnings. If your reporting isn’t timely, consistent and accurate, there’s a high probability that many other things are also not being done properly.

Are your internal controls documented?

We all expect public and highly regulated companies to have proper documentation and internal controls. But what if you’re a smaller, private company? Your finance or accounting department may consist of just a few people—perhaps just one. Is it really a big deal if your internal controls aren’t documented?

Maybe, and maybe not.

As the CEO, perhaps you make a habit of reviewing procedures and controls. Or perhaps you bring in an interim or part-time CFO on a weekly or semi-weekly basis to review your financials, adding another valuable level of control. Either way, documentation is a different story. Making a conscious effort to document the procedures and controls shouldn’t be viewed as extraneous work. It’s simply good practice.

KEY TAKEAWAYS

- Documentation brings strength. Processes that are well documented and clearly understood give a lot of confidence in how your policies, procedures and financial books are kept.
- It doesn't need to be complex. A well-run finance and accounting department can use simply written descriptions for each procedure, along with who is responsible for specific tasks.
- Question your questions. If you're asking, "Can I truly rely on these financial statements?" there's likely a reason.

Do you have hidden waste? If so, do you know what it is, where to find it and how to eliminate it?

Collectively, our expert CFOs identified the most common areas of waste. These are worth a closer look:

- Overtime
- Lost-time injuries
- Inefficient use of systems and manual processes
- Supply chain waste
- Product failures in manufacturing
- Process disconnects
- Office supplies
- Warranty costs
- Product returns
- Customer credits
- Telecommunications
- Travel and entertainment expenses

One CFO says: "When I walk into a plant, one of the first things on my radar is lost-time injuries."

KEY TAKEAWAYS

- Know the true challenge. Uncovering hidden waste shows prudence; but in some cases, it's also indicative of a company's culture.
- Compare yourself to others. Often there's industry information to benchmark what a company spends compared to similar companies in the same industry.
- Waste can happen anywhere. For production failures, look everywhere in the organization, not just the manufacturing floor.

Do you have a good cost system to identify the product cost by SKU? Do you know growth, margins and profitability by SKU, product line, consumer, industry and region?

The detail in these questions should give you a clue to its significance.

"Cost systems are really critical," warns one Cerius interim CFO. "You need to know this information—broken down to the smallest unit possible."

Eroding profitability by segment (also called 'product rationalization') is often seen when the business is growing faster than the profitability. Buying behaviors change, especially as a result of major external environmental change. For example, historically SKU 'A' may have been purchased with SKU 'C'; but in just 30 days, purchasing behavior could change, with SKU 'D' as the new preferred choice.

KEY TAKEAWAYS

- Profits and sales go hand in hand. To adequately support company growth, you need increased profitability as well as increased sales.
- You need to know where to expend your energy. Not all products and customers have the same margin.

Do you have dashboard metrics, scorecards and key performance indicators (KPIs)? Are they understood by everyone in your organization?

Each organization must define their most important performance metrics, set

benchmarks and measure against them. Those metrics might be customer contacts, number of sales calls or customer inquiries. Or if you're an e-commerce company, they might include number of site visitors, page views, time spent on your site, or percentage of orders shipped on time. In manufacturing, your key metrics may include inventory turns or number of defects per 1,000 pieces produced.

KEY TAKEAWAYS

- Without performance metrics, visibility is poor. When metrics and measurements don't exist, you can't easily see how your business is doing this month or this quarter.
- It pays to look at granular details. If you only look at outcomes and results, it's easy to miss the contributors that actually drive those results.

Do you have a robust strategic planning and execution process?

Strategic planning is time-consuming and typically enlightening—yet all too often, companies go through this arduous process, only to put the plan on the shelf.

Finance and accounting are important aspects of strategic planning that help to focus a company's limited resources on defined objectives, and contain initiatives that should be included on personnel scorecards. You can then hold employees responsible for executing on those initiatives.

KEY TAKEAWAYS

- Strategic planning is your business anchor. A strategic plan covers all the important priorities in your company, and allows you to monitor progress and review on a regular basis.
- Drill down to the task level. Break down the goals and objectives so that key executives know what they're responsible for and can be held accountable.
- The proof is in the pudding. The best plan, which you'll spend hours developing, is meaningless if not executed properly.

Is your management team properly incentivized? Are they rewarded based on performance? Do you have a quality performance evaluation plan in place?

This ties closely to your strategic planning and performance measurements. You need to have clear measures of success, and take steps to ensure those measures are understood by the organization.

To achieve the best results, top-performing companies tie pay to performance and have a good evaluation system. Understand, too, that if you're too focused on sales, you may be sacrificing the creation of a valuable enterprise. And never underestimate the importance of top-tier personnel.

According to one Cerius interim CFO, "One of the first things I do in a turnaround is what's often referred to as 'top grading' of key positions. I evaluate the quality of key personnel and make sure the company has A-quality (or at least B-quality) players in all key positions."

Remember: Most small companies never grow into large companies. They structure themselves from the outset to get profitable quickly and to stay profitable. Therefore, many small to midsize companies undervalue and understaf their financial department or positions. However, larger successful companies are just the opposite—the CFO is ofen the right hand of the CEO and an invaluable member of senior management.

You value top-tier personnel; you set reasonable and measurable expectations; and you should reward them accordingly. One expert emphasizes that this reasoning applies to companies of any size.

“Consider planning the structure of your company from the outset as though it’s a big company,” he said “That demonstrates a mentality geared toward success.”

KEY TAKEAWAYS

- Model your small to midsize company for success. Structure your organization from the beginning as though you expect to grow, making timely investments in people.
- Don’t skimp on hiring top talent for finance leadership roles. The upfront investment will likely pay off exponentially through better financial processes and outcomes.
- Get expert help. A leader with proven experience can easily jump in to manage costs, evaluate potentially burdensome infrastructure and gain access to unlimited capital. The key is to bring in expert resources before you need them.