What works best in the boardroom

Catherine Bromilow & Don Keller
Partners, PwC’s Center for Board Governance

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For today’s discussion

- Setting the stage: the current environment
- Overview of Board Effectiveness
- Selected leading practices
- Overview of Audit Committee Effectiveness
Setting the stage: the current environment

- Shifting governance landscape, partly in response to the economic crisis
  - Dodd-Frank Act and emerging regulations
  - Pressure on the SEC
  - Changing shareholder power dynamics and influence of proxy advisory firms
- Continuing focus on executive compensation – levels, link to risk
- Increased focus on anticorruption investigations, leading to significant increase in fines
- Greater stakeholder focus and regulatory requirements
  - Corporate social responsibility
  - Supply chains – e.g., conflict minerals
- In PwC’s 2011 Annual Corporate Directors Survey, 38% of directors believe their risk as a director had increased in the prior 12 months
**Board Effectiveness — What Works Best**

• PwC and the Institute of Internal Auditors Research Foundation will soon issue the 2\textsuperscript{nd} edition of *Board Effectiveness — What Works Best*

• The book describes leading practices in the key areas of board governance responsibility:
  - Strategy and implementation
  - Risk and crisis management
  - Corporate ethics
  - Monitoring company performance
  - Transformational transactions
  - Management evaluation, compensation, and succession
  - Communicating with stakeholders
  - Board dynamics

• PwC also authored the previous edition in 2000

• The 2\textsuperscript{nd} edition represents wide international input, including the results of director and thought leader interviews in the BRIC countries: Brazil, Russia, India and China
What works best
Strategy and implementation

• Gets needed information on industry trends, competitors, market and financial position, customers, suppliers, economic environment — to enable sufficient insight

• Debates proposed strategy considering
  - Key assumptions, major risks, required resources
  - Strategic acquisitions and relationships
  - Understanding of strategic alternatives considered
  - Revolutionary impacts of IT, social media and competitors
  - Degree to which management’s past strategies succeeded or failed

• Once approves strategy, considers management’s implementation plans
  - Achievable forecast
  - Encompass appropriate targets for measurement

KEYS:
- The right forum and investment of time
- The right horizon
- The right people
- The right flexibility and monitoring
- The right capital expenditures
- Don’t fall into numbers game
What works best

Risk and crisis management

- Regulators and shareholders very interested in risk management transparency
- Management’s process must include input from across the enterprise
- Satisfied with effectiveness of management’s process
  - Appropriately identifies and assesses risks and reflects proper risk appetite
- Understands key risks, with robust discussion at full board
  - Considers linkage of compensation to risk
  - Considers information technology and social media risks
- Recognizes which types of crises company most vulnerable to
  - Robustness of management’s crisis plan
  - Board’s readiness to step in if needed and role in investigations

KEYS:
- Decide who on board has what risk
- Management has process to identify new risks that arise
- Not getting lost along the way in the sea of heat maps
- Culture that empowers employees to raise issues
- Meet with the Chief Risk Officer
- Crisis means time for board to step up
- Recognize factors impacting risk profile
What works best
Corporate ethics

• Assesses management’s establishment of appropriate tone at the top
  - Employee surveys
  - Executive 360° feedback and degree of scripted interaction
  - Periodic onsite visits with managers and employees
  - Exit interviews of executives

• Understands whether compliance programs are effective, especially in light of:
  - A raised bar for bribery and corruption
  - Exposures company faces – where it operates, industry
  - Current enforcement activity
  - Effective recruiting and human resource practices

KEYS:
- Beware of related party transactions
- Appropriate dealings with evil doers
- Don’t underestimate CEO influence
- An empty hotline may not be good
- Don’t forget agents, resellers and distributors
- Training for everyone – considering local culture
What works best
Monitoring company performance

• Ensures right performance metrics used
  - Linked to strategy and value drivers
  - Balanced – forward-looking versus historical; financial versus nonfinancial
  - With right targets for the metrics (an art)

• Gains comfort metrics board uses to assess performance are reliable
  - Assurance by internal audit or external audit
  - Consistent with directors’ knowledge about company and industry performance

• Periodically evaluates information needed at board level for ongoing relevance

KEYS:
- Don’t let metrics consume value enhancement (counterproductive)
- Don’t measure anything that moves
- Don’t forget nonfinancial measures (customer satisfaction, etc.)
- Understand external expectations (consensus)
- Earnings guidance has pros and cons
- Objective input from employees and customers may prove valuable (no spin)
What works best
Transformational transactions

- Ensures proposed mergers, acquisitions, divestitures, or alliances
  - Are being pursued for the right objectives
  - Clear return on investment hurdles
  - Link with company strategy
  - Are subject to robust due diligence, identifying significant risks
- Management is capable of executing appropriately – skills, resources, decisions
- Understands the company’s history with transactions and if lessons learned are applied

KEYS:
- Most deals don’t work out
- Don’t wait until deal comes to prepare – establish parameters beforehand
- Pay attention to track record of deal success
- Post-merger integration planning should be a “deal point”
- Stay current with post-merger integration progress
- Don’t fall in love before seeing results of due diligence
- Beware of accounting surprises in divestitures
What works best
Management evaluation, compensation, and succession

- Approves CEO’s development plans
  - Align with strategy; reinforce importance of tone; include appropriate targets
- Monitors CEO performance continually
- Provides constructive feedback, building effective working partnership
- Formally assesses CEO’s performance
  - Against performance goals
  - Incorporating results of any upward feedback programs
  - With a focus on development points for subsequent years
- Establishes appropriate CEO compensation
  - Aligns rewards with meeting strategic objectives and both long- and short-term goals
What works best
Management evaluation, compensation, and succession (continued)

• For other executives
  - Whether development plans align with CEO’s plans and company strategy
  - CEO’s assessment of their performance
  - Meets and gets to know them as part of succession planning
• Has sound process to identify new chief executive – whether planned or unplanned

KEYS:
- The world is watching with new disclosure and voting rules – comp committees heavily scrutinized
- Consider the CEO’s upward feedback when evaluating – sets tone
- Say on pay results need to be considered or addressed
- Transparency on compensation can prevent problems
What works best
Communicating with stakeholders

• Review key financial reports provided to stakeholders, understanding management reporting decisions and external audit results
• Is confident other key performance indicators that management reports are reliable
• Understands what type of corporate social responsibility reporting management provides – both as mandated and voluntarily – and how management assures the information is reliable
• Discusses the company’s communications policies, including how they address crisis
• Exercises care when directors speak directly with stakeholders

KEYS:
- The voice of proxy advisory firms may be getting louder
- The Q&A of analyst calls may reveal more KPIs
- Social media monitoring is critical to crisis communications
- Pay attention to regulatory fair disclosure rules
- Directors are more engaged with outside communications
What works best

Board dynamics

• The board has the right composition and size
  - Director independence
  - Mix of skills, experience, diversity – SEC proxy disclosure and mapping
  - Committees with proper reporting to the board
• The board has the right leadership (combined, separate, lead director)
• Board meetings are effective and the right frequency
  - Supported by sound agendas and quality materials
  - Chair ensures all directors are engaged
  - Time reserved for private sessions
• Directors get needed education – both orientation and on an ongoing basis
What works best
Board dynamics (continued)

• Board periodically assesses its effectiveness
  - Of board as a whole, committees, and individual directors
  - Takes a continuous improvement approach
• Director compensation is appropriately set

Keys:
- Must have willingness to challenge CEO
- “Consent” agendas are increasing
- Retain flexibility with end of meeting time
- Advanced materials must be on time
- Executive sessions are critical
- Director training is good
- Deal with underperforming directors
Overview of Audit Committee Effectiveness

In 2011, PwC and the Institute of Internal Auditors Research Foundation issued the 4th edition of Audit Committee Effectiveness – What Works Best

• Represents a resource tool and a “handbook” for audit committee members to easily find discussion of relevant topics
Companion book: Audit Committee Effectiveness

- Represents the results of 80 audit committee chairs and internal audit director from 13 countries, including Brazil, Russia, India and China
- Seeks to identify key practices or challenges that have emerged in response to the global economic crisis that began in 2008
- The book covers:
  - Financial reporting and disclosures
  - Culture and compliance
  - Relationship with external auditors
  - Committee composition
  - Supporting processes: charter, evaluations, resources and training
  - Risk management and internal control
  - Oversight of management and internal audit
  - What to do when things go wrong
  - Meetings
Center for Board Governance

Our mission:

The mission of PwC’s Center for Board Governance is to enhance confidence in corporate governance by providing offerings that enable board members to more effectively meet the challenges of their critical role. We achieve this objective by sharing leading-edge governance practices, developing insightful and timely thought leadership, and offering forums for directors to discuss contemporary issues.

We also engage with boards of directors and audit committees to provide our perspectives on significant governance topics and share insights to enhance directors’ abilities to comply with evolving regulations and expectations. Our collaborations with other governance thought leaders expand the knowledge and value we provide to the director community.
PwC governance publications and resources
Available online at www.pwc.com/us/centerforboardgovernance

**Board Center App.** PwC’s App provides timely insights on corporate governance issues and trends to enable board members to more effectively meet the challenges of their critical role. Available for your iPad, the App brings together insights on strategy and growth, exec comp, financial reporting, and risk management with the corporate director in mind. Download at www.pwc.com/us/BoardCenterApp.

**Annual Corporate Directors Survey 2010:**
Survey results: PwC’s annual survey collects the opinions of more than 1,000 directors serving on the boards of the top 2,000 US publicly traded companies. The survey covers such relevant issues as risk management, compensation, director evaluations, director experience mix and board diversity, to name just a few.

**To the point: Current issues for boards of directors.** As the title suggests, *To the point* addresses contemporary issues in an impactful, insightful, and concise format. Each quarter addresses select topics that are of immediate interest to directors.

**The Quarter Close - Directors edition Q1.** This quarterly publication is designed to keep directors informed about the latest accounting and financial reporting issues. The Q2 2011 edition spotlights the FASB and IASB’s joint projects, the SEC’s latest release on the possible incorporation of IFRS into the US financial reporting system, and more other key topics.

**Current Developments for Directors.** *Current Developments for Directors* looks at the key issues facing you as a director. It offers information, insights, and practical guidance so that you can meet the demands of your role more knowledgeably and enrich boardroom discussions.

**BoardroomDirect®**—BoardroomDirect delivers our latest board level insights—and that of select third-party organizations—on a quarterly basis. Each edition delivers an in-depth perspective on one major issue, as well as updates on other important topics. We have also committed to notify you when important events unfold.

**Board Governance Series, Vol 17.** This Series features commentary from both PwC and external corporate governance professionals on issues impacting boards. This issue includes articles on what directors should know about combatting fraud and the findings from PwC’s 14th Annual Global CEO Survey.

**Board Vision: An on-demand video series for directors.** Watch PwC’s and the NACD’s on-demand video series, designed to help directors stay current on the issues most relevant to them. This series shares insights on governance developments to help directors meet the challenges of their critical role. Watch full episodes at www.pwc.com/boardvision.

*Not surprisingly, the most-watched shareholder votes this proxy season were the mandatory say on pay vote and the related say on frequency vote. Most companies received strong majority shareholder support for their say on pay vote, and there was a strong preference by shareholders for an annual voting policy.*

*One of a director’s most important obligations is to engage in meaningful strategy discussions with the CEO. The results of PwC’s 14th Annual Global CEO Survey can help directors gain perspective and understand what issues are on CEOs’ agendas, which will enhance the quality of those discussions.*
PwC’s Center for Board Governance

Catherine L. Bromilow
Center for Board Governance Partner
973-236-4120
catherine.bromilow@us.pwc.com

Don Keller
Center for Board Governance Partner
512-695-4468
don.keller@us.pwc.com

For additional information visit pwc.com/us/centerforboardgovernance