So what exactly does a Finance Director do? (4 do's and 3 don'ts)

Most firms have a board director who takes primary responsibility for accounting, financial control and reporting. In larger firms there may be divisions between accounting and finance, with possible specialisations in "treasury" and "shareholder relations" but generally these will all come within the remit of the Finance Director (FD).

In a recent article (Cambridge Business - October 2016) I outlined the importance to the chief executive of having the finance function covered competently, but what exactly should the board and chief executive be able to rely on the FD to do?

There are four functions which it is essential the FD should perform – they apply to all board members but the accounting training the FD has received will, with a bit of luck (and intelligence) allow him (or her of course, but for the rest of this article I shall use only the male participle) to make a rather better job than most of his boardroom colleagues at performing them. Before outlining what these are and how the good FD can add huge value to the firm I will try to point out the worst errors a firm can make in this area.

Avoid appointing auditors. The skill of an auditor is generally in forensic – in asking questions and working out what happened in the past. Generally accountants who have a business bent will have left the profession soon after qualifying. There is nothing wrong with those who stay – they may be the brightest stars – but the same characteristics which make them good as auditors are unlikely to make them into good business people. History is littered with brilliant audit partners who became dreadful Finance Directors – it is very tempting to add 2 for a good accountant and 2 for someone who has really known the firm/industry and make 4, but 4 is not the right answer in this case. Technical accounting expertise is often the worst thing the FD can have, it will allow him to lie for years. Profits can be inflated, expenses turned into assets and provisions run down until the firm has a slight difficulty which becomes a terminal disaster instead of a slight hiccup.

Detail is death to discussion. The board which has lots of detail easily deludes itself as the true nature of decisions is hidden rather than revealed. To have an FD who produces huge reports with lots of statistics, multi-coloured graphs and a million different scenarios is worse than not having one at all. A board presented with pages of numbers will almost universally ignore them – the worst FDs of all are those who produce meaningless management accounts saying nothing at great length. When they should say something they probably do not notice that buried somewhere in their reports is a significant message. The FD who deludes his board into thinking because they have lots of detail they must be in control is not quite as dangerous as the FD who persuades himself that if he has lots of detailed numbers he must know what is going on. Of course the good FD may use his mastery of the numbers to help achieve decisions; there is a fine line between the worst who think the numbers are all that there is and the best who use the numbers to demonstrate what is there.

Delaying decisions for further investigation and research is a recipe for the firm's demise. All business decisions are inevitably made on the basis of incomplete knowledge. Short of a pact with the Devil it is not open to mankind to know what tomorrow will bring and therefore ultimately every business decision is a guess – it may be an informed guess – it may be an educated guess based on the best possible evidence – but it can never be certain. Some FDs believe that if they perform enough research, if they build a good enough model, they can predict what the results of a particular decision will be. They are fooling themselves – but more importantly they are likely to miss the biggest opportunities for, by definition, any new business opportunity has not happened before. The bigger the company the greater the danger that the FD will jeopardise entrepreneurial spirit by vetoing any development which looks uncertain. The classic line "we cannot do that, we do not know how to account for it" should always lead to the dismissal of the FD, but rarely does so. The more frequent symptom of the dysfunctional FD under this heading is delay – delay for more reports, delay for market analysis, delay for consultants to study. It is often better to perform an experiment and lose some money than to pay another consultant to advise on whether an activity is worthwhile.

The four things a board should be able to rely on their FD to tell them are really the antithesis of what the poor FD does badly – numbers can inform and aid decisions and the good FD will be the person the board turns to on all financial matters if they trust and value his ability. They rely on him:

To say where they have been. The entire board is responsible for accounting to the owners of the firm but a good FD will ensure the directors have accurate figures, that they understand what the figures tell them, that they have relevant comparisons available to them and ultimately that the account they give to the owners is a fair and easily comprehended description of the firm's activities in any one period. The Report and Accounts should never be left entirely to the FD to produce but the good FD will help other directors to deliver something which describes what has gone on without going into so much detail the shareholder gets lost. It has to be said that auditors rarely help in this process – all too often they want to say the least possible and treat the process of reporting as something done to satisfy the accounting standards board rather than the one time of the year the owners of the business are told what their representatives have been doing with their money.

To say where they are. The first legal duty of a director of a limited liability company is to ensure they are trading solvently, and the first fiduciary duty is to ensure they are trading profitably. The connection between the duty to the law and to the owners is prudence and with the good FD, male or female, Prudence is their adopted middle name. Management Accounting is the grand name given to the process of knowing where you are and it is a slightly different skill set to the statutory accounting process which many accountants feel more comfortable with. Management Accounts are there to assist in managing a firm and it is more important that they inform decisions than that they are right. So the direction in which costs or resources are moving in different areas is often much more important than what their absolute level is. Similarly, whether an activity is profit-making is much more important than how much profit it is making. You can afford to take as long as you like to work out just how much profit an activity is making – but if it is making a loss the sooner you do something the better. For almost all purposes it is more important that the board knows roughly where the business is rather than exactly where it was. There is a tendency for accountants to concentrate on the latter rather than the former.

To say where they are going. This does not mean the FD can know the future – but he can produce plans and budgets, he can analyse projects and he can place plans into context by considering trends in markets, competition and the capacity the firm has to deliver to meet future demand for its product. Above all the board will rely on the FD to question the plans for exciting and unquantified new ventures, the pie-in-the-sky projections for sales and the assumptions of minimal costs. His should be the voice of sanity when flights of fancy lead empire builders to suggest new staff, better systems and lower prices for the product. It is the FD who should be the voice of reason, the one who asks for a rational link between costs and benefits every time a new initiative is proposed. It is he who should demand dates and amounts for the vague extra sales promised, who should seek to see how many staff at what salary are needed to achieve the sales. Of course such projections will be wrong – but that does not mean he is wrong to ask for them, and test them toughly where he has them. Budgeting and planning are not, and never can be, exact sciences but what they can do is provide a framework for sensible decision making. Project analysis does not ensure the success of the project – but failing to plan may ensure failure.

To say where they should be going. The unique nature of the FD puts him in an excellent position to see how the whole firm operates. He is in the best position therefore to see how it could operate better and to communicate the ways to do so throughout the firm. It is not just that he should know about tax, about financing and about resource allocation. Knowing all there is to know is utterly useless unless that knowledge is used. He may not come up with anything new but he can see what is working and suggest doing more of it. He can see how limited resources can be better applied and how fewer people can achieve the same effect more efficiently.

The ideal FD is the confidant of and consultant to the business leaders. He will understand their problems and be the person they turn to when considering a future development and he is likely to be a great help in identifying the areas which need attention.

In summary an FD who has the trust of his fellow directors and a good grasp of what the business flows are likely to be is of huge value to the owners of the business, and to the extent his prudence keeps expenses and over enthusiastic schemes in check will help the company survive and prosper. To run the business a chief executive needs more than anything else either to have a total grasp of every part of the business or a good FD and for every Arnold Weinstock who can inspire, lead and control at the same time there are ten thousand lesser mortals who need a bit of help. With a good FD they will likely succeed and with a poor one fail.

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