

# Great expectations

## Boards want more from CFOs, and building strong ties to the audit committee is the foundation

August 2011

The CFO-audit committee relationship is under intense pressure in this crisis-driven, high-regulation business environment. Building an optimum working relationship requires focused effort on building trust, getting past the must-do's of regulation, and pushing a larger agenda.

Accounting scandals. Excessive risk. Bailouts. Meltdowns. Financial crisis. Because of all that has transpired in recent years, the relationship between chief financial officers and the audit committees of corporate boards is now among the most intense and heavily scrutinized in governance.

Audit committees and CFOs must work together more closely, more frequently, and more effectively—which demands altogether new levels of mutual respect, trust, and cooperation.

“The board expects the CFO to be the conscience of the company,” said Nick Rose, former CFO at Diageo in the UK and currently on the boards of BAE Systems and British Telecom. “The intensity and increase in regulation has meant that the relationship and trust between the audit chair and the CFO is more critical than it has ever been.”

The elevation of both halves of this partnership has been dramatic. Members of the audit committee, once an ill-defined and unappreciated assignment, have emerged as critical players in the new fiscal landscape. Audit chairs must have qualifications that include a high level of financial expertise. Likewise, CFOs—both in their own firms and outside—are finding their knowledge, understanding of risk, and analytical thinking in growing demand in the boardroom. A decade ago, few CFOs outside the UK had seats on boards. Today, CFOs around the globe are being recruited to be directors.

As both groups step to the forefront of governance, their collaboration must advance as well. Fortunately, veteran CFOs and audit chairs from Europe, the United States, and Asia all report positive new dynamics at work. But the most effectual partnerships between CFOs and audit committees don't simply happen. Rather, such relationships are deliberately cultivated.

Interviews with these veteran CFOs and audit committee chairs produced a list of best practices for enhancing this vital working relationship. Specific methods varied, but the principles transcended industry and geography. In order to achieve world-class outcomes, CFOs should:

**Have an owner's mentality.** View the business issues through an owner's lens, and own the results.

**Push past the must-do's.** Drive the discussion of critical issues beyond the prescribed regulatory requirements.

**Get your hands around risk.** Guide the enterprise risk management process hand-in-hand with the audit committee.

**Showcase the bench.** The whole finance team, not just the CFO, should be familiar to the board.

**Get familiar.** Actively develop personal relationships with the audit committee. This is one case where familiarity breeds confidence.

## The owner's mentality

"Great CFOs think and act like owners," stated Bob Grusky, founder of Hope Capital Management and a member of the audit committee on two publicly traded corporate boards. All directors are deeply committed to oversight on behalf of shareholders, but audit committee members particularly so—and they expect CFOs to embrace that mindset. World-class CFOs, Grusky said, "allocate capital based on risks and return, push

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the company to take actions that drive intrinsic value, and appropriately challenge other members of the management team, including the CEO, to avoid poor capital allocation decisions (with overpaying for acquisitions the usual suspect)."

CFOs who emulate CEO-level thinking have a far more powerful impact. When Christa Davies, Aon Corporation's CFO, arrived at the company four years ago, Aon was a challenging blend of hundreds of global acquisitions. Charged with creating a coherent whole out of the chaos, she and CEO Greg Case used the opportunity to simplify the firm as they built a business model based on organic growth, best talent, and margin improvement for what is now the leading global provider of risk management services, insurance and reinsurance brokerage, and human resource consulting.

“CFOs have to thoroughly understand the business, just like CEOs, including the environment and the industry’s competitive context. If you don’t, it’s very difficult to run your finance function in a way that adds value to the business – which is its primary objective,” Davies says.

That type of attitude impresses audit committees. Richard F. Wallman, former CFO at Honeywell and currently an audit committee member on several boards, says he sizes up the “DNA” of the CFOs he works with. “I am comfortable when the role is filled by an executive who pushes to make the business better and is an ally of the CEO in making tough decisions,” he said. “CFOs who address problems with solutions and act quickly are those I find the most qualified. There needs to be a very good understanding of the pulse of the business.”

## Push past the must-do’s

In this new global business environment, companies are focused on finding competitive advantage. And CFOs who enable the conversation beyond regulatory issues to concerns that actually drive the business toward increased profitability are going to be embraced by board members.

New regulations promulgated over the past decade “left an indelible imprint on audit committees and boards,” says Judy Lewent, formerly CFO at Merck and currently a director at GlaxoSmithKline, Thermo Fisher Scientific, and Motorola Solutions. In addition to ensuring that state-of-the-art compliance procedures are in place, she advocates that management, boards and audit committees take a business-driven view.

One question then becomes how to draft a more proactive agenda.

Chuck Noski, formerly CFO and now vice chairman of Bank of America, has been active on several boards and is audit committee chair at Microsoft. Noski advocates that audit committees complete an annual “self-assessment process” that sets the agenda for the coming year. It should, he said, include input from outside auditors and senior executives in the company, as well as with the finance team. Noski also solicits a review of his committee from the full board, and asks them to identify audit-related priorities. The result is both an evaluation of the past year and a clear agenda for the coming year that the CFO and audit committee can work from.

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**Richard F Wallman**  
Former CFO, Honeywell

## Get your hands around risk

Enterprise risk management (ERM) remains one of the priority topics in corporate governance today. The board has overall responsibility for ERM, but managing this risk process is often a shared responsibility between the CFO and the audit committee. This critical issue forces the partnership to be at its most effective.

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**Roy Templin**  
CFO, Whirlpool Corp.

The audit committee sees the finance function as “the guardians of the risk process” in its widest sense, explains Liz Doherty, the CFO at Reckitt Benckiser. As the “bank of the company,” finance has the best view on options around cash, going concern, liquidity, and other balance sheet concerns with risk implications.

Working together, the audit committee and CFOs must identify all the critical risks—often extending into operations, not just finance. Excellent formal communication, transparency, and openness are required to focus in on the most critical issues. Meantime, pressure on CFOs is mounting to provide mitigation options on every level.

“It is getting very complicated with various risks associated with each line of business,” says Jason Yao, CFO of the Ping An Group, a listed financial institution in Hong Kong. “Board members are concerned that the interaction amongst businesses might result in different risks and have a potential impact on the entire organization. They therefore expect more analyses and insights from the CFO to give them comfort.” It’s incumbent upon CFOs, he adds, to ensure that his team has the best qualifications to handle the distinct risk issues.

## Showcase the bench

Behind every great CFO is a world-class finance team. A key factor in a strong relationship with the audit committee is the level of trust with that whole group.

“My audit committee deserves and expects to consistently see the effectiveness of my full finance team,” said Roy Templin, CFO of Whirlpool Corp. “They know me and my capabilities, but also need assurance that the team’s breadth and depth of talent is strong. My team interacts with the board regularly throughout the year in several formal and informal settings.”

“It is highly important for audit committees to have regular exposure to the CFO and the finance team,” added Richard Simonson, lead director at

Electronic Arts and former CFO at Nokia. “Without the dialogue, there is an incomplete understanding of the business, strategy, challenges, and risks. It’s also important that perspectives of key finance staff be highlighted and discussed.”

For finance executives, such exposure to the board is not only crucial to the success of the company but it can impact career aspirations as well.

“There is no question that my heavy exposure to the board when I was treasurer was instrumental in their assessing me as the future CFO,” said one Fortune 500 CFO. “I attended all the finance committee meetings and presented topics to the audit committee. While they assessed me, it gave me the opportunity to understand the board dynamic first-hand, which also made my transition to CFO that much smoother. As a result of that precedent, I make sure to have members of my team have similar interactions.”

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## Get familiar

Though most boards and management teams prefer a “professional working relationship,” CFOs and audit committee members who developed some degree of personal relationship said they felt better prepared to work together toward a successful oversight.

Tim McLevish, audit chair at Kennametal and former CFO at Kraft, said a simple summer golf outing with management was remarkably effective for understanding the senior executives’ team dynamic. Judy Lewent said practices such as a “Director’s Day,” during which a board member schedules a one day meeting with members of management to review specific aspects of the business, provides a valuable addition to continuing director education. GE’s vice chairman and CFO Keith Sherin said that extended time spent with the board at events like the 2010 Olympics in Beijing gave both the board and management an opportunity to develop relationships outside meetings and presentations. “We got to know each other and our families in a setting that helps build long-term relationships and trust,” Sherin said.

Valuable relationships might also develop one-on-one. Jeff Henderson, CFO at Cardinal Health, benefited from working with a chair of the audit committee who is a former CFO. The audit chair became a mentor and

sounding board. “When I’m wrestling with an issue, I feel comfortable discussing it with the audit chair to help decide our options,” Henderson said. “Because this person understands these issues at a granular level, we can have open and honest discussions and thoroughly vet an important issue in a fairly informal way.”

“It is imperative that the CFO and the chair of the audit committee have a strong relationship... A ‘them vs. us’ environment is a recipe for trouble and conflict.”

**Kimberly Ross**  
CFO, Ahold

## Conclusion

By adopting these five approaches, organizations have reaped important rewards. A strong and practical rapport between finance teams and audit committees contributes to:

- > Alignment of strategic drivers of the business;
- > Lucid protocols for assessing and addressing enterprise risks;
- > Smoother governance and financial control practices; and
- > Prioritization of shareholder interests.

“The CFO is the temperature check to the board through the audit committee,” said Kimberly Ross, the CFO of Ahold S.A. (who will soon become CFO of Avon). “It is imperative that the CFO and the chair of the audit committee have a strong relationship. Continual dialogue that includes things not directly in the audit plan is much easier when the relationship is strong. A ‘them vs. us’ environment is a recipe for trouble and conflict.”

## Acknowledgments

Korn/Ferry thanks all the executives and board members who were interviewed for the creation of this paper.

**Peter Barker**

CFO, Computershare Ltd.

**Andrew Bonfield**

CFO, National Grid; Audit Chair, Kingfisher

**Kenneth Cambie**

Executive Director and CFO,  
Orient Overseas (International) Ltd.

**Nicholas Chong**

Executive Director and CFO,  
Li Ning Company Ltd.

**J. Michael Cook**

Former Chairman and CEO, Deloitte & Touche; Audit Chair, Comcast Corporation; Board Member, International Flavors & Fragrances

**Christa Davies**

Executive Vice President and CFO,  
Aon Corporation

**Liz Doherty**

CFO, Reckitt Benckiser

**Irene Esteves**

Executive Vice President and CFO,  
Time Warner Cable

**Rick Grellman**

Chairman, WHK Group

**Robert Grusky**

Audit Chair, AutoNation and Strayer Education; Board Member, AutoZone; Founder, Hope Capital Management

**Jeffrey Henderson**

CFO, Cardinal Health

**Robert Hombach**

Corporate Vice President and CFO,  
Baxter International

**Martina Hund-Mejean**

CFO, MasterCard;  
Board Member, Prudential Financial

**Mark Joiner**

Chairman, JBWere; CFO,  
National Australia Bank

**Peter Klein**

CFO, Microsoft

**Judy Lewent**

Board Member, GlaxoSmithKline,  
Motorola Solutions, and Thermo Fisher

**Christopher Liddell**

Former Vice Chairman and CFO,  
General Motors

**Timothy McLevish**

Former Executive Vice President and CFO,  
Kraft Foods; Audit Chair, Kennametal

**Vernon Moore**

Audit Chair, CLP Holdings; Executive Director,  
CITIC Pacific Ltd.

**Charles Noski**

Vice Chairman and former CFO, Bank of America; Audit Chair, Microsoft

**Jeffrey Obermayer**

CFO, Johnson Electric Holdings Ltd.

**Nick Rose**

Board Member, BAE Systems and British Telecom Group; former CFO, Diageo

**Kimberly Ross**

CFO, Ahold; becoming CFO and Executive Vice President of Avon in fall 2011

**Keith Sherin**

Vice Chairman and CFO, GE

**Richard Simonson**

CFO and President, Business Operations, Rearden Commerce; Board Member, Electronic Arts and Silver Spring Networks

**Roy Templin**

Executive Vice President and CFO,  
Whirlpool Corp.

**John Thorn**

Audit Chair, National Australia Bank, Amcor, Salmat and Caltex Australia

**Doreen Toben**

Audit Chair, Liz Claiborne; Board Member, New York Times Co. and Virgin Media; Former CFO, Verizon

**Phil Twyman**

Audit Chair, Perpetual Limited and Insurance Australia Group

**Richard Wallman**

Audit Chair, Convergys, Dana Holding Corp, and Tornier NV; Board Member, Ariba Inc., Charles River Labs, and Roper Industries

**John Wulff**

Audit Chair, Moodys; Board Member, Celanese, Chemtura, and Sunoco

**Jason Yao**

CFO, Ping An Insurance



E. Peter McLean, Chairman of Korn/Ferry International's Global Financial Officer Center of Expertise.



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Margaret Lee, Vice Chairman of the Financial Officer Center of Expertise, based in Hong Kong.



##### South America

Jorge Maluf, senior client partner based in Sao Paulo.

Additional contributions from **Clare Metcalf**, a senior client partner in Chicago specializing in the consumer/retail market.

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