



Financial Management and the Role of the CFO

Corporate financial management typically encompasses seven areas of responsibility: controllership, planning and analysis, treasury, tax, risk, investor relations, and administration. Some functions do not apply to every firm, e.g., IR at a private company, but the firm would be expected to possess expertise, either internally or outsourced, in each relevant area, as well as policies and guidelines to ensure its proper application. Here's a brief checklist of financial management functions:

Controllership

- ❑ **Accounting:** Implement and maintain effective accounting policies, including revenue recognition, expensing, capitalization, depreciation, etc.
- ❑ **Management reporting:** Manage the preparation of financial statements and provide timely reports of financial performance to company management.
- ❑ **Cash controls:** Implement and maintain effective cash management policies, including billing, payroll, accounts receivable, accounts payable, and maintenance of the general ledger.
- ❑ **Internal control:** Assure sufficient resources, direction, and procedures throughout the company to safeguard the company's assets and to achieve timely and accurate financial reporting.
- ❑ **Audit:** Manage the company's audit process to assure accurate and timely closing and the meeting of regulatory filing and certification requirements.

Planning and Analysis

- ❑ **Financial planning:** Assist management in the formulation and implementation of business plans, including financial forecasts, risk analyses, and capital requirements.
- ❑ **Budgeting:** Establish and maintain budgets and variance reporting and analysis for projects or business units.
- ❑ **Financial analysis:** Support management efforts to determine the economic performance of products, processes, client relationships, or other business segments as well as the value of new initiatives, including partnerships or acquisitions, and to structure deals to achieve business objectives.

Treasury

- ❑ **Capital structure:** Establish a target capital structure consistent with minimizing the company's overall cost of capital and prudent levels of risk.
- ❑ **Capital management:** Manage the capital structure consistent with current and projected capital requirements through the sale or purchase of shares, borrowing, or retirement of debt; structure financial transactions to achieve corporate objectives.
- ❑ **Cash management:** Manage liquidity consistent with working capital requirements through effective collection of receivables and timely payment of vendors; manage the availability versus opportunity cost of cash and credit; manage currency exchanges for liquidity and risk.
- ❑ **Banking relationships:** Manage the company's relationships with financial institutions and intermediaries to maintain potential sources of financing; monitor and communicate compliance with all financial covenants.

Tax

- **Tax management:** Manage corporate tax liability and payments consistent with maximizing corporate cash flow over time.
- **Tax strategy:** Develop methods for minimizing tax payments and audit risk in cooperation with the firm's auditors.
- **Tax compliance:** Ensure compliance with all tax regulations, including proper filing of requisite forms and maintenance of relevant supporting documents.

Risk

- **Enterprise risk management:** Identify and monitor activities capable of exposing the firm to significant financial claims, or committing significant capital to risk of loss, to insure that they operate within guidelines established by the board of directors, or delegated by the board to appropriate managers.
- **Hedging and insurance:** Develop contingency plans, hedging, or insurance policies to counter risks posed by financial leverage, ownership of foreign assets or currency, or other insurable liabilities such as tort, environmental claims, etc.
- **Financial regulatory compliance:** Work with counsel to ensure that policies are in place and being enforced regarding actions that might expose the firm to significant penalties by financial regulatory authorities, e.g., insider trading.

Investor relations

- **Disclosures:** Manage the dissemination of required or relevant disclosures to the investment community, including shareholders, fund managers, securities analysts, credit agencies, etc.
- **Communications:** Coordinate press releases or other external communications with senior management and the Board of Directors.
- **Inquiries:** Establish and maintain policies for addressing inquiries from shareholders, the media, or other external stakeholders.
- **Annual meeting:** Oversee planning of the annual meeting with shareholders.

Administration

- **System integrity:** Assure the integrity of corporate financial systems, especially changes made to corporate systems with any interfaces to internal and outsourced financial components or modules.
- **Access:** Manage financial system user rights and administration.
- **Service performance:** Develop metrics for corporate administrative (including IT) effectiveness and efficiency; determine which functions or programs may be more economical to externally develop or outsource.

Role of the CFO

No one person is expected to be an expert in all seven areas, but a CFO would typically have a deep familiarity, if not expertise, in each area most critical to their firm. Beyond that, the CFO is expected to be a key member of the senior management team involved in all aspects of developing and executing strategy, promoting company goals and standards, representing the company to various external constituencies, staffing and personnel development, and otherwise focusing and supporting the organization on maximizing shareholder value.

Each CEO and Board has slightly differing expectations of their CFO, but most express the need for the CFO to identify and communicate—to employees and investors—the thread that connects business activities, current and potential profits, and the company's value. Besides these typical requirements, the CFO's job is evolving along several emerging themes:

- **Understanding the business drivers of profitability:** It is no longer enough for the CFO to say "Division X income is \$24 million year-to-date, \$1.3 million over budget, primarily driven by cost savings of..." The CFO must be able to articulate, at least roughly, how Division X's business activities translated into those financial results, i.e., who are Division X's main customers, why they are buying from Division X versus anyone else, why Division X is able to provide its products and services better than the competition, what threatens their ability to do so in the future, what investments (human and capital) are being made to overcome those threats, the likely returns on those investments, etc. More importantly, the CFO is expected to facilitate Division X management's addressing those issues with fine granularity and reasonable confidence.
- **Communicating value in terms of both profit and expectations:** CFOs can no longer focus solely on near-term profits and ignore profit expectations. They must be able to make value-enhancing trade-offs between short-term and long-term, reflecting a distinction between the "level and "quality" of earnings. For public companies, this means understanding the drivers of both earnings and P/E, and quantifying what current P/E says about investor expectations of future profitability. Consistent with the prior distinction of activities vs. results, CFOs must also enable managers to reconcile investor expectations with business plans, and require plans that justify at least current valuations.
- **Embodying integrity:** The CFO is, if not the chief ethics or compliance officer, at least a top deputy. Most of the things that can go ethically awry in a business eventually land on the CFO's desk. Strong CFO credibility on ethics and compliance issues becomes a critical factor in both minimizing the risk of lapses and assuring that when lapses occur they get surfaced and remedied as quickly as possible. (How the CFO balances his or her functional interests against overall corporate costs is considered one indicator of integrity, often tested in IT decisions where Finance is key beneficiary, major decision maker, or watchdog.)
- **Promoting financial literacy:** CFOs are expected to insure training and support across the company for a sufficient level of financial literacy such that managers can fluently use internal and external data to supplement direct contact with customers, vendors, and operations in identifying sources of profit. CFOs are expected to support management in intelligently sorting through their plethora of metrics to identify, communicate, and manage trends that might be driving or undermining profitability.
- **Paying special attention to human resources:** It is becoming increasingly clear that most value-destroying decisions are not due to lack of analytical sophistication but to lack of proper incentives. As the person most responsible for linking strategy and value, the CFO is also getting more involved in issues of motivation, particularly in determining compensation metrics and making the link between results and rewards stronger and more transparent for employees. The CFO must understand the trade-off between alignment, retention, and cost.