Private Funds CFO

By: Guest Writer
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FINANCE & ACCOUNTING

Is your portfolio company ready for prime time?

Many private companies haven't prioritized investing in their back-office functions, increasing the likelihood of adverse developments years after going public, write AlixPartners' Sean Dowd and Marc Landy.

In 2020, the phrase of the year was: "You are on mute." Halfway through 2021, we are beginning to hear some new contenders: "SPACs are booming" and, in the boardrooms of these booming SPACs: "Our audited balance sheet should no longer be relied upon."

Within a few years of completing their de-SPAC transactions, we are going to hear this again and again. How do we know this? We have seen restatements occur because a company has gone public before it's ready for prime time.

Whether a SPAC/de-SPAC transaction, reverse merger or a regular IPO for a nascent entrepreneurial business, there are companies that may not have the capabilities to deal with the pressures and expectations that come with being a public company.

While diligently focusing on EBITDA, profitability, revenue growth and related metrics, many private companies haven't prioritized investing in their back-office functions such as finance, accounting and compliance. As a result, there may be adverse developments that come to light a few years after the IPO and could manifest themselves as:

- Regulatory inquiries/investigations
- Delayed filings
- Restatements
- Liquidity issues
- Loan defaults
- Bankruptcy

Investors and sponsors must be perceptive and ask probing questions to evaluate whether their company is ready for prime time. They should ask CFOs and controllers about the operational challenges they are navigating.

What keeps them up at night? How capable is the finance and accounting team? Do they meet deadlines? How does the current reporting timetable comport with public filing deadlines? What does the audit partner say about the team? Does the accounting team deliver information to the auditors when promised? Is the accounting team knowledgeable about public company reporting requirements? Is the team prepared to meet public company reporting deadlines? And, if you are a board member of a newly public company, these same questions apply. The answers and timing are even more critical.

How do you evaluate whether your organization has more than an acceptable level of risk?

To be clear, these questions are not an internal controls checklist, and they won't be reported in a Quality of Earnings (Q of E) review. The questions are intended to provoke thought and discussion about the foundation of the accounting and finance function at a public company, taking into account processes, experience, culture and communication.

Financial close and reporting processes

- How reliant is the accounting close on spreadsheet-based analyses?
- Is the consolidation automated?
- Are all the entities on the same accounting system?
- Is there proper review of journal entries?

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Is it really happening or is the approval just a signature?
- How has the pandemic affected the accounting team's operating efficiency and capacity?
- If there are contracts/licensing agreements, how easily can the key non-standard terms be identified?

Experience and capabilities
- How many people in the accounting team have experience at a public company?
- What is the average tenure in the accounting department?
- Do you have a core group of accounting and finance team members that can support this function as you grow?
- Is there any person in the accounting department who is the only person in the company that knows how to do his/her job?
- How many hours do they work in a week?
- Is there any excess capacity in the team, or will the public company reporting requirements push the team beyond its capabilities?

Culture and transparent communications
- How open are the communication channels between the accounting team and other departments in the company?
- Does the company provide an easily accessible and confidential way for staff to express criticism and raise red flags without fear of reprisal?
- Is there a clear understanding among all staff of what represents risk?

What can you do?

Visit the company's offices to meet the members of the accounting department and speak with the team informally. If visiting is not possible, have an open conversation with the CFO and the controller. Make sure they know that you are seeking to understand their processes and be a resource/sounding board for them to understand how you can help.

The CFO or the controller should be comfortable knowing they can alert the board or sponsor to their challenges and seek their counsel on how to get ready for prime time. Develop a plan to get there. Be aggressive – but realistic – about the plan. And figure out a way to reduce dependency on spreadsheets!

A back office that may have been viewed as an afterthought in a private company environment is a critical part of a public company, and needs the proper level of investment, resources and oversight. The glare of regulators, investors and the media is intense. Acknowledging that being ready for prime time requires preparation will make it more manageable.

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