

Current issues for boards of directors



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The conflict minerals rule is now final

Directors should understand what it entails and discuss with management whether the company is subject to compliance.

What are directors thinking about?

PwC's 2012 Annual Corporate Directors Survey outlines progress directors have made in their roles and the challenges that persist.

Improving audit quality

The PCAOB released a new auditing standard to foster improved communications between auditors and audit committees.

Conflict minerals: The rule is final

In August, the SEC approved its final rule on conflict minerals. The rule, mandated by the Dodd-Frank Act, requires public companies to disclose whether they use conflict minerals (tantalum, tin, tungsten, and gold) and whether the minerals originated in the Democratic Republic of the Congo (DRC) or adjoining countries—called “covered countries.” The rule responds to concerns that conflict minerals mined in covered countries help finance armed groups that are responsible for violence in those countries. The disclosures are intended to pressure companies to ensure that their supply chains do not contribute to conflict or human rights abuse.

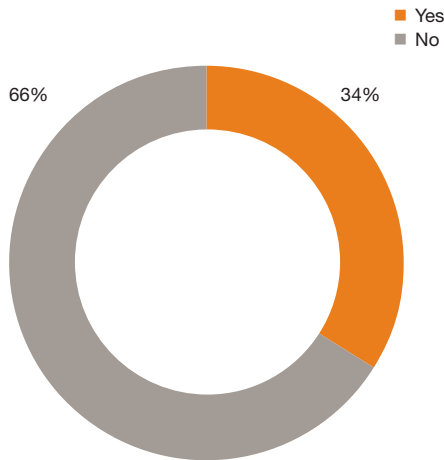
Conflict minerals can be found in hundreds of products ranging from cell phones and laptop computers to jewelry, golf clubs, drill bits, and hearing aids. An estimated 6,000 companies that are SEC issuers will have to provide new disclosures under the rule. Importantly, many private companies that are part of issuers' supply chains are also affected. The SEC estimates compliance costs at \$3-4 billion initially and over \$200 million annually thereafter.

A three-step process

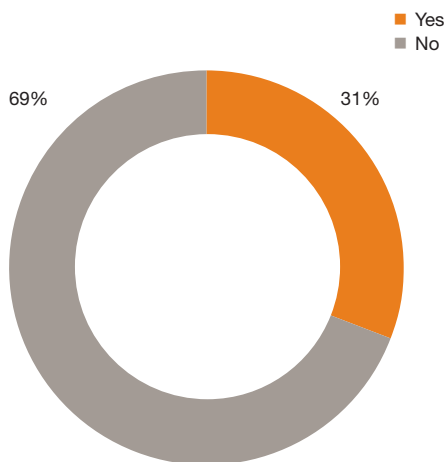
1. A company must determine whether any products it manufactures, or contracts to be manufactured, contain conflict minerals that are necessary to the functionality or production of the product. If so, the company must conduct a “reasonable country of origin inquiry.”
2. If the company concludes that its conflict minerals did not originate in the covered countries or are from scrap or recycled sources, it must annually disclose its conclusion, and how it reached that conclusion, in a new Form SD to be filed with the SEC. If the conflict minerals originated in covered countries, or their origin is unknown, the company must perform due diligence on the source and chain of custody of the minerals. The due diligence process must follow a nationally or internationally recognized framework.
3. In many cases, the company must file a Conflict Minerals Report that states whether its products are “DRC Conflict Free,” “Not DRC Conflict Free,” or “DRC Conflict Undeterminable,” and describes any due diligence process it used. An independent auditor must conclude whether the design of the due diligence process conformed to criteria in a recognized framework and whether the process was followed. Conflict minerals from recycled or scrap sources are considered “DRC Conflict Free.” If the company is unable to determine whether the minerals in

What's on directors' minds

Have you done anything in the past 12 months to reduce fraud risk?



Do you believe that any of your board members should be replaced?



Source: PwC's 2012 Annual Corporate Directors Survey

This summer, more than 800 corporate directors participated in PwC's 2012 Annual Corporate Directors Survey. Their responses, summarized in the survey report, paint a broad picture of how their responsibilities, time commitments, and priorities are changing. Directors are making progress to enhance their practices, but they acknowledge that challenges remain.

With the increasingly bright spotlight on boards, it's no wonder many directors are spending more time on their board work. According to our survey, more than half of directors say their time commitment to board work increased in the last year. Of those directors, two-thirds cite an increase of more than 10%.

We asked directors where they would like to spend more time in the upcoming year. Strategic planning topped the list, with 75% of directors wanting to devote more time to strategy, up from 60% a year earlier. Perhaps this increase is due to a more intense competitive landscape, changing customer buying patterns, and the adoption of emerging technologies such as social media. Succession planning was also an issue directors want to prioritize, with 68% saying they want to focus more time on it in the next year. Choosing the right CEO is an important decision; increased attention to this board responsibility may stem from several high-profile CEO turnovers that drew media attention in the past year.

Directors also want to understand how their company works and succeeds: 65% say they want to meet managers from key parts of the company, 59% say risk management is an important issue, and 54% want to develop human capital in the coming year.

Progress is made: Directors have enhanced many practices to improve their performance in the boardroom

Executive compensation: Almost two-thirds say their companies took some action in response to their 2011 "say on pay" vote. The two most common actions: 41% enhanced proxy statement compensation disclosures, and 29% made compensation more performance-based to better align with shareholder value.

Fraud risk: Directors demonstrate they are aware of fraud risk: Two-thirds say their board has taken action to address fraud risk, and 46% say they are focusing on "tone at the top."

CEO/chairman split: Just over half of directors say their boards currently split the Chair and CEO roles. For companies that still have a combined Chair/CEO role, about half of directors say they have discussed splitting the roles at their next CEO succession.

But challenges continue: Some issues continue to pose challenges.

Risk oversight: 37% of directors say there is no clear allocation of responsibilities for overseeing major risks among the board and its committees.

Information technology: Many directors are uncomfortable with the challenge of effectively overseeing IT strategy and risk.

Concern about peers: Nearly one-third of directors say someone on their board should be replaced. The top two reasons: age has led to diminished performance and the director does not have the expertise required.

For deeper insight and analysis, download the full report: www.pwc.com/us/directorsurvey.

Update from the PCAOB

In August, the Public Company Accounting Oversight Board (PCAOB) released a new standard designed to improve communications between external auditors and audit committees. PCAOB Auditing Standard No. 16, *Communications With Audit Committees* (AS 16), establishes requirements that enhance the relevance and timeliness of the communication and encourages effective two-way communication.

AS 16 requires an auditor to communicate specific information to an audit committee before issuing the auditor's report and emphasizes the importance of open communications between the two. It also codifies as standard practice certain types of communications that many audit firms had already been doing.

Under the new standard, the auditor must ensure the audit committee has acknowledged and agreed to the terms of the auditor's engagement. This is particularly relevant if the engagement letter is signed by parties other than the audit committee or its chair on behalf of the audit committee

New communications requirements

The standard requires more information to be provided to the audit committee about significant aspects of the audit:

- An overview of the overall audit strategy, including significant risks identified
- The nature and extent of specialized skill or knowledge needed to conduct the audit
- How the auditor determined that it can serve as principal auditor, if other auditors are involved
- Difficult or contentious matters for which the auditor consulted outside the engagement team
- Any departure from the auditor's standard report
- Other matters arising from the audit that are significant to the audit committee's oversight of the company's financial reporting process

- Any concern about management's anticipated application of accounting standards that are not yet effective and might significantly affect future financial reporting

Pre-existing communications requirements

It also retains pre-existing communications required by auditing standards and the SEC:

- Information about the company's accounting policies, practices, and estimates, such as revenue recognition and off-balance-sheet financing
- The auditor's evaluation of the quality of the company's financial reporting
- Information relating to significant unusual transactions, including the business rationale for such transactions
- Significant accounting or auditing matters that the auditor has a concern about and that management consulted other accountants about

The standard is expected to be effective for audits of fiscal years beginning on or after December 15, 2012, subject to SEC approval. Audit firms may adopt AS 16 before it becomes effective, and audit committees may request that their auditors discuss matters covered by AS 16 before the effective date.

The Jumpstart Our Business Startups (JOBS) Act stipulates that the PCAOB's pronouncements issued subsequent to enactment don't apply to audits of emerging growth companies (EGCs) unless the SEC determines that they would be in the public interest. AS 16 is the first auditing standard adopted by the PCAOB since the JOBS Act was enacted in April. In this case, the PCAOB will ask the SEC to apply this new standard to EGCs. (For more information about the JOBS Act, read the Summer 2012 issue of *To the point.*)

Conflict minerals: The rule is final

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its products originated in a covered country, those products will be considered “DRC Conflict Undeterminable” for a temporary two-year period (four years for smaller companies). During this period, an independent audit of the report regarding the conflict minerals in those products is not required.

What directors should know and do

- Even if a product contains minor traces of a mineral, the company must comply.
- Foreign private issuers, emerging growth companies, and smaller companies must also comply.
- Companies must file their first Form SD by May 31, 2014 for the year ended December 31, 2013, along with a Conflict Minerals Report, if required.

What should directors discuss?

- Management’s process to determine whether the company is impacted by these new rules
- The company’s planned approach to due diligence
- Cost estimates for compliance

This rule could face legal challenges by the business community, so directors should stay tuned for any developments as their companies move forward with compliance.

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

2012 Annual Corporate Directors Survey

Significant changes in corporate governance are impacting boardroom dynamics, compelling directors to spend more time on board work and prompting them to reconsider their oversight approach. Our *2012 Annual Corporate Directors Survey* outlines progress directors have made in their roles and challenges that remain. More than 800 directors responded to this year’s survey, offering insight into core areas that are “top of mind” to today’s world-class public companies.

BoardroomDirect

Our e-newsletter, BoardroomDirect, delivers our board level developments and latest board level insights on a monthly basis. The latest issue covers audit firm inspection reports, board declassification, proxy issues, virtual shareholder meeting guidelines, and FASB’s new proposed disclosure framework and revised asset impairment models.

Download the Board Center App for your iPad

PwC’s Board Center App provides the latest updates on corporate governance issues and trends to enable board members to more effectively meet the challenges of their critical role. The Board Center App brings together insights on strategy and growth, executive compensation, financial reporting developments, and risk management with the corporate director in mind.

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