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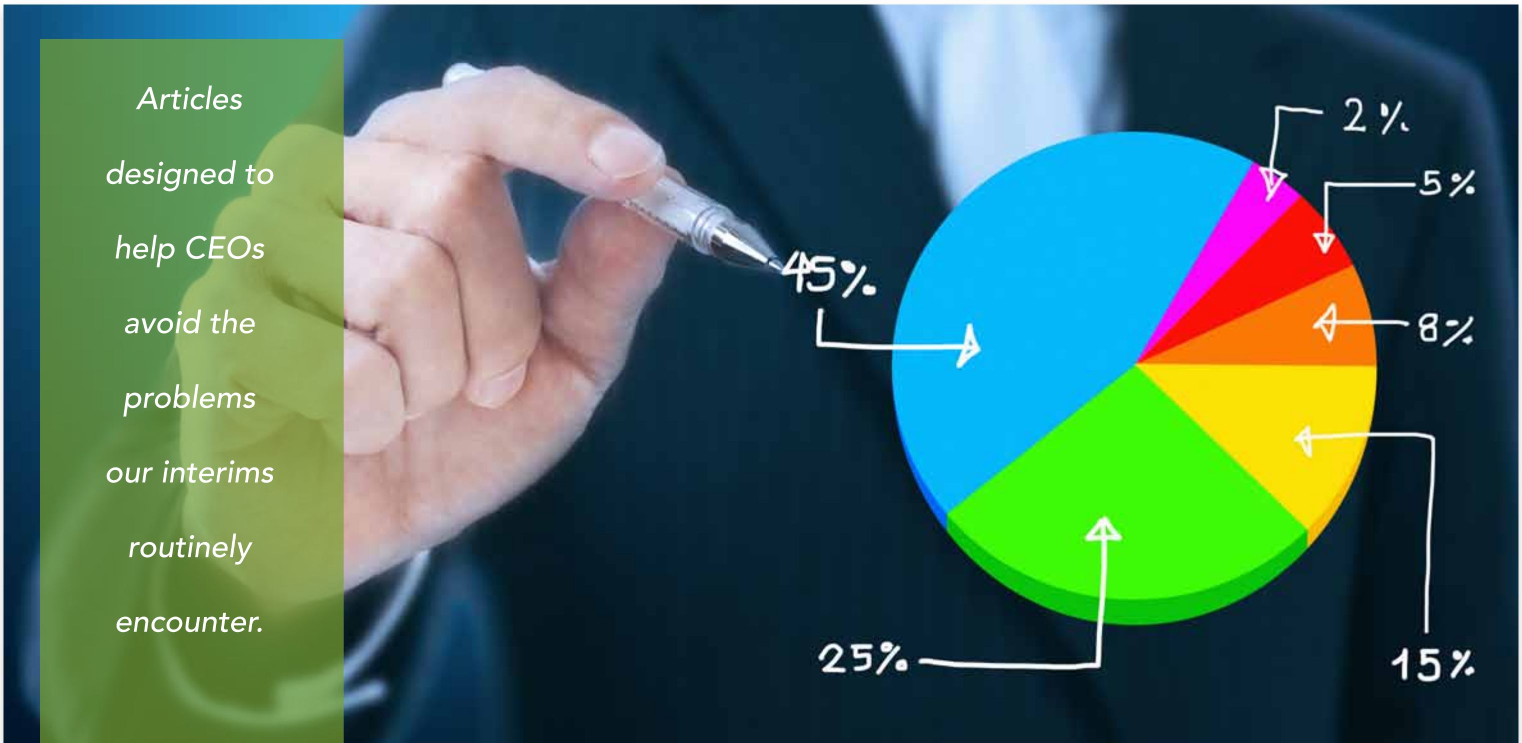
Interim Executive Solutions

Putting the Right Horsepower into Your Finance Department.

Questions that Reveal Hidden Weaknesses in Financial Controls



"Profit, and Peace." That's how one interim CFO for Cerius Interim Executive Solutions summed up the role of a Chief Financial Officer (CFO.) On the surface, they seem to go hand in hand, but what if you come to realize they are mutually exclusive in your company? If your peace of mind is derived strictly from the knowledge of your company's profit, are you missing some of the gremlins hiding under your financial bedcovers?

This is our first in a series of articles designed to help CEOs avoid the problems our interims routinely encounter. Three Cerius interim CFOs helped us unearth questions that CEOs might want to ask to uncover signs of weakness early in the game – before they morph into monsters that might devour resources, and hinder prospects for future growth or M&A opportunities.

Questions for All Companies

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

One of our CFOs explains that "closing your books gives you a good measure of where you are." If you are getting them closed in seven to 10 business days, congratulations – that's average.

"Two to four days is within the upper quartile of best practices," he says.

And how long is too long? "Well, it shouldn't take a month," he cautions. "The goal is to spend as little time as possible so the finance people have more time to support management in decision making."

Another of our experts has strong advice for CEOs. "Put a high value on getting the financial statements closed so they are as current as possible."

As for variances, ask yourself if you are getting a good month-to-budget analysis. Compare your results with the same month last year, or to the previous month. Look at, and then ask your finance people to help you explain any differences. "A surprising number of people don't do that," our CFO says. "The variances will tell a story. It may be in a language that is foreign to the CEO, but it is the CFO's job to translate it."

If you think you are too small to worry about this, or that you are large enough to justify taking more time than the average, think again.

"Size of the company really has very little to do with it. The systems and processes should be in place to get the books closed on a timely basis," he concludes.

Why it's important and what it suggests:
The longer it takes to close your books, the less useful your financial statements will be. You are running blind. As the CEO, you need to operate in "real time" as much as possible. That means getting information quickly enough for real-time decisions. It also provides an indication of your discipline, and how good your systems are. This is especially important if you will be seeking outside capital.

Do you utilize cash flow reporting? What about budgeting and forecasting? How accurate is it?

If you did an Internet search on "13 week cash flow," you'd be rewarded with pages of results. Why? As two of our financial experts point out, it's considered a "best practice."

Why 13 weeks? That's your quarter. A 13-week rolling cash flow allows you to see your cash on hand, usage, receipts, and disbursements. Then you update it the following week. This, points out one CFO, gives you a very good indication of where you are, and is one of the first things he does when he's called in to help companies in trouble.

But guess what? "If companies did it all the time – when things were going well – they could avoid getting into trouble," he says.

Why it's important and what it suggests:
If your financial staff is not being diligent about cash flow reporting, budgeting, and forecasting, it is not on top of its game. There is a high probability that a lot of other things are not being done properly.

Are your internal controls documented?

We expect public companies that have compliance issues to have proper documentation and internal controls. But you have a smaller, private company. Your finance or accounting department may consist of just a few people – maybe even just one. Is it really a big deal if you don't have your internal controls documented?

Maybe, and maybe not. Maybe as the CEO, you do periodic reviews of procedures and controls. Perhaps you bring in an interim or part-time CFO on a weekly or semi-weekly basis to review the financials, adding another level of control. Documenting the procedures, as well as these controls, adds another level. It's just good practice.

Why it's important and what it suggests:
If these processes are not identified and understood, it doesn't give a lot of confidence

Our CFOs identified areas in which they see the most waste. They might be worth a closer look...

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in how your policies, procedures, and financial books are done. If you walk into a company and ask for a simple written description of the procedures, who is responsible for specific tasks, and no such description exists, it should raise your antenna. You – or someone else – may be asking: "Can I really rely on your financial statements?"

Do you know if you have hidden waste? And if so, do you know what it is, or where to find it?

Our CFOs identified areas in which they see the most waste. They might be worth a closer look:

- ✓ Travel and entertainment expenses
- ✓ 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

Why it's important and what it suggests: Uncovering hidden waste shows prudence, but in some cases, it's also indicative of culture. In the case of lost-time injuries, for example, one CFO says this is the first thing on his radar when he walks into a plant. Are safety posters clearly visible? Is there a display of pride in having few injuries? For production failures, are you as the CEO getting to the root cause, looking everywhere in the organization and not just the manufacturing floor?

Do you have a good cost system that allows you to identify cost of product by SKU, and do you know growth, margins, and profitability by SKU, product line, product group, consumer, industry, state, region?

The detail in this question should give you some indication of its significance. "Cost systems are really critical," our CFO warns. "You need to know, broken down to the smallest unit possible."

Why it's important and what it suggests: You need to know where to expend your energy, as not all products and customers will have the same margin.

Do you have dashboard metrics, scorecards, and key performance indicators? Do you have clear measures of success and if so, are they understood by everyone in the organization?

Each organization has to define what is important to it, set a benchmark, and measure against that. It might be customer contacts, number of sales calls, or customer inquiries. Or, if you run an e-commerce company, it might be number of site visitors, page views, how much time is spent on your site, or percent of orders shipped complete and on time. In manufacturing, your key metric could be number of defects per 1000 pieces produced.

Why it's important and what it suggests: These sorts of metrics and measurements are usually lacking, which means that you cannot easily see how you are doing this month, or this quarter. Perhaps you are looking at outcome and results, and missing the smaller things that actually drive those results.

Do you have a robust strategic planning and execution process?

Strategic planning is time-consuming and usually enlightening – yet too often, companies go through this arduous process and then end up putting the plan on the shelf. Finance and accounting are important aspects of strategic planning that help focus your company's

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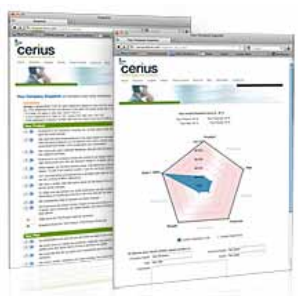
limited resources on defined objectives, and contain initiatives that should be included on personnel scorecards. You then hold employees responsible for executing on those initiatives. Companies that have taken advantage of Cerius's exclusive Company Snapshot found that the planning process scores the lowest – when, in fact, it should be driving your company's key processes.



Why it's important and what it suggests: A strategic plan covers all of the important basics in your company, and allows you to monitor progress and review on a regular basis. Once it's up and running, you can use it as a maintenance plan. But break down the goals and objectives so key executives know what they need to do, and so you can hold them accountable for actually doing it. The best plan – which you spent hours developing – is meaningless if not executed properly.

Is the management team properly incentivized? Are they rewarded based upon performance – and is a good performance evaluation plan in place?

This ties in closely with 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. Tie pay to performance to achieve the best results, and have a good evaluation system. Understand, too, that if you are too focused on sales, you may be sacrificing the creation of a valuable enterprise. And never underestimate the importance of top-tier personnel. "One of the first things I do in a turnaround is what is often referred to as 'top grading' of key positions," notes one CFO. "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."

Why it's important and what it suggests: You value top tier personnel, you set reasonable and measurable expectations, and you reward them accordingly. One expert emphasizes that this applies to companies of any size: "Consider planning the structure of your company from the outset as though it's a big company." That demonstrates a mentality geared toward success.

Conclusion

Our experts have some final observations for you:

1. When companies get into trouble, it's usually due to management! Mistakes made by owners and CEOs, such as investing in non-core assets, getting away from the non-core business, and expanding with large costs and infrastructure investments.

2. Second, many small to medium companies undervalue and understaff their financial department or positions – yet at larger, successful companies, the CFO is often the "right hand" of the CEO and an invaluable member of senior management. Model your small- to mid-sized company after success!

3. Most small companies don't grow into big companies. They structure themselves from the outset to get profitable as soon as possible, and stay profitable. Change your mindset: Structure yourself from the beginning as though you expect to grow, making timely investments in people. Big companies that have rapid growth sized and structured themselves to be big right from the beginning. Get expert help in managing costs, potentially burdensome infrastructure, and access to unlimited capital.

Everyone has monsters to slay.
The key is finding them, before they find you.

The Right Solution. The Right Fit. Every Time.

Cerius Interim Executive Solutions is the leader in delivering interim executive management solutions with the innovation and speed that small to medium business needs to tackle their business opportunities or to mitigate risk.

Cerius leverages the skill and experience of its deep pool of Interim Executives, who bring the broadest array of industry and functional experience, to deliver best-in-class leadership on-demand to our customers.

Cerius Interim Executive Solutions

15615 Alton Parkway, Suite 450

Irvine, CA 92618

T +1 (949) 250-0500

F +1 (949) 266-9597

www.ceriusinterim.com