



BoardroomDirect®

Update on current board issues - Spring 2011



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Welcome to the Spring 2011 edition of *BoardroomDirect*.

This quarter's "Issue in focus" shares critical trends and the questions that should be on your mind as you discuss your company's strategic direction with the CEO. "Audit committee issues" outlines the latest developments relating to key financial reporting issues, and we take a closer look at other topics of relevance to directors in "Issues in brief," including trends in say on pay voting, proposed rules on compensation committees and advisors, and recent SEC enforcement actions against directors. You should also be aware of BoardVision, a new on-demand video series for directors that PwC is doing in collaboration with the NACD.

As always, we welcome your feedback – please use the "Submit feedback" button at the end of this publication to send us your thoughts.

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Issue in focus: Understanding critical trends and the CEO's agenda

One of a board's most important obligations is to engage in meaningful strategy discussions with the CEO and other senior executives. These discussions should include understanding critical trends, their impact, and how they could create opportunities for growth. The results of PwC's *14th Annual Global CEO Survey* of 1,201 business leaders in 69 countries – including more than 100 US CEOs – can help directors gain perspective and understand what issues are on CEOs' agendas, which will enhance the quality of those discussions.

According to the survey, growth is top of mind this year for CEOs. Most CEOs are nearly as confident of growth in 2011 as they were in the boom years before the financial crisis. Key areas for growth and competitive advantage include the following:

Emerging vs. developed markets. Emerging markets are growing at a far greater pace than developed markets. This divergence within the global economy is one of the main reasons why most CEOs (84% globally / 80% in the US) say they've changed their company's strategy in the past two years – with a third of them describing the change as "fundamental." Emerging markets such as Indonesia, India, and China, are forecast to grow at a rate of 6.4% in 2011 – faster than both the projected global growth rate of 4.2% and the projected growth rate for developed markets of 2.2%. At the same time, however, CEOs believe that the US is second only to China in providing opportunities for growth. Developed markets have certain competitive

advantages, such as quality control, stable risk profiles, innovation capabilities, logistics, and existing relationships. Small percentage growth on a large base still equates to major opportunity.

Directors will want to ask the CEO: Do our growth plans have the right balance between emerging and developed markets? How do we enter new, ever-changing markets with confidence? How do we ensure our operations can adapt to change while remaining disciplined about costs?

Innovation: Historically, companies around the world saw increased share in existing markets as their prime growth opportunity. But for the first time in five years, just as many CEOs see new product and service development as their main opportunity. What sorts of new products and services? Eighty-eight percent of US CEOs see opportunities to leverage consumer use of mobile devices and social media, and over half say more environmentally-friendly products and services will also drive innovation.

Directors will want to ask the CEO: How do we remake our organization into a continually innovating one? How do we tap into growing opportunities involving sustainability, social media, and other dynamic new fields?

Talent: With growth comes greater demand for people with the right skills in the right places. More than half of CEOs say they expect to grow their workforces in 2011. However, the skills shortages and demographic shifts that faced businesses before the crisis still exist. For US CEOs, skillsets are such a concern that 45% indicate they are working with governments and educators to improve skills in the talent pool. At the same time, 38% consider limited availability of key skills as a potential threat to their growth prospects. Without a strong pipeline of future talent, companies won't have the capacity to pursue new opportunities and organizations won't realize their full potential.

Directors will want to ask the CEO: Are there skillsets the company is currently lacking? How do we identify, engage, and empower the talent that will distinguish our business from the competition?

Collaboration: CEOs increasingly call for a shared agenda with government in areas deemed critical for business growth, like addressing the risks of climate change and improving infrastructure. Forty-five percent of US CEOs indicate that the government needs to work together with business to be more effective at mitigating key global risks, like climate change, terrorism, and financial crises. However, some key growth countries put strategic sectors of their economy off-limits to ownership and control by foreign companies, meaning US companies will need to enter into alliances with domestic companies to penetrate new markets. With the significant amount of regulatory change occurring, companies can also collaborate with government in developing new standards.

Directors will want to ask the CEO: In what areas can we further collaborate with the government to promote business growth? How do we see beyond constraints to spot the opportunities in new regulation?

Of course, there are many other questions about the company's strategy that directors should ask the CEO. The overall question is *where* and *how* a company can change to prepare its business for the road ahead.

To learn more about these critical questions and other trends impacting the CEO agenda, refer to:

- [PwC: 2011 Global CEO survey report – US findings](#)
- [PwC: 10Minutes on the CEO agenda](#)
- [PwC: To the point: The CEO agenda for 2011](#)

Audit committee issues

There are several recent financial reporting developments that are relevant to directors. Many of these are addressed in the 2011 first quarter edition of [The quarter close - Directors edition](#). At a high level, significant topics include:

Convergence: FASB and IASB redeliberating priority projects; timetable extended

Standard setters have been busy redeliberating three of the boards' priority projects – leasing, revenue recognition, and financial instruments – changing course on some key aspects of the original proposals. The good news: it looks like the boards are taking to heart feedback received during the comment period. For example, two of the more

controversial aspects of the proposed leasing standard (definition of lease term and measurement of contingent rents) have been eased. Consideration is also being given to an "other than financing" lease category, which would align with the current operating lease standard from an income statement perspective. In the world of financial instruments, the concept of "amortized cost" is back as the FASB tentatively moved away from an across-the-board use of fair value. But there is still plenty left to debate. Due to that, and an appropriate emphasis on quality over speed, the boards announced on April 14 that they would extend the target date for completion of the priority projects from mid-2011 to the end of 2011. Regardless, companies have much to prepare for, and would be well-advised to start assessing the impact of the proposed changes across their organizations.

PCAOB considering changes to the auditor's reporting model

Several groups have expressed their dissatisfaction with the current auditor's reporting model, and have recommended that it be re-examined and made more meaningful for shareholders. As a result, over the past several months, the PCAOB Office of the Chief Auditor (OCA) has reached out to shareholders, investors, auditors, preparers of financial statements, audit committee members, and other interested parties to seek their views. On March 22, the OCA delivered an update on its findings. "We heard from investors that they want more information in the auditor's report. Investor dissatisfaction with the current auditor's reporting model should concern other constituents as well, including preparers, auditors, and regulators," said PCAOB Chairman James R. Doty. Overall, investors are looking for more information in the auditor's report, potentially including the risks the auditor faced in the audit and the judgments and estimates management used in preparing the financial statements. The PCAOB expects to issue a concept release, as early as this summer, detailing proposed changes to the auditor's reporting model.

Dodd-Frank proposed rule on disclosure of conflict minerals

Dodd-Frank includes a number of corporate governance and disclosure requirements that are not focused on financial reform. One such proposed rule applies to companies that use minerals from the Democratic Republic of the Congo and its adjoining countries ("DRC countries") in their products (so-called "conflict minerals"). Under certain circumstances, if a company uses conflict minerals, they will have to furnish an audited Conflict Minerals Report as an exhibit to their annual report. Think you're not affected? Don't be so sure – the conflict minerals defined in the rules are used in a wide range of products and industries. In fact, the SEC estimated that these rules will impact approximately 6,000 public companies. The significant challenge for companies who use these minerals, given the current lack of transparency into the metals supply chain, will be demonstrating that their minerals are not sourced from DRC countries – or if they are, demonstrating an adequate chain of custody out of the region. The sheer number of intermediaries and the degree of intermingling of these minerals along the supply chain adds considerable complexity. The SEC is scheduled to adopt final rules in April; initial disclosures and, if necessary, an audited Conflict Minerals Report will be required one year later.

Internal audit: A greater role in your organization?

As noted in our "Issue in focus," there is a high level of confidence among the respondents to our annual *Global CEO Survey* about the prospects for growth. At the same time, CEOs are focused on risk management, crisis prevention, and cost efficiencies. Correspondingly, PwC's *2011 State of the internal audit profession study* revealed that internal auditors are intent on meeting the changing needs and expectations of their stakeholders, including the CEO, audit committee, and other constituencies. Internal audit can help audit committees and management navigate the dynamic and complex risk environment and adapt to a rapidly changing world. Following are a few key questions directors should be asking about internal audit in order to get the greatest return:

- How is internal audit providing a clear point of view on our most significant risks and issues?
- Is internal audit well-connected in the organization?
- Is internal audit focusing on the new risks presented by changes in corporate strategy (e.g., M&A, emerging markets, etc.) and external factors (e.g., social media, cloud computing, etc.)?

The following resources provide additional insight on the above financial reporting issues:

- [PwC: The quarter close – Directors edition](#)
- [PwC: A closer look: Dodd-Frank impact on disclosures related to use of "conflict minerals"](#)
- [PwC: 2011 State of the internal audit profession study](#)

Issues in brief

Trends in say on pay voting

To date, say on pay voting results indicate that the vast majority of companies have received shareholder support for their executive pay programs. But for many companies where boards have recommended a triennial vote, shareholders have rejected this recommendation and supported annual voting. This has led many companies whose proxies were filed later in the season to recommend annual say on pay votes. This trend is particularly evident for larger companies. We have also seen a new trend this proxy season in how companies are dealing with negative voting recommendations from ISS. Companies have begun to push back on ISS's recommendations by reaching out to shareholders and filing additional disclosures with the SEC defending their pay plans. The voting trends highlight the importance of companies engaging their shareholders and being transparent with regard to their compensation plans and policies.

We recommend the following for additional current insight on say on pay:

- [Steven Hall & Partners: Say on frequency analysis](#)

SEC proposes rules on compensation committees and their advisors

On March 30, 2011, the SEC proposed rules directing the national securities exchanges to adopt certain listing standards on: i) the independence of compensation committee members; ii) compensation committees' authority to retain compensation advisors; and iii) compensation committees' responsibility for the appointment, payment, and work of any compensation advisor. The proposed rules give the exchanges flexibility to establish independence standards for compensation committee members. However, it is possible that independence standards could be enacted that are different from those for audit committees, and that standards could vary from one exchange to another. The proposed rules do not require that compensation consultants or legal counsel to the compensation committee be independent, but they do require compensation committees to consider the independence of the compensation advisors regarding: i) other services provided to the company by the advisor's firm; ii) the amount of fees paid to the advisor's firm by the company as a percentage of that firm's total revenue; iii) policies and procedures of the advisor's firm to prevent conflicts of interest; iv) the advisor's business and personal relationships with compensation committee members; and v) whether the advisor owns stock in the company. The proposed rules also require disclosures from companies concerning their use of compensation consultants and conflicts of interest, which are intended to integrate the Dodd-Frank disclosure requirements with the similar rules issued by the SEC in December 2009. The comment period ends on April 29, 2011, and the SEC must adopt rules by July 16, 2011.

We recommend the following for additional insight on the proposed rules for compensation committees:

- [SEC: SEC proposes rules requiring listing standards for compensation committees and compensation consultants](#)
- [Weil: Dodd-Frank Act update: SEC proposes rules regarding compensation committees and their advisors](#)

SEC enforcement actions against directors

The SEC's Enforcement Division has been very active in bringing a number of cases against alleged wrongdoers relating to insider trading, market manipulation, and financial reporting violations. And while naming directors in enforcement actions has been relatively rare up to now, two separate cases were recently brought against independent directors.

In one case, the SEC alleged that three board members who serve on a company's audit committee were not independent due to business and social relationships with the CEO and were "wilfully blind" to numerous red flags signalling accounting fraud, reporting violations, and misappropriations at the company. While it is unusual for the SEC to bring cases against directors, it is important to note that this case does not appear to be an attempt by the SEC to broaden or change the responsibilities of directors. As a matter of fact, a statement by the SEC's Chief of Enforcement, Robert Khuzami, indicated the intent of this action was not to second-guess the good faith efforts of directors. The second case against a director alleges insider trading based on information received in board meetings.

These cases, and the many others the SEC is pursuing, demonstrate the intensity of the current SEC enforcement agenda and the need for directors to continue to discharge their responsibilities effectively with appropriate care and to exercise a healthy professional skepticism.

We recommend the following for additional insight on SEC enforcement actions:

- [PwC / NACD: BoardVision – Focus on SEC activity](#)
- [SEC: SEC charges directors with accounting fraud](#)

Federal spending and tax policy legislation

As witnessed in the recent budget debate and near government shutdown, concern over the federal debt's unsustainable growth will likely serve as both a key motivator and a constraint regarding any action on federal spending and tax policy legislation in 2011 and beyond. With key individual and business provisions renewed temporarily, President Obama and some in Congress have expressed an interest in considering tax reform proposals along with deficit reduction efforts. In fact, the Senate Finance Committee is holding a series of hearings on tax reform. Reforms of individual and corporate tax rates, evaluation of territorial tax systems, alternative revenue sources, and other business tax proposals may be part of the discussion. The stakes for the business community are high. The US has one of the highest corporate tax rates in the world and US tax laws impact the global competitiveness of American companies. It will be critical for the business community both to monitor and have an active voice in shaping legislation and sharing their knowledge of how best to promote economic growth and reform US tax laws.

We recommend the following publication for an in-depth discussion of the impact of politics, the economy, and the deficit on tax policy:

- [PwC: Tax policy in a deficit-driven world: 2011 Tax legislative outlook](#)

Resources, webcasts, and events

BoardVision

PwC's Center for Board Governance and the National Association of Corporate Directors (NACD) are pleased to introduce BoardVision, a new on-demand video series designed to help directors stay current on the issues most relevant to them. Recent topics include the board's role in IT governance, the UK Bribery Act, the European Commission's Green Paper, say on pay, and whistleblower provisions in Dodd-Frank. For more information and the latest videos, go to www.pwc.com/boardvision.

Shareholder questions for management

A company's annual meeting provides its shareholders an opportunity to ask questions of management and the board about the company's performance and provides management an opportunity to present its views. Designed to assist management and the boards of directors of public companies in preparing for annual shareholder meetings, this PwC publication contains examples of questions that shareholders might ask as a result of past and current events. Read [Questions that shareholders may ask at 2011 annual meetings](#).

Thank you

Thank you for reading *BoardroomDirect*. For additional information, visit [PwC's Center for Board Governance](#) website. If you have any questions, please contact your PwC engagement partner or simply respond to this message using the "Submit feedback" link below. We will be in touch again next quarter, or sooner with any major updates impacting corporate governance.



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