

The audit committee, the CFO and the finance organization

Introduction

On 7–8 April 2010, members of the European Audit Committee Leadership Network (EACLN) met in Barcelona to discuss audit committee effectiveness¹ and the relationships among the audit committee, the chief financial officer (CFO) and the wider finance organization. *ViewPoints*² contains a summary of the key points raised during the discussion on the relations between the audit committee and the CFO, along with selected perspectives that members shared before and after the meeting. For further information about the network, see “About this document,” on page 7. For a full list of participants, see Appendix 1, on page 8.

Executive summary

As globalization, advancing technological and financial innovation, and demands from investors and regulators have put new pressures on CFOs and audit committees, the relationship between them has grown in importance.³ Audit chairs are very interested in the role of the CFO and their interactions with the CFO and the finance organization. At the April meeting, members discussed the following topics:

§ **The CFO should balance the CEO** (*Page 2*)

EACLN members want the CFO to act as a counterweight to the chief executive officer (CEO), checking unnecessary risk taking and other excesses. While they acknowledge the potential value of the CFO’s contribution to company strategy, they see tensions between this role and the need for prudent gatekeeping and other important duties in areas such as accounting and investor relations.

§ **The CFO is the audit committee’s point person in management** (*Page 3*)

Members reported extensive interactions – formal and informal – with their CFOs, both during and between audit committee meetings. The CFO may be involved in setting the agenda for audit committee meetings, but the degree of involvement varies. Members stressed the importance of a strong relationship with the CFO, even to the extent of sometimes acting as the CFO’s coach, but they cautioned against excessive interference in his or her work.

§ **Audit chairs are more involved in CFO succession planning than in CFO evaluation** (*Page 4*)

Members reported more consistent participation in succession planning for a future CFO than in evaluating the performance of the current CFO. Involvement in CFO evaluation ranges from active participation in the formal performance review to no involvement at all. Some members saw a need for more formal input from the audit committee chair.

¹ European Audit Committee Leadership Network, “[Enhancing audit committee effectiveness in a changing environment.](#)” *ViewPoints*, 30 April 2010.

² *ViewPoints* reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and guests and their company affiliations are a matter of public record, but comments made before, during and after meetings are not attributed to individuals or corporations. All member quotes appear in italics.

³ Scott Leibs, “[25 Years of Finance.](#)” *CFO Magazine*, 1 February 2010.

§ The external auditor provides insight on the wider finance organization (Page 5)

Members tend to interact with the finance staff reporting to the CFO, including such key personnel as the controller, the treasurer, the chief accounting officer and the head of internal audit. In some cases, audit chairs also see the tax director and the head of information technology, as well as business unit CFOs. Audit chairs also rely on the external auditor to gain insight into the quality of the wider finance organization, and they expect the external auditor to alert them to any problems.

Appendix 2, on page 9, includes a list of discussion questions for audit committees.

The CFO should balance the CEO

A recent study conducted by the executive search firm Spencer Stuart suggested that the role of the CFO has expanded well beyond the traditional focus on finance.⁴ The study, which surveyed about 150 CFOs across the globe, revealed that CFOs have become more involved in strategy and operations, even as finance remains critically important. As one CFO put, “There is now a very significant expectation from the CEO, board and the market to provide input and leadership in all dimensions of the business.”⁵

At the meeting in Barcelona, however, members stressed that the CFO should act as a counterbalance to the CEO, serving as a check on potential excesses and pressures to take unnecessary risks. One member said explicitly, “*In our CFO, I’m looking for a counterbalance to the CEO – you need someone to control the enthusiasm of the CEO.*” Another member elaborated, “*There are pressures on the CEO to do acquisitions, for example. You need to have someone who is the CEO’s intellectual equal to balance this ... In our company, it’s part of the CFO’s job description and personal incentives to stand up to the CEO.*”

Members see the advantages of greater CFO involvement in strategy development, but at the meeting, they questioned how commonly one finds CFOs with both strategy and finance qualifications: “*It’s transformative for the CFO to have a strong strategy [background], but it’s quite rare to find a combination of finance and strategy.*” Another member qualified the nature of the CFO’s strategic role: “*Our CFO often takes a strategic process approach rather than focusing on a breakthrough idea.*”

One member noted that the question of how involved in strategy the CFO should be is a perennial one: “*In some companies, the CFO is in charge of strategic planning. In others, the CFO doesn’t drive this. Should the CFO have strategic capabilities? Or be a gatekeeper? It’s a never-ending conversation.*” In a pre-meeting discussion, one member suggested that the recovery from the current crisis may drive a more strategic focus: “*With the return to expansion and a diminished focus on crisis management, there will be a need for a CFO who has a view on the strategic aspects of the company.*”

Other members noted that the role can vary among companies, depending on their situation. Companies facing severe financial difficulties will obviously present their CFOs with different challenges than companies that have a stronger cash position and are planning acquisitions.

⁴ See Spencer Stuart, *The Global 50: The new finance leader: Lessons from and advice for today’s CFO* (Spencer Stuart, 2009).

⁵ *Ibid.*, page 4.

The importance of the fundamentals

In discussions prior to the Barcelona meeting, members mentioned the importance of several other traditional capabilities of the CFO:

- Ø **Knowledge of accounting and financial reporting.** While members differed on the depth of accounting expertise that CFOs require, several members noted its importance. As one put it, *“The most important thing is that the CFO knows accounting and treasury. If [the CFO] doesn’t have the full scope of professional accounting knowledge, he can’t be the partner in the other areas you are looking for.”*
- Ø **Personal integrity.** A member emphasized a character trait that he thought was critical: *“Integrity – integrity vis-à-vis the board and the CEO.”* His remark echoed comments by members of the North American Audit Committee Leadership Network, one of whom noted that *“if you don’t have trust in the CFO, you don’t have anything.”*
- Ø **Management skills.** A member noted that the size of the finance function in a large, complex company makes the CFO’s management skills particularly important: *“There are thousands of people in the finance function. In addition to normal technical expertise, [the CFO] has to be able to talk to his experts.”*
- Ø **Investor relations skills.** The investor relations function typically falls within the CFO’s purview, and in the current environment, the CFO’s ability to assist the CEO in shareholder communications has become even more critical. As one member noted, *“At shareholder meetings, the CFO sits at the right of the CEO.”*

The CFO is the audit committee’s point person in management

Even before the current crisis was under way, observers remarked on how the relationship between the audit committee and the CFO had intensified due to the accounting scandals at the beginning of the century and the subsequent reforms in regulations. European CFOs interviewed in 2006 by Tapestry Networks for Ernst & Young noted that increased compliance responsibilities were strengthening the relationship.⁶ As audit committees came under scrutiny, they needed much more information from the finance organization in order to meet rising expectations.⁷

Members’ comments suggested that today’s economic environment has only magnified this effect. At the meeting, a member noted that *“the CFO is [the audit committee’s] point person in management.”* This comment summed up the picture that emerged in pre-meeting conversations. As one member put it, *“I can’t imagine an audit committee that isn’t putting more pressure on the CFO and [that doesn’t want] to know more from the CFO than a few years ago.”* In general, members reported frequent and in-depth consultations with the CFO. One member noted, *“The CFO is at every audit committee meeting except*

⁶ Ernst & Young and Tapestry Networks, [“The CFO’s evolving role: a pan-European perspective.”](#) *InSights*, 30 November 2006, pp 8–9.

⁷ Ellen M. Heffes, [“Audit committee to CFO: can we talk?”](#) *Financial Executive*, 1 October 2007.

when he is being evaluated [by the committee].” Another member said, “If something unusual happens, [the CFO] calls or emails me, and we speak informally frequently.”

In some cases, the CEO may join the CFO at audit committee meetings. One member at the meeting said that *“the CEO is always there”* while another noted that *“the only time when the CEO came was when the company had an emergency accounting issue.”* One member commented on the impact of the CEO’s presence: *“He is permanently invited, but only comes once per year. I find the impact is less openness when the CEO is there.”*

Setting the agenda for the audit committee meeting

At the meeting and in pre-meeting discussions, EACLN members described different approaches to developing the agenda for audit committee meetings. The CFO may or may not drive the process:

- § **The CFO drafts the agenda.** One member said, *“I get a proposed agenda and we discuss it.”* Another noted, *“I get everything I need: he sends a proposed agenda, I comment and he adjusts it.”*
- § **The audit chair drafts the agenda with CFO input.** A member said, *“I talk to [the CFO] to prepare the agenda ... I propose it and come with information, and we have an open discussion.”*
- § **Another member of staff drafts the agenda.** A member stated, *“We work with the company secretary. The process is to have an annual outline that is started by the secretary. It then goes to the audit committee [for comment].”* Another member noted that *“our chief internal audit person develops the agenda.”*

One member expressed interest in involving the CFO more actively in setting the agenda: *“It’s up to me what’s on the agenda. I ask for a forward agenda, but in terms of specific issues, it’s up to me. Over the years, I have found I have things I want to discuss, but I would like more input.”*

Advising the CFO

Members discussed their role as advisers to the CFO. One member said, *“I see the audit chairman as having the potential role of raising delicate issues. We should aim to do this. If so, the CFO will use you as a sounding board. I believe it opens the door.”* Another member agreed: *“I subscribe to that. You must have a relationship. It’s been helpful to have a relationship during the crisis.”*

Many members have themselves served as CFOs, and they discussed how this experience might influence their relationship with the CFO. A member noted, *“If you have a new CFO, or a CFO who is new to the role, you can coach them on how to present and how to react to the audit committee and the board.”*

Other members cautioned that the audit committee chair should avoid getting too involved: *“You have to be careful if you are a former CEO to not become too operational.”* Another member agreed: *“You have to give the CFO a bit of distance and not get in the way.”*

Audit chairs are more involved in CFO succession planning than in CFO evaluation

Audit chairs are alert to potential problems in CFO performance and will raise issues proactively with the CEO. One member noted that monitoring the CFO’s performance is a responsibility of audit chairs: *“As*

audit chair, if you think the finance function is not well run, you are obligated to step in.” However, members reported varying degrees of involvement in the annual CFO performance evaluation:

§ **Formal involvement.** *“We do 360-degree feedback [where the CFO’s superiors and direct reports evaluate him], and it’s done by questionnaire. It’s not disclosed who provides the input. It’s a formal process.”*

§ **Informal involvement.** Most members said that they are involved only informally in the evaluation of the CFO, providing feedback to the CFO directly or through the remuneration committee: *“I think it’s inevitable the audit chair will express his or her views, but it’s more likely informal, not formal.”*

§ **No involvement.** In a pre-meeting conversation, one member remarked, *“[I am not involved] even informally. It doesn’t fall within any of the roles we have ... The CEO has more than enough knowledge; he relates to [the CFO] very directly.”*

In forming an opinion regarding the CFO’s performance, members rely not only on their own impressions but also on those of the external auditor. As an Ernst & Young partner noted, *“Generally, the audit chair asks if I am at ease with the CFO.”*

Some EACLN members suggested the audit chair should offer more input. One member remarked, *“I’m amazed that the CEO never asks the audit committee what they think about the CFO ... They never ask if there are any issues.”* Another member said, *“Maybe we should be involved in the assessment.”*

In the area of succession planning, members reported more audit committee involvement. One member said, *“Our audit committee has discussed succession planning of our current CFO. The initial preparatory work is done by executives. Then the audit committee and the chairman’s committee (all non-executives) discuss it.”* Another member said, *“As audit chair, I am consulted by the CEO before the nomination of the CFO. [The last time,] I met with two candidates and gave informal feedback.”*

The external auditor provides insight on the wider finance organization

Most members reported that the audit committee interacts with other finance staff in addition to the CFO. A number of people from the finance organization generally attend the audit committee meetings: the controller, the treasurer, the chief accounting officer, as well as the head of internal audit when that function is part of the finance organization.

Other members reported that the head of information technology and the tax director also participate in audit committee meetings, reflecting further variations in the functions that companies include in the finance organization, as well as differences in company priorities. The audit committee may also interact with business unit CFOs, though such interactions are less frequent.

The quality of communications between management and the audit committee emerged as an overall theme of the meeting. Despite frequent interactions with the finance organization (CFO and staff), members were not fully satisfied with the information they were receiving on emerging issues, noting that the draft standard on revenue recognition, for example, was an issue that they would have liked to be briefed on earlier. The

ability of the audit committee to discharge its duties depends critically on the information it receives, an issue that also came up in the discussion on audit committee effectiveness.⁸

Interactions with tax and treasury

In pre-meeting conversations, some members saw tax issues as a growing concern and therefore were interested in seeing the tax director at audit committee meetings. A member said, *“The audit committee is looking more at the tax situation. Once a year we have a full review, and tax planning is a growing area.”* Another member said, *“We are close to the tax authorities: there’s more discussion than ever about assessments.”* A few members noted that the international dimension of taxation is driving the issue: *“As companies become global, tax is very important and not easily understood by regular audit committee members.”*

Other members, however, did not see tax as an increasingly urgent issue and reported no uptick in interactions with the tax director. Some reported company-specific circumstances: *“In our case, we devote less time to tax [now] than we did a year ago. We were in an extraordinary situation a year ago, but [we will] spend less time going forward.”*

Some members reported that the treasurer is coming to audit committee meetings more often because of issues related to the financial crisis: *“Not surprisingly, [we’re devoting] more attention and time on treasury operations to understand funding capacity, liquidity needs and control over hedging.”*

Evaluating the finance organization

Audit chairs depend heavily on the external auditor for insight into the wider finance organization. Given that the finance organization may include thousands of employees around the world, relying on the external auditor is the most practical approach for getting a broad understanding of their quality. A member said, *“I find it helpful to talk with the external auditor – this can be very helpful if you have a good relationship.”*

Other audit chairs attempt to get a broader perspective by identifying opportunities for informal interaction with members of the finance team. One member said, *“I attend the finance leadership team meetings. I listen, talk informally, attend dinners and discuss succession planning. I get a view of the quality of the people – [I] see how they perform under stress.”* Audit chairs may intervene if there are problems with key staff. A member offered an example: *“The CFO’s credibility with investors is important. This is an issue we are very sensitive to. We weren’t happy, and we changed the investor relations person.”*

In a pre-meeting conversation, a member noted that the CFO approved of audit committee interactions with staff: *“I like to discuss [issues] with the next level of people, so I have insight on them. [The CFO] is fine with me calling someone directly and spending time [with them] outside of meetings.”*

⁸ See European Audit Committee Leadership Network, [“Enhancing audit committee effectiveness in a changing environment.”](#) *ViewPoints*, 30 April 2010.

Completing the triangle: the external auditor, the audit committee and the finance organization

Both at the meeting and in pre-meeting conversations, participants noted that the external auditor is increasingly a key player in the relations between the audit committee and the finance organization. Indeed, the external auditor can be seen as the third point of a triangle in which the other two points are the finance organization and the audit committee. Members suggested that the external auditor can play several roles as the third partner in the relationship:

- Ø **Sounding the alarm.** The external auditor is in a strong position to notice when problems are emerging, which is particularly important if management is not forthcoming. A member remarked, *"We cannot accept a lack of transparency or a non-cooperative attitude from a CFO. If some executives are not cooperating, like the CFO, it's important to check with the external auditor."*
- Ø **CFO evaluation and succession planning.** The external auditor can offer valuable insight on the CFO and potential successors. An Ernst & Young partner noted, *"When it is CFO succession time, audit chairs are very much asking for our views."*
- Ø **Evaluation of the finance staff.** As one member put it, *"I get most of my intelligence [on the finance organization] from the external auditor. I trust him, and he trusts me [enough] to say what he really thinks."*

Conclusion

The coming years will bring fresh challenges for CFOs, audit committees and auditors. Audit chairs should continue to assess the optimal role for their CFO, and they should be prepared to engage more actively in the CFO's evaluation and in succession planning for the role. They should demand that the finance organization and the external auditor keep them fully abreast of important developments. Wherever possible, audit chairs should cultivate deeper relationships with key members of the finance organization, and they should create the trust required for candid feedback.

About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management and their advisers as they endeavor to fulfil their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* may share it with those in their own network. The more board members, members of management and advisers who become systematically engaged in this dialogue, the more value will be created for all.

The views expressed in this document represent those of the European Audit Committee Leadership Network, a group of audit committee chairs drawn from Europe's leading companies committed to improving the performance of audit committees and enhancing trust in financial markets. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young or Tapestry Networks. Please consult your advisers for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization.

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Appendix 1: Meeting participants

The members of the network participating in the meeting sit on the boards of about 40 large-, mid- and small-capitalization public companies. Network members participating in all or part of the meeting included:

- § Mr Aldo Cardoso, Audit Committee Chair, GDF SUEZ
- § Dr DeAnne Julius, Audit Committee Chair, Roche
- § Mr Daniel Lebègue, Audit Committee Chair, SCOR
- § Mr Anders Nyrén, Audit Committee Chair, Sandvik and SCA
- § Sir Ian Prosser, Audit Committee Chair, BP
- § Mr Pierre Rodocanachi, Audit Committee Member, Vivendi
- § Ms Guylaine Saucier, Audit Committee Chair, Areva and Danone
- § Mr Tom de Swaan, Audit Committee Chair, Ahold and GlaxoSmithKline
- § Mr Jack Tai, Audit Committee Chair, ING
- § Dr Bernd Voss, Audit Committee Chair, ABB
- § Mr Lars Westerberg, Audit Committee Chair, Volvo
- § Mr Mario Zibetti, Audit Committee Chair, Fiat Group

Ernst & Young was represented by:

- § Mr Tom McGrath, Managing Partner, EMEIA Financial Services
- § Mr Christian Mouillon, Global Vice Chair, Assurance

Appendix 2: Questions for boards and audit committees

- ? What expectations does the audit committee have of the CFO? Do those expectations change over time and with economic circumstances?
- ? What skills and experiences does the audit committee particularly value in the CFO? Is the CFO considered a potential successor to the CEO? Is the CFO seen as a balance to the CEO? If so, how does that affect the dynamics of their relationship?
- ? In what ways have interactions with the CFO changed in the last few years? What changes would improve the relationship between the CFO and the audit committee?
- ? If you are a former CFO, does that impact the relationship you have with your CFO? Do you offer guidance to the CFO? In what other ways can the audit committee assist the finance organization? Have the expanding responsibilities of the CFO led to a concomitant increase in the workload for the audit committee?
- ? What role should the audit committee play in evaluating the CFO and in appointing his or her successor? Has this role changed over the last few years? Will it change in the future?
- ? What characteristics of the finance organization are most important? What are the advantages and disadvantages of incorporating various functions, such as IT, internal audit or compliance, into the finance organization?
- ? How important are the audit committee's interactions with the rest of the finance organization? What staff members does the audit committee interact with the most? Has that changed due to the financial crisis and the state of the economy?
- ? How closely should the audit committee monitor the staff of the finance organization? Should the audit committee be involved in assessing bench strength and succession planning?
- ? What role should the external auditor play in the audit committee's relations with the CFO and the finance organization?