THE CFO BOARD

LETTER FROM CFO'S DESK

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INTRODUCTION

We have seen several failures in governance at growth companies in recent times. These failures, ranging from aggressive accounting positions, tax evasion, controls, and governance lapses to employee harassment – raise pertinent questions on how to best balance growth with governance. There is always a perceived tradeoff between governance and growth with concerns around over investing in governance and controls at a foundational stage impeding the pace of growth and operational freedom that founders and companies need to be able to grow and scale. Operational freedom, flexibility, and nimbleness are like life-giving oxygen for a new enterprise - however, too much of a good thing can be corrosive in the long run. Underinvesting in controls and compliance leads to lapses oftentimes existential and causing severe reputational damage. A commonly adopted approach is to phase in more evolved governance closer to an exit event such as an IPO or a private raise.

Investors are concerned about the long-term growth prospects of companies that have experienced corporate governance failures. They are also concerned about the lack of transparency and accountability at these companies. To restore investor confidence, startups need to take steps to improve their corporate governance practices.

This paper is an attempt to share perspectives on how companies can scale up governance in sync with business growth and other imperatives. We have tried to outline the “must have” building blocks that companies must pay attention to at a foundational stage and the “good to have” or “leading practices” that they can adopt as they scale up.

Regulatory non-compliance is the most serious of lapses – and these should be considered zero-tolerance areas. Here too it is important to prioritize between foundational regulatory requirements vs. ones that may be merely procedural. While compliance must be all round, the requirements that can imperil the continuance of the business or cause reputational damage should be addressed as a priority.

Graded governance
Growth with checks and balances

SORTING OUT THE BASICS

Financial reporting

At the outset, companies should choose appropriate accounting policies in line with applicable accounting standards and avoid taking aggressive positions or being creative with their accounting. These calls can come back and hurt companies as they scale up and need to access public or private capital as any change in their previously reported results because of a change in accounting policies or positions can call into question the credibility of the company and its founders and impact the valuation and the consequential capital raise.

It is equally (and maybe more) important to ensure internal, monthly, and other MIS which is shared with investors/shareholders is aligned with the financial reporting guidelines and policies adopted by the company. Especially at the initial stages, the MIS forms the base for capital raise discussions and the earlier the same is aligned with financial reporting standards, the better.

There should be no lag between the monthly MIS (which has stricter deadlines sometimes) and the financial reporting. The financial Trial balance should be prepared first and be the base on which to publish the MIS. It is also important to staff your finance team appropriately and build it up as you grow.

The right team members can be instrumental in getting governance right at an early stage. Resourcing the team with people with appropriate skill sets, experiences, and attitudes at each stage of the growth cycle is critical for good governance and controls.

Hiring a strong controller or CFO at the right stage helps the finance function evolve beyond simple bookkeeping and processing payments to ensuring the right financial stewardship, partnering with the founders as the organization scales, and providing assurance to external investors. Companies often wait (too long) till they scale up to a substantial size to appoint well-qualified or credentialed controllers and CFOs.

One alternative which is available nowadays for startups is to hire CFOs on an assignment basis either directly or through firms that provide such services.

There of course must be a balance with the cost of higher-end ERPs initially. Software is convenient and better to implement at the beginning. While maybe not the most robust, even most softwares have some basic controls – but these are not put in place.

From a business and operational perspective, the founders need comfort in the hygiene and accuracy of the data they need for decision-making. A strong month-close process with no changes in previously reported numbers is the bedrock for building investor trust in the founders and the company.

SORTING OUT THE BASICS

Document your processes and controls

Investing in setting up the right enterprise-wide risk management framework and internal controls can help prevent leakages and enable operations to scale without any hiccups. Constitutionally no business can operate without the right controls, very often these are not documented adequately or kept current in line with changes in the business. This can create a level of dependency on individuals and/or lead to control lapses or failures. Ensuring that the processes are adequately documented can help minimize the dependency on any individual(s).

This can be done step by step, starting with having a simple documented DOA/signatory matrix, three-way checks for payments, to more evolved processes and controls.

Setting up an internal audit function can also help monitor the operating effectiveness of the controls. This can be done by the finance team at a foundational stage and gradually scaled up as a separate function supplemented by external vendors/consultants as the business grows.

Given the pervasiveness of technology and the large volumes of transactions that several growth companies deal with, it is most important to develop the right IT controls and leverage technology to enable concurrent or frequent monitoring of key processes to provide additional comfort to the management and founders.

Many companies have disparate transaction systems that are not interlinked – in such cases, the month-end closing, and reporting process often involves manual upload of data extracted from these systems into the accounting software often resulting in errors in data transmission. Having a clear integration roadmap, a dedicated engineering team to implement the roadmap, and relentless execution can play significant dividends in the long run. This can help scale finance processes without a significant headcount addition even as the business expands. Adequate attention should also be paid to the controls for the disparate transaction processing systems in sync with those applied to the core accounting software or the ERP.

It is also important to keep sight of emergent risks and refresh your risk assessment periodically as the business scales given the pace of internal or external changes including business, regulatory, geopolitical, and climate-related risks. This allows companies to preempt emerging risks and avoid or minimize the impact of any disruptions. Risk management should incorporate monitoring and assessment as well.

It is also worth highlighting that a well-staffed legal function/office of general counsel can provide effective counsel to the CFO and the founders to avoid governance pitfalls.

SORTING OUT THE BASICS

Establishing an effective working relationship between the CFO and the legal function can add additional strength to the governance processes and compliance protocols.

In summary, companies need to define their risks, document the business processes and controls, leverage technology to integrate transaction systems, and monitor compliance regularly.

Establish clear policies and procedures

Having clearly defined policies and procedures can ensure your business is running transparently and ethically. This includes having established a code of conduct for employees, a whistleblower policy, POSH, Data security, etc. For simplicity, these can be integrated into employment letters, VRFs, etc. to begin with and then documented as specific policies in the right state. These policies need to be disseminated to the relevant stakeholders and refreshed periodically. It is also important to highlight the consequences of non-compliance.

Culture setting matters a lot in compliance. The tone at the top needs to be set at the outset on matters related to governance, controls, and ethics. Employees will emulate their leaders and founders. Defining the areas of no or zero tolerance, actioning cases of non-compliance, and exemplifying the right behaviors can go a long way in establishing the culture of the organization and consequential compliance with relevant policies and regulations.

Growth enterprises pride themselves in their go-get-it culture and a key part of that should be to define the importance of being compliant and ethical from the outset. Employees need to hear the messages from the founders/key management and see them walking the talk as far as compliance is concerned for these to resonate and be accepted.

Who is on Board?/Get the Board right!

Establishing an effective board can go a long way in providing the right steer and counsel to the founders to further the growth journey.

While decisions are done within the framework of the SHAs with Reserve matter approvals as necessary, startups need to have adequate investor representation on the Board as well. Formalizing the Board with adequate investor representation brings additional responsibility to the investors as well.

Conducting Board meetings formally and documenting decisions from the initial stages, helps set the tone of governance.

Once the organization builds up to a reasonable scale, Developing and maintaining a high-performing board that adds value requires a proactive approach to board building and diversity – of skills, experience, thinking, gender, ethnicity, and social background. One way of starting this off is for investors to appoint industry experts as their nominees on Boards.

SORTING OUT THE BASICS

Organizations can then transition to the appointment of independent Directors. Appointing independent directors can bring a broader perspective to the board and also provide confidence to investors and external stakeholders.

The boards must operate effectively. Often this depends on the working relationships that are established between the founders and external directors. Establishing mutual respect and trust by investing the right time in building these relationships, enabling the free exchange of ideas and information for the external directors to be able to discharge their obligations effectively. Simple steps like sharing information on a timely basis in advance of key meetings, addressing queries openly and constructively, and giving advance notice of key transactions can facilitate the right discussions and inputs from the board.

Audit Committee

While listed companies have specific requirements on the committees they need to set up and their charters, setting up an audit committee voluntarily can add a level of stewardship and oversight over the company's finances.

The audit committee should be constituted to review the appropriateness of the accounting policies and practices and be able to advise on achieving higher efficiencies in the deployment of capital.

Choosing the right advisors

Invariably companies need to hire several external advisors. While you may not necessarily choose large firms at the outset, hiring advisors with the right credentials and independent perspectives will provide the maximum mileage for your spends by ensuring you get practical advice with the right level of skepticism and insights. Amongst the more critical external advisors to be hired are external auditors, tax advisors, internal auditors, and law firms.

Proof of the pudding

As a final note, while a company can have the best-in-class policies and controls, the real value lies in how effectively they are adopted and implemented. Some factors that can influence these include the ease of access to policies, how well are they understood by the relevant stakeholders, and what are the consequences of non-compliance. A mix of incentives to encourage compliance and address noncompliance can have demonstrative value in establishing the right behaviors (or discoursing the wrong ones).

Most important is that Tone has to be set by the founders, senior leadership, and the CFO. The tone at the top sets the path for the rest of the organization to follow in embracing a culture of compliance and best-in-class governance.

THE TIME FOR GOVERNANCE IS NOW

Good corporate governance is essential for any company, but it can be especially challenging for startups. This is because startups are often under pressure to grow quickly, and they may not have the resources to invest in good governance.

However, startups need to remember that good corporate governance is not just about compliance with the law. It is also about creating a culture of transparency, accountability, and fairness. to boost the confidence of investors, employees, and customers.

Having a governance roadmap is the need of the hour that will help founders and the managing team to prioritize their governance goals by bifurcating the targets based on timelines. This will help them to establish a strong foundation for long-term success.

While in the early stages, the focus may be on aspects of governance that enable value preservation e.g. compliance frameworks, over time it should shift to value creation by leveraging effective risk management and best-in-class governance to steer and align strategy with outcomes and enabling agile responses to changing business environments.

The chart below lays out our views on what a typical progression may look like as companies make investments in governance commensurate with their growth cycle. This is by no means a "one size fits all" approach as it very well cannot be. Each organization will need to decide for itself how it balances growth and governance while avoiding significant disruptions.

	START-UP	GROWTH	MATURE
Financial Reporting	Keep track of payments and recipients, have adequate data to support founder and investor data requirements	Well-defined policies, alignment between MIS and financial reporting, monthly or quarterly close process defined	Disclosures and policies benchmarked to peers, appropriate governance for financial and non-financial data, well-defined close process
Accounting Software	Excel/Basic accounting software	Basic accounting software/More evolved ERPs	Evolved ERPs integrated with core and non-core applications and systems
CFO role	Part-time/Double hatting with the controller/Shared CFO	Full-time CFO (may double hat with the controller)	Full-time CFO and Controller

THE TIME FOR GOVERNANCE IS NOW

	START-UP	GROWTH	MATURE
Processes and Controls	Compliance focus		Leverage controls for operational efficiencies and risk management
Documentation	Rudimentary, practical, and actionable	Delegation of authority, three-way match for payments, key processes, and controls should be documented	SOPs for all business processes and support functions
ERM	Statutory compliance focus	Well-defined risks register, key risks identified	Dynamic ERM to track and leverage risk while minimizing disruptions
Internal Audit	Finance team oversees key controls	Finance team/separate team/small external firm	Established IA function and external reviews by an appropriate external firm
Board Composition	Founder/Investor(s)	Founders/Investors nominees/Industry/subject matter experts	The right mix of diversity and skills Adequate number of independent directors
Committees		Audit committee to monitor financial reporting and controls	Requisite committees including audit, nomination and remuneration, and others in line with applicable statutory requirements and best practices

Some other aspects of governance that require attention include:

Related Party Transactions – These should be limited to essential business transactions, carried out at arm's length terms, and be appropriately approved and disclosed.

Sustainability – In today's world sustainable business practices often define and enable organisations to differentiate from the competition. Whether it's responsible procurement, focus on employee health and safety, minimizing the environmental footprint, or embracing diversity and equity – being responsible and sustainable is a business imperative and should receive increasing attention ideally from the outset.

Corporate Social Responsibility – While this is a statutory requirement, CSR can be another strong differentiator for value creation by ensuring the adoption of appropriate causes in synergy with business objectives to expand the social operating license and realise tangible and intangible value and goodwill.

This is by no means an all-encompassing list and will continue to expand and evolve in sync with prevailing social-economic, geo-political, and cultural imperatives. We will continue to engage on this topic and related themes in our future papers.

This note has been prepared by The CFO Board, under the guidance of Mr. Abhay Mathur, Senior Vice President, Urban Company, Mr. Venkatesh Tarakkad, CFO, DealShare along with support of Mr. Karan Marwah, Partner, KPMG In India.

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