The Evolving Role of the INTERIM CFO

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Whether a company is large or small, public or private, the role of the CFO is moving from reporting the past to anticipating the future—and managing the associated risks and opportunities. One consequence of this expanded role and the resulting higher expectations is greater turnover. Recent studies cited a 20% turnover rate among CFOs in the S&P 500 and an astonishing rate of 80% for CFOs of private equity (PE)-backed companies.

The expansion of the CFO's responsibilities results in a reluctance to leave the position vacant for even a short period of time, as these activities cannot be neglected or shunted aside. Therefore, more companies are turning to an outside professional to step in on an interim basis—perhaps from four to six months—to sustain momentum and allow a thoughtful and deliberate search for a permanent member of the executive team.[1]

This article assists both companies and interim candidates in framing expectations for this critical position when providing a bridge to the future. Given the high turnover within PE-backed companies, the article focuses on that growing slice of the U.S. economy, although the lessons can be applied more broadly.

To understand the evolving role of the interim CFO, it is essential to start with the increased expectations for the permanent CFO. While there are many templates from which to choose, the following parameters offer an effective means to define the broad CFO role:

- **Steward.** The traditional role of the CFO and the bare minimum threshold is to deliver timely and accurate numbers, manage financial reporting to all stakeholders, build and transmit dashboards tailored to each audience, ensure that effective financial controls are in place, and fulfill compliance requirements, whether to lenders or other third parties. The CFO also must be able to effectively communicate financial results and variances to management, the PE sponsor, the board, lenders, and other stakeholders, including the firm's outside professionals, such as attorneys and auditors.
- **Operator.** There is a clear expectation that the CFO will adopt a forward-looking plan to manage cash and working capital—even in the most successful companies—and will monitor and forecast loan covenant compliance. While lenders and PE sponsors frequently will work with a company to manage through a working capital problem or a covenant default, ample notice will generate the most favorable solutions and substantial goodwill. It might

appear counterintuitive to think that problems generate goodwill, but each stakeholder has experience with the speed bumps that even the best companies encounter, and each respects transparency.

- **Change Agent.** A key evolution in the role of the CFO is to identify and propose solutions for inefficient processes—both within the finance function and in other areas of the company—particularly supply chain management and IT. A successful PE CFO will make strategic investments in technology to enhance processes, cut labor costs, and create a more efficient workflow within the company. Not only does this call upon a broad set of experiences from the CFO but also an ability to work across organizational silos in a nonthreatening and diplomatic manner.

- **Strategist**. The CFO has become the strategic partner to the CEO and the PE sponsor, particularly as it relates to assessing organic growth opportunities, acquisitions, dispositions, and capital structure options. The expectation is that the CFO will ensure that decisions are data-driven and subjected to rigorous analysis under multiple scenarios. To do so, the CFO must be able to articulate the key levers that will move the needle on results, including sales, margins by business segment, and both fixed and working capital requirements.

- **Mentor**. As the role of the CFO expands, forming a capable and cohesive finance team is increasingly critical. The more traditional financial reporting and compliance activities should be assumed by the controller, and the CFO should be serving as a coach and mentor to the finance and accounting team—with the key controls in place. Another key position that is critical to supporting the broad range of responsibilities is that of financial planning and analysis (FP&A), and the CFO should recruit a talented partner for this role.

How do these responsibilities translate to the interim CFO for a PE portfolio company?

Credibility, Integrity, and Transparency. The first thing to recognize is that there is a significant likelihood that something is amiss if an interim CFO is retained. A frequent reason for CFO turnover is the inability or unwillingness of the CFO of a newly acquired company to adapt to the demands and pace of a PE sponsor. Monthly closes that may have stretched previously to 15 days or longer are

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mandated in five to seven working days, and errors that previously could have been corrected in the following months are no longer tolerated.

Consequently, the role of steward is elevated for the interim CFO, who must move quickly to put in place the systems, controls, and procedures to close the books, report results, and ensure the integrity of the figures. While many of the basics are similar across companies (*e.g.,* revenue recognition, cash reconciliations, accruals, etc.), one area with which the interim CFO must gain familiarity quickly in a PE-sponsored company involves "addbacks" associated with adjusted EBITDA, because that is a pivotal figure for covenant compliance, as well as earnouts and bonuses.

A call to action can be triggered by well-thought-out, forward-looking analyses and reports—which are even more essential if the company is experiencing financial stress or if the historical reports have been unreliable. It is expected that the interim CFO will move quickly to quarterback the preparation of a 13-week rolling cash forecast with assistance from sales, purchasing, and operations. Additionally, there should be a rolling four-quarter forecast that provides visibility to capital requirements and covenant compliance, recognizing that PE-sponsored companies may be leveraged at four to five times EBITDA right out of the gate and that relatively small changes in financial performance can have an outsized impact on availability and compliance.

Concurrently, the interim CFO should become a communications hub for the company and its stakeholders by assessing the timeliness and quality of the reports (daily, weekly, and monthly dashboards) delivered to each audience. The individual should move quickly to establish working relationships with the executive team and the operating partner from the PE sponsor and allow them to be guides to revamped reporting. If there have been concerns with timeliness and integrity of the information, credibility must be restored quickly through full transparency, and the interim CFO must collaborate with the PE firm to resume an effective dialog with the company's lenders.

At the same time, the interim CFO must remain cognizant of the bandwidth of the finance and accounting team, as well as the IT team, and work with all parties to set priorities for new reports, particularly those that are not generated directly from the company's systems.

Organization and Personnel. One danger facing the interim CFO is getting caught up in fixing the basic needs of the business and its stakeholders to the extent that coaching and mentoring are neglected. The finance and accounting team, as well as the IT and human resources teams in some companies, will have just lost their leader, and perhaps a friend, and the emotional toll cannot be overlooked. Even those on the team who recognized the failings of the prior CFO may question their own futures and commitment to the business.

Moreover, the interim CFO must recognize that any further departures could jeopardize the central mission of restoring the finance basics. Therefore, the individual needs to reach out to each member of several teams to listen to each person's guidance and provide positive direction. Of course, any assurances that the interim CFO provides must be limited at this early stage in the individual's tenure.

A conundrum frequently faced by the interim CFO is how to manage an underperforming member of a team. In the best of situations, this can be a difficult call; here, there are two additional impediments to letting this person go. First, the loss of additional institutional knowledge at a crucial time for restoring the timeliness and credibility of financial statements can set back this goal and delay other opportunities to assist the company. Second, it is preferable to allow the permanent CFO to make key staff decisions.

The retention decision, which should be made in consultation with the CEO, hinges on a judgment call as to whether the individual in question is less effective in their role than is expected, which may be tolerated for a limited period of time, or is actually counterproductive, perhaps by delivering incorrect information or acting as a disruptive influence to the team.

Forward Looking. One cannot overlook the potential of the interim CFO to be a change agent. Each person brings a unique set of experiences and skills to the position, and that fresh perspective can identify opportunities for improved analytics, processes, procedures, systems, and controls. The interim CFO should consult early and often with the CEO and the operating partner to assess their priorities and drive key projects to their conclusion. For example, newly acquired platform companies or add-ons for an existing platform frequently require a review of existing systems and, perhaps, the implementation of a new enterprise resource planning (ERP) system.

These projects can't wait for a permanent CFO to join the company, and the interim CFO needs to take a lead role in this critical undertaking. A note of caution is in order, however. Some decisions—for example, organizational changes or changes in key management assumptions for accounting (*e.g.,* inventory reserve calculations)—may be left to the permanent CFO to avoid the confusion of changing processes multiple times.

Strategic discussions also can benefit from the interim CFO's new perspective. Introducing ideas and analytical tools from different industries can shed light on what may have seemed to be an intractable problem and lead to innovative solutions. For example, slicing and dicing data under several scenarios can yield insights into business unit profitability and growth potential. The management team also will benefit from the interim CFO's perspective on the skills and personal attributes that should be sought in the new CFO, and should make the individual a key member of the interviewing team.

Key Considerations for Companies, Candidates

In light of this, what should PE firms and portfolio companies consider when retaining an interim CFO, and how should candidates approach such engagements?

A company should consider bringing in an interim CFO, particularly if there have been financial reporting issues. It is essential to restore the credibility of the company's reporting as quickly as possible and to demonstrate a sense of urgency to stakeholders. The industry background of the candidate frequently is not a material issue except in regulated industries, such as banks, or in industries with unique revenue models, such as healthcare. In fact, as noted earlier, the perspective offered by a professional from another industry can be valuable.

Having experience with PE-sponsored companies and understanding their expectations is helpful for an interim CFO. If the company is facing financial difficulties, a candidate's turnaround and restructuring background would provide the company and the PE sponsor with a significant resource as they hold discussions with the lenders and other stakeholders.

Providing additional resources to the company and the interim CFO should be considered, perhaps from the PE team or other outside resources. An FP&A professional with strong modeling skills is an invaluable resource for understanding alternative forward-looking scenarios and actions.

For their part, interim CFOs should be prepared to work long hours—60 to 70 hours per week or more—and to be on call 24/7. It is likely that the company waited too long to make this change, and there is a significant backlog of work to be done. The first and highest priority is to get the numbers right. If there are historic issues or errors, they must be surfaced quickly and with full transparency to the CEO and the operating partner and, in turn, to other stakeholders. An interim CFO must learn quickly how to fit into the management team and its operating processes.

The interim CFO must assess key performance indicators (KPIs) being used to measure performance against the needs of each audience and define delivery methods that can be automated using software tools. Delivering data, such as spreadsheets without relevant analyses, results in frustration and confusion. The interim CFO should set expectations that thoughtful findings, conclusions, and recommendations will accompany data.

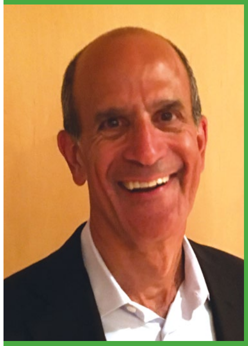
The interim CFO should also be an advocate for their team and let them know that's the case. They should work with the CEO and the operating partner to set priorities to avoid burnout among team members.

Finally, an interim CFO should always be preparing for the transition to a permanent replacement. What will the permanent CFO need? Interim CFOs should set up their successors for success; their success reflects favorably on the interim CFO's achievements.

Conclusion

The evolution of the CFO's role has had a direct impact on the need for, and expectations of, the interim CFO. The increased responsibilities of the CFO make it difficult to leave that position vacant for any length of time, resulting in a higher demand for professionals who can step in and get up to speed quickly. PE-backed companies—particularly those that recently made the transition from private ownership—can gain value by using an interim CFO as they conduct a deliberate search for the permanent candidate.

For the interim CFO, fulfilling the basic functions of steward is necessary but not sufficient; the individual must be able to step up as an operator, mentor, change agent, and communications hub for all stakeholders. Leveraging such experience to be a strategic partner to the CEO, even for the short duration of their tenure, can provide great value to the business by bringing new perspectives. J



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[1] Emerging growth companies can be seen adopting a similar strategy, although this may be framed as a fractional, rather than an interim, CFO. The difference is most evident in the time commitment, as a fractional CFO might be expected to work on the client's matters from a few days per month to a few days per week, while the interim CFO is dedicated to the client fully during their tenure.