

to the *point*

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Current issues for boards of directors

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The European Commission is exploring changes to auditing practices that could impact companies on this side of the pond. This article gives directors a heads-up on what may be changing.

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PwC's 14th Annual Global CEO Survey finds CEOs focused on three areas. This insight could help boards and management create competitive advantage for their companies.

IT risks—a director's perspective

Some directors may be uncomfortable with the subject of information technology. Given how complex companies' enterprise systems are, directors may be unclear about the questions they should be asking or the answers they should expect. But for some companies, where IT enables the company's operations, it represents a major risk that boards should oversee.

How does a director know whether to step up the level of IT oversight? Much depends on the company and its complexity. Greater director oversight of IT is likely warranted if your company:

- has a high volume of transactions; for example, a financial services company
- collects and stores sensitive data about third parties (customers, patients)
- has an open access network or open databases, allowing entry to the system by outsiders
- maintains proprietary know-how, processes, procedures, or other intellectual property
- has a multi-national scope

Even if your company doesn't have these environmental factors, you should consider the need to increase director oversight when the level of IT risk increases, such as when:

- major IT projects are underway—new systems, technologies or platforms
- integrating programs from more than one platform—using “best of breed” products from different providers that require “bridging” programs to pass data from one platform to another
- integrating an acquired business—especially one on a different IT platform
- technology is enabling a new corporate strategy

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European Commission looking at changes in auditing

In October 2010, the European Commission released a green paper on audit policy as part of its broader look at the causes of the financial crisis. It received close to 700 comments, and explored those comments in a February 2011 conference titled *Auditing—A Time for Change?*

The green paper is the first step in a process that in this case could culminate in legislation as early as mid-2012. Although the green paper is about auditing policies and practices in the European Union, it could have implications in other geographies as well, including the United States. Multi-national companies with operations in Europe would be directly impacted if their European subsidiaries are subject to the European Commission's rules.

At the February conference, Michel Barnier, EU Commissioner for Internal Market and Services, noted the Commission will focus its consideration on five main issues:

- Clarification of the role of the audit—to address the expectations gap regarding the public's perception of an audit versus the limitations of an audit
- Independence of audit firms—to address the role of the audit committee versus a third party in auditor selection, prohibitions on non-audit services, and rotation of audit firms
- Structure of the audit market—to foster the emergence of new audit firms

- Development of small and medium-sized entities—to allow more lenient rules for smaller accounting firms and small and medium-sized companies to provide an environment that supports their growth
- Strengthen international cooperation in auditing—to encourage worldwide adoption of international auditing standards

What happens now? Later this year, the European Parliament will issue its own report on the green paper. Meanwhile, the European Commission will continue to consider the comments it has received, as well as the views of Parliament, in drafting legislation that the Parliament and the EU member states will find acceptable. At the same time, the EC will prepare studies on policy options and cost-benefit analysis targeted for release in Fall 2011.

What's a director to do? For starters, stay informed about developments in this area. Consider the implications of these proposed changes to your companies, and be active in the debate by having your companies share their views with the European Commission. And remember, public policy ideas are no longer limited by regional boundaries and can be easily exported. We in the United States should monitor what develops in Europe because it may well put pressure on standard setters and regulators here to adopt reforms similar to what is being considered in Europe.

The CEO agenda for 2011

CEOs are turning their attention back to growth. PwC's 14th Annual Global CEO survey finds CEOs focusing on three areas: innovation, talent management, and relationships. While the survey had over 1,200 respondents from 69 countries, this article focuses on the responses of the more than 100 US CEOs who participated.

Innovation

CEOs believe firmly that innovation is the key to success. Most think innovations will lead to significant new revenue opportunities (74%), and innovations in operational efficiencies will provide their companies with competitive advantage (73%). What areas do CEOs see as ripe for innovation? Eighty-eight percent see opportunities to leverage consumer use of mobile devices and social media, and over half (58%) say more environmentally-friendly products and services will also drive innovation. Interestingly, one-third expect the majority of their innovations to be co-developed with partners outside their company.

Talent management

While job creation is key to economic recovery in the United States, most (63%) CEOs report headcount will remain the same or increase by less than 5% over the next twelve months. Only 15% expect further headcount declines in the period.

They also report their companies are developing workforce strategies to deploy more staff on international assignments and use more non-financial rewards as motivation tools.

CEOs' toughest HR challenges are recruiting and integrating younger employees (68%), competitors recruiting some of their best people

(66%), and a limited supply of candidates with the right skills (56%). And it doesn't end there; other top concerns include key employees making career changes for personal reasons, retirement of older workers, and providing attractive career paths.

Skillsets are such a concern for some CEOs that 45% indicate they are working with governments and educators to improve skills in the talent pool. At the same time, 38% of CEOs consider limited availability of key skills as a potential threat to their growth prospects. That said, only 18% report the availability of key skills as a significant risk they plan to mitigate over the next 12 months.

Relationships

Forty-five percent of CEOs indicate that government needs to work together with business to be more effective at mitigating key global risks like climate change, terrorism, and financial crises. 52% agreed national governments will put strategic sectors of their economy off limits to foreign ownership and controls—which could mean US companies will need to enter into alliances with domestic companies if they want to penetrate new markets. Looking forward, 66% of CEOs indicate they plan to enter into a new strategic alliance or joint venture, while 14% are planning to end one.

So what's a board to do with this information? Understand how your CEO is thinking about these trends and what impact they have on the company's strategic plan. Consider too how these trends could create competitive advantage for the company.

IT risks—a director’s perspective

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So, how can boards be comfortable they are in a position to oversee IT risks that are important to the company? By

- having someone on the board with reasonable technology skills,
- asking the right questions and applying skepticism when considering the answers, for example, by asking follow-up questions and seeking corroboration through other sources, possibly an independent board advisor
- understanding the full cost of technology, including the consulting fees to install the systems, as well as the licensing fees, equipment, training, maintenance, etc., and assess the implications of any cost variability
- getting regular updates on project status and understanding the factors that would signal when a project is in trouble

IT oversight often falls to the audit committee, though strategically significant technologies might be overseen by the full board. And it’s important to realize technology oversight doesn’t end with major systems as we’ve discussed here. Directors should be aware of and comfortable with the company’s web presence, as well as its use of social media and its policies governing such use (see also *To the Point*, “Social Media: What Directors Need to Know,” Summer 2010).

How PwC can help

To have a deeper discussion of how these subjects might affect your company or board, please contact:

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You may also want to see

NACD BoardVision, featuring PwC

PwC’s Center for Board Governance is participating in a new on-demand webcast series designed to educate directors and C-suite executives on current issues that impact their strategic and operational decisions. “NACD BoardVision” features PwC partners discussing these issues. Episodes may be viewed at www.nacdonline.org.

2011 Current Developments for Directors is available to help directors understand important developments and their impact on your companies and what you do in the boardroom. This edition addresses significant corporate governance developments and includes a special focus section on building competitive advantage in a global economy.

Coming soon: *Audit Committee Effectiveness—What Works Best, 4th edition*

The fourth edition of this popular book, written by PwC and published by the Institute of Internal Auditors, will be available by Summer 2011.

For these and other PwC corporate governance publications, visit the Center for Board Governance at <http://www.pwc.com/us/centerforboardgovernance>