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Accounting

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Technical Accounting: The CFO's Secret Weapon

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Charles Holley, the retired CFO of Wal-Mart, has said that CEOs want finance chiefs who are:

1. Adept influencers
2. Strong communicators
3. Tireless change agents

Nowhere on that list is "proficient accountants." The controller-style CFO has fallen out of favor, particularly in private equity environments, where fund sponsors believe bookkeepers lack the ability and strategic sensibility to help scale the business.

To those who argue that CFOs must be more than competent controllers — we wholeheartedly agree. But, to those who diminish the importance of capable, strategic, proficient technical accounting as a critical part of finance, we say, listen up: there's simply no greater partner than accounting for delivering desired financial results.

A good partnership with accounting will help provide an accurate reflection of financial results and expected returns. A great partnership with accounting will actually help drive and influence those financial results (legally, of course).

That latter type of partnership is rare. In too many companies, it is only after a transaction has occurred or a new standard has been adopted that accounting is asked to provide its "official accounting answer" (which is sometimes expected but often counter to, and occasionally even upside-down from, the company's projected/assumed impact).

Indeed, many fairly common business scenarios have unanticipated accounting implications. We call these scenarios "accounting accidents." The solution for such a scenario isn't complicated: it's to bring the accounting team into the process at its start, rather than its end.

That's a particularly important lesson for companies engaging in the three scenarios that tend to be the most accounting accident-prone.

1. **To Acquire or Not to Acquire, 'Tis the Accounting Question**

Actually, it's not. The accounting question is really: what, exactly, are we acquiring? An asset or a business? That determination is critical, if not always clear. Acquisition categorization has measurable accounting implications: from goodwill recognition to capitalized vs. expensed transaction costs, to the treatment of in-process research and development activities.

When considering the accounting approach to acquisitions, it is also critical to understand the impact of debt and equity financing as well as the consequences of minority shareholder rights. These factors influence whether the entity will be consolidated (affecting top-line revenue and expenses) or recorded under the equity method (affecting only margin).

In all cases, partnering with accounting during diligence (prior to engaging in a transaction) will not only better educate stakeholders on the financial implications of an acquisition but can actually inform how to structure the transaction to meet the desired financial goals and key metrics. Here, accounting can help structure deals to drive favorable financial results, not just record them.

2. To Recognize Revenue Now … or Later

Whether it's for a more favorable exit valuation or some other desired outcome, let's say your company wants to grow top-line revenue now (and who doesn't?). Incentives that will attract additional customers seem like a smart path to meet that end. But here, accounting accidents abound.

Take extended customer payment plans, for example. Successful customer relationship strategy? Sure. Successful top-line revenue generator? Not so much. In fact, extended payment terms may end up reducing revenue as a portion of it could get classified to interest income.

Customer promotions — free services, rebates — can similarly impact the timing and amount of recognized revenue. What's more, terms and conditions in reseller and distributor agreements may not only delay revenue recognition but may impact whether it's recorded gross or only net in margin. With the adoption of ASC606, the new revenue recognition standard, it's never been more important to pay attention to termination clauses and contract modifications.

Where top-line revenue is a key metric and timing is important, the accounting team's early involvement will be critical to ensure payment plans, incentives, and vendor agreements are structured accordingly. In fact, it may be the difference between top-line achievement and bottom-line accident.

3. To Lease by Any Other Name … Is Still to Lease

That's the impact of ASC 842, which puts nearly all leases, be it operating or capital, on the balance sheet. That shouldn't fool companies into thinking leasing structures won't have significant implications on the financial results. They will and they do. Finance leases, for instance, can have a positive effect on EBITDA, but (accounting accident ahead!) they can have an equally negative effect on debt covenants.

Too often, accounting is given the bookkeeping task of recording a lease's financial obligations and meeting them. It may not be the wrong role, but it's certainly a misuse of the function's real value. The smart company (and CFO) uses accounting to advise on lease options (prior to signing) to ensure that leases (and supply/service arrangements which could contain a "leased"

asset) are structured in a manner that will benefit the company's critical metrics (or will, minimally, not damage them).

Accidents happen. But accounting accidents don't need to.

Sophisticated CFOs not only understand the value of technical accountants to accurately account for decisions made, they partner with them to provide proactive guidance for the decisions yet to be made. Here, accounting can drive desired financial outcomes, while navigating away from the unanticipated, but all too common, accounting accidents.

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