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Finance Transformation:
Building a Risk Intelligent
Finance Function

Rethinking the CFO role

Today's CFO is more immersed in strategy than ever before. Top finance executives are increasingly involved in helping the organization navigate critical passageways related to strategic events such as mergers, acquisitions, new business ventures (including investing in new products and alliances) and business process outsourcing. Yet at the same time, the rising number of corporate financial restatements¹ has CFOs heavily focused on attending to core duties, such as accounting, reporting, and regulatory compliance. These dual responsibilities are placing significant demands on the finance function and are forcing CFOs to rethink their role, especially in terms of how risk is managed in the finance department and throughout the organization.

Data from a recent poll of financial executives in the Deloitte* Dbriefs webcast, *Finance Transformation: How to Build a Risk-Intelligent Finance Function*², suggests that many companies and CFOs are unsure about their ability to successfully manage competing priorities and the growing list of risks threatening their organizations. Such internal uncertainty can result in greater organizational vulnerability that can jeopardize the organization's ability to compete successfully in the marketplace.

While some CFOs may be reluctant to take on yet another challenge, others are already undertaking major initiatives to transform the finance function so that it can effectively and efficiently contribute value to the overall organization. Critical to the success of such an effort is managing risk intelligently.

How are leading CFOs dealing with this challenge? And what approaches can help CFOs take advantage of this opportunity to influence major change in their companies?

Dbriefs for Financial Executives

This paper presents information and polling data from Deloitte's Dbriefs for Financial Executives webcast series, *Finance Transformation: How to Build a Risk-Intelligent Finance Function*, held on February 21, 2007, with Deloitte & Touche LLP Partners John Gimpert and Sandy Pundmann presenting. Total webcast attendance: approximately 900 participants, including CFOs, directors, finance managers, analysts, auditors, and other financial executives. Polling results presented herein are solely the thoughts and opinions of the webcast participants' and are not necessarily representative of the total population of all CFOs. However, we believe the results do provide valuable insight regarding the opinions and concerns of CFOs in general as the results are consistent with the experiences of Deloitte practitioners who have worked on related engagements with numerous companies.

* As used in this document, the term "Deloitte" includes Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Tax LLP, and Deloitte Financial Advisory Services LLP.

¹ *Restatements Trend Alert - Getting It Wrong the First Time*, Glass, Lewis & Co, 2006

² Deloitte's Dbriefs for Financial Executives webcast, *Finance Transformation: How to Build a Risk-Intelligent Finance Function*, with Deloitte & Touche LLP Partners John Gimpert and Sandy Pundmann presenting, held on February 21, 2007. Total webcast attendance: approximately 900 participants, including CFOs, directors, finance managers, analysts, auditors, and other financial executives. Note: Polling results presented herein are solely the thoughts and opinions of the webcast participants' and are not necessarily representative of the total population of all CFOs. However, we believe the results do provide valuable insight regarding the opinions and concerns of CFOs in general as the results are consistent with the experiences of Deloitte & Touche practitioners who have worked on related engagements with numerous companies.

Finance Transformation: 4 Faces

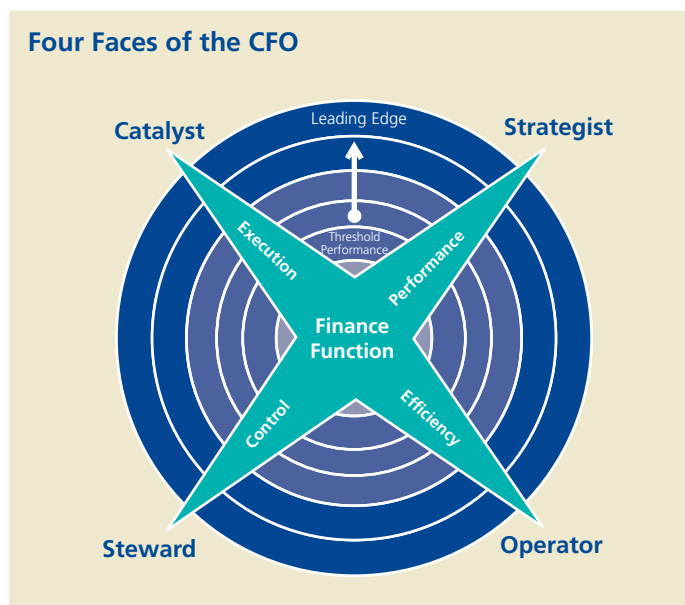
Traditionally focused on the mechanics of finance and the integrity of financial reporting, CFOs are now being pulled in different directions to help the organization meet its strategic, operational, and performance needs. As their sphere of responsibility expands and pressure mounts, more CFOs are seeking better ways to manage their multiple roles and effectively address a widening spectrum of risk.

The CFO's dilemma is real: CFOs are not only accountable for the organization's financial reporting, investor relations, and regulatory responsibilities, but they are also managing people, dealing with systems and technology infrastructure, and serving as a strategic partner to the CEO. Is it any surprise that the rate of CFO turnover at Fortune 500 companies has increased, with the average tenure now less than three years?³

Yet CFOs need not feel trapped or oppressed by these increasing responsibilities. Savvy and proactive CFOs are taking control and organizations are again investing in efforts that can help finance boost its productivity with fewer resources, deliver higher-quality information in shorter time frames, drive down the costs while addressing regulatory compliance, and bring about sustainable process improvements for greater efficiency. Accomplishing this requires a comprehensive and sustainable framework.

At Deloitte, we have sorted these responsibilities into four categories, a framework which we call the "Four Faces of the CFO"⁴:

- Steward** – protect and preserve the assets of the organization
- Operator** – balance capabilities, costs, and service levels to fulfill the finance organization's responsibilities
- Strategist** – provide financial leadership in determining strategic business direction and align financial strategies
- Catalyst** – stimulate behaviors across the organization to achieve strategic and financial objectives



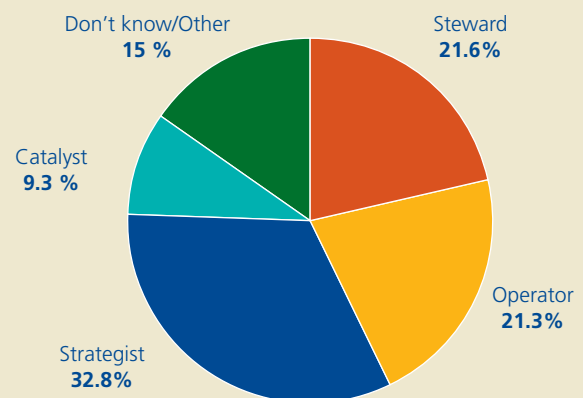
The CFO's main responsibility is, of course, to provide accurate and reliable information to the management, shareholders, and capital markets. This essential service to support the business is what we call "establishing the dial tone." And to do so, many CFOs are intensely, if not solely, occupied with the first two roles: steward and operator. Indeed, according to a recent poll in the webcast presentation, 43% of finance executives report that their CFO focuses most time in those two more traditional roles, (see Figure 1).

At the same time, more CFOs are devoting time and resources to strategic issues: 33% of participants state that their CFO spends most time in the strategist role. But note, for the catalyst role, there is room to grow: only 9% of participants say that their CFO attends strongly to stimulating the achievement of strategic and financial objectives. The catalyst role is critical not only for developing the proper mix of talent in finance for the organization, but is also essential for delivering relevant and timely financial information to those responsible for the organization's strategic decision making. While many CFOs may be focusing more on the strategist role, the survey results indicate that few CFOs are functioning in the catalyst role, despite the fact that the catalyst role is an important aspect of meeting strategic goals.

This highlights an interesting and natural conflict found in many organizations: as CFOs strive to meet growing expectations and goals, the key components for achieving the objectives remain underdeveloped.

Forward-thinking CFOs understand the requirements of each role, the unique risks they present, and the importance of having risk management strategies that effectively address the new risk profile of their finance organization. It begins with adopting a Risk Intelligent perspective. In the following section, we introduce the notion of Risk Intelligence and explore key concepts for understanding and managing risk more effectively and efficiently.

Figure 1: Which of the following roles do you believe the CFO of your organization focuses most of their time towards?*



*Responses received: 713

³ *Improving CFO Personal Effectiveness*, Corporate Executive Board, 2005.

⁴ For more information, see Deloitte's *Breathing Lessons: How CFOs can thrive under pressure*, Deloitte's Straight Talk Book No. 7.

Attributes of a Risk Intelligent Finance Function

Risk Intelligence takes risk management to new heights, providing an integrated approach to addressing risk.⁵ But, in our experience, too often CFOs are risk averse, hesitant to advise on or advocate for strategic risk-taking. But providing business leaders with a way to consider risk - especially around strategic pursuits - can be an invaluable means of generating profitable growth. CFOs should be proactive in strategic discussions addressing both opportunities and risks related to strategic growth. A Risk Intelligent finance function exhibits the following attributes:

- Acknowledges and manages the full spectrum of risks (fraud; misstatements; material losses; failure to produce timely, accurate, and relevant information; missed growth opportunities; etc.)
- Advocates transcending department barriers or “silos” to gain a broader perspective on the totality of risk
- Understands and contributes to the company’s view of risk
- Recognizes the need to take intelligent risks to create value and operates as a “risk advisor” to management
- Manages risk proactively - with a view toward maximizing the upside of strategic decisions while minimizing the downside
- Anticipates and helps the organization prepare coordinated and integrated responses to risk
- Delineates and communicates roles and responsibilities of the CFO and finance function
- Values adaptability

The Risk Intelligent CFO understands the difference between practicing risk avoidance and effectively managing risk taking as a means to create value for the organization. And it’s important to note that each role may call for a different risk approach. For example, the steward and operator roles view their risks (material misstatements, noncompliance, fraud) in a more traditional way, focusing purely on protecting company assets and avoiding risk. In contrast, the strategist role takes a proactive view, pursuing and initiating intelligent risk taking (international investments, new product launches, joint ventures) then managing any threats to strategic growth.

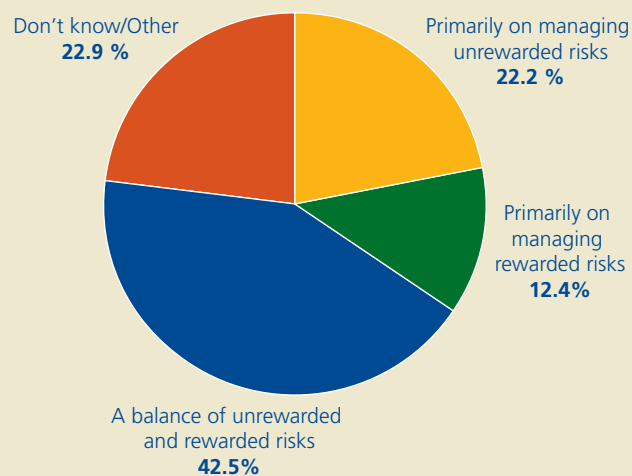
We call these two types of risks:

Unrewarded Risk - risks to existing assets: Unrewarded risk involves the need to protect existing assets (both tangible and intangible assets) or the need to adequately prepare against an event, such as a natural disaster or theft. Mitigating unrewarded risk, while essential, does not improve competitiveness or increase shareholder value.

Rewarded Risk - risks to future growth: Rewarded risk draws on available information to pick and the best strategy to execute, such as new product development, entering new markets, and making strategic acquisitions. Rewarded risk, effectively managed, can bring significant benefits to the company and its shareholders.

In our Dbriefs webcast survey, 43% of participants say their finance function is trying to balance unrewarded and rewarded risk (see Figure 2). We suspect that if this question had been asked a few years ago, amid accounting scandals and the early Sarbanes-Oxley implementation struggles, the response would likely have been much different - at that time many CFOs were focused solely on managing unrewarded risk due to heightened expectations for financial reporting compliance.

Figure 2. Where does your finance function currently focus its risk management efforts?*



*Responses received: 680

The data also shows that over one-third—about 35% of companies—are not applying a balanced view to managing rewarded and unrewarded risks: 22% of companies said they focused primarily on unrewarded risk, while 12% of companies focused mainly on rewarded risk. The latter result raises particular concerns about these companies’ potential exposure to the hazards posed by unrewarded risks, (including regulatory noncompliance, potential litigation, and other issues), which they may not be managing properly.

This unbalanced focus is to be expected from companies that lack an integrated view of risk. Companies may focus on strategic (rewarded) risk, thinking it offers a path to increased value, yet their inattention to unrewarded risk indicates they lack the foundational basis to address risk efficiently and effectively.

Knowing which risks are rewarded (as the catalyst or the strategist) and knowing which ones aren’t (as the steward and operator) is essential for any CFO. Risk Intelligent CFOs must be adaptive, weaving a balanced understanding of risk across all Four Faces. The benefits of adopting a Risk Intelligent view are significant: For the finance function and the organization, it can mean better detection, correction, escalation, and prevention of critical risk issues; improved strategic flexibility for upside and downside scenarios; and reduced costs—costs that are often associated with a more “siloes” approach.

Another key concept of Risk Intelligence is that of bridging silos. Risk Intelligent CFOs not only nurture risk knowledge and skills within their divisions, departments, and units, but also open lines of communication between departments and across the organization. Picking up the phone and connecting with colleagues serves as a way to transcend organizational barriers, which, in turn, helps clarify accountability, share information, consider risk scenarios and the interaction of multiple risks, and gain a broader perspective on the totality of risk.⁶

Cultivating these business relationships can also expand the CFO’s sphere of influence, enabling CFOs to offer financial and risk perspectives on business issues, value-creating opportunities, and

⁵ For an in-depth discussion of Risk Intelligence, see “The Risk Intelligent Enterprise: ERM Done Right” and related titles at www.deloitte.com/riskintelligence.

strategies. Adopting and exercising this practice not helps spread the “gospel” of finance, but also raises risk awareness throughout the organization. As a result, financial literacy and risk intelligence increase, contributing to the strength and resiliency of the enterprise.

Based on our experience with hundreds of companies, we see that organizations that embrace these risk concepts are more effective and efficient in managing risks to both existing assets and to future growth and in the long run will likely outperform those that are less so. That is, companies can make money by taking intelligent risks and lose money by failing to manage risk intelligently.

Risk Areas for CFOs

For companies that haven’t yet adopted a Risk Intelligent view, high-risk areas may remain a mystery, potentially causing damage across the organization that goes undetected until it is too late.

Which areas pose the greatest risk for finance functions? The top risk area identified by financial executives from the Dbriefs webcast survey includes financial reporting errors and internal control failures (see Figure 3). That is, almost 27% of participants still don’t feel that they have the basics—the dial tone—down. Getting one’s house in order is the most important priority of finance, requiring that the steward and operator roles be “locked down” so that unrewarded risk is successfully managed. Getting this foundational piece in place is critical before risks to strategic growth can be successfully addressed. Put rhetorically: If the financial data and reporting is inaccurate, how could finance contribute valuably to strategic decisions?

The next key risk area for finance, as identified by respondents in the webcast survey, is strategic risk—those risks related to growth initiatives. The data reflects the dilemma facing CFOs: Torn between competing roles, CFOs must strive to achieve efficiencies in the finance area, functioning as steward and operator, while grappling with marketplace expectations to drive growth and increase shareholder value as strategist.

The Risk Intelligent CFO knows that all pieces must be satisfied at the same time. This includes the catalyst role, which among a variety of things, focuses on properly aligning the finance skill-set with the needs of the organization. In the webcast survey, only 15% of participants identified “developing suitable finance talent” (again, an essential part of the catalyst role) as a key risk for companies. Perhaps companies aren’t concerned about developing talent because they feel they are already doing that. But here’s another consideration, based on cases observed frequently in the field: Few companies acknowledge or are aware of the connection between the people/talent component and the ability to address business and risk objectives. Two simple questions expose this fallacious thinking: (1) How can reporting errors be minimized if companies don’t have the right people in place? (2) If the company does not have the proper competencies to address strategic issues, then how can it successfully drive growth?

Not to say that this is a universal problem. Some companies, although perhaps not enough, are keeping tabs on the risk (and opportunity) of hiring and developing talent as a way to successfully transform finance and the organization. And these finance departments are figuring out the best ways to retain their best employees—even if it means growing the talent so they move up in different business units

(outside of finance). The upshot: the organization is populated with experienced employees who are financially literate, familiar with the organization, and can add greater value (faster) to the organization—instead of leaving to work for the competition.

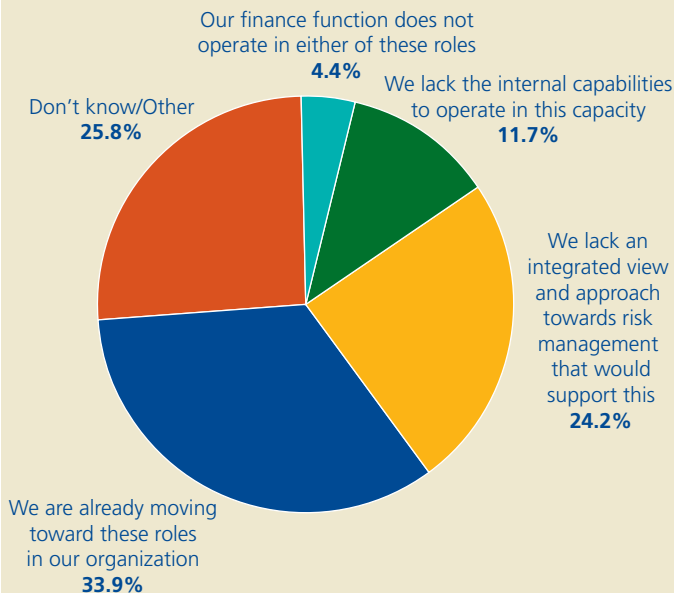
Figure 3. Which of the following areas present the greatest risk your finance function faces?*



*Responses received: 708

However, the data is indicative of what’s happening in the marketplace: many companies lack an integrated risk view and don’t have the finance infrastructure necessary to fully support the CFO and the organization in obtaining its performance goals. When asked about key challenges related to addressing risk for the catalyst and strategist role, 40% of respondents stated that their organization lacked an internal approach and capability to adequately support this aspect of their roles, (see Figure 4).

Figure 4. What key challenges does your finance function face to address risks relating to the Catalyst or Strategist role?*



*Responses received: 682

⁶ Indeed several “lessons”—we call them Breathing Lessons—can help the finance function obtain a better view of risk and boost organizational performance. Here, we mention only a few. For more information, see Deloitte’s *Breathing Lessons: How CFOs can thrive under pressure*, Deloitte’s Straight Talk Book No. 7. See www.deloitte.com/straighttalk.

Yet, considering that so many participants reported earlier that their finance functions were involved in strategic efforts, this inconsistency again highlights a major internal contradiction that, in turn, exposes companies to significant risk: Not only do many companies lack a formal risk management program, but they also are ill-equipped to deal with upside and downside risk scenarios (despite their beliefs to the contrary).

Interestingly, over a third (34%) of respondents reported that their finance function is moving in a direction where risks related to the catalyst and strategist roles (shortage of qualified finance professionals, inability to provide relevant and timely information to inform strategic decisions, missed growth opportunities) are more readily addressed. Yet, the 26% that responded “don’t know/other” may indicate an uncertainty about how the organization and finance function views risk, which is a reality for many organizations. And if they don’t know, then they’re probably not practicing effective risk management.

Key Considerations

Transforming the role of finance and adopting the principles of Risk Intelligence requires CFOs to engage in informed reflection on the risks they’re facing. They must be ready to shed light on the weaknesses, vulnerabilities, and contradictions within the finance function and the organization. Making such a transformation involves embracing an attitude that is open to change and innovation. Here, we’ve outlined key steps in beginning the journey:

Get your “dial tone” right

The core responsibility of all finance departments is to produce accurate and timely financial statements. Creating effectiveness and efficiency in the steward and operator roles may require investments in:

- Hiring and developing the right talent to handle increasingly complex accounting and compliance matters
- Automating and integrating financial systems to produce timely and error-free reporting
- Simplifying the internal control structure by leveraging the latest SEC/PCAOB guidance, rationalizing controls, and minimizing testing, etc.
- Optimizing the financial close and consolidation processes

Graduate to advising on strategic decisions

Once the “dial tone” is established, the strategic role can be developed based on an understanding of various risks and threats as well as a solid grasp of the company’s risk profile. Consider these steps to develop the strategist and catalyst roles:

- Allocating resources to managing rewarded risk, such as new product launches, technologies, or acquisitions
- Evaluating internal reporting by working backwards from decisions that need to be made ultimately
- Embedding finance and risk capabilities and expertise in operations
- Fostering disciplines, fact-based decision making

Conclusion

As M&A activity heats up and outsourcing soars, CFOs must adjust accordingly to play a more strategic role, preparing agendas encompassing a wider range of issues. At the same time, concerns about financial restatements and SEC fines and penalties for finance executives undoubtedly have many CFOs focused on the basics—attending to controls, reporting, and compliance duties. In this paper, we’ve touched on some of the factors driving CFOs to rethink their role especially in terms of how risk is managed—not only in the finance department but throughout the organization.

The ability to face such a challenge—to successfully manage multiple and conflicting roles through addressing risk—may determine the organization’s success in the long run.

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