THE CFO AND THE AUDIT COMMITTEE

71% SAY AN AUDIT COMMITTEE CAN DETERMINE THE JOB SUCCESS OF A CFO
THE CFO AND THE AUDIT COMMITTEE

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EXECUTIVE SUMMARY

According to a recent survey of Canadian financial executives, including Financial Executives International Canada (FEI Canada) members, more than 90% of respondents reported the CFO of their organization had an excellent relationship with the company’s audit committee, a relationship that is based on trust and transparency, among other things. In addition, 69% of respondents were happy with the approach of their audit committees, reporting the committees are neither over-involved nor under-involved. Meanwhile, 83% disagreed with the suggestion that the CFO has an ‘us versus them’ relationship with their audit committee.

The CFO and the audit committee comprises the results of an online survey of financial executives, some of whom have also served on audit committees. These results were combined with insights gathered during a round-table discussion of senior financial executives. This Canadian Financial Executives Research Foundation (CFERF) report is sponsored by KPMG LLP.

The study also shows that increasing concerns around risk management and turmoil in the capital markets are driving changes in the dynamics between audit committees and CFOs. Scrutiny of management performance in the boardroom seems destined to increase, as vigilant and involved directors are driven by heightened benchmarks in accountability and transparency, in addition to risk and market forces.

According to survey results, 92% of respondents say greater concerns around risk management are expected to increase demands on the audit committee in the next 24 months, which will in turn translate into higher pressure on CFOs, while 83% cited greater turmoil in the capital and debt markets as a factor. The organizations expected to be at the forefront of increased demands on audit committees include accounting standards setters and securities regulators.

Despite this increased scrutiny from the audit committee, overall, financial executives are confident when fielding tough questions and engaging in difficult conversations at audit committee meetings. A majority also agreed that their audit committee members request information in a reasonable time frame.
The study shows that CFOs need to help board directors, and audit committee members in particular, better understand organizational challenges while demonstrating the fortitude to withstand the inevitable tensions arising as a result of oversight of their performance by the audit committee. CFERF’s *The CFO and the audit committee* attempts to explore the current state of the relationship between the two and how CFOs communicate in order to assist the audit committee in fulfilling their agenda effectively.

The nature of the CFO-audit committee relationship is clearly of strong interest to financial executives. In fact, 71% of survey respondents say that the audit committee can determine a CFO’s job success. In response to open-ended questions, executives gave detailed accounts of their views of the roles and responsibilities of the CFO and the audit committee members.

Successful audit committee relationships feature trust, respect, professionalism, collaboration, openness and transparency. Communication should be frequent and regular, and in addition to face-to-face meetings, the relationship should allow for comfortable access by phone or email as needed. Although some informality is encouraged by respondents to foster an open dialogue, some stated personal friendships would not be appropriate and could in fact compromise the independence of the audit committee member.

Survey respondents said CFOs can do the following to assist audit committees:

- Try to think like a CEO by working to understand all aspects of the business rather than focusing only on finance.
- Bring a holistic, integrated perspective – including operations issues – towards managing enterprise risk to the audit committee table.
- Respond as quickly as possible when the audit committee raises an issue or question, and make their concerns a top priority.
- Take the shareholders’ mindset when examining issues relevant to the business and agree to expand discussion and debates at the audit committee table beyond compliance and regulatory issues.
Likewise, the audit committee and its chair should:

• Have a good technical knowledge of finance and accounting.
• Take the time to thoroughly absorb information between meetings.
• Offer positive, not adversarial feedback, yet push for continuous improvement.
• Give the CFO adequate time to obtain answers to queries.

The mandate of the audit committee should be clear, with well thought out agendas and objectives for the year.

Like any relationship, it would be ideal to have a two-way exchange between CFO and audit committee, based on a free flow of information, as well as mutual trust and respect. This comfort level must be balanced with the need for maintaining enough distance that the quality of the CFO’s data can still be critically assessed and tested.

RESEARCH METHODOLOGY AND DEMOGRAPHICS

The CFERF research study *The CFO and the audit committee* highlights the perspectives of senior financial executives, from public and private companies, who have shared their insights into the relationship between CFOs and audit committees. For more demographic information, please see Appendix A.

While the primary focus of the study is to review financial executives’ experiences of interacting with audit committees, it also offers some perspectives from financial executives who have also served on audit committees. The study was prepared based on the results of an online survey of 199 financial executives from November 16 to December 17, 2011, representing a cross-section of Canadian industries and sectors, and the views of a group of financial executives who attended a research forum on January 26, 2012.
THE ROLES AND FUNCTIONS OF THE AUDIT COMMITTEE

OVERSIGHT

For years, corporate directors were seen as being most effective when following the so-called “nose in, fingers out” philosophy. In other words, directors were supposed to provide oversight at a high level, but not actually usurp the manager function of operating the organization.

Canadian boards continue to adapt to a brighter public spotlight, first triggered by the passage a decade ago of the Sarbanes-Oxley Act in the U.S. and its Canadian Securities Administrators’ counterpart, National Instrument 52-109: Certification of Disclosure in Issuers’ Annual and Interim Filings, which charged boards specifically with the duty of risk oversight. This was combined with an overall increase in scrutiny following the recent financial crisis of 2007-2009.

Audit committees in Canada and the U.S. must now comprise directors who are both financially literate and independent. In the U.S., companies must disclose that they have at least one audit committee financial expert, and if they do not, they must explain why. Financial executives say that these evolving expectations of boards and their audit committees from external organizations – from securities regulators as well as standard setters in accounting and auditing – will continue to result in increased pressure on CFOs (see Chart 1).

Along with the goal of increasing transparency for the benefit of investors perusing financial statements, helping to restore confidence and stabilize the capital markets, audit committee members are also motivated by personal liability. These increased expectations may cause some audit committee members to actually adopt a “nose in, fingers in” philosophy, if not all the time, at least during times of management upheaval, increased risk, or particularly challenging times.

Other factors are shaping expectations of audit committees, and by extension, CFOs, including greater concerns around risk, cited by 92% of survey respondents, and turmoil in the capital and debt markets (83%).
Directors who will be held accountable for their decisions must be prepared to take the initiative when it comes to being informed. Gone are the days of figure-head directors, or those who rubberstamp documents for fear of being seen to be asking ‘dumb’ questions. That is to say, all these changes may result in the perception by management that directors are digging fingers into the management pie.

It can be argued the board members most sensitive to following the enhanced rules of governance may be found on the audit committee. They must be meticulous as they examine disclosures, among other duties. Survey participants expect audit committee testing and interrogation to increase as a result of greater concerns around, for instance, accounting standards setters (87%).

The board, the audit committee, senior management, the internal auditor, and the external auditor – all are seeing their roles evolve, as the bar for performance is raised by investors, securities regulators, compliance bodies, self-regulatory organizations and accounting standards setters. In particular, audit committee members are seeing an increase in director liability and more pressure from activist shareholders and other stakeholders.

“...It’s important to be involved as an audit committee member. I totally agree you’ve got to have your nose in. But what if your nose tells you something’s wrong? Can you afford to keep your fingers out at that stage? Then the question is: ‘What’s the duty of the audit committee to make sure that’s fixed?’ They can’t just step back and say: ‘Well, go fix it.’ I think there’s a level of involvement and that’s when you are going to get your fingers into it.”

Laurie Tugman – former CEO of Marsulex Inc.; current member of Pinova Inc. audit committee, a U.S. specialty chemical business controlled by private equity concerns.
THE ROLES AND FUNCTIONS OF THE AUDIT COMMITTEE: OVERSIGHT

CHART 1 - INCREASED DEMANDS ON AUDIT COMMITTEES FROM THE FOLLOWING ORGANIZATIONS WILL CREATE MORE PRESSURE ON THE CFO OVER THE NEXT 24 MONTHS

Accounting standards setters
- Strongly agree: 32%
- Agree: 55%
- Neither agree nor disagree: 12%
- Disagree: 1%
- Strongly disagree: 1%

Securities regulators
- Strongly agree: 26%
- Agree: 49%
- Neither agree nor disagree: 22%
- Disagree: 2%
- Strongly disagree: 1%

CPAB: Canadian Public Accountability Board
- Strongly agree: 6%
- Agree: 33%
- Neither agree nor disagree: 33%
- Disagree: 3%
- Strongly disagree: 1%

Lenders and note holders
- Strongly agree: 14%
- Agree: 47%
- Neither agree nor disagree: 34%
- Disagree: 1%
- Strongly disagree: 1%

Canadian Revenue Agency
- Strongly agree: 6%
- Agree: 60%
- Neither agree nor disagree: 29%
- Disagree: 1%
- Strongly disagree: 1%

PCAOB: Public Company Accountability Oversight Board (U.S.)
- Strongly agree: 5%
- Agree: 65%
- Neither agree nor disagree: 23%
- Disagree: 6%
- Strongly disagree: 1%
THE CFO AND THE AUDIT COMMITTEE

The reporting relationships between the various parties involved in corporate governance are changing. In the past, for instance, a CFO might have been the primary or even only contact for an external auditor. Audit committee members may have focused on debating external audit fees. Nowadays audit committee members will find their direct contact with the external auditor has increased significantly. In fact, the external auditor’s engagement letter is now signed by the audit committee chair, not the CFO. In the past, a CFO might have reported only to the CEO. Today, some CFOs find themselves doing joint-reporting to both the CEO and the audit committee, allowing, at least in theory, for more independence for the CFO.

When asked about the main focus of audit committees, survey respondents said the topics most frequently addressed other than risk included: financial reporting (cited by 91% of respondents), compliance to regulatory requirements (62%) and cash flow/liquidity (49%). Secondary concerns included cost management and capital structure.

The audit committee depends on the CFO for independent insight into the financial workings of the organization, to put financial results and risk assessments in context (what do the numbers mean, and why? Are these sales forecasts realistic?) The CFO and additional senior finance staff are needed to translate technical information such as the application of accounting principles. The challenge is to present the information in a way that can be digested by non-financial directors, just as a CFO would report information to a CEO with a non-finance background. Ideally, the CFO offers a regular flow of information to the audit committee, indicating positive trends or bad news, so that members are not surprised at meetings. Audit committee members appreciate red flags from CFOs.
Greater turmoil in the capital and debt markets

Activist shareholders

Greater concerns around risk management

Threat of double-dip recession

Globalization

CHART 2 - FACTORS THAT WILL INCREASE DEMANDS ON AUDIT COMMITTEES CREATING MORE PRESSURE ON THE CFO IN THE NEXT 24 MONTHS
AUDIT COMMITTEE RESPONSIBILITIES

Risk

Financial executives were divided as to who has the ultimate responsibility for risk, a hot topic for audit committees. Although risk is clearly a board responsibility, its complexity may result in its diversion to the audit committee. The complexity drives the board to rely on the audit committee to do the research, ask hard questions, make recommendations and report back to the board.

Risk was seen as mainly a board responsibility by 42% of respondents, and at the research forum, this concept found resonance with governance experts such as William Swirsky, a corporate director and a retired Vice President of Knowledge Development at the Canadian Institute of Chartered Accountants (CICA). Meanwhile, 36% of survey respondents said risk was a responsibility shared equally by the board and the audit committee. Only 22% said risk was mostly an audit committee responsibility.

While risk is often seen as an area under the realm of finance, it remains the responsibility of the entire board since it encompasses all aspects of a business, observed Carl Gauvreau, former CFO of Hartco Inc., who has served as a director on a small company audit committee and has dealt with board directors at Hartco and as a senior financial executive at Quebecor World. Risk includes security, environmental, political and other issues, said Brian Gabel, CFO of the Greater Toronto Airports Authority.

“Our audit committee’s view is that the committee’s mandate with respect to enterprise risk management is to ensure that there are adequate processes in place to identify and report on risks to the board. The board’s role is to understand the potential risks and the impact on the organization and to ensure that there are mitigating strategies in place where possible to minimize these risks.”

Gord Nelson – CFO, Cineplex Entertainment

It’s natural for boards to delegate some work in the area of risk to Audit Committees due to members’ skill sets, observed Isabel Meharry, CFO of Green Shield Canada. “The board owns everything and they can choose to delegate any area to a committee. In our
company, we delegate the ERM (enterprise risk management) to the audit committee. So they do the detailed legwork, but of course it goes up to the board and the major risks are discussed at the board.”

Another factor that can cause the board to delegate more responsibility to the audit committee is the size of the board itself, said Laurie Tugman, who holds a dual perspective as both the former CEO and President of Marsulex Inc. and a board member of Pinova Holdings Inc. “The bigger the board gets, the more likely it is going to be relying on committees,” Tugman said. “A smaller board will simply use the committee to make recommendations to the board (for a final vote),” he said. He compared his experience sitting on the small board of Pinova, a chemical company owned by TorQuest Partners, a Canadian mid-market private equity firm, with serving on the larger, 20-member board of the Chemistry Industry Association. “You can’t hide with only seven people on the board.”

Of course, boards by their nature must delegate significant work to all their committees, observed John Glicksman, EVP and CFO of PowerStream Inc. “It doesn’t mean important topics are not discussed at the board, depending on the issue, but there is a very strong reliance that the committees have done their analysis of the issues before they come up to the board.”

Lesley Gallinger – VP of Corporate Services and CFO of the Electrical Safety Authority

“Boards need to make sure there isn’t a gap or a blind spot.”

Victoria Davies – CFO, Knightsbridge
THE CFO AND THE AUDIT COMMITTEE

Financial statements

The primary area of focus of Audit Committee, according to 91% of financial executives surveyed, is the oversight of financial reporting (see Chart 3). Isabel Meharry, CFO of Green Shield Canada, said financial statements will always come first for audit committees. “That’s the reason audit committees came into existence,” she said. Compliance with regulatory requirements was identified as the second most pressing concern for audit committees, cited by 62% of survey participants, followed by cash flow/liquidity (49%), cost management (28%) and capital structure (26%).
RESPONSIBILITIES OF THE CFO

How can the CFO help the audit committee in carrying out its responsibilities effectively? Responding to the concerns of audit committees should be a top priority for CFOs, according to the vast majority (90%) of financial executives surveyed (see Chart 4). The CFO should be prepared to respond to queries, with specific examples to illustrate answers. If the answer isn’t known, the CFO should admit this and get the information as quickly as possible.

The CFO can assist by being easy to reach between meetings; taking the initiative to reach out to the audit committee rather than waiting to be contacted. For instance, CFOs may consult the audit committee before an important decision which could have a material impact, or take time to educate audit committee members about major changes in accounting policy decisions.

Respondents were almost unanimous (97%) that the CFO should act like a CEO by working to understand all aspects of the business beyond finance. The CFO should also consider the perspective of the company owners when analyzing the business and making decisions, according to 85% of respondents. At the audit committee table, they should expand the discussion beyond compliance and regulatory matters, and embrace a holistic, integrated perspective on risk management, most executives agreed.

“"I’m finding the increasing complexity of information and disclosure is causing other members of management and non-financial board members to just block it off and not deal with it. We’re moving towards simpler non-GAAP financial and operational metrics. I’m finding that this is also true for existing and potential investors.”"

Gord Nelson – CFO, Cineplex Entertainment

“"For a number of years, we actually held combined audit committee/board meetings. Prior to, and through the IFRS transition, the board was well versed in the accounting and disclosure issues.”"

George Chiarucci – CFO, Prism Medical Ltd.
The CFO and the Audit Committee

Chart 4 - Survey Respondents Rated Their Agreement with the Following Statements

- The CFO should take the company owner’s perspective or shareholder mindset when s/he examines issues relevant to the business.
  - Strongly agree: 41%
  - Agree: 44%
  - Neither agree nor disagree: 12%
  - Disagree: 2%
  - Strongly disagree: 1%

- The CFO should try to think like a CEO by working to understand all aspects of the business rather than focusing mainly on finance.
  - Strongly agree: 65%
  - Agree: 32%
  - Neither agree nor disagree: 3%
  - Disagree: 2%
  - Strongly disagree: 1%

- The CFO should try to expand discussion and debates at the audit committee table beyond compliance and regulatory issues.
  - Strongly agree: 49%
  - Agree: 37%
  - Neither agree nor disagree: 9%
  - Disagree: 4%
  - Strongly disagree: 1%

- The CFO should respond as quickly as possible when the audit committee raises an issue or question, and make their concerns a top priority.
  - Strongly agree: 50%
  - Agree: 40%
  - Neither agree nor disagree: 8%
  - Disagree: 1%
  - Strongly disagree: 1%

- The CFO should bring a holistic, integrated perspective – including operations issues – towards managing enterprise risk to the audit committee table.
  - Strongly agree: 64%
  - Agree: 31%
  - Neither agree nor disagree: 2%
  - Disagree: 3%
  - Strongly disagree: 1%
LEVEL OF INVOLVEMENT

Most survey respondents (69%) are happy with the approach of their audit committees, and report they are neither under-involved nor over-involved. A minority (14%) report the committee is somewhat hands-on, and the same percentage (14%) state their committee is somewhat hands-off and under involved. A small minority are seen as either overly involved (2%) or extremely under involved (1%). Most respondents (83%) disagreed with the notion that there is an “us versus them” relationship between the CFO and the audit committee.

“Audit committees today are getting good at oversight. One of the things we often overlook today is insight. So when I look at the board or the audit committee – obviously they have a fiduciary role in terms of oversight – but given their background and their skill level, I really appreciate their insight. I don’t see this as meddling. If you’ve got the right people with strong backgrounds, their insights can be invaluable. It’s always good to hear thoughts from smart people.”

Isabel Meharry – CFO, Green Shield Canada

Directors need to understand when ‘nose in, fingers out’ is enough and when it is necessary to insert themselves more fully into the management of a company. The importance of strong, competent directors is critical to good governance.

Todd Buchanan – National Leader, Accounting Advisory Services, KPMG LLP

Audit committee members are usually veteran business people offering not just oversight but insight, wisdom and advice. Sometimes the CFO may actually seek out more involvement from the audit committee, said Mark Donaghy, vice president with SCiAN Services Inc., who found that non-financial risks were the most bothersome. “I can quickly get over the financial structures, it’s the things that are not nearly as easily measurable but still fall in that risk profile that keep me awake at night,” he said.
1) Perceived over-involvement by audit committee members in minute details

There are several possible drivers of perceived over-involvement by audit committee members, starting with the brighter spotlight on accountability and transparency for public companies. Accountability for audit committee members is the new normal, although expectations depend on whether an organization is not-for-profit, government, private, or publicly listed. The perception of over-involvement may also be the result of internal management issues, noted Vic Wells, a former CFO who has experience on several public company audit committees. “Part of it depends on not only the maturity of the organization, but also on the skills and experience of the CFO. Not all CFOs are created equal,” he said. “Sometimes you have to be more involved than other times, so it depends on the maturity of the organization. The skill and experience levels are also something that have to be considered and determined by the chair of the audit committee.”

“...You’re hoping you have an audit committee that represents very strong leaders – people who have very broad business experience – but they can have a fascination with some issues beyond their scope and that’s just human nature. It typically can work very well, but there’s always this risk of engaging yourself to a degree that you don’t need to be engaged. Obviously the audit committee and the board are not trying to be management, but they can venture down some rabbit holes.”

Brian Gabel – CFO of the Greater Toronto Airports Authority
To keep members focused, it helps to have sharply defined governance guidelines, said Alysia Carter, who communicates regularly with the audit committee of Ainsworth, Inc., a privately-held company where she serves as Vice President and CFO. “We have mandates for the board and audit committee. It works well, such that you have a clear layout of what the requirements are – where they will provide guidance or dive in when necessary. And there are instances where at times they do need to dive in, but once those questions have been addressed, then you can back away and carry on with what’s listed in the mandate.” Carter puts copies of the audit committee and board mandates inside briefing binders members receive before meetings and annually all mandates are reviewed and approved according to the yearly planning calendar.

If audit committee members are overly engaged, it’s difficult to go to the audit committee chair for assistance unless the chair is in agreement. “It’s also a dangerous and fine line to start pushing back to the chair if that chair is not sensing the same level of over engagement,” said one CFO at the forum. “I’ve experienced it in both divestitures and acquisitions, where we’re being, as management, asked to do layers and layers of analysis by a committee member but the chair might not be aware of it.”

“\textit{It takes a focused chair, with a disciplined agenda – timelines assigned to discussion points to ensure that you navigate through the requirements of the meeting and don’t move off topic. For us it came down to working closely with the chair on agendas and timelines to ensure that we got through everything that we needed to do.}”

\textbf{Gord Nelson – CFO, Cineplex Entertainment; serves on a hospital audit committee}
2) Difficulty in identifying priorities, developing consistent perspectives

Sometimes competing interests will send audit committee members in different directions as they seek to make the “right” decision or recommendation. Although public company directors must ultimately represent shareholder interests, different committees on the same board may take different perspectives on an issue, according to Brian Gabel, CFO of the Greater Toronto Airports Authority, a non-share capital, not-for-profit corporation. “Our mandate is to create value within the community. Through one lens, there’s an environmental sustainability issue for the enterprise. Through another lens, there’s a concern that we maximize economic value for the community’ ... The board has to have these vehicles to assist in reconciling those different points of view,” he said.

“Transparency between the CFO and the chair is important. Make sure that you have good open communication; that you’re transparent, so all the issues are put on the table. Sometimes you may want to discuss some of those issues ahead of the committee meeting with the audit committee chair, concerning how to approach them, within the committee, to make better use of the time of the members and be proactive with that respect. That’s what has worked for me over the years.”

Carl Gauvreau – Former CFO, Hartco Inc.
3) *Weak, under involved audit committee*

Board directors are recruited for a wide range of reasons, some of which can lead to real or perceived under-involvement with an organization’s affairs. Some are personal contacts of company founders or management, or they are appointed as high-profile “figure head” members, not necessarily because of their credentials, skills or experience.

Audit committee members may be challenged by the realities of financial and accounting complexity, or are timid about asking questions, particularly if they are not financial experts. Others think they should know better and are reluctant to endanger their image as a seasoned business veteran by asking a “stupid” question.

> “We learned early as auditors that there is no stupid question in auditing. And somehow, even as a CA or FCA, we sometimes tend to forget how important that little mantra is. Ask the stupid question, because you never know what that’s going to uncover.”

*William Swirsky – corporate director; former VP of Knowledge Development at the CICA*

CFOs can ensure information divulged is accessible, clear and easy to understand. Financial executives might also consider following the lead of one of their colleagues who felt the company audit committee was weak and actually requested that the bench strength be improved, for the benefit of the organization. Suggest that more than one member of the audit committee, not just the chair, be a financial expert (e.g. have a finance or accounting designation). “I felt we were light on our audit committee,” said the CFO and forum participant. “So I spoke to the chair of the board and asked would they put focus on that in the recruitment, and they did. This is an opportunity. You don’t want to be running the show. If you feel that the quality isn’t good enough, you very discreetly try to get that,” the CFO said.
THE CFO AND THE AUDIT COMMITTEE

THE CHARACTERISTICS OF A STRONG RELATIONSHIP

An overwhelming number – more than 90% – of survey respondents reported their CFO had an excellent relationship with both the chair and members of the company’s audit committee. Two-thirds of respondents also agreed that getting to know audit committee members and the chair on a personal level improves the relationship, although there a significant number who were neutral on the topic, or disagreed (see Chart 5).

Most survey respondents agreed directors are experiencing an increase in pressure, which is translating to more pressure on CFOs. Overall, they said, company CFOs are confident when fielding tough questions at audit committee meetings. A majority also agreed that the audit committee at their company requests information in a reasonable time frame.

CFOs and audit committee members have good reasons to work collaboratively. The audit committee can determine a CFO’s job success, according to most survey respondents, and a good relationship can boost CFO retention, most agreed. The committee relationship can also be enhanced if senior staff accompany the CFO to meetings. According to 63% of survey respondents, the presence of the controller at meetings may enhance the CFO-audit committee relationship, followed closely by the presence of the VP Finance (60%). According to 85% of survey respondents, the presence of staff serves to support the CFO, and 83% said it presents a training and development opportunity to the finance team. Seven in ten note finance team members can offer additional details, and their presence can highlight the bench strength of the team. Conversely, seeing the audit committee dynamics in action can help the finance team understand the external demands on the CFO, 67% agreed.

Trust and communication were repeatedly cited by executives who participated in both the survey and the research forum. Steady, reliable two-way communication – with the opportunity to touch base between formal meetings – was seen by many as necessary for the smooth functioning of the CFO-audit committee relationship. “In terms of relationships between board committees and management, it really has a lot to do with the level of trust and communication between the two groups,” said George Chiarucci, CFO of Prism Medical Ltd. “If there is a situation where the audit committee is
not happy with the CFO, it becomes a very difficult situation to manage and you’ll have these confrontational relationships that people sometimes exhibit.”

**CHART 5 - SURVEY RESPONDENTS RATED THEIR AGREEMENT WITH THE FOLLOWING STATEMENTS**

The CFO at my company has an excellent relationship with:
- the **members** of our audit committee.
- the **chair** of our audit committee.

Getting to know **members**...
...of the audit committee on a personal level – improves the CFO-audit committee working relationship.

Getting to know the **chair**...

![Pie charts showing survey responses](chart5.png)
THE CFO AND THE AUDIT COMMITTEE

Communication should be frequent and regular, and in addition to face-to-face meetings, the relationship should allow for comfortable access by phone or email as needed. Although this informality is encouraged by respondents to foster an open dialogue, some stated developing personal relationships would not be appropriate and could in fact actually compromise independence. One executive expressed concern that boards, and by extension, audit committees, tend to be filled with friends of company founders who find candidates based on personal connections and who seem like a “fit.” This can lead to an overly close atmosphere that can interfere with objectivity, resulting in “too much” trust and not enough distance.

“It can get too cozy. There are lots of boards that are made up of supporters of the business and obviously, some of these directors are on the audit committee,” said Victoria Davies, CFO of Knightsbridge. “A board has to be careful about not only how it is put together, but how the audit committee is sourced, so that there is not too much trust in what’s going on.”

Conflict resolution

When conflicts arise, open dialogue and disclosure is key to a speedy resolution, executives said. “It’s rare that conflicts can’t be resolved with additional analysis to support recommendations,” one participant stated.

Many participants said conflict resolution is not a problem, as issues are resolved before they get to the audit committee stage. The key to managing conflict is prevention, by avoiding surprises. Another participant suggested the process would involve discussion amongst the CFO, CEO and audit committee, and potentially the external auditors (depending on the issue), while the Chair of the Board might be the final arbiter. Another alternative might be to send the matter before the entire board of directors. Others said conflicts would get worked out at the committee level and said the CEO would only get involved in an extreme situation.
The **CFO** is confident fielding tough questions and difficult conversations at audit committee meetings.

Increasing pressure on directors has translated into more pressure on **CFOs**.

A good relationship between finance staff and the audit committee can boost **CFO** retention.

An audit committee can determine a **CFO's** job success.

The **CFO** is able to meet all the demands of the audit committee.

The audit committee demands information or answers in a reasonable time frame.
THE CFO AND THE AUDIT COMMITTEE

THE ROLES OF THE INTERNAL AUDITOR AND CEO

The internal auditor offers key insights into areas overseen by the audit committee. For instance, the internal auditor assesses whether an organization’s controls and enterprise risk management programs are efficient and effective.

Since the internal auditor serves both management and the board, financial executives had mixed views about the function and reporting structure of the internal auditor. In order to be successful and as impartial as possible, the internal auditor must retain organizational independence.

Some stated the internal auditor should report administratively to the CEO and audit committee. But others said the CEO might not have the time, or want to take the time, to meet with the internal auditor, and that this person should report administratively to the CFO, and formally to the audit committee. “I have found as an internal auditor working for the CFO, especially if you have a CFO who wasn’t territorial and who wasn’t defensive and was willing to improve areas, I found it so much more helpful than working for the CEO. But you do have to have that contact with the CEO,” said Isabel Meharry, CFO of Green Shield Canada, whose head of internal audit reports to her.

Proponents of the internal auditor reporting to the CEO pointed out that since the internal auditor is in effect second-guessing the finance function, it is perceived to be a conflict for the internal auditor to report to the CFO. This is the practice that has been adopted by the federal public service, said Michel Cavallin, VP of Corporate Services and CFO of the Canadian Nuclear Safety Commission, a quasi-judicial regulatory body. At the nuclear safety commission, the internal auditor reports to the corporate secretary. The internal auditor has regular scheduled meetings with the CEO. “It’s not to shoot the breeze,” Cavallin said. William Swirsky, a former audit committee chair at the Ontario Teachers’ Pension Plan, who teaches corporate governance at the Director’s College at McMaster University, said the CEO is obliged to listen to the head of internal audit. According to Swirsky, if the internal auditor is requesting a meeting, the CEO should know it’s important. He agrees reporting to the CFO would pose a conflict. “Why are you double checking what the CFO is supposed to do, if the CFO is your boss?” he said.
The internal auditor can’t report to anybody in management because you could have a conflict of interest. Just think about fraud. The internal auditor will do an investigation and management will be completely out of it and that’s the best way to handle the situation. The role of the internal auditor is not to manage risk. It’s to report that the controls are working as they are supposed to work, and maybe offer some recommendations to improve the cost model of the controls and their effectiveness.

Carl Gauvreau – Former CFO, Hartco Inc.

Similarly, the CFO has a dual reporting relationship to the CEO and the audit committee, although most respondents agreed the CFO is responsible for reporting to the CEO first (see Chart 7). Interestingly, survey respondents said CFOs are more likely to find support from their CEO when facing tough questions from the audit committee, than they are to find support from the audit committee when faced with challenging requests from the CEO.
THE CFO AND THE AUDIT COMMITTEE

THE ROLE OF THE EXTERNAL AUDITOR

Generally, financial executives had a positive view of the role of the external auditor. More than three-quarters said the external auditor is helpful in explaining finance issues to the audit committee, and even more (89%) said the three-way relationship between finance, the external auditor and the audit committee works well. That said, this could be in part because most CFOs said they settle their differences with the external auditor before the audit committee meeting (84%). The external auditor was seen by about half (52%) of those surveyed as offering insights into the industry or sector in which the business is functioning, and was not seen by the majority of respondents as “complicating” matters (slightly more than one in three (35%) said this, and more respondents disagreed than agreed with this statement). The audit committee was not seen by most as helping in negotiating the fees of the external auditor (see Chart 8).

The presence of and requests from the external auditor can feel like a burden to finance staff. But the CFO can set a positive tone by reassuring employees, management and directors alike that the auditor is not engaged in a “witch hunt,” and the checks are diagnostic in nature, said Mark Donaghy. “The CFO can get right to their team and say, ‘look, this is really not a big deal, they’re checking to make sure we do what we say.’ And that personal touch really changes the nature of the relationship.”

Because the CFO and external auditors normally work out their differences prior to the audit committee meeting, the relationship may appear more cozy than it is – at least from the perspective of the audit committee, said Isabel Meharry, CFO at Green Shield Canada. “Sometimes I wish the audit committee members could be a fly on the wall when we are in tough discussions with the external auditors so they could see that it’s not nearly as cozy as it appears.” she said.

CFOs have had to adapt to a change in the relationship with their auditors; in the past they could contact the external auditor for accounting advice. Now some firms tell their clients they must hire a competitor for accounting advice, several CFOs complained. While audit firms can and do provide a wide range of services to their audit clients, there are situations where this is necessary to maintain auditor independence, observed Todd Buchanan, National Leader, Accounting Advisory Services, KPMG LLP: “We can’t be the doer and the reviewer,” he said.
The external auditor is helpful in explaining finance issues to the audit committee.

The external auditor can complicate matters.

The audit committee facilitates the fee negotiation process.

We always ensure that differences with the auditor are settled before the audit committee meeting.

The three-way relationship between finance, the external auditor and the audit committee works well.

The external auditor provides insights and views into your business and sector.
THE CFO AND THE AUDIT COMMITTEE

The relationship between the audit committee and the external auditor may be more arm's length, and tinged with anxiety on the part of the directors, who bear the fiduciary responsibility of signing off on the financial statements.

“My experience is nobody wants to come to grips with audit planning reports or the boiler plate of engagement letters,” observed William Swirsky. “The engagement letter is passed by the CFO ... and usually it may elicit a ‘wink, wink, nod, nod’ response. Sometimes I wonder whether we should go seek outside counsel and say, ‘Okay, if I sign this, what am I missing’?”

When asked what issues arise as a result of the auditor reporting to the audit committee while working with management, many survey respondents simply replied that there were none. One respondent observed that an open and strong relationship between all these parties is very important. “Financial reporting decisions are often not clear and significant discussion of the alternatives, under the specific circumstances, must take place,” the survey participant said. “The experience of all these groups in dealing with similar issues is very important. At the end of the day, the external auditor must have an independent view of the conclusions reached. If positions are fully discussed and understood, all the parties can take comfort that the appropriate process has been followed.” Another participant said there should not be any issues since roles and responsibilities are clearly delineated.

Survey participants with concerns about external auditors expressed a range of concerns including:

• Limited knowledge of the business.
• Expectation gap between the audit committee and external audit (committee thinks external auditors are doing more testing than they really are).
• External auditors may raise relatively insignificant issues to the audit committee.
• Lack of responsiveness to finance staff requirements and deadlines.
• Issues that have not previously been discussed with management – CFO is unprepared to respond.
• External auditors may feel need to justify their process and fees to the audit committee, sometimes at the expense of management.
• The external auditor has significant power and this could be a concern to the CFO
THE ROLE OF THE EXTERNAL AUDITOR / CONCLUSION

if he or she does not have a strong relationship with the audit committee. However, this is not a bad thing from a governance/independence perspective. If the auditor and CFO are experienced, most issues should be dealt with outside of the audit committee.

- Indecision by auditors related to opinions on complex accounting matters can result in uncertainty.
- Auditors should keep to core competencies and advocate for common sense approaches to auditing (e.g. eliminate the notion of firm rotation).

Some of these issues might be addressed through improved communication between the external auditor and the CFO prior to audit committee meetings. For instances, the external auditor may choose to ask for explanations from finance staff to clarify issues before raising them at the audit committee, which would better allow the CFO to place the issue in context for the external auditor and fully prepare answers and required data before the meeting.

CONCLUSION

CFOs toil for years to become experts in financial management. They can trim costs, seek financing, do hedging and prepare financial statements with new accounting standards. Their jobs have become more challenging as the increasingly complex fields of risk management and information technology continue to evolve. In addition to technical skills, however, CFOs are now required to continually adapt to the varying landscape of corporate governance, which now requires them to effectively communicate with aplomb to audit committees about what’s going wrong, in addition to what’s going well. Similarly, more is expected from those charged with governance – e.g. audit committees, and this is bound to have a spillover effect on those who report to them, such as CFOs.

The vast majority of Canadian financial executives surveyed report their company CFOs maintain an excellent relationship with their audit committees. That said, the evolving nature of the CFO-audit committee relationship is clearly of strong interest to financial executives. In response to an open-ended question, executives gave very detailed accounts of their views of the roles and responsibilities of both the CFO and the
THE CFO AND THE AUDIT COMMITTEE

audit committee members, and how those responsibilities would result in an effective relationship. According to survey respondents, the majority of whom comprised CFOs (60%) and VP Finance (11%), the CFO should abide by the following guidelines:

**Conduct**
- Be open to email and phone requests between meetings.
- Conduct one’s self with utmost integrity and professionalism.
- Listen and respond to audit committee requests.
- Be open to advice from the committee.
- Be able to handle criticism, since it’s the audit committee’s job to focus on gaps.
- Be open about the reasons behind any perceived issues or flaws.
- Be open to an alternative course of action.

**Disclosure**
- Provide information in a timely manner, allowing committee plenty of time for a thoughtful review.
- Provide enough high-quality information consistently so audit committees are making fully-informed decisions. Disclose beyond basic financials and expand into risk profile and be forward looking. Summarize information so as not to overload directors with excessive detail.
- Be prepared to highlight areas of concern which need to be addressed. Be as transparent as possible with information and avoid surprises; be proactive.
- Provide advance discussions of concerns. Never have an issue arise in the audit committee meeting that the audit committee members are not already aware of. Consider briefing the chair before meetings.
- Offer company perspective to help committee members be more effective.

According to survey respondents, the responsibilities of the audit committee and chair include but are not limited to the following guidelines:
- Be open to communication from the CFO between formal meetings.
- Do not hesitate to ask for information or clarification.
- Take adequate time to digest information thoroughly before meetings.
- Act as a sounding board for CFO.
CONCLUSION

- Chair of the committee should have a strong finance and accounting background.
- Chair should be able to balance shareholder requirements with regulatory/legal requirements and fiscal responsibilities of the CFO role.
- Request information or answers in a reasonable time frame.
- The audit committee should not be always satisfied with what is being presented by the CFO. It is the audit committee’s job to push for continuous improvement. The CFO has to get used to it and deliver to the best of his/her capabilities.
- Develop clear cut agendas and objectives for the year.
- Identify issues early and allow for plenty of time to think through particularly thorny issues.
- Audit committee training is critical. Their roles should be very clear. Continue to increase frequency of periodic audit committee educational sessions (on emerging and hot topics) throughout the year.
- There should be a time out period where the CFO is alone with the committee, in order to address any issues that involve the CEO. Similarly, the audit committee must have in camera sessions with the external auditor without the presence of management.
- Ensure there is a good open relationship with the external auditor. If there are continual conflicts, this will reduce the confidence level at the audit committee, since apart from the head of the audit committee, not all members necessarily have a good finance background.

Like any relationship, a two-way exchange between CFO and audit committee, based on a free flow of information, as well as mutual trust and respect, would appear to be the ideal. This comfort level must be balanced with the need for maintaining enough distance so that the quality of the data from the CFO can still be critically assessed and tested.

Audit committee members are busy and the demands continue to grow. If the CFO is instrumental in smoothing the audit committee’s workflow, and organizes the agenda appropriately, so responsibilities are addressed without undue effort, the CFO can actually make an audit committee appointment an attractive opportunity.
APPENDIX A: DEMOGRAPHICS

INDUSTRY CLASSIFICATION

- Mining, quarrying, and oil and gas extraction: 17%
- Finance and insurance: 14%
- Manufacturing: 9%
- Utilities: 6%
- Agriculture, forestry, fishing and hunting: 5%
- Retail trade: 4%
- Professional, scientific and technical services: 4%
- Health care and social assistance: 4%
- Telecommunications: 4%
- Wholesale trade: 2%
- Transportation and warehousing: 2%
- Real estate and rental and leasing: 2%
- Management of companies and enterprises: 2%
- Education services: 2%
- Arts, entertainment and recreation: 2%
- Construction: 1%
- Information and cultural industries: 1%
- Administrative and support, waste management and remediation services: 1%
- Accommodation and food services: 1%
- Other: 17%
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APPENDIX B: FORUM PARTICIPANTS

Forum Chair
Michael Conway – Chief Executive & National President, FEI Canada

Moderators
Christian Bellavance – VP, Research & Communications, FEI Canada
Todd Buchanan – National Leader, Accounting Advisory Services, KPMG LLP

Toronto Participants:
Alysia Carter – VP & CFO, Ainsworth, Inc.
George Chiarucci – CFO, Prism Medical Ltd.
Victoria Davies – CFO, Knightsbridge
Mark Donaghy – General Manager and Vice President Finance, SCiAN Services
Brian Gabel – VP & CFO, Greater Toronto Airports Authority
Lesley Gallinger – VP, Corporate Services, & CFO, Electrical Safety Authority
John Glicksman – EVP & CFO, PowerStream Inc.
Edmond Lee – VP & CFO, Tarion Warranty Corporation
Isabel Meharry – CFO, Green Shield Canada
Gord Nelson – CFO, Cineplex Entertainment
Craig Pattinson – VP, Audit & Risk Advisory Services, Bell Canada
Glen Shipp – EVP & CFO, BBM Canada
William Swirsky – President, William J. L. Swirsky & Associates, corporate director; former VP of Knowledge Development at the CICA
Laurie Tugman – Former CEO & President, Marsulex Inc.
APPENDIX B: FORUM PARTICIPANTS

Participants by telephone:
Michel Cavallin – VP Corporate Services Branch & CFO, Canadian Nuclear Safety Commission
Carl Gauvreau – Former CFO, Hartco Inc.
Vic Wells – Chair, Canadian Financial Executives Research Foundation, former CFO with experience on several public company audit committees

Experts:
Sebastian Distefano – Partner, Audit, KPMG LLP
Dave Schlesinger – Partner, Tax, KPMG LLP
Dan Zbacnik – Partner, Advisory, KPMG LLP

Observers:
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THE CFO AND THE AUDIT COMMITTEE

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