

## The CFO's perspective

The strategic importance of the chief financial officer has grown over the years. Always critical to public companies' stewardship and performance, the CFO has taken on new responsibilities since the 2002 enactment of the Sarbanes-Oxley Act. Today's CFOs bear more responsibility, have more visibility, and face more pressure than CFOs of the past. The quality of the information that the audit committee receives from the financial organization – information the audit committee needs to fulfill its own responsibilities – depends to a large extent on the leadership qualities of the CFO, who oversees the financial organization's people, processes, and systems in the production and distribution of that information.

This issue of *InSights* has been developed to help audit committee chairs gain a deeper understanding of:

- How CFOs and finance teams are coping with the increased demands of Sarbanes-Oxley, two years after its implementation
- What CFOs see as the main effects of Sarbanes-Oxley on their roles
- How audit committees can best work with the company's financial organization to tap the CFO's expertise, to evaluate his or her performance, and to assess the finance function's bench strength

Tapestry Networks spoke with the CFOs of nine companies represented by members of the Audit Committee Leadership Network in North America and U.S. regional Audit Committee Networks. Four of the executives interviewed also chair, or have chaired, audit committees at other companies; they provide a dual perspective on the audit committee-CFO relationship. The CFOs interviewed were:

- Janet Haugen, Senior Vice President and Chief Financial Officer, Unisys; former Audit Committee Chair, Sungard Data Systems
- Rob Knight, Executive Vice President, Finance, and Chief Financial Officer, Union Pacific
- Chris Kubasik, Executive Vice President and Chief Financial Officer, Lockheed Martin
- Jim Lawrence, Executive Vice President, Chief Financial Officer, and International, General Mills; Audit Committee Chair, Avnet
- Mike Losh, former Executive Vice President and Chief Financial Officer, General Motors Corporation; former interim Chief Financial Officer, Cardinal Health; Audit Committee Chair, TRW Automotive
- Kevin March, Senior Vice President and Chief Financial Officer, Texas Instruments
- David Rickard, Executive Vice President, Chief Financial Officer, and Chief Administrative Officer, CVS Corporation; Audit Committee Chair, Harris Corporation
- Peter Rubenovitch, Senior Executive Vice President and Chief Financial Officer, Manulife Financial
- David Shedlarz, Vice Chairman, Pfizer; Audit Committee Chair, Pitney Bowes

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## Executive Summary

- **CFOs surveyed say Sarbanes-Oxley has increased the controller’s workload more than their own, yet CFOs believe their role is less attractive than it was before.** *(page 3)*

Most of the surveyed CFOs, who represent large public companies, said the burden of added Sarbanes-Oxley-related compliance is falling primarily on the controller within the finance organization, as well as on internal audit. However, many CFOs still feel their own position has become increasingly less attractive due to the increased scrutiny, pressure, and responsibility involved. [For additional information, see “In the media spotlight: CFO turnover” on page 4.](#)

Sarbanes-Oxley has not materially affected already sound internal controls at their companies, but has enormously impacted the documentation of those controls. The degree of work added by Sarbanes-Oxley depended on the company’s pre-Sarbanes-Oxley culture and practices. Many CFOs are seeking to leverage the extra workload imposed on the finance function to their companies’ advantage.

- **The finance organization, including the CFO, is interacting more closely with the board and the audit committee.** *(page 5)*

Audit committee members often have more questions for the CFO and are probing issues more deeply. However, some CFOs are concerned that audit committees may now be examining marginal issues in too much detail. As the amount of time spent on Section 404 compliance subsides, CFOs are seeking to involve the audit committee in broader initiatives, including enterprise-wide risk management. [For examples of questions the audit committee should be asking the CFO, see page 7.](#)

In order to help the audit committee assess the bench strength of the finance team, companies have instituted practices in which finance department “rising stars” interact with committee members both formally and informally.

CFOs noted that the traditional reporting line between the internal audit function and the CFO has been eroding as companies position internal audit as an objective voice on corporate financial processes.

- **The CFO’s relationship with the external auditors has become strained.** *(page 7)*

While many of the CFOs interviewed sympathize with the challenges that external auditors face in the new environment, they feel their companies’ relations with external auditors have become strained since implementation of Sarbanes-Oxley. According to these CFOs, external auditors may still feel constrained by the regulators in their authority to provide adequate insight or counsel on complex accounting issues. These CFOs also say that external audits follow processes dictated by the national office of the audit firm with little customization, even as fees have risen.

- **CFOs are evaluated by the CEO, with informal input from the audit committee.** *(page 8)*

Although many CFOs have both financial and non-financial objectives, many CFOs say their performance is ultimately evaluated based on their relationship with the CEO and on the company’s financial results. The audit committee rarely plays more than a marginal role in assessing the CFO’s performance, but this may evolve over time. [Formal criteria used for CFO evaluation can be found on page 9.](#)



Recognizing their important relationship with the audit committee, the CFOs recommended several approaches they believe would help audit committees work more effectively with CFOs.

### Good practices CFOs recommend

- Assess the finance function's quality and the depth of its bench by inviting "rising stars" on the finance team to present regularly to the audit committee on specific topics. Invite them to less formal events, such as post-meeting meals, so that audit committee members can get to know them in a more casual setting.
- Harness the expertise of the CFO (especially if he or she comes from an auditing background) to help the audit committee negotiate external auditors' fees.
- Encourage all the CEO's direct reports, not just the CFO, to sign off on their contribution to financials before the CEO signs off.
- Shift the focus of the audit committee's agenda to current enterprise risks, as these risk items change over time. The committee should not cover the same issues year after year.
- Ask "soft," non-finance-specific questions of the CFO and other finance staff. One CFO was surprised when a new audit committee member asked, "Are you having fun?" This question elicited a revealing and useful response that covered the support the CFO received from colleagues, resources in the finance organization, and levels of personal stress.
- Rather than homing in on specific financial data, focus on the people and processes that are generating the data.
- Recommend that if the company conducts a regular employee survey, two or three questions on ethics be added to help assess 'tone at the top.'

### CFOs surveyed say Sarbanes-Oxley has increased the controller's workload more than their own, yet CFOs believe their role is less attractive than it was before

Even the large public companies surveyed for this edition of *InSights*, many of which had strong internal controls in place before Sarbanes-Oxley, have become burdened with greatly increased documentation procedures in the post-Sarbanes-Oxley environment. One CFO said, "*Sarbanes-Oxley formalized much of what the company was already doing – representation letters from the business units, senior officers reviewing the 10-Q. The process of implementing 404 was a challenge, as it required us to document controls already in place. But now the company continuously and dynamically assesses internal controls.*"

At another company, the extra work required by Sarbanes-Oxley did not increase management's level of comfort in certification, which the CFO believed was already high. However, it did help people within the organization understand other functions' and business units' processes because "*the documents are tested every six months by internal people, non-subject experts outside the specific area.*" This CFO chose to regard Sarbanes-Oxley requirements as "*a big learning exercise rather than a burden.*" As an additional benefit of Sarbanes-Oxley, one CFO noted that with Section 302 certification, the CEO has been more willing to devote attention to finance.

Despite these benefits, one CFO described Sarbanes-Oxley's adverse impact on the CFO's position as *"significant. The CFO's strategic role hasn't lessened – these have been add-ons."* Another CFO told us, *"I don't have less time to spend on strategy, but it's true for my controller, who must now revert to spending more time on compliance, not business."* As a consequence, one CFO noted, *"Nowadays it takes a while to fill the controller position."*

Several respondents agreed with the studies reporting increased pressures and turnover among CFOs (see box below). One CFO said, *"There's more pressure on the CFO: the job has a greater scope of responsibility and demands a greater base of knowledge..."* Given the internal and external pressures, another CFO said, *"I'm not sure that being CFO is that desirable anymore."* A third laughed at the question proposed by another respondent, "Are you having fun?" This executive felt *"few CFOs and controllers these days are having fun."*

### **In the media spotlight: CFO turnover**

- *"More CFOs are resigning, retiring or getting fired. A buildup in the demands, pressures and risks has turned the position into what some describe as a thankless chore. Meanwhile, boards of directors, facing personal liability if a company's numbers prove to be faulty, are pushing out old CFOs to make room for those with more experience to handle the new rigors of accounting-reform regulations. The result: a swirling revolving door. CFOs at more than 200 companies were fired or replaced between Dec. 1, 2004, and Jan. 31, 2005, according to [SEC-data search engine] 10-K Wizard's analysis of thousands of Securities and Exchange Commission filings."  
USA Today, March 23, 2005*
- *"According to analysis conducted by the CFO Executive Board, annual CFO turnover at the largest 162 global companies between 1995 and 2003 was 17% – even higher than for CEOs – and three out of four current Fortune 500 finance officers have been in their positions less than five years. And Sarbanes-Oxley is expected to accelerate that turnover, as more CFOs are dismissed for failing to prevent material controls weaknesses or else throw in the towel out of frustration. Yet while CFOs have less and less time to learn the ropes, boards and CEOs are hoisting more and more responsibility onto their backs. As a result, they spend much of their time on administrative challenges, with few opportunities to develop such skills as critiquing corporate strategy and improving operational performance."  
"The Trouble with CFOs," Harvard Business Review, November 2005*
- *"Total turnover among the CFOs of Fortune 500 companies is on the increase, according to a survey released earlier this year by executive-search firm Russell Reynolds Associates, Inc. CFO turnover rose 23% in 2004 from a year earlier. Some of the increased turnover is due to promotion. However, some observers think the position has lost its attraction; that CFOs are buried by increasing compliance duties and ever-increasing pressure by the investment community for short-term results. There isn't enough time to focus on strategic business issues and serve as the CEO's right-hand person."  
Wall Street Journal, April 7, 2005*

## The finance organization, including the CFO, is interacting more closely with the board and the audit committee

Many of the CFOs surveyed agreed with the words of one CFO, who observed, “CFOs today are more engaged with the board, as well as [with] the audit committee and its chair.” This CFO said that boards and audit committees are asking more questions, and that they are the right questions. “Discussions between financial managers and auditors get played back to audit committees more fully and transparently.”

One CFO commented, “The audit committee is more engaged and involved than before Sarbanes-Oxley. Meetings have expanded from a half hour to three or four hours of quality discussion. The committee has longer agendas and goes into greater depth with each item. There’s more constructive skepticism now on the part of the committee.” Another CFO added, “The board’s and audit committee’s questions haven’t changed, but their level of interest has. That’s good.”

One CFO reported spending more time on regulatory activities – in part because of the environment and in part because of the company’s acquisitions. This executive asked, “Will only CPAs be willing and able to sit on the audit committee? That’s too narrow a background. We have [audit committee] members who are not [CPAs] starting to feel uncomfortable, and that’s terrible.” This CFO also said that the finance team is providing more information to the audit committee and had recently sent its first “three-book”-size mailing to committee members.

Another CFO hoped that eventually “the pendulum will swing back.” This CFO said the job of the audit committee is “to make sure the right people are doing the right things; they should be kicking the tires every once in awhile, not stopping the car every five miles.” In today’s environment, “the audit committee is fearful, so they probe lots of places they don’t need to.”

However, one CFO values the audit committee as a source of independent perspective and counsel on financial issues, particularly when former CFOs sit on the committee: “I have sought the audit committee as a proactive way of [getting] a different perspective and driving the organization forward. I have teed up tough issues for a healthy dialogue.”

## CFOs are seeking to involve the audit committee in broader risk management

A CFO who is also an audit committee chair told us, “The audit committee’s direct involvement with [Section 404] testing and certification requirements should lessen as its comfort level increases. It shouldn’t focus on the same five issues year after year. [An] example of the danger of this is Enron. The company’s key risks changed. There was probably very good coverage of energy trading [risk], but derivatives were probably not well addressed. The audit committee should help define with management what a firm’s key risks are.”

One CFO reported that the agenda for the audit committee has stabilized, and the committee is spending less time on Section 404-related compliance and more time on risk management and business strategy. “Directors used to be ‘fed from a fire hose’ with information. Now we tailor and stagger the flow of information. Fewer business areas are covered per meeting, but in greater depth. Our goal: never surprise

*the audit committee.*” Another company is leveraging Section 404 compliance initiatives as a platform for enterprise-wide risk management.

### **Assessing finance organization bench strength**

Participating CFOs reported a range of practices at their companies to help the audit committee gauge the skills of finance staff below the CFO and controller level. Broadly speaking, all these practices foster regular interaction between junior finance staff and audit committee members, in both formal and informal settings.

According to one respondent, *“A finance person below the CFO level routinely attends each audit committee meeting. My direct reports rotate in attending meetings of the full board or the audit committee, and high-potential staffers are invited to the post-board meeting lunch. In this way the board gets to know the company’s top dozen financial people. Also, when the audit committee chair makes on-site visits, he may be hosted by the facility’s CFO and thus gets to know finance staff [outside the home office].”*

At another CFO’s company, *“the audit committee has long had exposure to finance staff below the CFO level. In fact, I rarely present to the committee. A few finance ‘rising stars’ get to present at full board meetings.”* In his role as audit committee chair, another respondent notes, *“I meet not only with the CFO, but also [with] his [direct] reports and with people in middle and lower ranks of my choosing. If you sit down and talk with them, they’ll tell you about the finance organization’s culture, esprit de corps, how they’d handle tough situations. You’ll also get a feel for the level of integrity.”*

### **Changes in internal audit’s relationships with the CFO and the audit committee**

In July 2004, *InSights* reported, “Sarbanes-Oxley has elevated and deepened the relationship between the audit committee and the external audit firm. In order to ensure independence from management, external auditors now report directly to the audit committee and it is the audit committee that holds external auditors accountable for their work ... In contrast, Sarbanes-Oxley has not dramatically changed the working and reporting relationships between audit committees and the internal auditors...”<sup>1</sup>

CFOs interviewed for the current research stated that the traditional reporting line between the internal audit function and the CFO has been eroding as companies position internal audit as an objective voice on corporate financial processes. Although reporting lines for the internal audit function vary across the companies represented, the function typically reports both to senior management and the audit committee.

Below are three of the variations mentioned by CFOs:

- **Internal audit reports both to the CFO and the audit committee chair.** One CFO believes this arrangement poses no threat to internal audit objectivity: *“Internal audit’s dual reporting lines balance out the audit function.”*
- **Internal audit has direct access to both the CEO and the audit committee,** but the CFO retains administrative oversight of the function.

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<sup>1</sup> Audit Committee Leadership Network, “The internal auditor’s perspective,” *InSights*, July 4, 2004, explores the internal auditor’s role in greater depth. Available at [http://www.tapestrynetworks.com/documents/Tapestry\\_EY\\_ACLN\\_Jul04\\_InSights4.pdf](http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Jul04_InSights4.pdf).

- **Internal audit reports directly to the CEO with a line to the audit committee chair, circumventing the CFO altogether.** At this company, internal audit’s scope of coverage is broad, covering not only finances but also environmental safety, health, and other non-financial areas.

The work being undertaken by internal audit has also evolved, and several CFOs were critical of the bias toward Section 404 work. One CFO said, *“Internal audit is so absorbed by Sarbanes–Oxley, it doesn’t have time for traditional activities ... A balance must be struck between internal auditors, external auditors, and third-party consultants.”*

### Questions the audit committee should be asking the CFO

CFO respondents were asked to identify questions the audit committee should be asking the CFO.

Responses include:

- What keeps you up at night?
- What is the tone at the top management level?
- What are the company’s biggest financial and operating risks?
- What are the key judgment calls you are making on accounting, financial, and operational issues?
- Where do you need support?
- How long does it take to close the books?
- How well do the systems support the finance function’s work?
- Who are the key people you rely on?
- What are you doing to satisfy yourself about the quality and integrity of the financial statements?
- Who wrote the 10-Q [or other major document under discussion]?

### The CFO’s relationship with the external auditors has become strained

Many respondents were concerned about their companies’ relationship with the external auditors. Several CFOs empathized with the external auditors over the challenges the auditors face, such as independent regulation and standard setting.

- **Regulation.** One CFO said, *“Sarbanes–Oxley has been hardest on the external audit firms. Sarbanes–Oxley didn’t have clear guidelines for implementation; the Big Four didn’t have a safe place to land, which made client relationships more difficult. Now ... things have calmed down.”*
- **Standard setting.** Another executive told us, *“There isn’t a CFO in the country who [doesn’t] wish they had more influence [on the standard-setting process]. Board members expect a level of professionalism from auditors, and the need to apply seemingly inconsistent, illogical rules hurts the auditors.”*

Even so, many of the CFOs felt their relations with the external auditor had suffered from the distancing of the auditor-management relationship and the reduced autonomy of local-office lead audit partners, along with higher fees. One CFO commented, *“External auditors have become much more adversarial,”* and despite the PCAOB’s guidance on working with audit firms (issued in May 2005)<sup>2</sup>, another respondent felt that *“our external auditors have changed from accounting experts very familiar with their clients to accounting experts who won’t touch anything in your reporting. We can’t go to them for advice...”* A third executive said, *“I... [am] unhappy about our relationship with the external auditors. The industry is less competitive, clients are somewhat captive, [and] fees are high.”*

### **CFOs are evaluated by the CEO, with informal input from the audit committee**

The Conference Board Commission on Public Trust and Private Enterprise has stated that “in fulfilling its oversight function, boards must monitor management’s operating performance as well as ethical and legal compliance.”<sup>3</sup> Almost all of the surveyed executives said the CEO was the key evaluator of the CFO’s performance, with the audit committee, or its chair, providing informal feedback at the CEO’s request.

Prior to Sarbanes-Oxley, a 1997 survey conducted by *CFO* magazine found that only 62% of companies regularly evaluated their CFOs.<sup>4</sup> In companies that did not, many CEOs said it was “awkward” to evaluate their CFO due to the close working relationship between them and believed that their day-to-day interactions and continual “mid-course corrections” provided sufficient ongoing feedback and guidance. In companies that did undertake evaluation, practices ranged from very informal feedback to a formal, structured, and interactive process. Results of performance evaluations were considered most useful when they drove future performance and goal setting and were shared with other senior management and the board – a practice undertaken by fewer than 30% of the companies.

When CFOs were asked to state the formal metrics by which they were evaluated, non-financial metrics outnumbered financial metrics (see table below). However, many of the CFOs noted a gap between the formal metrics established to assess their performance (if indeed such measures were in use) and the factors on which their performance was actually evaluated.

For many CFOs, actual performance evaluation focused on two main factors: the CEO’s subjective judgment and the company’s financial performance. One executive told us, *“I’m [supposedly] evaluated by progress toward a set of objectives, including financial metrics such as EPS growth and return on invested capital. But in practice, if you make your numbers, you’re great, and if not, you’re a goat.”* CFOs told us that non-financial goals play little role in the process. One CFO commented, *“I’m not sure how meaningful [the formal metrics] are. The real question is ‘Is the CEO happy?’”*

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<sup>2</sup> Public Company Accounting Oversight Board, “PCAOB Issues Guidance on Audits of Internal Controls,” press release, May 16, 2005, [http://www.pcaobus.org/News\\_and\\_Events/News/2005/05-16.asp](http://www.pcaobus.org/News_and_Events/News/2005/05-16.asp)

<sup>3</sup> The Conference Board Commission on Public Trust and Private Enterprise, *Findings and Recommendations, Part 2 – Corporate Governance: Principles, Recommendations and Specific Best Practice Suggestions* (New York: The Conference Board, 2003), 9. Complete text available at <http://www.iasplus.com/resource/confboard.pdf>.

<sup>4</sup> Bill Birchard, “CFOs on Review,” *CFO*, September 1, 1997. Available to subscribers at <http://www.cfo.com/article.cfm/2990457?f=search>.

Other respondents said their evaluations were based on more objective measures. One CFO commented, *“I have to meet several criteria. Metrics include expense control, productivity, support of business goals. I’m also measured on performance of people who report to me, giving them new experiences and opportunities for promotion, and practicing and exhibiting our company’s long-held values.”*

One of the respondents explicitly recognized the value of audit committee input into his evaluation. *“My main evaluator is the CEO, which is appropriate, but the board, audit committee, and compensation committee should have input too.”*

Members of the Audit Committee Leadership Network in North America spoke on the subject of the audit committee’s role in assessing the CFO earlier in the year. Many members do contribute to the CFO’s performance review. In the case of several boards one member serves on, “the chair of the audit committee attends the compensation committee on evaluations of the CFO and internal auditor; the further that conversation can go, the better.” Another company receives ad hoc feedback from both internal and external auditors about the CFO after each audit committee meeting. The audit committee then offers input to the compensation committee, primarily through a side conversation over lunch or a telephone call.

### **Formal criteria used for CFO evaluation**

#### **Financial**

- EPS growth and return on invested capital
- Contribution to corporate strategy (e.g., potential mergers and acquisitions)
- Ability to deal with capital-structure issues
- Ability to control expenses
- Improvement of the organization’s bottom line

#### **Non-financial**

- Integrity
- Leadership of the finance area
- Quality of decision making
- Compatibility with the CEO, executive team, board, employees, and investors
- Performance of direct reports; provision of new experiences, promotion opportunities
- Meeting of Sarbanes-Oxley requirements, including implementation of sound internal controls
- Practice and exhibition of the company’s values

# InSights

FOR AUDIT COMMITTEE MEMBERS



## Conclusion

The CFO position has always been demanding, but it is increasingly clear that today's CFOs are dealing with more work, broader responsibilities, and more personal and professional risk. In the face of these challenges, companies need to attract and retain talented executives willing to serve in this vital role. They also need to consider carefully the burden that is falling on the controller, as future CFOs are often drawn from the ranks of controllers.

Given the stresses of the CFO role, it is important for audit committees to understand how the CFO's motivations align with performance measurement metrics and rewards, both intrinsic and extrinsic. To achieve this level of understanding, audit committees may want to spend more time with their CFO, discussing some of the more open-ended and softer questions recommended by CFOs in our research. In this way, audit committees and CFOs can work collaboratively to provide shareholders with top-quality financial management and confidence in the integrity of financial reports.

## About this document

*InSights* is produced by Tapestry Networks to provide assessments of key issues of interest to audit committees. Initially, *InSights* will be distributed to members of audit committee networks sponsored by Ernst & Young and orchestrated by Tapestry Networks, who, in turn, will share it with colleagues on audit committees and boards, and their advisers. It will be distributed by Ernst & Young to its partners. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

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