WHAT NON-CFO EXECUTIVES NEED TO UNDERSTAND ABOUT FINANCE

Preparing yourself for success in the C-Suite and boardroom

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Introduction

Senior leaders must demonstrate their ability to take a holistic view of a company's purpose, performance, risk, and opportunities. For every leader – not just the CFO – this means paying attention to finance beyond your area's P&L. Solid financial acumen serves as a foundation for leaders to drive strong business performance, confidently present to the board, and achieve a board seat.

This guide covers the top areas of finance an executive is expected to understand and articulate (from audit to board-level finance to the earnings calls). These are just a sampling of the topics that we cover at Athena Alliance, the executive development community for women leaders, through our ongoing financial acumen series for members. The goal is to empower non-CFOs to gain the basic knowledge they need in these areas to accelerate their rise through the senior leadership ranks, including in the boardroom.

Board finance basics

One common misconception among many aspiring or new board directors is that finance is limited to the Audit Committee. The Audit Committee oversees the process and procedures of the company, ensuring all the financial transactions are recorded and reported according to compliance. It's a "look back" approach to ensure everything is happening in tune with laws and stakeholders.

On the other hand, finance is forward-looking; it's intertwined with strategy and asset management, ensuring the company is creating value along with the broader company strategy. Finance – in the true, forward-looking sense – is typically discussed with the whole board. That means every director is expected to prepare for these discussions and come to the table with intelligent questions and a baseline understanding of the financial health of the company.

Directors and C-Suite management should have basic knowledge of:

Company worth.

What would your company be worth today if someone agreed to buy it? For a public company, this may mean viewing an enterprise evaluation or a recent 409A valuation.

The levers that drive your valuation.

Understand the "why" behind your company's worth, which is specific to your company and your industry.

Your company's budget.

Your company budget tells the story of whether value is being created or destroyed. It also gives insight into the management team's approach to problem-solving, resource-building, and scaling.

Cost of capital.

A core part of the budget is your cost of capital. If your cost of capital has skyrocketed, it may mean important projects or resources are off the table; if low, it may open the door to big opportunities. Keeping an eye on your cost of capital helps tell the story about whether your business is even viable, and whether it's actually creating money (value).

How your budget links to company strategy.

Smart board directors should watch for changes in spending that may or may not relate to a company's broader goals and strategy. For example, if there was massive company growth, did the company hire sales reps to match that growth? If the company is predicting massive growth, are they allocating resources to marketing or other teams to actually drive that growth? Strategy and spend should tell parallel stories.

Liquidity.

Your company's liquidity is its safety net, making it either incredibly vulnerable or quite powerful, depending on the numbers. Always understand your current liquidity position and how decisions that are made in the senior management ranks and board levels affect that position. Understanding the company's cash "runway", or how many months of cash is available, is critical, especially during times of economic downturn and uncertainty (at both company and broader economic level). Not only is it important for the board to understand the forward-looking cash projections, but also for management's plans for fundraising and/or rightsizing to address liquidity issues. Boards should ask for risks and opportunities as part of the cash flow projection scenarios.

Finance plays a crucial role in removing emotion from forward-looking spend. People, especially early-stage founders, can become emotionally attached to the business. They may make decisions that are not necessarily in the best interests of the company because they can't see through that emotion. Finance helps paint a clearer picture of where spend should be going, what the forecast of the business truly is, and whether the decisions being made are strategic and rational. Finance drives many tough, emotional conversations; however, the intention is that it makes tough, emotional decisions easier.

Finance also plays a role in financial statement presentations to explain the story behind the numbers. For example, is revenue up to the budget because of volumes and/or rates? The same goes for an explanation of expense variances.

Understand the role of the Audit Committee

The Audit Committee is one of the core three key committees required on any public company board. In addition, some private companies and many Private Equity-backed companies have an Audit Committee. The Audit Committee monitors the company's financial reporting practices and controls. It's typically composed of three to five independent board members, but it's very common that any number of directors attend Audit Committee meetings as non-voting members, as well as the CEO and CFO. The author believes it is a good practice for new directors to observe audit committee meetings to get a better understanding of the financial aspects of the business.

Often, it is Audit that oversees compliance, disruption, and risk management – key boardroom topics applicable across many areas of the business. Directors who serve on the Audit Committee are required to meet minimum levels of financial literacy and be independent directors. For public companies, these levels are defined by the stock exchanges. The specific duties of each committee, including the potentially wide breadth of the Audit Committee, will be outlined in each committee's charter.

Typical areas the Audit Committee oversees include:

- Managing outside auditors (approve the Engagement Letter from outside auditors; oversee the audit);
- Managing taxes and tax compliance;
- Ensuring financial and data integrity through a strong internal control framework;
- Overseeing end-of-year proxy statements (for public companies)

Additional areas the Audit Committee somtimes also oversees include:

- Internal Audit (approve the engagement; internal auditors have dotted line to audit committee);
- Enterprise Risk Management program;
- Cybersecurity program;
- Compliance, if a regulated company (example Financial Services or healthcare);
- ESG reporting

New board directors may want to attend Audit Committee meetings as silent observers, simply to absorb knowledge and business acumen. I highly recommend this as a way to learn more about the Company. Directors should also review the charters for each committee and understand which committee owns what. And, they should be prepared to read and engage in discussions around financial statements, which have two parts: the opinion and the ICOFR (which stands for Internal Controls on Financial Reporting).

The integral role of the CFO

Every board director must recognize that the responsibility of the company's financial oversight extends beyond the Audit Committee. To be a successful leader, each director should be able to speak to financial topics such as budgeting, allocation of capital, and liquidity. The CFO plays an integral role in each of these discussions – both in the backward-looking evaluation to account for spending but also in the future-looking function, which is more strategic.

A "full stack" CEO can do both. Board members need to be aware of the capabilities of the CFO. Depending on what you observe and what the CFO's background is, you need to be comfortable asking a lot of inquisitive questions to press hard on the accounting or the finance side.

For example: If a CFO is strong on strategy, they may be spending extensive time with the CEO; they're pitching investors; they're in operational discussions about the business. These are signs that board directors should ask more questions on the accounting side or get to know the controller.

Regardless of the CFO's areas of expertise, the full board is charged with ensuring the company creates economic value. Board members should always understand what the company is worth, and be aware of situations where there is a major disconnect between perceived worth and investor perception of worth. Additionally, board directors should always understand the company's cost of capital, as well as understand the end-to-end process for how the company puts together a budget. Each of these areas will provide insights for the entire board as to the vulnerabilities of the business, as well as help take emotion out of decision-making.

Board directors should review board charters in detail, as well as Audit Committee notes, to ensure they understand their responsibilities.

Mergers and Acquisitions

Buy-side acquisitions

Companies often grow through acquisition. It can be extremely challenging to scale without going through an acquisition at some point. Board directors need to know what to look out for, how to make acquisitions work, and understand the key reasons companies undergo acquisitions, typically in a "buy versus build" mindset.

Companies may choose to expand into new regions, to eliminate the competition, to acquire new technologies, or to consolidate companies or assets. Through each of these scenarios, board directors need to understand what to look out for and protect the fiduciary interests of the company. Board directors should ensure that with every acquisition there is a solid strategy in place, and should vet that strategy. When evaluating whether to acquire a company, board directors need to understand if the product, people, processes, and infrastructure they are acquiring are solid and scalable. Board directors are also involved in discussions regarding valuations, integrating operations, consolidating functions, and more.

Sell-side M&A

But what happens when you're on the board of a company that is looking to sell? There is enormous pressure on the board to successfully oversee any M&A. Regardless, every company — and especially smaller companies – must be prepared to undergo strategic evaluations should an offer to buy come its way unsolicited. The board's role in each of these scenarios is the duty of fiduciary oversight. Companies engage in mergers and acquisitions as a growth strategy to add enterprise value to the company.

However, about 75% of mergers and acquisitions fail to meet investor expectations. Board directors are expected to ask constructive (and potentially challenging) questions to dig into the strategy, the plan, and the pro forma to evaluate if the acquisition makes sense. Board directors must evaluate risk, reward, and the plan for a potential integration to ensure each is being thought through carefully, and that the transaction is accretive to the company's enterprise value.

Working with third-party experts

Mergers and acquisitions can be extremely complex. In exercising a board's duties of loyalty and care, the board must ensure it is well-informed and that all decisions are in the best interests of the company and its stakeholders. To do this, many boards turn to outside experts for help, ranging from attorneys and investment bankers to accountants and valuation specialists.

During a merger or acquisition, boards may choose to establish a special committee that is focused entirely on the transaction. The board members sitting on this committee oversee the process of the deal and manage any conflicts of interest along the way. These third parties evolve to be critical partners should the board evaluate alternate paths to growth, such as whether to stay the course or to sell. Boards can lean on these partners for advisory services, to manage sticky "curve ball" scenarios, due diligence, conflicts, to help improve board dynamics, and more.

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Going public: Understand the path to an IPO (the 'old-fashioned way')

Preparing for an IPO entails an extensive list of controls, skills, and resources to be in place, both at the company level and around the board table. It also requires thoughtful consideration of key partners, especially your bankers, as well as taking a disciplined and methodical approach to financial controls. A public company Audit Committee must have direct lines to the accounting and finance team, internal auditors, and external auditors. The Audit Committee should be very involved with the CFO to oversee that the company has put in place a strong set of internal controls and reporting that will withstand the scrutiny of the external markets.

Why the controls? A public company must be able to speak to shareholders and the community at large with confidence, accuracy, and governance. Strong financial governance includes a tight budget, an accurate forecast, and a thoughtful and precise approach to business planning and operations. Controls beyond financials entails things like customer privacy, cyber security, and human resources. It all comes together to create a much more disciplined, controlled environment.

The shift to IPO is a leap for the entire company in terms of process, strategy, discipline, controls, and privacy. However, at its core, moving to IPO is intrinsically linked to company value. Approaching the IPO process with a solid financial acumen is critical to success.

Directors should understand:

- Financial controls
- Compliance and regulation expectations
- Team gaps and resources needed to scale
- Communications strategy
- The story behind the IPO and how to communicate the value of the company to the world

Going public: The pros and cons of going public via SPAC

Many companies choose to go public via SPAC, or Special Purpose Acquisition Vehicle. SPACs are indeed a real public company – yet, they just consist of funds that have been gathered explicitly to acquire another company. SPACs can raise up to billions of dollars – they just must use 80% of the money they have pooled to achieve the acquisition.

After a SPAC transaction, a new board is typically put into place. Remember, the purpose of a SPAC is to acquire – post-acquisition, the board should reflect a public company board, including all of the best practices and governance frameworks you'd expect to see within a public company. SPAC transactions involve all the due diligence typically required in an acquisition, and including third-party experts as partners and advisors is also common.

Note that there has been an enormous amount of activity and aftermath reported about SPACs in the past year (2021/2022). While on the one hand the company can become public more quickly via a SPAC than through a traditional IPO, the regulatory environment around SPACs is becoming more challenging and the look back data on post SPAC performance has lagged that of traditional IPOs (as of the writing of this article). Regardless, the board should take an active role in oversight of the due diligence and decision making related to an IPO.

What’s happening behind the scenes of the earnings call (public companies)

Earnings calls begin on the inside of the business, typically taking place between management leaders, board members, communications leaders, and legal. Individual management contributions begin with having a deep understanding of the business, the external metrics that are shared in external-facing reports, as well as internal metrics and other indicators that may influence decision-making.

Before an earnings call goes live, there are several rounds of discussions and strategy meetings internally about what the tone of the call should be. Usually, these discussions focus on the immediate strategy or hurdle. For example, during the first years of the Covid-19 pandemic, a common communication strategy from companies was telling the story of how they would be resilient and weather the storm in the year ahead. But remember, the story must be backed by metrics.

Earnings calls – and the story within them – must relay the company strategy, growth plan, competitive differentiators, as well as why investors should even continue to invest and maintain their excitement. It always begins with deep work, tearing through the numbers and deeply analyzing the business. It means looking back at historical trends and correlating those to the forecast. And, then concluding as a board and senior management team on the guidance that you will share with investors on each call.

The earnings call also looks at “how you did versus the street” – which is a way of saying, “how did you perform based on the consensus you guided the previous quarter?” Each quarter, the call should lay out the breadcrumbs of the overall strategy for the year. Individual quarterly calls should reflect the progress of that strategy.

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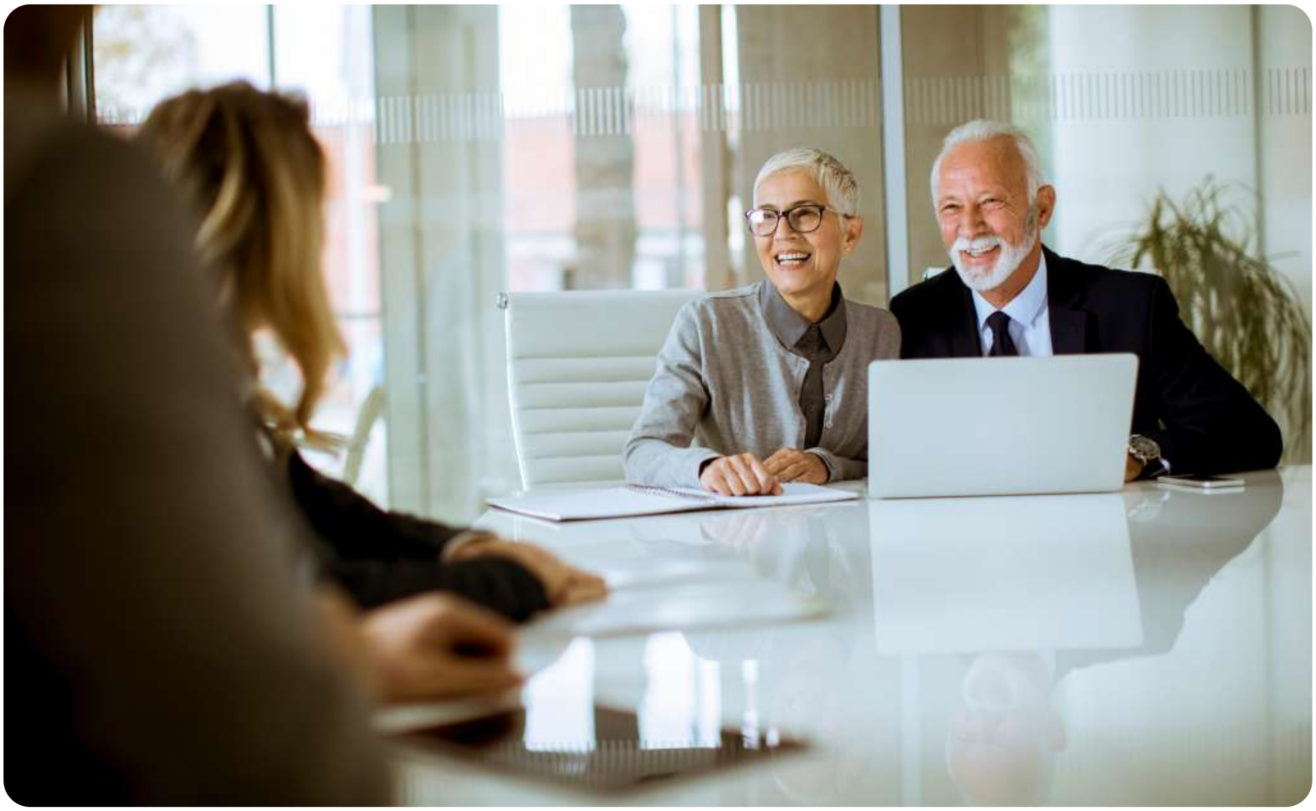
In preparation for earnings calls, directors and senior leaders should have knowledge of:

- Deep understanding of the business and the annual and quarterly strategy
- External and internal metrics
- Historical trends
  Finance forecast
- The current story/tone and how it relates to the previous call and the strategy moving forward.
- Expectations of investors



How Athena can help: Ongoing access to executive learning, live and on-demand

Athena members, current or future board members, can gain access to an entire financial acumen Salon series, taking them through the art of budgeting, presenting to the board, what it means to be on the Audit Committee, the metrics surrounding various business models, and so much more. Currently, we offer more than 20 hours of video content, growing every month.

For members who want a deep dive or one-on-one support, we offer connections to members and coaches for additional targeted learning, specific to your goal. We also offer a quarterly Learning Circle to deep-dive into the content with a cohort of peers.

New to Athena: Members who are experienced Audit Committee board members, may also join the Audit Committee Peer Group for live support and networking. This is an opportunity to discuss Audit Committee best practices live and build a strong network of peers to turn to for one-on-one advice and support. It's also a chance to shape the future of audit in discussions around the Audit Committee's role in ESG, risk, cybersecurity, financial controls, and more.

Learn more about becoming a member at athenaalliance.com/membership

Quick Reference Sheet for Financial Acumen

- EBITDA: Earnings before interest, taxes, depreciation, and amortization is a measure of company profitability used by investors. It is helpful to compare one company to another in the same line of business. In some cases, it also can provide a more accurate view of the company's real performance over time. (Investopedia)
- ICOFR: Internal Controls Over Financing Report. Applies to any control meant to ensure the company's financial reporting is reliable and accurate.
- Liquidity: Liquidity refers to the ease with which an asset, or security, can be converted into ready cash without affecting its market price. (Investopedia)
- Cost of capital: Cost of capital is a company's calculation of the minimum return that would be necessary to justify undertaking a capital budgeting project, such as building a new factory. (Investopedia)
- Valuation: Determining the market value of a publicly-traded company can be done by multiplying its stock price by its outstanding shares. (Investopedia)
- 409A Valuation: A 409A valuation is an appraisal of the fair market value (FMV) of the common stock of a private company by an independent third party. Startups typically pay for these assessments and then use the findings to inform the price at which employees can purchase shares of the company's common stock. (Angelist)

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Carol Coughlin is an experienced public and private company board leader, audit committee chair, and is highly skilled in corporate governance including board refreshment, strategic alternatives and M&A for growth and highly regulated companies. She is a Board Leadership Fellow (NACD). Following an IPO and after nomination to board chair, she led a public company board through acquisitions that doubled the size of the company, followed by a merger with a larger company. A qualified "financial expert", she is an accomplished healthcare CFO with a track record of achieving profitability through growth, highly successful turnarounds and M&A. She is known as an energetic, collaborative leader and a quick learner in both organizational and board settings. Carol currently sits on the boards of Hopebridge, a PEG-backed healthcare company with autism therapy centers across the country, TrustyCare, an early state digital health company providing precision benefit tools for insurance and financial professionals using AI and predictive modeling, GoodCap Pharmaceuticals, an early stage drug development company, and University of Maryland Medical Center, a $2.5B academic medical center.

About Athena Alliance

Athena Alliance is an executive development community for women leaders who are advancing into the C-suite or boardroom. Athena is a platform that brings together women leaders, investors, CEOs, board directors, and corporations in one global, digital ecosystem. We offer live and on-demanding learning (including self-guided curriculum, focused peer groups, and learning circles), a supportive networking community, access to hundreds of hours of executive learning content, and 3+ live Salons each week.