Accounting Infrastructure & Outsourcing

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Introduction

In this white paper, we seek to highlight the importance of accounting system selection at an early stage in company growth. Critical aspects such as GAAP compliance, preparation for eventual audit and maximizing equity value in an exit event should be given careful consideration in this process. To assist in the selection, we've prepared a flowchart tool for companies to use in determining a solution. Companies can also seek experienced input and guidance from outsourced providers in assessing options and implementing the chosen solution.

Small Business Accounting

The emergence of user-friendly cloud-based accounting platforms in recent years has empowered the small business manager to take ownership of tasks that previously would have been the domain of a dedicated resource such as an accountant or bookkeeper. Electronic data feed access to banking and credit card accounts and online payment processors—the primary sources of cash transactions—has enabled automated transaction posting via pre-assigned conditions. However, these systems tend to mask the more complex functions of accounting to reduce potential confusion on behalf of the user. An intuitive and productive experience for the business user is of paramount importance to the success of platform products. Such platforms meet the desire of the modern manager to optimize and reduce service costs of their company by empowering them to process typical bookkeeping tasks with a high degree of automation.

For small businesses and companies that do not expect exposure to the tougher regulatory environment of M&A, IPO or institutional capital investment these basic accounting platforms are an ideal and very practicable solution choice. However, for those ventures that predict significant growth and target a shareholder exit then these platforms fall significantly short in functionality, user controls and database performance.

Sample Complex Accounting Tasks

Deferred revenue – a feature common to all SaaS businesses, this requires precise definition of a revenue recognition policy and careful management of the deferred revenue schedule, both tasks that are out-with the functionality of basic systems.

Expense accruals– GAAP accrual accounting requires adjustments that allocate expenses to the relevant period, which may be before or after the actual cash payment. Using simply the vendor payment date is not always sufficient.

Capital assets and inventory – managing depreciation and inventory asset usage are not typically comprehensive enough in basic systems to achieve full GAAP compliance—independent schedules are necessary to calculate and provide backup for manual entries.

Board reporting – Start-ups also have to contend with reporting metrics such as bookings, revenue and deferred revenue to their boards from initial product roll-out, increasing the importance of handling revenue recognition correctly.

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GAAP Compliance Requirement

Any company that receives institutional investment, often even at seed stages, will be required in the investment documentation to produce regular financial statements in compliance with US GAAP. Producing such statements requires considered decisions and adjusting entries to correctly match transactions to the period in which they occurred among other essential accounting tasks. Without appropriate expertise the management of the accounts of such businesses can quickly get out of hand and result in misrepresentation of the financial status of the company.

Fully functional accounting systems support these tasks with dedicated modules, such as deferred revenue—a fundamental component of SaaS businesses—inventory and capital asset registers. Early stage ventures also regularly develop cap table structures with multiple convertible notes or preferred stock classes that result in complex accounting, which is usually beyond the skillset of the typical business manager to account for correctly on the balance sheet. These cap tables and the corresponding balance sheets are often reviewed in detail by the board and investors to ensure suitable corporate governance is in place.

The pursuit of increased automation and reduced manual transaction activity is accomplished using integrations with cloud-based APIs for most platforms used in the development and delivery of company products and the accounting platforms themselves. Inter-system connectivity to capture financial information, such as Stripe-based credit card processing, is a crucially important feature. However, such automation must be complemented with a rigorously implemented policy to validate and adjust the automated data to achieve full GAAP compliance—working on the simple assumption transactions can be posted directly to the ledger without review and potential revision is typically where things go wrong. The tendency of more basic accounting platforms to mask the adjusting entries function or not provide modules for managing these more complex elements mean it is significantly more challenging to correctly and reliably prepare GAAP-compliant financials.

Audits & Internal Controls

A further major limitation of basic accounting systems is that of limited or no controls on approving transactions to the general ledger. A formal audit, which is practically inevitable before any shareholder exit or significant transaction can occur, will review very closely the procedures used at a company on creation and posting of such transactions and journal entries and any absence of multi-level approval hierarchy or other controls will be flagged as a deficiency.

In our experience and that of our audit partners, no company will look to go through a thorough audit with a review of internal controls whilst using a basic accounting platform. Companies instead will seek to transition to a fuller function system such as NetSuite sufficiently far in advance of the audit, thereby ensuring procedures and policies have time to solidify within the company.

Market-Leading Platforms

NetSuite – is the leading integrated cloud business software suite, including business accounting, ERP, CRM and ecommerce software

QuickBooks – highly recommended solution for small business bookkeeping and accounting

Bill.com – online solution for businesses to manage accounts payable and accounts receivable

Expensify – online expense management, reporting and documentation service tempCFO

Transitioning Infrastructure

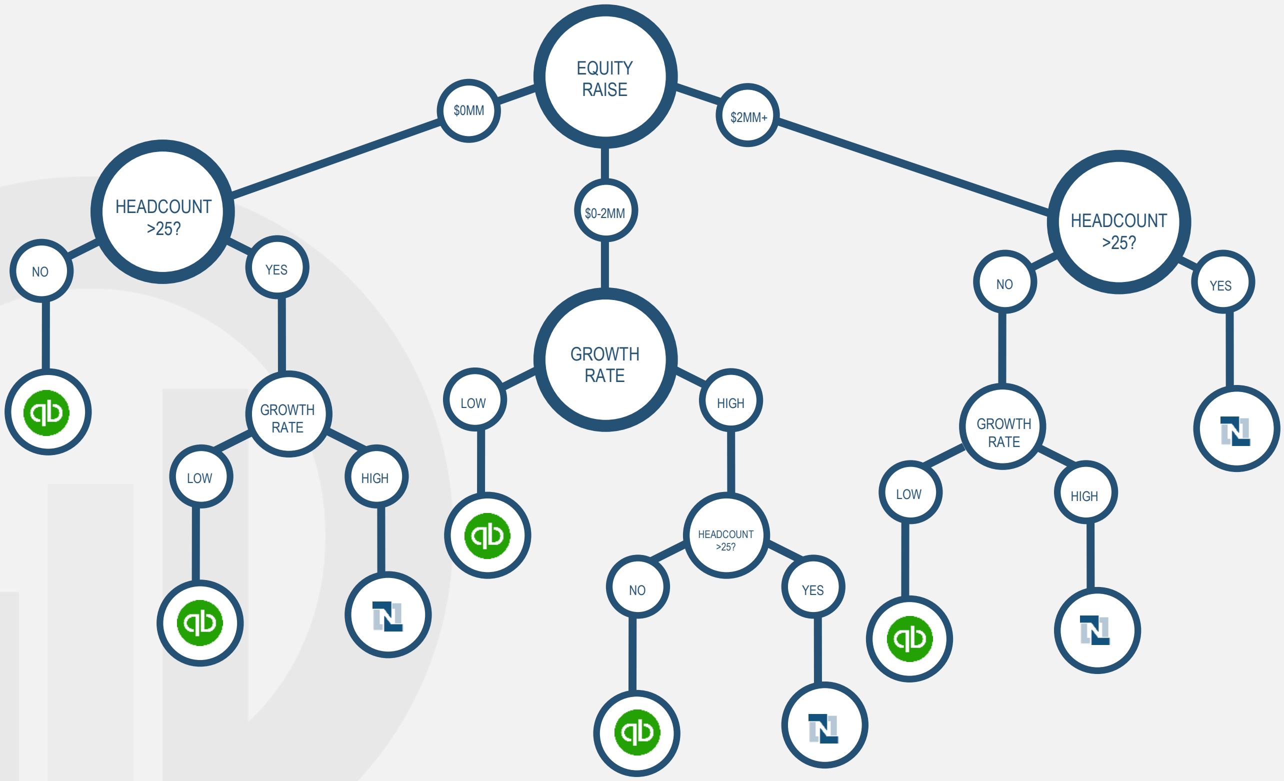
The route to upgrading accounting infrastructure often isn't as simple as companies and their managers expect. The more basic platforms do not tend to support easy transition—they typically limit data export functions especially double-entry accounting schedules, if they allow it at all. Data export is an important step in preserving the value invested in the accounting data stored to date—wouldn't you want to retain records on individual customer sales, vendor specific costs, and employee payroll specifics? You can of course transition with just annual period data for annual statement comparisons, but this accepts such a loss of potential data value in the business that it generally is not a recommended route.

The resulting cost of transition is then proportional to the quantity of data, the detail required in the new system and the quality and detail of the data being exported. Of most relevance here is the unavoidable cost portion due to the data manipulation and aggregation required to compensate for reduced export functionality from basic systems.

The simple and more cost effective answer is to implement a proper system infrastructure earlier rather than later in the growth of the company by adopting a fully-fledged general ledger accounting system. Performing this earlier in the company's evolution can significantly reduce the transition cost. With appropriate and well-designed procedures, this infrastructure can provide the necessary financial rigor but without overly impacting overhead in running the company.

Recommended Accounting Software Solution

tempCFO has developed a summary tool for helping companies determine the most appropriate accounting software solution based on key criteria for the business and growth strategy. In selecting the solution options, tempCFO has leveraged our 20 years of experience in the sector and research across the variety of platforms available today. Our analysis concluded that Quickbooks and Netsuite were best of breed solutions for smaller companies and larger or high growth companies respectively. The tool described below assists companies in the selection of one of these platforms as their ledger-based accounting environment.



The main criteria you should assess in using this tool are:

Equity Raise – The amount of equity raised by the company from investors, whether in common equity, convertible debt, SAFEs or preferred stock. Companies with significant equity tend to have more aggressive objectives in the short-term. Companies with lower or zero equity are either earlier in their lifetime or typically have agreed a longer timeframe for given objectives.

Headcount – Accounting complexity is proportional to team size. Smaller teams may not yet be on salary, or will have payroll but basic benefits and compensation structure, that simplifies accounting tasks. The task of expense reimbursement is also more easily controlled and regulated. Larger teams have much more complex, multi-category payroll cycles and are more likely to be housed in multiple locations with different US state considerations. Efficient and robust controls for those larger teams require hierarchical review and approval structures that involve more platform functionality and experienced management.

Growth Rate – Our last criteria assess the actual speed of growth being experienced by the company, and should consider revenue, expenses and organizational metrics. A high rate of growth would be companies experiencing around 50% or greater increase in revenue or headcount per year. A low rate of growth would typically be companies with around 10% increase in revenue or headcount per year. Similar guidelines can be used for expenses and company scale metrics.

The selection tool prioritizes an equity raise to define overall business category and headcount and growth rate are subsequent assessments to refine the eventual, recommended solution. To aid comprehension and usage of the tool, listed below are some usual company types that fit into the three major categories as defined by equity raise.

Left side, $0MM Equity – Consulting and service sector businesses tend to require zero external equity as the service delivery is cash-flow positive and growth is governed by availability of resources. Larger companies that have established a higher-growth business model with a more complex product/service dynamic should adopt NetSuite. Otherwise, QuickBooks is the recommended solution for smaller and lower growth rate companies.

Middle, $0-2MM Equity – Companies with more consumer-oriented products that require smaller capital investment, such as most mobile apps, or are just earlier in their growth phases fall into the middle segment. In our experience, the growth rate is a more prominent driver of accounting complexity than headcount for this category, and so for high growth rate we recommend NetSuite regardless of team size.

Right side, $2MM+ Equity – The larger equity raises usually indicate enterprise software companies or multi-geography product companies. With any degree of team scale or growth rate these companies should select the rigorous scalable solution in NetSuite. Only small and low growth rate companies here should consider QuickBooks.

As with all tools of this type not every company will fit neatly within the categories and this tool should, therefore, be used as part of a fuller process of software option review and comparison.

Outsourcing

Companies do not typically possess the skillset to manage more rigorous accounting platforms, and this is where they can seek to leverage high-quality outsourced accounting relationships. Outsourced agencies bring the qualified expertise to implement and manage a comprehensive accounting environment almost always at a commensurably lower cost to the company than internal staffing. At tempCFO our clients are able to access not only staff accountant and controller resources but also CFO advisory services, a range of skill-sets that would be very difficult to replicate cost-effectively using only internal staffing at early stages.

In addition, it is a core competency of outsourced providers to preserve up-to-date knowledge of regulatory changes and expertise with technology platforms related to financial accounting processes. Strong providers build a variety of tools into a comprehensive solution, for example integrating Bill.com and Expensify alongside the NetSuite or QuickBooks accounting suites. Clients can then depend on the rigorous testing and qualification these providers have performed to verify the integrity of the solution. Outsourcing can also be viewed from the perspective of opportunity cost. It makes little strategic sense to have a senior member of the founding team tasked with managing the accounting of the company—especially when the risk of mispresenting financials and non-compliance with GAAP increases as the activity gets more complex. Setting aside the comparison of simple costs—salary vs outsourced charges—the lost value of having the founding member not focus on product development, team management and customer acquisition is significantly greater.

The delivery of an outsourced accounting solution has also been significantly enhanced with the advent of online platforms for project management, task management and messaging. Venture-backed companies can now leverage expert outsourced providers to implement an enterprise-class accounting system at an early stage, experiencing minimal additional cost and eliminating the alternative of significant transition expense further downstream.

Outsourcing Considerations

Rely upon trusted referrals
ask for suggestions from colleagues, your investors, other CEOs and portfolio companies

Carefully assess the pricing
you get what you pay for - paying less in the short-term for a service can result in greater cost downstream to correct ineffective service

Research prior client history
demonstrable experience over time of supporting high-growth clients through exit is a key indicator of service quality and expertise

Look for efficient and optimized processes
providers with a wide array of accounting solutions may not have developed robust internal procedures. Look for streamlined solutions tailored for a wide range of company growth stages.

Established, proven providers offer the most reliable service
look for companies with significant in-depth experience, with US domestic employed teams and not disjointed contractors

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Meet the Authors

Stephanie Gillen

Stephanie started her career in financial services at Deloitte specializing in audit primarily in the Retail & Life Science practice. Following Deloitte, she worked at two eCommerce startups on ERP implementations, technical accounting, audit assistance, building out the finance infrastructure from the ground up and improving efficiencies in the month end close process. Currently, as a Senior Controller at tempCFO, she serves as a finance advisor for her clients, helping improve efficiency in day-to-day finance related operations and ensuring accurate and timely financial reporting.

Jason Granado

Jason Granado is a controller/director at tempCFO who brings 17 years' experience in accounting. He received his accounting degree from San Jose State University. Prior to joining tempCFO, he worked with start-ups in the Silicon Valley learning from firsthand experience while working toward his degree. Mr. Granado has been with tempCFO for over 10 years and has worked with a variety of clients during his tenure. He has taken part in assisting clients through financial audits and due diligence for clients during their M&A processes

Alan Yang

Alan has been with tempCFO since 2008 and has been the Controller for over 40 startups. He has extensive expertise assisting clients choose and implement accounting systems. Prior to his role with tempCFO he was an auditor with Deloitte and a tax accountant with PricewaterhouseCoopers.

Conclusion

Accounting system selection is an important decision throughout a company's growth trajectory. However, efficiencies sought at an early stage can rapidly create excessive transition costs further downstream. This paper is designed to help companies understand the potential value and necessity of a robust accounting environment and make the most appropriate technology decision given cost and complexity consideration.

Companies should also assess carefully the benefits and drawbacks of outsourcing, whether just for design and implementation of the accounting infrastructure or if also for ongoing finance and accounting management. There are many advantages for small businesses and venture-backed companies in accessing this key resource to help grow their businesses.

Key Benefits of Outsourcing

Access to expertise
Recruiting quality finance and accounting personnel can be a challenge and present a significant overhead to executives. Outsourcing instead offers a team of qualified and proven staff accountants and controllers and on-call access to CFO advisory—resulting in much higher value than internal staffing.

Standardized procedures
Outsourced providers offer standard, proven procedures and processes, ensuring companies will be audit ready when it matters. Companies can leverage the aggregate experience of outsourcing teams to implement best practices in their accounting operations.

Flexibility with company growth
Outsourcing usage can fluctuate with company needs and demands, resulting in greater cost-efficiency, particularly so during an audit that would otherwise be a significant overhead on a company.

Develop trusted advisor relationship
An outsourced provider is a knowledgeable and independent source of advice on sensitive issues. Over time, this builds to be a valuable mentoring relationship for venture CEOs.

tempCFO, Inc. was founded in 1999 by principals with Big Four accounting firm experience to provide fully outsourced accounting solutions for small and medium businesses, including start-up, emerging high-growth, and established companies. **tempCFO, Inc.** provides its clients with peace-of-mind that their financial reporting is accurate and timely. We also help our clients create financial opportunity with services that range from optimizing cash management to mergers and acquisitions or transitioning from a privately held to a public company.

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