THE INTERIM CHIEF FINANCIAL OFFICER

Much More Than You Think

Trinity
Consulting Group
International, LLC

INTRODUCTION

A world-class Interim Chief Financial Officer[1] provides his client with much more than merely accounting, finance, and administrative assistance. World-class denotes a rank far exceeding the normal, delivering a skill-set beyond ordinary expectations.

Most private companies cannot attract such an individual as an employee; however, the advent of the interim chief financial officer has changed the paradigm and brings this higher level of service within the reach of many mid-size companies.

For more than the last decade we have been providing such services for clients that not only exceed the expected, but substantially add to the company's bottom line. We generally work with a minimum of two to a maximum of four companies at one time, with clients changing periodically depending on their particular needs and circumstances. Companies that engage our services are typically $10+ million in revenues and 50+ employees. They're business-to-consumer and business-to-business companies that have achieved a certain level of stability and require a high level of financial sophistication to support external stakeholders (banks, investors) and internal stakeholders (owner tax planning, succession planning.) Because of our service guarantee[2], we devote substantial time and effort to the financial, operational and tax affairs of the business and its owners.

[1] *Sometimes referred to as an outsourced, part-time, fractional, acting, or interim chief financial officer.*

[2] *Multiple of compensation. See our other publications for examples.*

SITUATION

We're brought on board to remedy a specific situation typically outside the time confines or financial knowledge of the owner. This may include replacing the existing chief financial officer exiting due to termination, resignation, death, division sale, etc. Alternatively, we may commence work for a company rapidly expanding and in quick need of high-level financial expertise. Sometimes, a company's lender or auditor may "suggest" the need for an addition to the financial staff. Lastly, we're sometimes brought in when the owner needs a second set of independent eyes.

Probably the biggest immediate challenge is the realization that the train is moving and we need to hop on, and its not slowing down to pick us up. This requires an ability to be flexible and rapidly responsive. The stated reason for being retained is rarely the real problem (or at best its only one of many.) Notwithstanding an owner's statements, our real job is to find out what the problem is, fix it, and make sure that it doesn't continue. Unfortunately, because the train isn't slowing down, the remedy is to deal with both the problem and its symptoms efficiently and effectively.

EXAMPLE

A prior engagement serves to provide some insight into these issues: We were retained by the owner of a multi-store retailer with numerous big box locations, clearance center, and warehouse operations. The twenty-year-old chain had revenues exceeding $20 million and 80+ employees. The owner was primarily responsible for company marketing efforts and delegated operations to his "partner," titled the general manager. Because of the profitability of the operation, the owner spent a large amount of his time constructing his dream estate. Recently, he found it necessary to begin devoting more time to the business since bills were beginning to alarmingly pile up and making payroll every two weeks was becoming difficult. We were brought in to review operations.

A business review engagement is typically completed in less than 60 days with a report issued which includes a detailed and prioritized list of actions to be undertaken as well as suggestions regarding the implementation of the tasks. To the extent that internal resources are available a complete plan is presented utilizing those resources. If some resources are unavailable we provide on-going assistance in carrying out our recommended actions.

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In this situation the cash flow "difficulties" were merely symptoms of the following problems:

- The so-called partner and general manager was an undocumented 2% owner that left the office early most days to coach several Little League teams and was for the most part unaware of operations from late afternoon through the evening, even though the stores were open late. During the one-on-one interview process most of the discussion centered around baseball, irrespective of how many times it was redirected back to operations.

- Financial projections for store financial operations were overly simplistic, mostly consisting of revenue and cost of goods sold estimates with no allocation of corporate/warehouse overhead. Consequently, the stores were always shown as profitable. Landlords' free rent periods were conveniently forgotten.
- Store/warehouse inventory was managed on a computerized system that no one knew how to use. The integrated accounting system was completely unused and the controller used QuickBooks to manage and reconcile cash independent of inventory management and other general ledger accounts. The controller was married to the general manager.
- IT systems were patched together with little reliable real time data. Communications among stores and inventory transfers were notoriously unreliable.
- Customer deposits were used to fund operations.
- Quarterly store inventories were usually pre-announced, often rescheduled, and if completed showed huge stock variances that were found to be the result of unidentified employee theft.
- Average accounts payable exceeded 120 days.
- Sales tax collected was used to fund operations with the owner personally liable for the multistate deficiencies.

About the only positive thing that could be said was that the payroll was outsourced and consequently there were no delinquent payroll tax issues. Given the severity of the issues encountered the general manager and controller were terminated, and we were asked to develop an orderly company self-liquidation that resulted in paying off all the sales tax obligations and making sure that all employees were paid in full.

While this situation was extreme, it highlights two important points. First, perception and reality are often quite different. What externally appeared to be an expanding profitable chain actively courted by suppliers and landlords was, in fact, a house of cards ready to crash unbeknownst to the hapless owner. Second, what initially precipitated the engagement was only a symptom of the underlying problems.

TASKS

In nearly all engagements the same sets of issues are found. These include:

- ✔ Poor cash planning
- ✔ Inappropriate and untrained staff
- ✔ Internal operations difficulties
- ✔ Tax miscalculations
- ✔ External stakeholder mismanagement

The issues encountered are not industry specific and all require quick remediation. Most of the first six-months of an engagement are spent in these areas and training employees/owners in the proper use of tools to manage each of these areas.

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POOR CASH PLANNING

This is by far the biggest problem area for company owners and senior management. In nearly every situation, the following problems immediately manifest:

PROBLEM	SOLUTION
Little knowledge of current and future cash uses.	Management should have a daily updated dashboard with metrics for detailing cash resources and their deployment.
Constant scrambling for payroll.	Minimum one payroll in bank for bi-weekly or semi-monthly pay dates. Weekly payroll filers should have two payrolls in reserve.
No plan to deal with accounts receivable aging issues or credit granting activities.	Specific written credit policies to be followed with minimal exceptions on a case-by-case basis.
No consistent accounts payable plan.	Small vendors to be consistently paid on time. More favorable trade terms to be negotiated with large vendors.
No budget.	Minimum twelve month rolling budget required.
No benchmarking.	Annually updated benchmark report against all major competitors.
No monthly variance report.	Monthly actual-to-budget variance reporting. Not to be set up by chart of accounts. Entire management team to be involved in the monthly review in open session.
Believing the sales backlog report.	Probability of closing; no use of sales order placeholders.

Unfortunately, most owners don't undertake even the simplest form of cash management: viewing online checking account balances each day or at least having bank statements mailed to their home address. Further, separation of duties with respect to the sales and collections cycle is usually not practiced. Consequently, it is little wonder that owners do not understand where the cash is going and are often susceptible to insider dishonesty.

INAPPROPRIATE AND UNTRAINED STAFF

Most companies suffer from the following deficiencies. The excuse is usually that everyone is "too busy" to take care of the matter.

PROBLEM	SOLUTION
No proper segmentation of duties even when sufficient people are available.	Critical elements of functions are concentrated in the hands of one employee. This leads to lack of oversight and often fraud. Critical functions dealing with cash must be separated among two or more persons.
No proper cross-training.	Institutional knowledge is lost when a person quits. Operational gaps occur until a new employee is brought up to speed. Every critical employee must have a backup.
No proper employee training programs.	Leads to inferior work product and law suits. (technical training, sexual harassment, discrimination, etc.) Institute formalized outsourced in-house training programs.
Improper classifications (independent contractor vs. employee.)	Just because you 1099 an employee doesn't mean they're an independent contractor not subject to W-2 withholding requirements. The IRS has made this a major audit area. If you're wrong you're probably out of business.
Improper overtime payment (exempt vs. non-exempt classification.)	Just because you pay someone a salary doesn't mean that they're exempt from overtime pay. The IRS has always made this a major audit area.

Correctly designed and implemented human resources management systems are established to ensure proper compliance and keep owners out of court, whether civil or administrative. Failure to implement and maintain correct human resource systems and planning will eventually produce a significant financial drain on the employer and senior management time.

INTERNAL OPERATIONS DIFFICULTIES

While the list of operational issues is often endless, the same key issues continue to arise:

PROBLEM	SOLUTION
Lack of written policies and procedures.	Unwritten policies and procedures means no consistent policies and procedures and makes internal operations susceptible to information hoarders. All functional departments need written, detailed documentation.
Information hoarders.	No one person should be permitted to have carte blanche control over any functional area. Cross-training and cross-responsibilities are required, even at the senior level.
Inadequate IT systems and/or training.	Lack of material investment in internal IT systems or outsourcing of IT infrastructure leads to unresponsive environment. Investment in employee training programs required.
Lax security.	Failing to properly secure corporate assets through proper security measures opens the company to IP theft (e.g., minimally protected networks, lack of biometric security on mobile devices, unrestricted work environment, etc.)
Inadequate or mispriced commercial insurance coverage.	Vigorous oversight of broker-of-record with multiple insurance company quotes required.
Poor hiring/termination procedures.	Institution of standard hiring procedures (e.g., criminal/credit/drug background check, etc.) and standard annual evaluation and oral/written disciplinary documentation procedures required.
Unaccountability.	Resist the urge to hire friends and family. Generally it damages employee morale.
Document retention/destruction policies.	Institute and consistently follow best practices.
Privacy/disaster planning.	Document best practices and ensure that all employees are aware of the planning procedures; undertake periodic system tests.

As previously mentioned, the usual excuse for not being adequately prepared and documented in this area is that “we’re too busy.” Unfortunately, studies have consistently shown that the average employee wastes up to two hours per day on non-work related matters, and the younger the employee the greater the time wasted.

TAX MISCALCULATIONS

Inadvertent non-payment of taxes is a way to unwisely spend necessary corporate resources. Outside of outright tax fraud, most tax problems are easily avoided through proper planning and education. We often see problems in the following areas:

PROBLEM	SOLUTION
Failure to make timely payments of payroll withholdings.	Use an outside service that impounds all withholdings and employer tax responsibilities on the pay date. The extra cost will be offset by their added expertise and liability shift.
Failure to collect/pay sales/use tax.	Gain an understanding of what the term "nexus" means and make sure that sales are appropriately taxed, collected, and remitted on a timely basis. This will become increasingly important and technical as Internet sales begin to be taxed.
Improper employee classifications.	Don't think that classifying workers as contractors or exempt employees absolves the business from collecting and remitting tax withholdings or paying overtime. The IRS continues to focus on this red-flag issue.
Pass through entity improper planning.	Resist the temptation to take a below market wage and classify most compensation as dividends.
Incomplete tax planning.	Owner tax planning is usually inextricably entwined with pass-through entity cash planning. There must be an annual tax plan based on the company budget.

Each of these issues has major implications and getting caught up in only one area can easily overwhelm what may appear to be a successful business.

EXTERNAL STAKEHOLDER MISMANAGEMENT

Most businesses fail to actively manage their external stakeholders. The thought is that so long as they're getting the periodic documentation required either by law or by covenant, nothing more is required. Unfortunately, nothing could be further from the truth. Failure to properly court external stakeholders during prosperous times often results in draconian measures taken in difficult times.

PROBLEM	SOLUTION
Failure to manage commercial bankers.	In person quarterly financial statement presentations and updates. Advance notice of potential adverse covenant compliance and requests for waivers with written remedial plan.
Failure to manage auditors.	Quarterly meetings to keep the auditors/tax accountants fully informed of business direction and plans. This makes the annual attestation service timely and less cumbersome.
Failure to manage minority shareholders.	Hold official annual shareholders meeting and completely answer shareholder questions.
Failure to manage aging creditors.	Keep creditors informed if their account is aging past normal payment terms and present a reasonable plan to get current. Then keep your commitments.

External stakeholders are often ignored until it is too late. Treating them like a valued business partner (as opposed to a pest) can provide you with time to rectify adverse situations which always arise.

BIGGER PICTURE

When engaging an interim chief financial officer, there is no reason why all of these solutions cannot be implemented during the first six to nine months of any engagement. However, this is the routine…not the extraordinary. What you really get in a world-class Interim Chief Financial Officer engagement is a professional who becomes so intimately familiar with your business as to be able to sense opportunity often viewed by others as an acute problem. This takes time and interaction with all parts of the business and its owners. However, doing so can identify opportunities where the reward is a multiple of the compensation paid.[3]

CONCLUSION

Some have stated elsewhere that the main purpose of hiring an interim chief financial officer is to "bridge the gap between the CFO who was there and the CFO who will be there." And in some circumstances this may be the case. However, in many cases the ability to provide tangible financial value to the company and its owners many times exceeding compensation cost warrants an extended stay and proves to be a win-win situation for everyone.

[3] *See our publication entitled "The Interim Chief Financial Officer: Cost Center or Profit Center?" for a thorough discussion of this issue.*

Trinity
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A GENTLE PLUG FOR OUR FIRM

With offices in Washington, D.C., Trinity Consulting Group International, LLC has provided a broad range of financial advisory and interim CXO level services to dozens of clients in multiple industries since 1998. Whether you require short-term assistance or an ongoing management partner, we have the experience and expertise to help ensure your financial and business success. In all of our services we emphasize thoroughness of preparation, professionalism in execution, and effectiveness in assisting you in meeting business objectives.

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