

## The audit committee and the finance organization

On June 5, 2013, members of the North American Audit Committee Leadership Network (ACLN) met in New York to discuss the audit committee's relationship with the chief financial officer (CFO) and the finance organization, among other topics.<sup>1</sup>

This document summarizes the key points that members raised in the discussion, along with background information and perspectives that members shared before the meeting.<sup>2</sup> For further information about the network, see "About this document" on page 8. For a list of participants, see Appendix 1 on page 9.

### Executive summary

The roles of the CFO and the finance organization are expanding and shifting, and audit chairs are adapting their oversight in response to these changes. ACLN members emphasized three general points, which are summarized below and described in more detail on the following pages:

- **CFOs and their teams are taking on a broader set of responsibilities** (*page 2*)

Changes rooted in the financial crisis, globalization, and accelerating technology advances are putting new pressures on CFOs and the finance organization, leading to the emergence of CFOs who handle a broader range of responsibilities in investor relations, major transactions, and international control policies and standards. CFOs increasingly partner with the CEO in developing and implementing company strategy. This role necessitates a strong relationship between the CFO and the CEO, characterized by both collaboration and "*constructive tension*." It also requires support from a strong team of finance executives, operating as a well-balanced "*Office of the CFO*."

- **Audit chairs need a strong relationship with the CFO** (*page 4*)

The audit committee relies on the CFO as a key source of information for its oversight duties. ACLN members underscored the importance of building trust between the audit chair and the CFO, a process that involves engaging in high-quality dialogue and rewarding candor when discussing problems. Members reported frequent interactions with the CFO, supplemented by regular engagement with other finance executives.

- **Audit chairs want a detailed understanding of the finance organization** (*page 6*)

Audit chairs assess the overall health of the finance organization by interacting with staff more broadly, checking with internal audit, and raising issues in more informal settings. While members reported a range of involvement in the annual evaluation of the CFO, many said they play a significant role in

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<sup>1</sup> In other sessions, ACLN members joined the members of the Lead Director Network for a discussion of risk oversight and a discussion of board leadership. See Audit Committee Leadership Network and Lead Director Network, "[Risk Oversight](#)," *ViewPoints*, July 19, 2013, and Audit Committee Leadership Network and Lead Director Network, "[Effective Board and Committee Leadership](#)," *ViewPoints*, July 19, 2013.

<sup>2</sup> *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

choosing a new CFO. The external auditor can provide valuable input on the CFO and the finance organization more generally, but such input should be sought in the context of a strong relationship between the audit chair and the audit partner.

For a list of discussion questions for audit chairs, see Appendix 2 on page 10.

## CFOs and their teams are taking on a broader set of responsibilities

Today's CFOs operate in a turbulent environment characterized by rapid change on multiple fronts. This environment is having a transformative impact on the role of the CFO, even as it brings to bear pressures that sometimes push in different directions and require CFOs to perform a balancing act between traditional responsibilities and new demands.

### Current trends and pressures

Some of the trends affecting CFOs stem from the consequences of the financial crisis and economic slowdown that began in 2007–8. Other trends stem from longer-term developments that predate the crisis but have, if anything, accelerated in recent years, such as globalization and information technology (IT) advances. Observers and CFOs themselves often highlight the following trends, which exert pressure on companies and, in turn, CFOs:<sup>3</sup>

- **Focus on cost.** As the crisis unfolded, companies made an effort to control costs and bolster their cash positions. Though many were successful and now have strong balance sheets, the focus on efficiency continues as the economic uncertainty persists. One ACLN member said before the meeting, *“The CFO is trying to figure out how to reduce costs without cutting too close to the bone.”*
- **Demands for growth.** Shareholders want returns, but the sluggish economic recovery and continued economic uncertainty are making growth difficult for companies, even as they accumulate cash. This challenge is putting pressure on the entire C-suite as executives look for profitable but prudent ways to invest the cash. CFOs are weighing the risks and benefits of organic growth versus acquisitions.
- **Escalating regulatory requirements.** New regulations such as Dodd-Frank and tougher enforcement of existing regulations such as the Foreign Corrupt Practices Act are putting pressure on compliance programs and internal controls. The quest for growth is amplifying the challenges. As a member noted in pre-meeting conversations, *“We’re pushing out globally, so there are lots of control and compliance issues.”*
- **Focus on risk.** Like the worries about cost, a heightened concern with risk management is a major legacy of the crisis and the continued uncertainty. Financial risks are especially salient for CFOs, but operational and strategic risks are also an issue because enterprise risk management programs are often part of the CFO's mandate.

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<sup>3</sup> This list is synthesized from discussions with Ernst & Young experts, CFOs, and ACLN members, as well as articles on trends affecting CFOs. See David M. Katz, [“The Top Corporate Finance Trends of 2013.”](#) *CFO.com*, January 22, 2013; Andrew Wheeler, [“Ten Megatrends That Are Rocking the CFO's World.”](#) *The Capital Exchange* (blog), March 14, 2012.

- **Big data.** New tools for collecting, storing, and analyzing data are presenting challenges as well as opportunities for companies. Given the importance of data analytics for the finance organization, and the fact that the IT function often reports to the CFO, CFOs are integrally involved in mastering these tools and other IT innovations such as cloud computing.<sup>4</sup>
- **New media environments.** Social media are becoming new channels for communicating financial information, forcing companies to review and revise their media strategies. This challenge affects all staff involved in communications and financial reporting, including the CFO, CEO, and investors relations professionals. The fact that the information circulating in these media does not necessarily come from the company further complicates matters. At the meeting, a member noted, *“A lot of data in the social media sphere is not well informed ... It requires the CFO to be aware of all the activity, not just analyst reports and Wall Street Journal articles. The discussions are so many and varied.”*

### A broadening job description

Current trends have sparked discussion in the corporate world about the role of the CFO and the skills he or she must have to be successful in the new business environment. Many observers see the crisis and its aftermath as a watershed event – much like the enactment of Sarbanes-Oxley – that is dramatically changing the role of the CFO.

International surveys of CFOs conducted in recent years by EY found that the CFO’s mandate has broadened considerably. According to the report on the most recent survey, conducted in the Americas in 2012, “CFOs now increasingly contribute to organizational strategy ... The CFO remains an objective voice on financial performance but contributes to operational decision-making as well. CFOs manage or materially support information technology, investor relations, real estate and strategic [mergers and acquisitions] – and some are involved in commercial activities.”<sup>5</sup>

At the meeting, ACLN members described two types of CFO, one representing the CFO’s more traditional role and the other reflecting the new demands, which are affecting some companies more than others. As one member explained, *“The expectations and needs of the company and the CEO drive the CFO profile. Some companies want a glorified controller, and some companies want something broader.”*

- **The traditional CFO.** The CFO as a controller focuses on the integrity of the numbers and the internal controls around financial reporting. Some members noted that the traditional CFO was still prevalent in certain industries. One member said, *“A heavy engineering company would be more likely to have a controller type.”* Another member mentioned a company in a consumer-oriented industry and joked: *“The CEO didn’t know the name of the CFO. The company’s focus is all about marketing. There, the CFO role is very much a control function.”*
- **The broader, strategic CFO.** The new type of CEO has a broader set of responsibilities. A member noted, *“The job is much less about being a one-trick pony and much more about multitasking.”* The

<sup>4</sup> Paul Taylor, *“New IT Tools Aid Evolution of Finance Chief’s Role.”* *Financial Times*, March 26, 2013.

<sup>5</sup> Ernst & Young, *Views. Vision. Insights. The Evolving Role of Today’s CFO* (Ernst & Young, 2012), 2.

role is also much more strategic, entailing a partnership with the CEO. A member explained, *“We need a strong financial person who can play a role in strategic and business development conversations in the global environment – that’s critical to us.”* Another member said, *“The CFO is the most meaningful and strategic partner for the CEO.”*

Members highlighted important elements of the partnership between a more strategic CFO and the CEO, especially their ability and willingness to challenge each other. One member said, *“The board and the market expect that the CFO can stand up to the CEO.”* Another noted, *“A constructive tension within the team is valuable – be careful if you don’t have it.”*

A few members flagged potential problems presented by this evolution in the CFO role. In a pre-meeting conversation, a member said, *“You get into a dangerous area. You have someone thinking about what to do for growth, but can they be true to what the role used to be?”* In other words, can the CFO be a strategist and still attend to accounting, financial controls, and the other basic functions of the job? Also, while a more strategic CFO is a more viable candidate to become the CEO, a member suggested that such ambitions could introduce certain risks: *“The CFO who wants to be the CEO could subtly undercut the CEO.”*

### **The “Office of the CFO”**

Given the broader set of responsibilities that more and more CFOs must handle, some ACLN members saw value in viewing the CFO role as a team effort that is led by the CFO but covered jointly by several finance executives who operate as an *“Office of the CFO.”* In this view, the CFO is free to take on more strategic tasks because there is a strong controller and a strong accountant, for example, who each can lead effectively in their respective areas.

If the role of the CFO is a team effort, however, ensuring that the team has all the skills and expertise required becomes critical. Is the team appropriately balanced? In addition to a good controller and chief accountant, are there strong leaders in treasury, tax, and audit? Is there someone who is adept with technology and big data? Transitions need to be handled with care to ensure that the requisite balance of skills is maintained. A member recounted how the transition to a new CFO at one company became particularly challenging because the company hired a new controller at the same time. In pre-meeting conversations, members noted that companies do not automatically address these dynamics. One member said, *“My message is that the audit committee needs to step up by being more observant, more questioning.”*

### **Audit chairs need a strong relationship with the CFO**

ACLN members also discussed the relationship between the audit committee and the CFO. The audit committee relies on the CFO as a key source of information about the company’s finances and other issues. As a member explained, *“They come to you to share the issues that are bubbling up and identify the areas of tension.”* Another member said, *“I want the CFO to tell me when we have a question we don’t know the answer to – give me a heads-up.”* A CFO can provide a pragmatic perspective to counterbalance an overly optimistic strategy: *“We want to learn from the CFO that the CEO can deliver on plans, and that they can deliver in the face of constraints and demands.”* By working together effectively, the audit committee and

the CFO can identify and start to compensate for any shortcomings on the part of the CEO. As a member put it, *“You need to protect the flank.”* Members identified some of the elements that foster a successful relationship: building trust, having frequent interactions, and engaging with other finance staff.

### **Building trust**

A key element in getting unfiltered information is trust. A member explained how to build trust over time: *“You need to have a relationship with the CFO. You may have no agenda for the first five times when you speak to the CFO. You get a dialogue going with the CFO so that they tell you things – and the CFO never gets whacked for doing so.”*

Other members elaborated on this approach. One member said, *“You set up a regular call or meeting, a call with no particular reason. You tell them you want to be informal about these things, that you need constructive criticism.”* Another remarked, *“You can’t beat them up for overturning the rock and finding what is underneath.”* Such an approach also entails discretion: *“You have to demonstrate to the CFO that you, as the board, know how to use information. You can’t call the CEO right after you get a call from the CFO.”*

The relationship between the CFO and the audit chair may include a mentoring role on the part of the audit chair. Many audit chairs have themselves served as CFOs, often at similar types of companies where they now serve on the board, and they have a deep and comprehensive understanding of the job. In pre-meeting conversations, one audit chair remarked, *“We talk about everything in the role. I’ve been a mentor.”* Others noted that a mentoring role was more likely with a younger and relatively inexperienced CFO.

### **Frequent interactions**

In pre-meeting conversations, members reported frequent interactions with the CFO. One member said, *“I have a very close, direct relationship with the CFO. He and I talk with the head of internal audit, and we talk separately, the two of us, before each meeting.”* Another member said, *“I talk to the CFO about the audit committee agenda four or five times a year. We also discuss specific issues a few times per year. I have dinner with him a few times a year just to get the temperature.”*

Before the meeting, members also discussed ways to ensure that problems are brought to the audit chair in a timely manner. One member implemented a formal approach: *“We’ve resolved it by setting thresholds, leaving as little as possible to speculation. There’s a protocol for when to bring something to my attention.”* Other members emphasized that they did not have any formal thresholds, leaving it to the CFO’s judgment.

One member noted the importance of overcoming reluctance by some CFOs to communicate frequently with the audit committee: *“When the new CFO joined, I told the CFO we needed good communication. The CFO said, ‘I don’t want to bother you.’ I said, ‘Your job is to bother me – if there is ever a question in your mind about whether to call me, then call me. It’s critically important that you inform me. It’s much worse if there is already a crisis.’”*

### Engagement with other finance staff

In pre-meeting conversations, audit chairs discussed the value of interactions with other finance staff besides the CFO. One audit chair said, *“It’s good to have the people responsible for an area present rather than just the CFO – like the controller, the chief accounting officer, the treasury staff, and the tax staff.”* Another concurred: *“Sometimes the CFO calls me directly. Sometimes they delegate it to a controller or someone else. I don’t worry about chain-of-command issues – it may make sense for me to speak with the controller rather than the CFO. You have to be sure you are keeping everyone in the loop.”* One member mentioned the morale-boosting effects of broader engagement: *“Recognition from a board member of someone below the CFO goes a long way.”*

### Audit chairs want a detailed understanding of the finance organization

Given their reliance on the CFO and the finance organization, audit chairs take a keen interest in the performance of the finance organization, including its culture and dynamics, as well as the performance of the CFO and other senior staff. Members outlined various approaches to performance assessment and staff selection.

### Assessing the overall organization

At the meeting, ACLN members mentioned several approaches to assessing the performance of the finance organization as a whole:

- **Interact extensively with the staff.** A member said, *“We work with everyone enough to get a full understanding of the culture in the finance organization. Do they feel listened to or ignored?”* Another member said, *“When I travel, I add a day to the front or the back end of the trip to meet with both finance and non-finance people. I have enough interaction to understand what’s going on.”*
- **Check with internal audit.** A member said, *“I speak with internal audit – they know.”* Another member mentioned that the head of internal audit had previously served as the CFO of a business unit, giving the person valuable perspective on the CFO role that would inform the insights they derived from leading internal audit.
- **Have informal conversations.** Highlighting once again the importance of an intimate relationship between the CFO and the audit chair, a member said, *“Sitting down with a glass of wine over dinner can unearth more about how the finance team is working.”*

Members noted that their efforts have to be tactful: *“We use a light-touch approach to get at the key issues without causing anyone to feel like they are undermining a boss.”* One member mentioned a more general indicator of how well the finance organization is working: *“One way to observe it: are we getting push back against us? You know as the audit committee that you’re not always right.”*

## Evaluating and selecting the CFO and other staff

ACLN members reported differing levels of involvement in the formal evaluation of the CFO:

- **Some members play a substantial role.** Before the meeting, a member said, *“I am a significant part of the evaluation of the CFO when we do performance reviews and make decisions on compensation. I talk to the CEO and give perspective.”*
- **Other members are less involved.** In pre-meeting conversations, one member said, *“The audit committee plays a very small role – I can’t recall where we were involved. Once in a while, the CEO calls me to touch base, see if I agree. I will provide feedback on my own if something needs enhancing.”* At the meeting, a member pointed out that if the audit committee, rather than the CEO, assumes primary responsibility for evaluating the CFO, it could take away accountability from the CEO.

Several ACLN members reported that the audit committee is closely involved in choosing both the CFO and other members of the finance organization. In a pre-meeting conversation, a member described the process for the staff: *“The audit committee is quite engaged. Annually, we have an executive session with the CEO and CFO on succession for the finance organization, looking at the chief accountant and other positions as well as the CFO. We have a good sense of the talent pool. When a key finance position opens up, I will know that and have input.”*

The member elaborated on the CFO selection process: *“At the CFO level, the audit chair and one member of the committee would interview candidates and provide input to the CEO – here are the people we would be comfortable with, and here are the people we would be uncomfortable with, and here are the best ones. It’s not in our experience that the CEO would ignore us.”* A member at the meeting remarked, *“You have veto rights over these jobs.”* Another described a joint effort with the lead director: *“The lead director and I engage with the CEO to consider if we could work with the new candidate.”*

Members noted that if a sitting CFO does not meet a certain level of competence, the board may initiate the process of selecting a new CFO. One member said, *“If you don’t have confidence in somebody who presents to you, it is unacceptable.”* Another added, *“It is protecting the CEO, and it is protecting the board. If you feel this strongly, you need to do it.”*

## Obtaining feedback from the audit partner

Audit chairs have noted that the external auditor can be helpful in flagging problems within the finance organization and in providing input on the CFO and other finance staff. At the meeting, the discussion touched on two factors involved in getting candid feedback from the external auditor:

- **A strong relationship between the audit chair and the audit partner.** The audit partner needs to be able to trust the audit chair completely: *“Audit chairs need to cultivate the relationship.”*
- **Discretion.** While it is acceptable to discuss the internal audit function with the external auditor in a committee setting, the audit chair should ask about the quality of the finance organization in a private, one-on-one conversation.



## Conclusion

Audit chairs work closely with the CFO and other members of the finance organization, and they take a deep interest in the evolving role of the finance organization in company operations and strategy as well as finance. The strategic partnership between the CFO and the CEO receives close attention, as does the team of finance executives supporting this partnership. Trust between the audit chair and the CFO is nurtured through frequent interactions and candor, but audit chairs also seek input from other finance staff, internal audit, and the external auditor. Audit chairs play a role in selecting a new CFO and overseeing the bench strength of the finance organization, and they have a high bar for the CFO and his or her team. As one member said, *“Even great audit committees can’t overcome mediocre financial management.”*

## About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

*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 fulfill 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. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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## Appendix 1: Participants

Members participating in the meeting sit on the boards of 34 large-, mid-, and small-capitalization public companies:

- Denny Beresford, Audit Committee Chair, Legg Mason
- Les Brun, Audit Committee Chair, Merck
- Aldo Cardoso, Audit Committee Chair, GDF SUEZ\*
- Michele Hooper, Audit Committee Chair, PPG Industries
- Labe Jackson, Audit Committee Chair, JPMorgan Chase
- Marie Knowles, Audit Committee Chair, McKesson
- Heidi Miller, Board Member, General Mills
- Chuck Noski, Audit Committee Chair, Microsoft
- Tom O’Neill, Former Audit Committee Chair, Archer Daniels Midland
- Sandy Warner, Audit Committee Chair, General Electric

\*Member, European Audit Committee Leadership Network

The following participants represented EY at the meeting:

- Tom Hough, Americas Vice Chair of Assurance Services
- Steve Howe, Americas Managing Partner



## Appendix 2: Questions for audit committees

- ? What trends are you seeing that are having an impact on the CFO? How are the demands on the CFO changing?
- ? In your experience, how are these trends influencing the role of the CFO? What is required of the CFO today?
- ? What is the impact of current trends and the changing CFO role on the broader finance organization? How is it adapting?
- ? How do you, as an audit committee chair, work with the CFO? What kind of a relationship do you have and how do you maintain it? How do you preserve independence while mentoring the CFO?
- ? What is the protocol for when the CFO should contact you about a problem? How do you respond?
- ? How do you interact with other members of the finance staff? Which members of the staff do you interact with and why?
- ? How does the audit committee assess the performance of the finance organization?
- ? How does the audit committee participate in the evaluation of the CFO? What kinds of evaluation criteria are important to the audit committee? Does the audit committee evaluate other finance staff?
- ? What role does the audit committee play in CFO succession planning? Does it provide input on selecting or developing other finance staff?
- ? How does the external auditor assist the audit committee in its interactions with the CFO and the finance organization?