Today's CFO: New Prominence and Relationship to the Board

By Hal Shear and
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The CFO is the company's chief accountant, reporting solely to the CEO and tallying numbers for the financial statements. But many top finance officers also have become their company's chief dealmaker or a business unit manager or both. Moreover, most of these senior money managers have a very significant relationship with the company's board of directors that board members no longer take for granted.

It is not uncommon today for the CFO of a large public company to structure complex financial transactions, manage one or more business divisions, and supervise the company's acquisition program, all while also overseeing an elaborate internal control and financial reporting system. The CFO is often the most prominent officer in the company next to the CEO, whether the organization is a public or private company or a not-for-profit organization.

Public company CFOs have special obligations. They have had to cope with the Sarbanes-Oxley Act's (SOX) financial accounting and corporate governance reforms in addition to their regular duties. Their counterparts who head the financial function in privately held firms and not-for-profit organizations have seen this wave of reform splash over their decks even in advance of new law and rulemaking by state legislatures and regulators. No CFO can hide from the reality of governance reform.

What follows is a discussion of five categories of tactics used by successful CFOs in response to the new duties and prominence of their posts. Those who routinely rely on the performance of a CFO to ensure their own success, such as a CEO, audit committee, general counsel, and directors, may do well to evaluate the activities of their finance chief in relation to these success markers.

Director Summary: The role of the chief financial officer has changed dramatically since the advent of increased internal controls scrutiny mandated by Sarbanes-Oxley. Ensure your CFO succeeds in the new role by hands-on knowledge, spotlighting risk, acting as a bridge between constituencies, being impartial, and aggregating financial information for dissemination.

Tactility and Immersion

Section 404 of SOX requires the principal executive officer and principal accounting officer to annually assess the company's internal control structure and procedures for financial reporting. To fulfill their new mandate, effective CFOs must carefully evaluate the steps they need to take to support their signature on the company's internal control certification. Indeed CFOs, whether in a public, private, or nonprofit company setting and regardless of the firm's size, should make internal control improvements a priority. While there are many ways for a CFO to get comfortable with the status of the company's control protocols, one important step is to have a better feel for the various functions of the organization. A CFO experiences this tactility when she:

- Drops in periodically and impromptu on meetings of management committees that oversee different functional areas of the organization
- Talks from time to time with the company's accounts payable clerk
- Visits the manufacturing floor or inventory site unannounced
- Communicates periodically with the finance officers of the company's most significant customers
- Flips through new order files on a sampling basis.

By immersing herself in the major functional areas of the organization—touching the business issues, tracing sample transactions, knowing the people and observing the culture of particular situations—a CFO reaches behind the numbers. This sensitivity and awareness

gives the CFO a better feel for the organization and enhances the prospect for spotting internal control weaknesses. Conversely, the intuition of CFOs who only crunch numbers and review financial reports day in and day out may be less acute than the financial officers who are imbedded in their company's business ebb and flow.

Directors can use tactility and immersion to expand their understanding of and comfort with the quality of a company's controls. While not at the level of the CFO, audit committee chairs and other board members can make sure to ask the right questions not only of the CFO in formal meetings, but with his or her direct reports formally and informally. Asking questions of a variety of high and low level managers gives a director a sense of the complexion of the organization; asking the follow-up question can be as important as making the first inquiry.

Risk Spotlighting

Successful CFOs cast an intense and canvassing light through multiple layers of their company. They have a rare perspective on the company's entire operation. Their job is to closely review financial reports and the internal control system, traversing many business areas of the enterprise. All of the risks affecting the organization funnel through the financial reporting process with the CFO at the helm, giving him a unique perspective regarding the risks jeopardizing the company's future success.

The other roving spotlight in the company is cast by the internal auditor, the role of which has changed dramatically. Until very recently, most internal auditors or outsourced internal audit functions were hired by and reported directly to the CFO, with almost no involvement by the audit committee. In recent years, thoughtful CFOs have established a new relationship with the audit committee, which has a role in the hiring, firing, and compensation of the company's internal auditor. The CFO can benefit from the intelligence gathered by the internal auditor as he searches for accounting irregularities.

At a minimum, the internal auditor will report directly or indirectly to the chair of the audit committee, and has unfettered access to the committee and the full board. CFOs who interact regularly with the audit committee will hear first-hand any concerns raised by the internal auditor about financial reporting and internal control systems. Access to this early detection system and prompt communication about impending system failures gives an alert CFO a jump-start in problem solving. Such attentiveness may save the CFO his position and the company from a financial reporting debacle.

The CFO's perspective on risk can be an invaluable resource to the board of directors and the CEO as well as other senior officers as they manage the company's affairs. The CFO may be in the best position to anticipate high-risk transactions and the adverse consequences of a changing external environment. But this know-how is only valuable if the CFO is communicating effectively with the CEO, the board, and other senior managers, and being kept informed by these same individuals about the company's initiatives. The CFO can serve as an important risk mitigation officer. The organization, however, starting with the board of directors and CEO, needs to evaluate whether its relationship with the CFO is optimal for this risk-control purpose and if not, alternatives should be considered. For instance, many boards are appointing a separate chief risk officer in order to emphasize the importance of this function within the company.

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Liaison and Resource

The CFO is often the hub in an organization with many spokes. The CFO will interact with the board of directors, the CEO, the audit committee, the company's general counsel, the internal auditor, the external auditor, and the heads of various lines of the company's business. Strong verbal and written communication skills are essential if the "hub" is to support the spokes effectively. Well-run organizations use the CFO effectively as a bridge between these various constituencies, and highly valued CFOs are trusted advisers to each of these individuals and groups. A CFO whose job duties are restricted to the financial reporting area often is not providing optimal benefit to the organization. On the other hand, CFOs who spend most of their time "doing deals" or running divisions may by necessity delegate financial systems and controls work to others with less than optimal oversight. This can create the potential for major risk-management weaknesses.

The board, the CEO and the audit committee in particular need to assess whether the company's CFO is providing optimal value to the organization as a liaison to the most important policymakers in the firm. Furthermore, the board and its senior business managers should be encouraged to use the CFO as a valuable resource, who in turn must provide value to those in need of support. Giving information and advice and, importantly,

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granting access to the CFO's broad network of contacts within and outside the company serves the best interests of the organization and should be a priority. A CFO who brings his risk management, accounting, finance, and business skills to a wide range of policymakers in the organization improves the company's chances for success.

Impartiality and Advocacy

In some matters a CFO needs to exhibit impartiality, such as when advising the CEO or the board on accounting matters. The ability to present both sides of an accounting or tax issue is important when the final determination is in the hands of those to whom the CFO reports. Blind advocacy of an accounting position that boosts earnings to the detriment of financial transparency, for instance, diminishes a CFO's credibility and can result in poor decision making by directors, an audit committee, or senior management.

In the new corporate governance regime, boards of directors, audit committees, and CEOs need to understand all sides of a financial accounting or disclosure issue so they can make an informed, reasoned decision. The CFO can and should be a trusted adviser in matters of financial reporting. There are other times, however, when the company wants the CFO to be a strong advocate for a position, such as when the CFO is negotiating an acquisition or advocating the merits of the company's legitimate position to the external auditors or regulators. Likewise, the CFO may be charged with negotiating an important supply contract, commercial insurance policy or D&O liability policy. No more is the simple low-cost option sufficient; CFOs must clarify liability coverage among and between the directors and officers. Knowing when to be impartial and when to take an advocacy stance is important. CFOs with good judgment and a light touch are highly valued members of a management team.

Information Aggregator

Financial and other information will naturally flow through the company's financial reporting function, which the CFO oversees, giving the senior finance officer access to a wealth of information that, if properly distilled and organized, can give direction to company policymakers. But the information has to be collected and processed by the CFO and shared with others.

The CFO, like the CEO, will interact with senior business managers of the company, the board of directors, vendors, and many outside service providers and customers. Effective CFOs find opportunities to educate themselves in many aspects of the company's business, including its future business prospects. This is a challenging task; the CFO's knowledge base often needs to cover areas of legal and regulatory danger as well as operational risk. In larger organizations the information aggregation function may be allocated among the CFO and other senior officers such as a general counsel and risk management czar. But in middle market and smaller organizations, the CFO may have very broad duties. There is reason to be cautious, however. Highly effective CFOs can find they are relied on too heavily by too many people in the organization and for too many projects. They can often become stretched too thin and their effectiveness can suffer. For these individuals a balance needs to be struck so that high performers can maintain their natural inclination to excel.

As companies place more emphasis on risk management and control, the board must ensure that the operational needs of the company get sufficient support. It is also important to recognize the need for CFOs to develop a candid and supportive relationship with the board of directors.

Conclusion

While a CEO may effectively rely on the "I didn't know" defense if his actions are scrutinized by the SEC in an administrative action or by a shareholder in court, the CFO, given her central role in the company's financial reporting and internal control function, by definition has reason to "know" about all material aspects of the company's operation. The burdens of the post in the new corporate governance environment mandate that CFOs re-evaluate how they do their job and maximize their performance. All interested parties, including the CFO and her management counterparts, will benefit from a periodic evaluation of the CFO's activities and responsibilities in the organization. Focusing on these tactics will enhance the CFO's and the company's performance. ■

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