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Wise directors have CFO in wings

Corporate boards have come to rely on chief financial officers as key resource

Today's complex global business environment hands corporate directors immense responsibility for governance and oversight. But in the end, their performance can be only as good as the information they receive.

Chief financial officers are the vitally important source for much of that front-line information.

"CFOs today are probably more involved at a board level than they've ever been," says John Caldwell, CA, president and chief executive officer of SMTC Corp. and a member of the Canadian Institute of Chartered Accountants Directors Advisory Group.

From a legal standpoint, notes William Pepall, a partner and head of the commercial litigation practice group at Lerner LLP, statutes such as the Canada Business Corporations Act impose duties on a director to act in good faith and in the best interests of the company, and to use reasonable skill, care and diligence in their role.

The Ontario Securities Act imposes specific liabilities on directors for such things as prospectuses and secondary market representations.

"Most statutes imposing a potential liability on directors also provide them with a due diligence defence which permits good-faith reliance on information and data received from senior management," Mr. Pepall adds. "In order to perform their duties and to avail themselves of the due diligence defence, directors will want to ensure they receive timely, accurate and complete data and information to inform and support their decisions. Having regard to their mandate and accountability, CFOs play a vital role in this process."

In particular, the board's audit committee needs to have an especially close relationship with the chief financial officer. "The CFO's reporting line to the audit committee is stronger today than it's ever been. They are clearly in the leadership position from a management standpoint at the audit committee level," Mr. Caldwell says.

The CFO's value to the board has also increased in



Michael Conway (left), chief executive and national president of Financial Executives International Canada and Gino Scapillati, national managing partner of PwC Canada, view relationship between boards and CFOs as critically important.

proportion to the position's enhanced breadth of responsibility.

"The role of the CFO has evolved over the last few years from historically just reporting what the company has done via their financial statements, to more of a strategic orientation toward the future," says David King, Canadian president of Robert

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David King
 Canadian president,
 Robert Half

Half Management Resources. "They've definitely emerged into more of a visionary for the board."

"Think about the economic challenges that have presented themselves over the last several years," says Gino Scapillati, FCA, the

national managing partner of PwC. "Global competition has heated up. There are increased operational challenges; there is a heightened role for technology and information systems; all of these tie into the board's mandate. And CFOs have become more relevant because rather than simply focusing on financial statements or internal controls they are giving insight into all of these other areas."

The CFO is also one of the key officers responsible for advising the board on how to deal with myriad corporate risks on the horizon – financial, strategic, regulatory, and reputational, among others. "The CFO's mandate has become one of providing guidance and insight into potential risks, because the reality is that neither the board, the CEO nor investors want any surprises," says Mr. King.

With respect to financial risks, for example, the board needs to understand critical factors such as the degree of leverage carried by the company, liquidity issues, the cost of capital and the veracity of internal controls for financial reporting. The CFO can also help the board understand accounting policy choices that might affect the firm's financial reporting results or

covenants with bankers.

"I think the big challenge today is International Financial Reporting Standards (IFRS). All Canadian public companies are right in the middle of adopting IFRS, so that stands out ahead of everything else when it comes to reporting," says Mr. Caldwell.

Directors also need to know that their firm is meeting all of its financial obligations because there can be personal liability attached to items such as unpaid wages. A standard checklist for any audit committee should therefore include regular assertions by the CFO that such obligations are fully up to date, recommends Michael Conway, CA, chief executive and national president of Financial Executives International Canada.

Another oversight responsibility of the board is to ensure that disclosure requirements covering both financial and non-financial matters of a material nature are covered in reports such as the management's discussion and analysis, which the CFO bears a large responsibility for producing.

"For a board to be in a position to properly carry out its risk oversight responsibilities it must ensure they

have a system in place to identify and then mitigate all of the company's risks as best they can," says Mr. Conway. "Particularly in smaller companies, the CFO may be wearing multiple hats and be in the best position to help the board along with that knowledge."

The business world has also become subject to tighter scrutiny over the past decade; therefore part of the board's oversight entails ensuring that all relevant laws and regulations are being adhered to. For instance, the CEO and CFO of a publicly accountable enterprise must attest to the adequacy of their firm's internal controls over financial reporting; to assure shareholders and other stakeholders that their systems are capable of producing accurate financial information.

"The audit committee of the board should exercise some oversight over the management certification process. They should understand what management has gone through to reach those certifications, rather than just seeing whether they're filed," says Mr. Scapillati.

If internal controls for financial reporting are flawed, the CFO should present board members with a detailed plan of the steps being taken to fix

that situation. It is then up to the board to exercise leadership and determine whether those steps are sufficient, notes Mr. Conway.

Mr. Scapillati also recommends there be ongoing discussion between the CFO and the board about regulatory obligations. The board should, for example, be made aware of any correspondence issued by provincial or territorial securities commissions to the company, the company's response to that request and whether its external auditors have been involved in that response, he says.

For CFOs in a private company, interacting with their board should entail many of the same duties and responsibilities as their colleagues in a publicly accountable enterprise, experts stress.

However, a major difference is the board composition in a private company. This often includes the owner and founder of the firm, which means the interaction might be more personal. For example, succession issues could become important, particularly if it is a family-owned business.

"I would describe it in many cases as the CFO bringing a level of financial discipline and professional management to owners of private companies. Perhaps there is less emphasis on the regulatory and compliance side, and more on operational, hands-on advice to the owners," says Mr. Scapillati.

Regardless of whether the company is public or private, however, "the CFO is at the hub of a very important governance oversight aspect to the enterprise," says Mr. Pepall.

Increasingly, too, the corporate talents and invaluable skills of CFOs are also being recognized by their appointment as independent directors of other companies.

"Based on their makeup, CFOs have a very keen financial sense and organized way of evaluating the performance of a company – particularly in challenging times. Those are skills that are sought after by companies, and the demand for CFOs to become directors is increasing," says Mr. Conway. ■

CFOs embrace new social responsibility role

CSR reporting seen as natural fit in expanding mandate of chief financial officers

Any lingering perception of the chief financial officer as a one-dimensional figure in charge of the coffers is contradicted by contemporary reality. Today's CFO has a much wider strategic leadership role, and a key element of that is corporate social responsibility (CSR) reporting.

"The expectation on CFOs is that they will be responsible for a broader mandate than just financial reporting," says Mel Wilson, an associate partner with PwC in Calgary. "This expectation is coming from both shareholders as well as other external stakeholders in a lot of companies."

A 2009 survey of Canadian senior financial executives confirmed that CFOs often take the lead in CSR reporting, says Michael Conway, CA, chief executive and national president of Financial Executives International Canada (FEI Canada). In that survey, conducted by the Canadian Financial Executives Research Foundation (CFERF, which is FEI Canada's research arm) in collaboration with PwC, 90 per cent of respondents said they recognized the importance of

reporting on the environmental and social impacts of their companies.

"In focusing on enhancing shareholder value, we recognize that it's not only about generating profitable operations, it's also about doing the right thing in the course of responding to the environment and social pressures and opportunities," says Ivor Ruste, FCA, the chief financial officer of Calgary-based Cenovus Energy Inc.

"As a member of the executive leadership team, the CFO needs to understand public responsibility issues and make sure there's good transparency, along with accurate measurement and reporting of all those costs – whether it's environmental performance, reclamation, or community investment," he adds. "The CFO also needs to make sure the processes capturing that information are appropriate and complete, and reporting meets or even exceeds statutory requirements."

Alberta, for instance, has a limited cap-and-trade system, which requires Cenovus and other provincial companies to report their greenhouse gas emissions. "One of the

important aspects of our internal processes has been the disclosure controls that I have responsibility for in terms of making sure we report material items on a timely and appropriate basis to our shareholders," Mr. Ruste stresses.

But in addition to its mandatory reporting in compliance with legislation, Cenovus also issues an annual corporate responsibility report discussing items like air and water emissions, land reclamation, energy efficiency, health and safety and aboriginal relations.

Contributing to shareholder value works hand-in-hand with committing and adhering to the CSR policy developed in the grassroots of our organization.

Ivor Ruste
 Chief financial officer,
 Cenovus Energy Inc. and member of
 CICA's Risk Oversight and
 Governance Board

"Smart corporations today are recognizing there are ways you can be environmentally responsible that also

often fall in line with being financially responsible," notes Mr. Conway. "Many of their suppliers, employees and customers demand this level of responsibility."

Cenovus is a case in point. "There's been a big focus on energy efficiency in our operations," Mr. Ruste says, pointing to reduction of the steam-to-oil ratio in steam-assisted gravity drainage operations. "That has a direct impact on our bottom line, because we're saving on energy usage," he says. "Contributing to shareholder value works hand-in-hand with committing and adhering to the CSR policy developed in the grassroots of our organization."

The CFO is primarily responsible for ensuring there is appropriate disclosure on CSR-related documentation such as the management's discussion and analysis (MD&A) and annual information form (AIF) for their shareholders and other corporate stakeholders. A CFO has direct responsibility for ensuring the information in those filings, including the accounting treatment of environmental liabilities and expenditures, is materially correct.

"Both the MD&A and AIF include discussion about the company's risk and what they're doing to manage those risks," says Mr. Wilson of PwC. For example, he notes, "environmental risks have, over time, become more and more material for certain organizations. So the CFO has to ensure they are appropriately evaluated and disclosed."

Furthermore, some organizations have gone the extra mile and provided their shareholders with additional voluntary sustainability-related disclosures, as has Cenovus.

"If you go into the websites of many large companies, there will be a pull-down menu on corporate responsibility. Historically, this has not been under control of the CFO. But that is changing; those disclosures are now coming under the purview and responsibility of the CFO, because they touch on things that are material to investors and shareholders," Mr. Wilson notes.

The accounting profession has also intensified efforts to formalize the incorporation of environmental and sustainable development data

into reporting initiatives for which the CFO bears a major responsibility.

Since the 1990s, there has been increased emphasis on accounting for direct environment-related expenditures. "Where you have a direct outlay of cash for environmental costs such as a big clean-up from a spill or liabilities where you're sitting on contaminated land that will someday have to be cleaned up – that accounting treatment has been addressed," notes Mr. Wilson.

Furthermore, the Canadian Institute of Chartered Accountants offers guidance for preparers of financial statements and MD&A documents surrounding risks related to environmental performance and CSR reporting. The Canadian Securities Administrators also publish an environmental reporting document dealing with similar issues, says Mr. Ruste.

"The profession's involvement in those types of issues reflects that we know it's important and want to be doing the right thing. The objective is to enhance transparency around disclosures so investors and stakeholders can understand," he adds. ■

The risk-return balancing act

CFOs play key role in identifying corporate risks and executing strategies to mitigate them

The tightrope runs from executive suite to boardroom in corporate offices across Canada. On each is a chief financial officer performing the risk-reward balancing act that can mean the difference between success and failure.

Today, identifying corporate risks and developing strategies to mitigate them – while making sure to keep directors in the risk-management picture – looms large among CFO duties.

“A company’s management of risks is intertwined with the achievement of its strategic objectives – it is a balance between risk and return,” says Michael Conway, CA, chief executive and national president of Financial Executives International Canada. “It is the CFO’s role as chief risk officer to assess a company’s risk tolerance and get the balance between risk and return right, and it is the board’s role to provide appropriate oversight to ensure this occurs.”

In agreement is Alex Guertin, CA, the chief risk officer of Great-West Lifeco Inc. and a member of the Canadian Institute of Chartered Accountants’ Risk Oversight and Governance Board. “I think of the CFO as the gateway for evaluating the financial viability and sustainability of a firm, he says. “I see them as central in partnering with the CEO and executive team to raise the attention of the board to key potential risks that could have a significant negative impact on the firm.”

Such risks might be in traditional areas such as finance, operations, litigation or governance. With respect to financial risks, for instance, “it’s up to the CFO to see that a company has liquidity and capital available to carry out its strategic business plan,” notes Mr. Conway.

But a multitude of new potential risks have also emerged.

“The world is evolving quickly, and the nature of risk is more complicated today,” says Brenda Eprile, FCA, head of the risk and regulatory advisory services practice at PwC. “Emerging risks have come onto the radar, such as the political risk of operating in new jurisdictions,” she adds. “More robust regulatory disclosure is also required regarding items such as sustainable practices, which could potentially create a liability if those practices are not followed.”

Reputational risk has also become increasingly important. “CEOs and CFOs set a critical tone from the top, influencing the behaviour of key executives who in turn influence their entire workforce,” says Michael Sherrard,

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Michael Conway
Chief executive and national president,
Financial Executives International Canada

a partner with Sherrard Kuzz LLP, a management based employment and labour law firm. “We have witnessed the destruction of more than one company by key executives who made poor decisions often undetected by the absence of appropriate risk oversight systems. CFOs are well placed to influence the design and implementation of risk oversight systems to prevent and/or identify executive behaviours that risk corporate reputation.”

Adds Mr. Conway: “A corporation has to assess a lot of things, including its risk tolerance, and the extent to which it can sustain shocks. If, for example, a company is looking to strategically grow through mergers and acquisitions, they’re going to have to look closely at how to manage the risk implications.”

To fully prepare for all types of risk, a CFO must envisage various scenarios, even those that may seem improbable at first glance. Although such “black swan” scenarios may be unlikely, if they do unfold they can have a profound impact on the financial position of a firm, as well as a domino effect on various interconnected risks, warns Mr. Guertin.

Various graphical tools can be used to assess risk and enable the CFO to focus attention on critically important items.

Such methods might include a four-quadrant chart to map the severity of risk impact against the probability of occurrence. Another would be to construct a “heat map” to pictorially prioritize risk in terms of severity, likelihood, and ability to mitigate the impact, Mr. Conway suggests.

Another important element of risk management, after identifying and prioritizing the variables, is to develop a strategy to mitigate the impact of the most damaging events.

One strategy for mitigating risk involves directors’ and officers’ (D&O) liability insurance, which can transfer some of the risk faced by the corporation through its directors’ and officers’ actions to a third party – the insurance firm. “D&O insurance is one of the critical pieces in terms of transferring risk. CFOs add value by assessing the different products available today balanced against the risk tolerance levels of their corporations,” says Mr. Sherrard.

Other strategies might include covering the unexpected departure of a key executive. “The mitigation strategy there could involve having clear succession plans already in place, with executive development plans to encourage an ability to promote from within; or having clear



Brenda Eprile, head of the risk and regulatory advisory services practice at PwC



Alex Guertin, chief risk officer of Great-West Lifeco Inc.

up-to-date job descriptions to facilitate a quick orderly plan for recruiting outside the firm,” Mr. Conway explains.

Furthermore, from a financial preparation standpoint “when you’re looking at risk assessment, a company that is capitalized with a strong balance sheet can withstand more shocks, foreseen or not,” he adds.

“With the increasing mobility of key executives, companies are also well advised to

have comprehensive employment agreements in place,” says Mr. Sherrard. “Well drafted agreements can save a company when faced with a departing executive who attempts to take confidential information and/or intellectual property across the street to a competitor. Courts are prepared to step in and assist companies who have provided for such restrictions in a clearly drafted employment agreement,” he adds. ■

Guidance for directors in risk oversight

A valuable handbook for corporate directors with the self-explanatory title *A Framework for Board Oversight of Enterprise Risk – Draft for Exposure* has been published by the Canadian Institute of Chartered Accountants.

Written by John Caldwell, CA, the booklet sets out steps that boards of directors should take in fulfilling their risk oversight responsibilities. These include: analyzing the underlying conditions affecting their firm’s risk; identifying material threats; assessing the impact of risk and likelihood of occurrence; analyzing the potential for risk interconnectivity; prioritizing items that need response; assessing risk tolerance; developing a response strategy; and ongoing monitoring of the risk environment and strategies chosen.

“The framework is unique because it embraces areas where management is conflicted, such as in assessing leadership,” explains Mr. Caldwell. “Most importantly it addresses the interconnectedness and compounding effects of risks that may occur simultaneously.”



John Caldwell, president and chief executive officer, SMTC Corp.

A CFO checklist

The chief financial officer’s position is a demanding one, with multiple tasks to be tackled on a daily basis. Here are some of the important duties that two prominent CFOs, Cynthia Devine and Richard Bird, the 2010 winners of Canada’s CFO of the Year Award, consider of importance in their professional lives.



Cynthia Devine
chief financial officer of Tim Hortons Inc. in Oakville, Ont.

- **Assessing business performance and trends:** “Reviewing sales data and other leading performance indicators and trends to ensure we are managing risks and opportunities and are on top of emerging developments.”
- **Leadership:** “Leading and developing the finance team by providing tools, information and support needed for their success.”
- **Cross-functional work:** “At Tim Hortons, our executive team works in a highly collaborative environment where we are all expected to contribute significantly to the company’s strategies and execution.”
- **Planning:** “Making sure we are being thoughtful, and focused on our financial policies, long-term business strategies and support to other parts of the business.”

- **Financial operations and reporting:** “Ensuring excellence in the execution of our primary responsibilities including cash and capital management, financial reporting, budgeting and analysis, and risk processes.”
- **Competitive intelligence:** “The competitive landscape changes all the time. I make sure I stay informed of changes that might affect our business, the sector and also the financial strategies we employ to ensure our continued long-term success.”



Richard Bird
executive vice-president and chief financial officer of Enbridge Inc. in Calgary

- **Liquidity management:** “Making sure the company always has access to sufficient cash to pay its bills and take advantage of unexplored opportunities.”
- **Risk management:** “Making sure the principal financial risks and business risks facing the company are fully identified and taken into consideration in all decision making.”
- **Performance analysis, capital allocation, and mergers & acquisitions analysis:** “Identifying which of the company’s existing businesses and prospective opportunities are generating favourable financial results that contribute to shareholder value creation, and which are not.”
- **Capital funding and investor relations:** “Selecting the best mix of sources and varieties of long-term capital funding; the timing

- of accessing such funding; and communication of the company’s policies, strategies and prospects to investors.”
- **Financial reporting:** “Ensuring that the company’s financial statements and management’s discussion and analysis are accurate and complete, including ensuring the soundness of the internal controls over financial reporting.”
- **Staff retention and development:** “Ensuring that programs are in place to attract and retain high quality financial staff and to provide for ongoing training and development of their skills and capabilities.”