A WATCHFUL EYE

CFOs are more than just the financial stewards of their organisations. They also have an important role to play in risk governance, say Leonardo Peklar and Jahanara Sajjad Ahmad

Pawns or Potentates is the title of an excellent corporate governance book by Harvard Business School professor Jay Lorsch. In the book, he explores the role of directors and the title comes to mind when we think of the CFO and the governance ecosystem. The role of CFO is, by default, associated with being the steward for the financial resources of the company. Reality is much more complex, however.

A CFO's role and responsibilities are often connected only with transparency and disclosure, but it is important to understand that the finance function typically touches every aspect of a company and its operations, and therefore, it has to be associated with all areas of governance of an organisation in one way or another.

Beyond managing the financial affairs of a company, today's CFO is involved in strategy, deal structuring, risk management and other activities of the organisation. Hence, it is important for the CFO to gain knowledge across all functions within the organisation. Meanwhile, interaction between the CFO and the CEO, and interaction between the CFO and the board, is absolutely essential.

The CEO usually presents the strategy of the company before the board. There may be instances, however, when the CEO's strategy may not fit well within the liquidity management plan for the company as envisaged by the CFO. In order to avoid such situations, it is important that the CEO consults the CFO prior to presenting the strategy to the board. If the CEO still feels obliged to go ahead with the plan, the CFO should clearly document and highlight his or her concerns about the proposal to the CEO.

CFOs also have a major role to play in risk governance. This is because they are in a position to have a holistic view of the financial affairs of their organisation and can therefore assess the internal and external factors that may impact company performance. The CFO must ensure that disclosures regarding risk oversight go beyond minimum requirements in order to provide a complete picture and explain organisation-wide risk management efforts.

The CFO's role becomes critical when a contingency materialises into financial risk. The financial impact of a contingency can certainly be reduced if the CFO acts promptly by informing stakeholders of the company's plans to deal with the situation before the news hits the market.

The board

Some jurisdictions, such as the UK, encourage an executive board and hence the CFO is invariably a member of the board. In countries where there is no such requirement, it is now considered increasingly important to have board members who come from a financial and audit background, so that they can assist the board in carrying out the financial aspects of their governance responsibilities.

The role of the CFO is particularly important for boards that do not have financial expertise. The CFO can be present at board meetings to explain the financials to the board, which, in turn, will help the board to effectively carry out its functions of reviewing and approving financial policies and financial statements, approving the strategic plan and monitoring changes in the business environment.

Some boards establish audit committees that consist of members who are experts in audit and finance, or they invite experts in those fields to assist them in fulfilling their financial and audit oversight-related governance responsibilities. This does not make the CFO's interaction with the audit committee any less important, however. The CFO's regular interaction with the audit committee is important as he or she can present periodic financial statements to the committee members in a credible, simple and understandable way. In essence, the CFO can guide the board and the audit committee through the review and approval process of the financial statements.

Another important, but mostly ignored, aspect of governance for the CFO function is that of succession planning. As organisations grow, and enter cross-border deals and complex financial arrangements, succession planning for the CFO should be considered a part of the organisation's risk management strategy and therefore deserves appropriate attention. Boards give due and rightful importance to the issue of succession planning when it comes to the CEO, but few pay attention to the issue of CFO succession.

The regulators

How do regulators see the role of the CFO in corporate governance? They are trying to encourage enterprises to adopt a risk-averse approach and hence we have seen a stream of regulations being issued across the world following the global financial crisis. Most of these regulations relate to liquidity management, capital adequacy requirements and other relevant checks

and measures to be put in place by those charged with stewardship of the funds of a company. But little attention is being paid to the governance of those who are in charge of this stewardship function, in other words, the CFOs.

The regulatory bodies of the accountancy profession have increased their emphasis on corporate governance by including this subject in course materials as well as defining the term 'those charged with governance'[1] in the International Standards on Auditing. But much still needs to be done to create awareness about the particular role played by the CFO in the corporate governance of an organisation beyond its financial reporting.

To put the matter into perspective, a lot of regional and international codes for corporate governance have been issued recently. Very few of these codes[2] actually provide guidance on the role of the CFO with respect to corporate governance, however.

Conclusion

The global financial crisis has highlighted the role and responsibilities of the CFO. CFOs played a key role in restructuring, refinancing and reorganising businesses to help steer them out of the eye of the storm. This experience has made boards of directors and CEOs more aware of the role of the CFO in the governance function of an organisation.

In addition, the crisis exposed the insufficient exposure of the CFO to the governance framework of an organisation. It revealed that, in certain instances, had the CFO been involved at the early stages of business decision making, he or she would have been able to inform and quantify the effect of the decision on the short-, medium- and long-term prospects of the company, equipping the decision makers with additional necessary and relevant information. This would have led boards to adjust their business plans to incorporate prudence and be better prepared and equipped to make the right decisions. As they say, prevention is better than cure. Having a proactive CFO with a governance framework that complements the finance function would benefit the company and make it better equipped to respond to crises, should the need arise.

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1 In October 2012, the International Auditing and Assurance Standards Board issued an invitation to comment on *Improving the Auditor's Report*, with enhanced descriptions of the responsibilities of those charged with governance in the *Auditor's Report*. http://tinyurl.com/cj9lnuv
2 The *Code of Corporate Governance 2012*, issued by the Securities and Exchange Commission of Pakistan, contains specific provisions on governance for CFOs. http://tinyurl.com/m6n2grx
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