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DYNAMIC ADVISORY SOLUTIONS

Financial and Strategic Integrators

Building Your Profit Team

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Contents

Introduction

Although most business owners understand the importance of having strong marketing and operational teams, the finance department is often overlooked. Just like your marketing department generates sales and your operations team produces your products/services, your finance department should drive profits. In order to create a profit-driven business, you need to have the right team in place.

Members of Your Profit Team

I will use the terms Profit Team, accounting department, and finance department interchangeably. Although I understand there are differences between the accounting and finance department in some businesses, these differences are not relevant to this topic. Overall both of these department should be focused on driving profits, hence my Profit Team terminology.

Chief Financial Officer (CFO)

Your CFO is responsible for the overall financial management of your business. This role requires a mix of analytical and communication skills. True CFOs should have at least a Bachelor's Degree in finance or accounting, possess an MBA or CPA, have 7-10 years of finance and/or accounting experience, and have outstanding communication skills. Your CFO should have the following responsibilities:

1. Participate in strategic planning activities
2. Perform financial statement analysis
3. Prepare budgets and projections
4. Establish and maintain financing
5. Manage risk
6. Manage merger, acquisition, and divestiture activities
7. Hire, fire, train, and evaluate the Controller

Participate in strategic planning activities

A true CFO's role should not be engaged in the overall strategic planning of the business. Strategic planning includes developing the organization's vision, formation of the core values, performing a SWOT analysis (Strengths, Weaknesses, Opportunities, Threats), setting goals for the next 1-10 years, expansion/contraction planning, etc. Your CFO's role should be to contribute ideas, as well as evaluate the feasibility of the plan from a financial perspective.

Perform financial statement analysis

Preparing financial statements is important, but interpreting the data is critical. Many of the techniques we described in the previous chapters assist in this function (e.g. dashboards, budget-to-actual analysis); however, it is still necessary to analyze the trends and overall condition of the company. Is the organization on track to hit the goals for the year? Are corrective actions required (e.g. downsizing, expansion, investment in equipment)? Is the available cash sufficient? These questions often can be answered through analysis of the financial statements and management reports.

Prepare budgets and projections

Both profitability and cash needs to be budgeted and monitored. Specific tasks include creating the annual budget, performing a monthly activity-based budget-to-actual analysis, explaining material budget variances, and recommending any applicable corrective actions. Creating projections that utilize current data to project future performance may also be needed. Additional responsibilities can include evaluating potential capital expenditures, analyzing expansion plans, etc.

Establish and maintain financing

This responsibility requires both analytical and interpersonal skills. This includes finding and interfacing with potential sources of funding (banks, private equity, friends/family, etc.), securing adequate financing, and maintaining the relationships with financing sources. The financing function also consists of monitoring cash reserves and identifying additional sources of funding (in case the need arises).

Manage risk

On the surface, this responsibility may appear simple. Majority of organizations feel that managing risk is as simple as purchasing insurance. Although it is critical that all of the proper insurances are in place (workers' compensation, umbrella, D&O, etc.), what about the risks of entering a new market (especially outside the countries you normally do business in)? Acquisitions, currency fluctuations, regulatory changes are just a sample of the risks a CFO needs to manage. Managing risk includes running the applicable what-if analysis and determining the cost-vs.-benefit of hedging the applicable risk (if possible).

One of my clients almost lost everything because of improperly managing currency fluctuation risk. In 2007, the U.S. dollar experienced a substantial weakening against the Canadian dollar. My client had numerous long-tem contracts that required my client purchase a certain product from Canada. Historically the translation adjustment was a hidden profit center (since the U.S. dollar was typically significantly stronger than the Canadian dollar). Due to the unprecedented fluctuation in currency, my client had to subsidize the currency swing. Fortunately, we were able to renegotiate terms with some of my clients' customers. Although my client did suffer losses, the negative impact was manageable. It is the CFO's job to anticipate these types of problems and make sure the business is properly protected.

Manage merger, acquisition, and divestiture activities

These types of transactions are life–altering for an organization. Differences in cultures, systems, customers, product lines, and vendors can be difficult (if not impossible) to align. Failure to run the numbers and properly plan the transaction drastically increases the likelihood of disaster. Your CFO needs to manage these transactions for your organization.

I had a client that was in the process of selling their business. In the midst of negotiating terms with the buyer, news of the sale leaked to the employees. Four key operational employees stated that they were "off the table" and were going to start their own business (essentially stealing my client's customers.) Fortunately we planned for this contingency. Although two of these employees did ultimately leave, they were unable to steal clients due to a non-solicitation clause in their employment agreement. Their departure did virtually no damage to the transaction (or the eventual selling price of the business).

Hire, fire, train, and evaluate the Controller

Since the CFO is responsible for the entire finance department, it is important to have the right team in place. The Controller is responsible for providing the CFO with timely and accurate financial data, as well as building the rest of the finance team. Therefore, it is critical that the CFO finds the right individual for the Controller role.

Controller

Your Controller is responsible for producing timely & accurate financial information. This role requires a mix of analytical and managerial skills. True Controllers should have at least a Bachelor's Degree in finance or accounting, possess an MBA or CPA, have 4-8 years of accounting experience, and have good computer skills. Your Controller should have the following responsibilities:

1. Produce financial statements and management reports
2. Establish and maintain the accounting system
3. Manage cash
4. Manage costs
5. Establish and maintain internal controls
6. Hire, fire, train, and evaluate the Transactional Accountants

Produce financial statements and management reports

This includes performing month-end closing activities (adjusting the financial statements for accruals, prepaid assets, depreciation, etc.), producing financial statements (income statement, balance sheet, and statement of cash flows), and the applicable management reports. It is critical that these activities are produced in a timely and accurate manner.

A few years ago we were hired by a client to evaluate their accounting department. Although this business had a full-time "CFO" and "Controller" (in addition to about ten other financial people on their staff), our client was receiving financial statements at least three months late. And the late statements had errors that were identified by the owners. This caused the owners to make poor tax planning decisions (they essentially spent money they did not have to offset income that did not exist)! After building good reporting processes, we were able to help our client produce accurate financial statements by the 7th of the following month (vs. three months late, an improvement of approximately 80 days).

Manage cash

Cash is king! Although it is your CFO's job to secure financing, it is your Controller's job to manage the available cash. When cash is tight, your Controller needs to stretch vendor payments without disrupting the business. When cash is abundant, your Controller should be taking advantage of investment opportunities (quantity discounts, cash discounts, sweep accounts, etc.)

Manage costs

Costs need to be controlled. Budgeting is a useless exercise if the underlying expenses are not monitored. Whether it is phone service, insurances, employee benefits, or banking, it is your Controller's job to periodically review costs to ensure your organization is getting the best possible price.

Establish and maintain the accounting system

Your Controller is responsible for maintaining an adequate accounting system for your business. This includes utilizing the proper accounting software, creating job descriptions for the entire finance department, and establishing the accounting processes for the organization. This function also includes maintaining proper documentation of the entire accounting system.

Establish and maintain internal controls

A good system of checks-and-balances prevents errors and fraud. Internal control activities include proper separation of duties, periodic review of subordinates work, job rotation, mandatory vacations, etc. Although fraud happens, errors are far more frequent (e.g. double paying invoices, inaccurate invoicing). A good system of internal controls can reduce (if not eliminate) errors, as well as keep employees away from situations that invite theft/fraud.

Hire, fire, train, and evaluate the Transactional Accountants

Your Controller is responsible for building your financial team (except for your CFO). This team consists of the individuals that are responsible for processing the daily transactions (I refer to these people as Transactional Accountants). Strong Transactional Accountants makes the production of timely and accurate financial information much simpler.

Transactional Accountants

Transactional Accountants are responsible for processing your business's daily transactions. These positions typically require a lot of repetitive tasks (e.g. data entry, filing, phone calls). Transactional Accountants should have a minimum of a High School degree, 1-2 years accounting experience, and good computer skills. Transactional Accountant responsibilities include disbursements and accounts payables, invoicing and accounts receivable, payroll, job-costing, purchasing, bookkeeping, and serving as assistant to the Controller or CFO.

Staffing Options

There are multiple ways to staff your Profit Team categorized as follows:

1. Hiring employees
2. Temporary services
3. Outsource

Hiring employees

This is the most traditional method for staffing a finance department. Hiring employees has the advantage of creating long-term relationships with your business. Since employees typically stay with their employer for an extended period of time, your employees should have extensive knowledge of your organization and industry. You also can utilize employees to work on projects outside the scope of their job if the need arises. Hiring employees may also be your most affordable option if your business has the need for a full-time CFO, Controller, and Transactional Accounting staff.

Hiring employees for all of your financial roles does not always make financial sense. Although Transactional Accountants work well in businesses with annual sales under $50 million,

DYNAMIC ADVISORY SOLUTIONS

Financial and Strategic Integrators

these size companies often have difficulty hiring a CFO and Controller. Although there is a need for the CFO and Controller services, it is tough to justify the costs of hiring a true CFO and Controller (possessing the credentials noted above).

What often happens is the business tries to improvise by hiring either a CFO or Controller. This individual is often under qualified to fill one (or even both) of the roles. This individual may supplement their knowledge by leaning on the outside CPA for help; however, it is often a formula for disaster. Most outside CPA firms are good at accounting and tax, not at CFO and Controller services (cash management, budgeting, financing, etc.)

Temporary services

Temporary staffing companies can be a business-saving resource when crisis occurs. When one of your financial staff members disappears unexpectedly (e.g. quitting, medical condition), staffing companies can supply you with an accountant almost immediately. Although this only offers a relatively short-term solution, temporary staffing companies offer sufficient alternative until a permanent replacement can be found.

Although the staff provided by these companies are relatively easy to hire and fire, majority of these people are not good long-term fits for an organization. Whether it is lack of commitment, skills, or desire, people who choose to work for temp agencies are often there for a reason. If you do choose to utilize a temporary employee for a long-term assignment, it can get expensive (since you are paying both the staffing company and the employee for the work being performed).

Outsource

Outsourcing is predominately used to replace Transactional Accountants. The premise is that accounting is not one of the core functions of a business, so it should be outsourced. This allows the business to focus on its core competencies. In addition to reducing the cost of maintaining your finance department, outsourcing eliminates the human element. Essentially you are paying a vendor to complete tasks A, B, C, and D. If the outsourcing company only performs tasks A, B, and D, you can negotiate a discount, replace the vendor, etc. The situation is typically much more complicated when dealing with employees.

Although there are distinct advantages to outsourcing, there are also some drawbacks. You may lose an element of control (since frequently the work is performed off-site). You will likely have a limited amount of input regarding how the work is completed. You may also lose capacity for performing projects outside the scope of the outsourced engagement. If you are paying an outsourcing company to perform tasks A, B, C, and D, this is what you are going to get. The outsourcing company may be unable or unwilling to work on your projects (whereas employees with available time may be more than happy to help).

A relatively innovative concept is outsourcing the CFO and/or Controller functions. This may be an ideal option for your businesses if you are having difficulty securing a true CFO and Controller. Outsourcing allows you to get exactly the services you need, while not having the costs of employing a true CFO and/or Controller. Since outsourced CFO/Controller businesses typically employ a wide variety of financial specialists, this also gives you the flexibility to increase/reduce services based on your needs. Because of the flexibility and cost, outsourcing the CFO/Controller function can be a viable long-term solution (until the business grows to a size that warrants a full-time CFO and Controller).

DYNAMIC ADVISORY SOLUTIONS

Financial and Strategic Integrators

Ineffective Profit Teams

It is tough to know what you don't know. How can you tell if your accounting and finance department is doing a good job? Here are some problems that indicate you need to make changes to your Profit Team:

1. Uninformed business decision making
2. Financial surprises
3. Ongoing cash crisis
4. Inaccurate financial reports
5. Losses
6. Lender or investor friction
7. Consistently late financial reports
8. Cash-basis financial statements
9. Turnover in accounting department

Uninformed business decision making

If you think running a business is tough, try doing it blindfolded! The proper financial data is critical to making good business decisions. Whether you are buying a piece of equipment, considering expansion, or planning for taxes, you need to have a clear understanding of where your business is (and where it is headed).

Financial surprises

Good or bad financial surprises show a lack understanding and/or control in your finance department. When unplanned events occur, the financial impact of these events should be anticipated and planned for. Unpredicted swings in income and cash can have catastrophic consequences to your business. It is your financial department's job to be prepared.

Ongoing cash crisis

It is the CFO's job to obtain adequate financing for the operation. It is the Controller's job to manage the available cash. If your organization is always dealing with a shortage of cash, it is likely one of these two areas is not being handled properly.

Inaccurate financial reports

I would rather receive no financial information then get inaccurate financial data. We signed a new client towards the end of the 2007 tax year. This client thought they were breaking even at best. Once we implemented our processes, we discovered they were going to make a significant profit. Good news, right? Wrong! Our client was going to pay approximately 40% of every dollar they earned towards taxes! And this particular client was delaying necessary capital expenditures because he though they were performing poorly! Although we weren't able to spend as much as my client would of liked, they were able to spend down a good portion of the profit (essentially getting a 40% discount on everything they bought due to the tax savings).

Losses

It is the CFO and Controller's job to monitor performance. If your business is losing money, your accounting department should be screaming for the applicable cost reductions (e.g. layoffs, delaying capital expenditures). Unfortunately a lot of financial departments stop here. It is also your Profit Team's job to identify opportunities to become more profitable through acquisition, additional product lines, etc.

Lender or investor friction

It is critical your CFO keeps your funding sources happy. One of the core values of our firm is over-communication. This is definitely a formula for success with your sources of capital. Keeping your financiers informed of where you are and where you are headed is extremely important. Obviously this communication can be challenging during tough times; however, it is the CFO's job to instill confidence in your financing sources during both good and bad times.

Consistently late financial reports

The older the financial data, the less useful it becomes. Timely financial information is critical to making good decisions.

Cash-basis financial statements

When utilizing cash-basis statements, the financial condition of the company can be substantially different than reported. Although cash is king, accrual basis statements truly capture the revenue you have earned and the expenses you owe. Your finance department must be capable of producing accrual-based financial statements.

Turnover in accounting department

Frequent turnover is expensive, time-consuming, and distracting. It is your CFO and Controller's job to effectively manage your accounting department. This includes identifying and retaining financial talent.

Conclusion

Realize that some errors and problems will occur, regardless of the strength of your accounting department. However, the indicators I outlined above should occur rarely (if ever). The greater the frequency and reoccurrence of the above problems, the greater the likelihood you need to reevaluate your Profit Team.

Some financial people may argue that economic factors cause some of the above problems (e.g. losses, ongoing cash crisis). I agree this is partially true; however, I would also argue that it is the CFO and Controller's job to figure out how to produce profits and cash despite the economic factors. Otherwise what are you paying them for? If your sales department is not producing sales, aren't you going to hold your salespeople accountable? If this is how you run your sales department (and I hope it is), shouldn't your Profit Team be held accountable for the profitability of your business?

Author's Profile

With his 15 years of experience creating profit-driven organizations, Ren assists his clients with forecasting, establishing employee metrics, creating organizational dashboards, obtaining financing, and executing acquisitions and divestitures. Ren is both a Certified Public Accountant (CPA) and a Certified Specialist in Management Consulting (CSMC.) He currently serves as President and CEO of Dynamic Advisory Solutions. After graduating with honors from Oakland University, Ren spent a few years working with privately held businesses in public accounting. After serving as Chief Financial Officer for a Tier 1 manufacturing company, Ren launched Dynamic Advisory Solutions in 2000. Ren also hosted the award winning Business Reality Network radio program for three years. Ren currently volunteers as a board member of the Detroit chapter of Entrepreneur's Organization (EO), and has previously served on the Michigan Association of Certified Public Accountants' (MACPA) Ethics Task Force and the Troy Community Foundation's board of directors.

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