EY Center for Board Matters

Board agenda 2018
Top priorities for European boards
## Contents

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>01</td>
</tr>
<tr>
<td>Developing long-term value and defining corporate purpose</td>
<td>02</td>
</tr>
<tr>
<td>Interacting with shareholders</td>
<td>04</td>
</tr>
<tr>
<td>Focusing on corporate reporting</td>
<td>06</td>
</tr>
<tr>
<td>Optimizing capital allocation decisions</td>
<td>08</td>
</tr>
<tr>
<td>Enhancing talent and corporate culture</td>
<td>10</td>
</tr>
<tr>
<td>Defining reward</td>
<td>12</td>
</tr>
<tr>
<td>Strengthening partnerships and governing risk</td>
<td>14</td>
</tr>
<tr>
<td>Managing cyber risk – a new era of security</td>
<td>16</td>
</tr>
<tr>
<td>Reflecting on new responsibilities for audit committees</td>
<td>18</td>
</tr>
<tr>
<td>Creating boards of the future</td>
<td>20</td>
</tr>
</tbody>
</table>

Read *Top priorities for European boards in 2017*
Introduction

The pace and scale of disruption will continue to present a number of challenges to companies; however, opportunities to harness new technology and trends will undoubtedly emerge to reshape business models, improve companies’ performance and value creation, and focus on and address emerging risks. In this continually changing environment, board members need more than ever to focus on key and strategic priorities.

That disruption takes many forms, including political instability fueled by economic uncertainty across the world, digital transformation and business model disruptions, greater scrutiny of corporate behavior, and regulators that are under increasing pressure to develop frameworks that foster growth but curb short-termism and unfair practices.

In order to reflect these dynamics, Board agenda 2018 covers an increased range of disruptive factors. They are all evolving quickly, and it’s unlikely that “tried and trusted” approaches and remedies will be sufficient by themselves. In practice, that means board members must look outside the boardroom, into the business and beyond, for help in navigating this new landscape.

Building on Board agenda 2017, with its top priorities such as geopolitical risks, regulatory change, digitalization and its business impact, corporate compliance and culture, Board agenda 2018 confirms that all these remain highly relevant. Managing tax risk will be particularly important in 2018 in respect to US tax reform and Brexit.

The 2018 edition draws on the expertise of professionals to outline the most pressing topics and questions facing boards and audit committees: communicating effectively with stakeholders; developing a robust corporate reporting framework; optimizing decision-making around capital allocation; identifying, developing and retaining the best and brightest talent; anticipating and mitigating risks through internal processes and external partnerships; and developing potential board directors.

In addition to addressing risks and identifying growth opportunities, board members are facing a set of more fundamental questions about the behavior and purpose of both their businesses and themselves. They center on defining corporate purpose, communicating what the business stands for, and demonstrating a commitment to the creation of long-term value by sustainable and socially acceptable means.

These pressures require boards to look not just outward, but inward too. Does the board have the right mix of skills? Is the board empowering its people to make smart decisions? Are remuneration strategies sustainable, in line with industry standards and defensible, given the increased scrutiny of executive pay? Directors who are able to understand the pressures and design effective strategies can set the tone for the business’s future.

Understanding how these trends will affect the business in the short and longer term is now the key challenge facing boards. The opportunities presented by the fast-moving corporate landscape will not wait. Inaction is not an option.

And the thread that ties all of this together is digital technology. Today’s board directors are fortunate to have at their disposal an unprecedented set of tools with which to modernize and grow their businesses. Digital is the engine of both opportunity – opening up new markets and potential business models – and challenge, fueling disruption in every area of the business and threatening established models and methods. Indeed, from artificial intelligence and cybercrime to more integrated supply chains and smart factories, digital is the new normal.

Our suggested priorities do not appear in order of importance and will not be of equal relevance to every board or every organization. However, we believe they encompass the issues that should be high on the agenda of all boards, regardless of their structure. In addition, we have provided a list of key questions for board members to consider in relation to each priority.

We hope that this will offer food for thought when planning your personal and corporate agenda for the new year. We wish you all a happy and prosperous 2018.

Jean-Yves Jégourel
EY EMEIA Assurance Leader
Boards face a growing set of challenges in 2018, as greater scrutiny from stakeholders begins to gather pace. In short, boards must demonstrate how they plan to deliver sustainable returns over the long term.

To a large degree, this has sprung from the trust deficit that has grown up around business in all sectors since the financial crisis. Growing mistrust of big business and short-termism, concerns over inequality, and demands for greater focus on sustainability and fairness — all combine to challenge and disrupt how boards perform.

Boards are now under pressure to articulate their long-term plans in order to demonstrate an understanding of how underlying trends affect the creation of value in their business. That will take in issues such as energy use, employee satisfaction and diversity, and how they aid long-term value creation.

This is a reflection of the fact that different stakeholder groups have different priorities. Boards have grown used to communicating their short-term aspirations and performance, but must now widen that to discuss the drivers underlying long-term value creation. For instance, long-term investors seek different assurances from those demanded by other stakeholder groups.
In the past, board members enjoyed far more power over the company’s narrative: they could choose which parts of the story to emphasize. But, with greater access to information, investors are increasingly prepared to make their own judgments based on information they can glean from a range of resources.

This will involve a number of tools, including data mining, analysis and web scraping, as investors, analysts and others mobilize a new range of tools to build their own perception of a company’s performance and prospects. That will require not only a well-crafted response but also a proactive approach to shaping that narrative.

Given these trends, there are three key issues for boards to consider: first, are you being transparent in how your value creation strategy is transforming in a fast-changing political, economic and social environment?

The second question centers on how stakeholders are assessing the value the organization delivers for them. As a corollary to that, are your stakeholders’ rapidly evolving needs being recognized? How is that narrative playing out?

The third and final question is more intangible, but nonetheless one that cannot be ignored: the social contract that businesses have with society is coming under threat, so is the board genuinely engaging with all its key stakeholders to address that? Is the board clear about its corporate purpose, and does that purpose address all stakeholders? Just as important, is it delivering against that purpose and is it seen by its stakeholders to be doing so?

Boards that choose to sit on the sidelines of this fundamental debate run a serious risk. Society will drive politics, and that will drive regulation, which may hinder future plans. The Shareholders’ Rights Directive (SRD) is just the latest example of activist legislation aimed at realigning business with social good.

Failure to engage with these questions in the years ahead could represent a genuine threat. If boards don’t seize the opportunity and respond to the prevailing trends (diminished trust in business; the growth of a populist, protectionist agenda; and growing regulatory activism), they face a challenge in demonstrating long-term value.

Make no mistake, politicians across the world are expressing concern about corporate behavior and, for many, legislation is the next step. For many boards, there is little time to waste in developing and articulating an adequate response.

Related resources

Questions for the board to consider:

- Is the board clear on the company’s corporate purpose? Can it adequately summarize and explain it?
- How does the board plan to measure the creation of value for its stakeholders?
- If the board is on a journey of transformation, does it have the right metrics in place to measure its progress?
- What would it take for the board to disclose these measures and regularly report on them to improve transparency and trust in the business?
- How is the company aligning its strategy and business with long-term value concepts? If it needs to transform to do this, what is its approach?

Related resources

*Can a different framework of value enable greater trust in business? Defining the journey towards more effective measurement and reporting of value*
The global financial crisis and recent corporate scandals highlighted the need for shareholders to have more of a voice in corporate governance. This will align long-term shareholder interests with business strategy by reducing short-termism in the corporate landscape, and also by increasing the focus on environmental, social and governance issues. Regulators across the world have been encouraging companies to simplify engagement with shareholders and to increase transparency. The result has been mixed. Therefore, the introduction last year of the amended EU Shareholders’ Right Directive (SRD) is a response to the slow progress made by corporates under voluntary codes.

European regulators in particular have recognized that, while institutional investors have a long-term investment mandate, asset managers’ performance is evaluated several times a year. This puts pressure on asset managers to produce short-term results. As such, there is a growing need to align investment strategies with the long-term interests of shareholders.

The SRD facilitates interaction between shareholders and companies. It provides a framework for improved flow of information and easier exercising of shareholder rights, such as voting. This is particularly significant for cross-border shareholders, as pricing for shareholder services must be transparent and nondiscriminatory.
The SRD requires increased transparency of institutional investors and asset managers regarding shareholder engagement and their investment strategy. Proxy advisors are required to disclose key information about their activities.

The SRD strengthens “say on pay,” i.e., shareholder rights regarding remuneration of directors. Shareholders now not only have the right to vote on the remuneration report but also on the remuneration policy.

The SRD’s framework for disclosure and approval of related party transactions increases shareholder rights and protects minority shareholders. Directors must explain how each transaction is structured and who ultimately benefits. While there may be some difference in this area between jurisdictions, the move is toward greater transparency.

Under its rules, the SRD presents boards with an opportunity to improve the alignment between corporate strategy and the long-term interests of its shareholders. Boards will be expected to develop more accountable governance policies proactively, taking increased stakeholder participation and feedback into account. All of this fits squarely into the wider trend of greater transparency of board behavior and the increased focus on building long-term company value.

Questions for the board to consider:

- Is the board clear on which of its members takes the lead on stakeholder engagement?
- Is the company’s governance aligned with stakeholder interests and expectations?
- How is the board engaging with stakeholders to understand their views on key issues such as director remuneration, the environment and social matters?
- Does the company culture reward integrated thinking and integrated management?
- How prepared is the company to implement the SRD?

Henrik Kronborg Iversen
Partner, Assurance, Ernst & Young P/S
+45 732 3 3277
henrik.k.iversen@dk.ey.com
Denmark
Focusing on corporate reporting

Corporate reporting will continue to be a topic of intense focus and scrutiny in the coming year. Boards need to focus on what matters, both in financial and nonfinancial reporting, and in scrutiny by stakeholders and regulators.

Board members must be aware that the reporting landscape continues to change. As will be seen with the advent of the SRD, directors must now take a proactive approach to communicating with stakeholders. In addition, the International Accounting Standards Board (IASB) has engaged in a wide project around the quality and effectiveness of financial reporting under IFRS, under the umbrella of “Better Communication in Financial Reporting.”

Preparers of corporate reports must make sure they are putting historical performance into context, as well as presenting the risks, opportunities and prospects for the company in the future. The primary purpose will be to help investors and stakeholders understand the company’s strategic objectives and the progress made in their execution. This means delivering a clear and consistent sustainable value creation strategy. There must also be coherence between financial performance measures and other performance indicators. Finally, reports must establish a clear link between strategy, key value drivers and the executive remuneration structure.
Of course, long-term value creation is not entirely sustained by financial growth. Nonfinancial measures have gained currency in the past decade as sustainability concerns, risk reporting and scrutiny of corporate governance have become more important.

While some market observers (and preparers) may choose to cast the issue as an “either-or” question, the integration of nonfinancial measures is increasingly accepted as a vital part of a bigger “integrated” picture.

Boards can expect more progress on this. For instance, the Task Force on Climate-related Financial Disclosures will be further along in its work. This will require boards to integrate climate risk into their corporate reports.

In the wake of these consultations, stakeholders will expect to see directors demonstrating that they have assessed and reported on their exposure to climate-related risks. This will also extend to greater transparency in areas as diverse as bribery, human slavery and energy use.

Indeed, the coming year will see further strengthening of the EU’s commitment to ensuring companies report on non-financial information. Along with anti-bribery provisions, the NFRD also covers environmental reporting, social and employee matters and respect for human rights.

These new provisions are already enshrined in EU law, and companies with a December year end will soon begin to report against them.

Related resources

Is your nonfinancial performance revealing the true value of your business to investors?

Questions for the boards to consider:

- How does the philosophy on corporate reporting need to change to take these issues into account? And how can it add value?
- How confident is the board that the company is measuring and disclosing the financial and nonfinancial KPIs that best indicate how well the company is progressing against its strategy?
- How have the company’s remuneration policies been updated to align with the key drivers of value creation?

Vincent de La Bachelerie
EMEIA IFRS Leader
+33 1 46 93 62 05
vincent.de.la.bachelerie@fr.ey.com
France

Christophe Schmeitzky
EMEIA CCaSS Leader
+33 1 46 93 75 48
christophe.schmeitzky@fr.ey.com
France
The role of the board in capital allocation has been the subject of debate in recent years. There are varied views on what directors should be doing in terms of setting strategy, providing oversight and measuring success against a range of metrics.

However, it is certainly true that stakeholders now expect board members to take an active role in developing long-term strategies to grow the company, be that through core, adjacent or even new business. Taking on questions of opportunity and risk management is of upmost importance. This is especially true while businesses continue to experience digital disruption.

Given this, the board must become a “constructive challenger” of the capital allocation strategy. By maintaining a healthy distance from everyday operations and having a diverse composition, it should have the advantage of being able to come up with constructive challenge to the status quo by asking the right questions.

The challenge for a business in a disrupted phase is to design and implement the right metrics to measure ROI. Entering into new markets, developing new products or innovating around new systems and processes will require a more nuanced way of measuring success. With no precedent to fall back on, board directors must quickly...
Questions for the boards to consider:

- In what way is constructive challenge encouraged at board level?
- How has the company updated its capital allocation strategy and metrics recently for agile investments?
- To what extent does the board feel that executives within the business are empowered to make informed investment decisions?
- When it comes to evaluating the company’s metrics on its capital program, how confident is the board that the company is collecting and updating the right data, and that it is equipped to interrogate it meaningfully?

Faced with these questions, board members must also demand that business managers offer a broad range of investment strategies: if investing in organic growth is too risky due to a lack of the right skills and capabilities or the speed of change, examining the prospects of acquisitions must also come into play. The classic “buy versus build” question even gets extended to “ally” and building an agile digital ecosystem around the organization as its borders start to become more permeable. And that will also test the effectiveness of the board’s decision-making – does it have the right skills to assess this? Is there a succession plan in place to ensure that, whatever effect disruption has on the business, the board is equipped to take a full, active role in sensible capital allocation, both in the short and long term?

Related resources

Global Capital Confidence Barometer
Board members have a critical role to play in developing a healthy corporate culture that supports the company’s purpose and underpins the delivery of its strategy. Stakeholders increasingly expect to see board directors understanding and nurturing their company’s people as a key asset.

The links between diversity – both at boardroom level and beyond – and better corporate performance are growing in both strength and number. Boards need to grasp these links and ensure they are embedded into recruitment and talent management.

Diversity does not simply mean ensuring a balance of ethnicities and gender in the workplace. It also requires boards to seek out and champion a diverse set of voices from a range of educational and cultural backgrounds. By doing so, companies should develop a more innovative and engaged workforce.

Increasingly, external stakeholders expect these issues to be measured and reported on. From basic KPIs such as employee turnover to more sophisticated qualitative analysis tracking staff engagement and productivity, businesses are now expected to monitor how their culture...
Questions for the boards to consider:

- How is the company treating its people as a strategic asset?
- Is the board clear on what sort of culture it wants to underpin the company’s purpose? If so, how is this being measured to ensure that it is on track?
- How is the board approaching diversity and inclusion both at board level and within the company itself?

and people are affecting performance. More transparency is expected on how their approach to performance management is working to nurture and develop these people assets.

Stakeholders who are concerned with the long-term performance and sustainability of the business will expect to see boards empowering management to pursue innovative and effective hiring and development practices. They will also want to see a culture of independence and challenge present at board level.

That should include a well-crafted succession plan for senior executives that takes into account not only the requirement for technical and leadership skills but also the need to inject fresh impetus into the highest levels of the company.

Boards must be ready to be transparent with stakeholders. This includes how decisions are arrived at, how challenge and criticism are dealt with, and how standards of personal behavior are maintained. In an age of engaged stakeholders, setting the right tone from the top has never been more important.

Not only should this increase diversity, it will also help embed in the corporate culture an ethos of openness to new thinking and a long-term view of risk and opportunity.

Related resources

Boards turn to the talent agenda
Executive pay has long been seen as separate from the broader themes driving business, but increased scrutiny over the creation of sustainable long-term value is bringing it firmly into the center of corporate culture and reporting. Stakeholders now have a wider and stronger set of powers to demand more transparency and oversight of executive remuneration.

The UK has already traveled some way down the path on this but, for other EU Member States, a new era is about to begin. The biggest change will be the introduction of an annual vote on the compensation report. This will cover not only the remuneration policy that the board adopts but also the actual reported executive pay packages that are offered as a result.

In practice, that means boards will be required to defend their remuneration reports and policies; and if there are votes against the board’s recommendation, they will have to report back at the next AGM on how they have incorporated this negative vote into their decision-making, as well as outlining how they have followed the voting recommendation from shareholders.
Another change that boards will have to build into their thinking concerns the ability of consultancies to deliver comparative information across a wider international and cross-sectoral landscape.

Previously, institutional investors had a limited pool of comparison, using only benchmarked figures from the same stock exchange or the same region, for instance. This local comparison model will soon change. Instead, investors and other stakeholders will have a broader range of comparisons with which to benchmark executive pay across Europe and beyond.

While this may introduce greater scrutiny and discussion over executive pay, the intention is to improve the quality of the discussion surrounding the topic, which can be misunderstood and open to misinterpretation.

This improvement may follow the example of the credit ratings agencies, where initial skepticism over the quality of comparative information dissipated over time. The information can then underpin better understanding and more informed discussion of executive pay.

This will require real board engagement in new areas, such as pay ratios that contrast executive pay with others within the organization. It may also extend to include the gender pay gap. If these ratios, as well as a perceived misalignment of performance and reward, continue to cause concern at national level, boards should be prepared for further legislation in the coming years.

Stakeholders will be more able to exert greater influence over this by demanding that boards create a set of KPIs that feed into the remuneration strategy. These KPIs will go far beyond the financial indicators and will demand more of the remuneration committee in setting, monitoring and communicating how the board is rewarded.

This should drive improved, more transparent behavior at board level. It will be up to boards to demonstrate their commitment to this in the future.

Questions for the boards to consider:

• How is the company innovating its executive remuneration policy and why?

• How has the company updated its remuneration policy to reflect the coming changes?

• Has the board considered how nonfinancial KPIs feature in the company’s executive pay structure? If not, why not?

• How has the board reached out to the company’s investor base to explain its remuneration policies and quantum of pay?

Jens Maßmann
EY EMEIA Area Leader Reward
+49 6196 996 24574
jens.massmann@de.ey.com
Germany
Understanding and managing third-party risk has become a corporate priority due to greater oversight from regulators, as well as stakeholders taking an active interest in how corporates run their supply chains, tax affairs, boardrooms and talent programs, and manage customer data.

Historically, a company's suppliers have managed their own risks, but greater integration of supply chains means that is changing. Suppliers, partners and customers must all be considered part of the wider risk picture.

Specific risks continue to evolve. Cyber risk remains a key area for boards. A number of trends account for that: one is that third parties are asking for more connection into organizations to facilitate engagement with customers.

As a result, the closer integration of third parties and large multinational businesses is creating more access points and areas of vulnerability. In turn, that creates greater risk that unwanted information may pass from the company into the third party.
Boards must also grapple with a new challenge: how can they isolate mission-critical information within the organization while maintaining integrated and efficient operations? Managing financial data, trade secrets and commercially sensitive material must now take third-party exposure into account.

The introduction of the General Data Protection Regulation (GDPR) will only add to the need for boards to bring third parties into the effort to secure data and manage it effectively.

External risk cannot be siloed, and confusion can arise when clear lines of responsibility become blurred, leaving compliance gaps where oversight may be compromised. Investors will expect a clear and comprehensive risk management framework that sits at the center of board discussions, independent of compliance and legal functions.

Boards must also regularly examine their risk register to identify where responsibility lies. This requires comprehensive management that outlines the exact exposures and the mitigation tools employed.

Increasingly, there will be pressure on boards to assess and — in some cases — rationalize the partners they are working with and why. This will be especially important in the context of the Bribery Act, which came out of the FCA requirements in the UK that challenge boards to assess risk in a more in-depth and holistic way.

The impact of the disclosure of corporate behavior in leaks such as the Panama Papers only heightens the need for boards to address this through adequate and robust oversight policies. The mere appearance of impropriety will be enough to attract the attention of media, NGOs and other stakeholders.

Indeed, the expectation from shareholders and from regulators is that boards must know exactly what the company is doing across the globe, which third parties are acting on its behalf and what they are authorized to do. Boards — and individual directors — are increasingly exposed, should any inappropriate or criminal behavior take place that jeopardizes the interests of the organization and its stakeholders.

Related resources
Europe, Middle East, India and Africa Fraud Survey 2017

Questions for the boards to consider:
- How does the board allocate enough time for a discussion about risk?
- How confident is the board that it is mandating risk management adequately throughout the company’s supply chain?
- How far along is the board in leveraging the technology available to help its governance, risk management and compliance efforts?
- How does dealing with third-party risk fit into the board’s conception of the company’s purpose?
Managing cyber risk – a new era of security

In the wake of recent high-profile cyber breaches, board members can no longer afford to leave the management of cyber risk to the technical functions within the organization. The need for a well-crafted, flexible and effective defense is clear, as is preparing an effective response before a breach occurs. It’s when, not if. Understanding the extent to which cyber risks could potentially affect the business along with oversight is the key responsibility of the board.

With supply chains increasingly integrated, and many operations running on “just in time” logistic principles, the vulnerabilities and potential damage are significant and difficult to anticipate. Boards will have to empower their management leaders to design and implement proportionate risk management strategies. That will include all parts of the business.

Internal audit will have an important role to play here, but may need to be augmented with external expertise to provide technology assurance. Regular cyber risk assessments must become routine.

The new Global Data Protection Regulation (GDPR), which comes into effect in 2018, will increase pressure on boards to reach best practice in how they process and manage personally identifiable information data.
The penalties for compliance failures have increased considerably. In addition, the Network and Information Security Directive (NISD) will sit alongside the GDPR and require EU Member States to develop their own cyber strategies for the public and private sectors.

The focus of any efficient strategy to manage cyber risks will follow a simple mantra: “sense, resist, react.” This requires systems that are sensitive to any attack and robust enough to withstand it; and that any breach can be minimized, and normal service restored quickly and with minimum fuss. Board directors must be aware that effective cybersecurity cannot be achieved by technology alone.

To manage cyber risk, directors must effectively corral a range of inputs to respond effectively: corporate crisis management, external parties’ press and public opinion, regulators and even ministerial scrutiny in some cases. All of these aspects must form the backbone of an integrated plan to minimize the overall impact on the corporation and return to business as usual.

Directors must also be prepared to look outside their organization to stay abreast of the latest developments. Nonexecutive directors, potentially from a nontraditional background, should be of particular help here, bringing a broader industry perspective to how peer companies are handling this often sensitive risk.

In addition, as with many other areas of board concern, stakeholders increasingly expect to see board directors take a proactive approach. The risk sits with the board. Effecting cultural change must be a priority in both understanding the best approach and building effective defenses. This means empowering staff to spot and report cyber threats and encouraging a policy of effective and free challenge from all areas of the business. It may also require the use of more sophisticated metrics to give directors a better sense of how well the company is managing its exposure to risk.

People are simultaneously the weakest link in the chain, and an organization’s strongest asset in this area. HR policies must promote awareness and encourage vigilance at all times.

Related resources
EY’s 19th Global Information Security Survey 2016-17

Questions for the boards to consider:

- Has the board considered which external partners and suppliers are involved in the cyber defense strategy?
- Does the board have the right type of external expertise on hand to help develop adequate strategies?
- Does the board have a direct line into the heart of the business’s cyber risk management?
- Has the board been briefed on how the GDPR will affect data management operations?
- Has the board considered designating a specific board member to own this risk?

Contacts

Mike Maddison
EY EMEIA Advisory Cybersecurity Leader
+44 20 7951 3100
mike.maddison@uk.ey.com
United Kingdom

Paul Walker
EY EMEIA Forensics Technology & Discovery Services Leader
+44 20 7951 6935
pwalker@uk.ey.com
United Kingdom
Reflecting on new responsibilities for audit committees

The audit committee has always played a pivotal role in corporate governance. Changes to EU audit legislation in 2016 have seen the committee assume even greater importance in promoting confidence in the audit. This is challenging boards to ensure their audit committees not only have the right balance of skills and competencies in place but are also properly focusing on one of their key roles: overseeing the external auditor and the audit.

This key change centers on the audit committee’s new responsibility for the appointment of the external auditor, which was previously a management board decision with some input from the audit committee. This is a significant shift, meaning that, for the first time, the committee must have the necessary skills to assess the performance of its current auditor and the quality of the audit, as well as identifying buying criteria for future tenders.

The new regime also requires the audit committee to recommend two audit firms for appointment, expressing a preference for one. This demands a comparative assessment. To be able to do this, the committee will have to assess, among many factors, not only technical competence but also softer factors such as the working relationship, the character of the team and the sector expertise each auditor offers.
Ensuring a competitive tender process requires advance planning due to the interrelationship between tendering timetables and non-audit services restrictions. This will require boards, and particularly audit committees, to have a good understanding of how professional services are procured across the group; which firms are providing what and where; how those engagements are structured; and how long they may take to unwind.

The reforms aim to improve audit quality and to enhance the performance of the audit committee. The EU has signaled that it intends to strengthen monitoring rules to increase quality, with the suggestion that the performance of an audit committee should be assessed every three years. At present, it is unclear what this means — while there is no indication that it means direct oversight, the European Commission has noted in its first report on the implementation of the legislation that the way that oversight bodies do this across Europe is inconsistent. It will be looking more closely at this in the future.

There are also other changes that the audit committee needs to consider. These include strategic disruption and the future sustainability of the business model; the digitization and automation of the finance function; new demands on external reporting; new performance metrics where digitization will be key; and, finally, how auditors are using technology in their audits to increase audit quality, drive efficiency and provide greater insight. This means we can expect more focus on the audit committee’s role. For many, this will mean enhancements to current practice. To ensure that all stakeholders get value out of these enhancements, preparedness is a must.

Related resources

Improving audit committee performance

Questions for the boards to consider:

- How is technology changing the company’s finance function and what sort of assurance is the board getting that financial information integrity is preserved during and after any transition?
- How is technology being used to enhance the effectiveness of the audit and the work of the audit committee?
- How has the board assessed whether the audit committee has a balance of skills and competencies, including sector, business, financial, technology, accounting and audit?
- How is the audit committee managing and monitoring the non-audit work your auditors deliver across the group?
Boardrooms are beginning to change. In 2018, that will continue as the diversity agenda takes center stage. And that now extends beyond simple compliance with gender or ethnicity guidelines. Investors and other stakeholders want to be sure that boards have the right blend of different skills, voices and backgrounds. This will be felt across all competencies.

Take digital, the quintessentially disruptive opportunity for boards in 2018. Developing and adding digital competency on the board will inevitably change its composition, as newer members bring fresh ideas and a different approach to hierarchy, dissent and challenge. Cultural leadership behavior will change as discussions become more open, with less dominance granted to seniority and experience.

Experience, as expressed at board level, will also acquire new value: the experience of questioning traditional methods and strategies. In short, boards will have to adapt to more challenge, not only from nonexecutives but also from executives: successful directors will have the determination and confidence to ask the right questions. They may not, however, have all the answers.
Questions for the boards to consider:

- How is the board priming its pipeline of new directors, internally and externally?
- What is the board hearing from stakeholders on the issue of board diversity? Is there interest there?
- Is succession planning an ad hoc process or is the board formalizing and professionalizing it?
- What does constructive challenge look like in the boardroom?

Board members may find that professionally derived competency metrics play more of a role in identifying the next generation of directors in the future. Many boards are already using these, adding to the traditional skill set matrices a broader set of criteria: communication skills, independence and receptiveness to innovation.

Tone at the top remains a central part of company culture. The working environment that tone creates will remain critical in not only attracting the best from outside but also retaining your own talent. In practice, that means taking seriously the need for effective, visible succession planning. Talent must know there is a route to board membership – seeing a diverse, meritocratic board leadership is the most effective way. Example remains the best inspiration.

So, finding the next generation of directors remains a challenge. Stakeholders expect a diverse and energetic board that is open to challenge. A new network of digital thinkers is emerging, and it is there that boards must look when searching for fresh talent, as well as in their succession planning. And, while a professional executive search will remain an important tool, leveraging and freshening the list of potential new directors will become a responsibility for all members of the board.

The direction of travel is for more transparency in the makeup of boards. This extends beyond the background and connections of directors; it means showing stakeholders that the board is serious about anticipating and planning for the business’s future needs, and about mitigating future risk.

Contact

Daniela Mattheus
GSA Corporate Governance Board Services Leader, Ernst & Young GmbH
+49 30 25471 19736
daniela.mattheus@de.ey.com
Germany