



EY Center for Board Matters
Board Agenda 2020

Priorities for boards during COVID-19 and beyond

Contents

Introduction	03
COVID-19: rising to the oversight challenges posed by the pandemic	04
Purpose and integrity: new ways of strengthening and focusing board decision-making	07
Climate change and sustainability: from environmental, social and governance (ESG) to a robust business strategy	10
Fighting fraud and anti-money laundering: key considerations for boards	13
Digital business transformation: managing risk and seizing the upside of disruption	16
Risk management: enhanced oversight of strategic opportunities and threats	19
Audit committee perspective: understanding the CFO's expanding responsibilities	22
Board effectiveness: the changing dynamics of governance	25



Where should your board focus during COVID-19 and beyond?

2020 has proved to be an eventful year for boards. The COVID-19 pandemic is forcing them to navigate an extremely difficult business environment and pivot quickly in response to a string of unexpected scenarios. As well as being in crisis management mode, boards are also having to consider a wide range of other issues that impact on their organizations. These include complex and large-scale challenges, such as climate change, digital transformation and financial crime.

The breadth of oversight that is expected of boards today – and the fact they are facing the greatest crisis in generations – makes this a very interesting time to be a member. Yet they are also under a huge amount of pressure – pressure to safeguard the wellbeing of their employees, pressure to ensure the financial and operational viability of their organizations, and pressure to generally live up to the ever-mounting expectations of their stakeholders.

COVID-19 is rightly top of board agendas at the moment. At the same time, however, board members must also prioritize the other “big picture” matters that are currently driving corporate governance. In this publication, we identify seven of those matters and explain why they should be considered by boards and audit committees alongside the urgent issues posed by the pandemic. The suggested priorities we list are not ranked in order of importance since their significance will vary by country, organization and sector. Our discussion of each priority features some helpful questions that can be used to initiate conversations with board members and executives.

Today there is huge uncertainty around what the future will look like. One thing boards can be fairly sure of, however, is that the world will not go back to how it used to be. To adapt to impending economic, social and technological change, organizations need their

boards to simultaneously focus on three time horizons – now, next and beyond. When planning in these three dimensions, members will derive practical assistance from this publication, which is based on an analysis of available research into the current challenges and opportunities facing boards. It is intended to inform your board’s roadmap for the next 12 months and even further ahead.

We wish you every success as you take your organization forward amid challenging times.

The topics we explore include:

- ▶ **COVID-19:** rising to the oversight challenges posed by the pandemic
- ▶ **Purpose and integrity:** new ways of strengthening and focusing board decision-making
- ▶ **Climate change and sustainability:** from environmental, social and governance (ESG) to a robust business strategy
- ▶ **Fighting fraud and anti-money laundering:** key considerations for boards
- ▶ **Digital business transformation:** managing risk and seizing the upside of disruption
- ▶ **Risk management:** enhanced oversight of strategic opportunities and threats
- ▶ **Audit committee perspective:** understanding the CFO’s expanding responsibilities
- ▶ **Board effectiveness:** the changing dynamics of governance

COVID-19:

rising to the oversight challenges
posed by the pandemic

Priorities for boards during COVID-19 and beyond |

In a period of crisis,
what's your board
strategy for helping
the organization to
navigate now, next
and beyond?

The COVID-19 crisis is the greatest challenge that most boards have ever faced. As a result of the pandemic, they are having to manage a wide range of issues all at once – including many they have never encountered before.



Naturally the biggest issue for boards to manage is the threat that the virus presents to human wellbeing. Safety must be prioritized above all else.

Fortunately, remote working allows many companies to keep operating comparatively seamlessly while respecting social distancing rules. Nevertheless, safety restrictions have caused widespread operational disruption in sectors, such as manufacturing, where employees cannot easily work from home.

As well as being a humanitarian crisis, COVID-19 has been a major economic shock. The pandemic – with all its associated implications for corporate profits, government borrowing and energy use – has disrupted the stock, bond and oil markets. Furthermore, demand has plummeted due to consumers spending more time at home and hoarding their cash in response to uncertainty. Businesses in sectors such as aviation, hospitality and retail have seen their revenues plummet or even dry up overnight. To ensure their survival, many companies have had to take advantage of the financial support schemes offered by governments.

In this highly volatile environment, cash is king – which is why boards are currently paying close attention to their organizations' cashflow and liquidity. They want to ensure that their companies remain financially solvent as they adapt to the evolving needs of the market and the operational constraints posed by the crisis. They are also asking management teams to undertake scenario planning and stress testing to gauge the potential impact of different scenarios on the capital, credit and liquidity of the business.

The other COVID-19 related issues that boards have been considering include: supply chain disruption, increased cybersecurity threats, the infrastructure challenges caused by large-scale remote working and the potential emergence of sector-specific risks – for example, bad loans in the case of the financial services industry. They have also been making important judgements in sensitive areas such as executive remuneration and dividend awards.

COVID-19 is not a short-term problem for boards. The implications of the pandemic are far-reaching and lasting. Going forward, organizations may have to completely rethink their business models, relationships with stakeholders, working practices and workforce structures, as well as how they create long-term value. So, boards will need to keep the medium- and long-term perspective firmly in mind when dealing with any urgent issues that arise. The challenge is that while there may be clarity around the immediate steps the company should take, a lack of visibility around how the crisis will ultimately play out makes it hard for boards to anticipate the future.

As the business, economic and societal landscape evolves in response to COVID-19, boards will want to keep refining the questions they ask of management teams. They will look to understand how management intends to address issues such as reengagement of the workforce following a period of furlough or remote working, the adaptation of customer offerings to meet new demands, and the restarting of any operations that have been halted by the crisis.

Organizational solvency will inevitably be a major focus of questioning, as will stakeholder management. Boards will want to know what management teams are doing to reset stakeholder expectations in areas such as salaries, budgets, payment terms and supply chain management. In addition, boards will want to continually evaluate the organization's business continuity and contingency plans. The COVID-19 crisis exposed many of these plans as being inadequate or outdated, so it is essential that they are continually updated going forward.

With the world changing around them, boards must be ready to adjust their strategies as the future unfolds. Evolving customer needs and behaviors could impact on their company's sense of purpose. In fact, the organization might have to change its purpose if it is to secure its own agility and resilience while seizing new opportunities that emerge in the market. This change of purpose could even be a driver for faster innovation, as well as strategic transformation.

COVID-19 poses many challenges to boards and requires them to take some difficult decisions. In every decision they take, boards should be mindful that the way in which their organization responded to the COVID-19 crisis will be remembered by all its stakeholders over the years to come.

Five key questions for boards

- 1.** How is the board supporting the organization's management team to navigate the COVID-19 crisis? Are there opportunities to improve channels of communication and report on additional metrics so that the board can better monitor the organization's exposure and response to crisis-related disruption?
- 2.** What actions must be taken now, in the near term and beyond to ensure that the organization remains viable into the foreseeable future? How can board members work effectively with the management team to reset and refine strategy during a period of rapid change?
- 3.** Does the management team have sufficient resources and the appropriate skillsets to successfully navigate emerging threats or is there a need to bring in external expertise in specific areas such as cybersecurity and supply chain management?
- 4.** How can the board ensure that the organization evolves during the current crisis so that it is well-placed to capitalize on recovery and new market opportunities as they arise?
- 5.** How can the board allocate time effectively to ensure that both urgent problems and future strategic issues are sufficiently attended to, and in alignment with the organization's sense of purpose?



Purpose and integrity:

new ways of strengthening and focusing
board decision-making

Priorities for boards during COVID-19 and beyond |

How can your board support the organization to activate and articulate its sense of purpose?

Stakeholders increasingly expect companies to fulfill their purpose through their business strategies. When a company fulfills its purpose, it is contributing to society in a much broader way than it does if it pursues profit alone. Companies that are guided by their sense of purpose are believed to enjoy sustained financial success. This is because they make decisions that are right for the long term and take the reasonable interests of key stakeholders into account.



Both the recent and the longer-term history of a company can offer insights into its core purpose.

The importance of purpose to stakeholders has been particularly underlined by the COVID-19 pandemic. Companies face grave reputational risks if they do not use their purpose to inform the decisions they take in response to the crisis. Customers, employees, shareholders and suppliers will publicly complain of mistreatment if companies take actions – such as pay cuts or dividend cuts – without clearly aligning these actions with their specified sense of purpose.

Why was the company founded in the first place? Which societal needs does it create solutions for? The company's core purpose will also inform and influence its business activities and goals, as well as how it manages its economic, social and environmental impacts – both positive and negative.

When purpose is used to shape strategy, companies benefit in the following important ways:

- ▶ **Long-term sustainability:** the combination of a company's core purpose, together with its related values and belief system, serve as a beacon to inform its ongoing strategy development.
- ▶ **Brand reputation:** companies that act in line with their purpose are perceived as authentic by their stakeholders and enjoy high levels of trust and credibility.
- ▶ **Collaboration:** powerful alliances are formed based on a company's purpose. Purpose helps to build connections between business functions within organizations and between different organizations.¹
- ▶ **Customer loyalty:** customers want to buy from brands that reflect a strong sense of purpose and have values they admire. These values often reflect the organization's responsible business ethos.

▶ **Innovation:** the organization's core purpose helps to optimize the positive impact of human capital value creation. It drives innovation within the organization since employees are encouraged to work together to develop solutions.²

▶ **Risk mitigation:** a company that is strongly guided by its core purpose conducts its business with integrity when engaging with its customers, employees, suppliers and the community more broadly. Adopting the perspective of a good corporate citizen as the "default setting" (i.e., conducting business with integrity and purpose) is a strong component of an effective risk mitigation strategy.

▶ **Simplified systems and processes:** purpose encourages management teams to focus on the organization's main strategic goals while minimizing complicated or unproductive working practices.

▶ **Talent attraction and retention:** purposeful companies have the edge over their competitors when attracting talent since people are drawn to organizations that share their sense of purpose. Purpose also helps to set expectations around behaviors within organizations.

Purpose can seem a relatively abstract concept that can be hard to articulate and even harder to activate. So, what can boards do in their oversight role to ensure that the company is guided by its core purpose?

Firstly, boards should engage with the management to determine its understanding of the company's core purpose. Furthermore, how is it using that purpose to inform decision-making and influence working practices across every area of the business?

¹ "Why business must harness the power of purpose," EY Beacon Institute, 2018 (accessed via www.ey.com, 4 December 2019).

² "How purpose can help you transcend disruption," EY Beacon Institute, 2018 (accessed via www.ey.com, 4 December 2019).

The board should also review what the management team is doing to ensure that the business is executing on its purpose. Is the management team scrutinizing the human rights practices and environmental performance of its suppliers? Is it communicating proactively with employees and meeting their own expectations when it comes to maintaining a purpose-led workplace?

How are the company's remuneration policies guided by its sense of purpose? For example, a company that claims to have a strong sense of social purpose should not link the bonus awards of its executives to financial performance alone.

Boards should also ensure that their composition and structure allow them to have an effective oversight of their company's purpose. This might require them to recruit new members with specialist competencies and skills. Alternatively, it might be appropriate to establish a committee that is dedicated to overseeing the management's adoption and implementation of a responsible business ethos that is aligned to the organization's core purpose. The key role

of this committee would be to monitor how the organization lives its core purpose through its business strategy, thereby achieving long-term value for a broad range of key stakeholders.

Boards and management teams are increasingly aware that companies must fulfill their societal obligations if they are to retain their license to operate. For example, France is already planning to amend the concept of corporate purpose in its civil code by requiring companies to consider the social and environmental stakes of their activities.

The EY CEO Imperative Study, a global survey of CEOs, board directors and institutional investors, found that the majority of respondents believed that large companies should be greatly engaged with addressing today's pressing social, economic and environmental challenges, including climate change, increasing scarcity of critical natural resources and income inequality.³ It is widely anticipated that expectations in this area will only accelerate further – especially because of COVID-19. To succeed, both today and in the future, companies must be able to activate their sense of purpose.

Five key questions for boards

1. How well does the board and management team understand the core purpose of the organization, and how well does the organization articulate that purpose clearly to its stakeholders?
2. How is the core purpose of the organization, as communicated, reflected in the way that it executes its strategy?
3. How does the organization's purpose, both positively and negatively, impact on society, the economy and the environment? And what are the potential consequences of this impact for the organization?
4. How does the management team go about activating the organization's core purpose in the context of its day-to-day activities?
5. How well is the board set up to assess how the organization is performing against its core purpose? To what extent are the board's own activities and focus consistent with that purpose?

³ For CEOs, are the days of sidelining global challenges numbered? *EY CEO Imperative Study*, EYGM Limited, 2019 (accessed via www.ey.com, 22 October 2019).



Climate change and sustainability:

from environmental, social and governance (ESG)
to a robust business strategy



Priorities for boards during COVID-19 and beyond |

Does your board consider climate change and other sustainability- related issues in its decision-making?

Climate change and other sustainability-related issues are featuring more prominently on the board agenda. This is partly in response to evolving stakeholder expectations and partly because of national and international developments. Global policy makers and regulators are looking to address the massive risks associated with extreme weather events and rising social equality.

3

The European Parliament has recently declared a climate emergency.

The European Commission wants to make Europe a climate-neutral continent by 2050 and climate change is likely to feature prominently among the European Central Bank's strategic priorities under its new President Christine Lagarde. Meanwhile, the United Nations (UN) is rallying organizations globally around its Sustainable Development Goals, which aim to address major global challenges, including poverty, inequality, the growing scarcity of natural resources and environmental degradation.⁴

Boards have a public-interest responsibility to make their companies more sustainable. At the same time, clear business challenges are emerging as a result of climate change and other sustainability-related issues. Extreme weather events are already causing significant disruption to business operations and are impacting the human and capital resources that organizations can draw on. Furthermore, the COVID-19 crisis has highlighted that the wellbeing of communities will always take precedence over economic activity – and any threat to wellbeing will invariably result in significant repercussions for businesses. Unsurprisingly, then, the

EY *CEO Imperative Study* found climate change is one of the top five global business challenges that could harm business growth and the global economy over the next 5 to 10 years.⁵

Given this context, it is unsurprising that investors are factoring sustainability into their decision-making and there is a growing trend toward responsible investment. Responsible investment is where the investment mandates of funds favor companies that can demonstrate that their business operations have a significant positive impact on the social environment or the natural environment, or both.

Increasingly, investors believe that sustainable companies are more likely to create long-term value. As a result, they want better information around how companies are affected by, and are responding to, sustainability issues. This information allows them to make more robust decisions around capital allocation and to price risk.

In the past, boards tended to view climate change and sustainability-related issues as ESG matters, implying that these could be treated separately from core business strategy and performance. There was also a perception that integrating ESG commitments into operations would come at the cost of financial returns. Now, however, many boards acknowledge that due consideration of climate, social and other sustainability – related issues is critical to both short-term and long-term value creation. Many boards also understand that neglect of these issues can be detrimental to financial performance.

To demonstrate their commitment to sustainability, more and more companies are voluntarily seeking certification as a B Corporation (B Corp). B Corps

are businesses that balance profit and purpose by conforming with the highest standards of social and environmental performance, public transparency and legal accountability.

It is crucial that boards understand how the risks and opportunities associated with climate change, social responsibility and sustainability can impact their company's evolving business model. An integrated approach toward addressing sustainability-related risks and opportunities will bolster the company's resilience, leading to better returns in the long term. It will also foster a clearer picture among the board and the management team of what long-term business sustainability looks like.

Companies that put sustainability at the heart of their business models are likely to be more competitive, efficient and resilient than their peers. Boards can encourage management teams to reskill the workforce rather than make redundancies and consider adjusting their operations and business models to capitalize on developments such as renewable energy, advanced recycling techniques and the rise of the circular economy. They can also support management teams to identify the greatest

⁴ "The European Parliament declares climate emergency," News European Parliament, 29 November 2019, via The European Parliament (accessed via <https://www.europarl.europa.eu>, 2 December 2019);

Martin Arnold, "Christine Lagarde wants key role for climate change in ECB review," *The Financial Times*, 27 November 2019, 2020 The Financial Times Limited;

"About the Sustainable Development Goals," *United Nations*, 2019, (accessed via <https://www.un.org>, 2 December 2019).

⁵ *For CEOs, are the days of sidelining global challenges numbered? EY CEO Imperative study 2019*, EYGM Limited, 2019 (accessed via www.ey.com, 22 October 2019).



strategic risks facing the business in the short, medium and long term. If they are to provide effective guidance to management teams, however, boards themselves will need to have information, expertise, and the right structures and processes in place.

The way in which a company embeds climate change, social responsibility and sustainability into its strategy will vary according to its business model, objectives and sector, as well as the specific risks it faces. Investors will hold board members accountable in the event that a company fails due to poor management of a climate change, human capital or another sustainability risk.

At present, there is no standardized framework for companies that want to report on how they are managing the risks and opportunities associated with climate change, human wellbeing and sustainability. Nevertheless, they can demonstrate an integrated business strategy by choosing from a variety of frameworks. One such framework was developed by the Embankment Project for Inclusive Capitalism (EPIC), launched by the EY organization (EY) and the Coalition for Inclusive Capitalism. This framework contains useful metrics and narratives that can help businesses to measure and articulate the value they create for stakeholders in four key areas. One of these areas is society and the environment.⁶

Five key questions for boards

1. How good is the understanding of the board and management team of the material risks and opportunities that climate change, human wellbeing and other sustainability-related issues present to the organization?
2. How well integrated are climate change, social and other sustainability-related risks and opportunities with the overall business strategy?
3. How do climate, social and sustainability-related issues feature within organizational decision-making, at both strategic and operational levels?
4. How does the board hold the management team accountable for setting, meeting and measuring targets as part of managing the organization's climate, social and sustainability-related risks and opportunities?
5. How well does the board and the management team engage with investors on the organization's long-term sustainability, including how it is integrating climate-related and social risk into its business model?

⁶ Embankment Project for Inclusive Capitalism (EPIC), EY and The Coalition for Inclusive Capitalism, 2018 (accessed via www.epic-value.com, 15 November 2019).



Fighting fraud and anti-money laundering:
key considerations for boards

Priorities for boards during COVID-19 and beyond |

Do you understand
how exposed your
business is to the risk
of money laundering?

Companies today are under pressure to help combat the spiraling problem of financial crime. Over the past couple of years, there have been several high-profile money laundering cases involving politically exposed persons and well-known financial institutions, as well as some significant cryptocurrency frauds. Furthermore, the risks of financial crime have escalated further as a result of the COVID-19 crisis and the economic uncertainty and suffering caused by the pandemic.



Policy makers are responding to the challenges associated with financial crime by introducing more stringent legislation for companies to comply with.

A string of terror attacks across Europe in 2017 also heightened concerns about deficiencies identified in anti-money laundering and counter-terrorist financing controls. As a result, there is a consensus around the need for much greater robustness in the implementation and monitoring of anti-money laundering law and regulation.

Among the most recent legislative initiatives is the EU's Sixth Anti-Money Laundering Directive, adopted by the Council of Europe on 23 October 2018. Member States must transpose the directive, which complements and reinforces the Fourth and Fifth Anti-Money Laundering Directives, into national law by 3 December 2020.⁷

The latest directive includes new criminal law provisions relating to money laundering and the financing of terrorism. A concern for boards is the fact that the directive extends criminal liability to organizations and people who hold positions of responsibility within the organization when an offense occurs. They can be prosecuted if a money laundering offense is committed for the benefit of the organization, including in situations where the offense was made possible by a lack of supervision or control.

At the same time, the Sixth Anti-Money Laundering Directive introduces tougher punishments for money laundering. The minimum prison sentence that individuals face for committing a money laundering offense has been increased from one year to four years. Meanwhile, companies found guilty of the offense could incur a temporary or permanent ban on doing business, or even a judicial winding-up. Switzerland has also announced proposals to revise its own Anti-Money Laundering Act, which has been in force since

1998. The amended act will explicitly require financial intermediaries to verify information relating to the beneficial owners of client accounts.

Regulators are paying increasingly close attention to virtual currencies. These have become the favored settlement method for money launderers and terrorists due to the relative anonymity that trading in virtual currencies provides. The EU's Fifth Anti-Money Laundering Directive, adopted in April 2018, imposed regulations on cryptocurrency exchanges, requiring them to implement due diligence measures and transaction monitoring.

Although companies are committed to meeting their anti-money laundering obligations, they are struggling to keep up with rapid developments in money laundering techniques. In the future, emerging technologies could provide them with the capability and means to tackle the threat more effectively.⁸ For example, they could use artificial intelligence (AI) to detect unusual patterns in large volumes of data and combine AI with blockchain to build anti-money laundering systems that are able to efficiently identify and stop suspicious transactions.

Until technology catches up with what criminals are doing in practice, boards should expect to see continued regulation in the area of financial crime. So, it is important that they monitor developments in the regulatory environment as part of their governance oversight in relation to risk management. Financial crime poses greater risks to certain sectors when compared with the others – with the risks being particularly acute for companies operating in the financial services sector.

⁷ L 284/22, Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law, Official Journal of European Union, 2018 (accessed via <https://eur-lex.europa.eu>, 13 November 2019).

⁸ "How to trust the machine: using AI to combat money laundering," EYGM Limited, 2019 (accessed via www.ey.com, 5 December 2019).



Allowing for the specific landscape of their company's sector, boards should ask management teams to provide an assessment of the extent to which the company is exposed to anti-money laundering compliance risks, such as cryptocurrencies or politically exposed persons, and how they plan to mitigate those risks. They should also ask for information on how the company's banks are complying with anti-money laundering laws. Additionally, what practices are those banks putting in place to instill ethical and responsible behaviors within their organizations?

Boards should also challenge management teams to provide detailed information on what they are doing to improve the detection and prevention of economic crime within their organization. What use are they making of technological tools that already exist? And how are they collaborating with partners and peers within their ecosystem to develop and share the leading practices? In sectors that face high levels of challenge, it may be necessary for the board to recruit a member with anti-money laundering expertise or to establish a committee that is dedicated to the monitoring of financial crimes.

A further way in which boards can strengthen their organization's defenses against financial crime is by ensuring that the right processes are in place to encourage the reporting of illegal activities. For example, an anonymous whistle-blowing helpline might highlight some poor practices and provide valuable insights into areas of the organization where financial crime poses a particular risk.

Five key questions for boards

1. How well does the board understand the requirements of the EU's Fifth and Sixth Anti-Money Laundering Directives?
2. How good is the board's understanding of the methods and processes that the organization uses to move money safely around the world? How good is management's visibility over the organization's main financial counterparties, particularly banks, and how does it apply appropriate third-party due diligence to assess those counterparties?
3. How does the board oversee any connections the organization has with politically exposed persons?
4. How is the organization investing in new technologies to be more effective in complying with anti-money laundering legislation?
5. How confident is the board that management has a framework for monitoring and mitigating anti-money laundering risks and that the framework is working effectively?

Digital business transformation:
managing risk and seizing the upside of disruption

Priorities for boards during COVID-19 and beyond |

Is your board
aware of how the
organization can use
new technologies to
create more value
for stakeholders
over the long term?

Technology is disrupting every aspect of business, from how companies produce and distribute their goods and services to how they interact with their customers and other stakeholders. AI, blockchain, data analytics, enterprise resource planning (ERP) systems, robotic process automation (RPA) and the internet of things (IoT) are among the technologies and tools that are having the greatest impact. Social media is also heavily influencing business engagement strategies – it has proven to be a powerful business communications channel that can make or break a company's reputation.

5

Digital business transformation presents boards with several key issues to consider in their oversight capacity.

Firstly, the board needs to understand the strategic opportunities that digitalization presents. How can new technologies enable the business to enhance its operations, and create a better experience for its customers and suppliers? Also, how can the company use these technologies as a platform for increasing efficiency, accelerating growth, developing new partnerships and overhauling its business models for competitive advantage? Only through understanding the strategic value of digital transformation, will the board be well-positioned to ask the right questions of the management with a view to driving change.

Another important consideration is the emergence of some major technology-related risks. These include cyber risks, e.g., the risk of the organization's systems being breached and customer data or personal information getting stolen. Also, there are ethical risks associated with certain technologies, such as AI. An AI system might make biased decisions because it has been trained using an inaccurate or incomplete dataset. A further risk is the emergence of a disruptive competitor that could undermine the organization's business model or seize market share because it has developed a digitalized service offering that customers prefer.

The COVID-19 crisis – which has necessitated a large-scale shift to remote working – has accelerated the digital transformation that was already underway in many organizations. So, as transformation continues to gather pace, the board must be equipped with the right knowledge, skills and tools to provide effective oversight in relation to technology-related risks. For example, the board composition may need to change to include one or more directors who have digital knowledge and skills.

It may also be necessary to ensure that the collective board skillset includes directors who are well grounded in business ethics and responsible practices. If not, it may be necessary for the board to consult externally to obtain such expertise. Appropriate board composition is the key to board preparedness when it comes to engaging with management on digital business transformation challenges, opportunities and risks. It enables the board to consider a broad range of perspectives that go beyond what it may have been traditionally used to dealing with.

Talent and digitalization are inextricably linked. Companies will only succeed in their digitalization strategies if they are able to attract and retain staff and contractors with valuable digital skills. They will also need robust change management programs for embedding the new approaches and processes that underpin the successful deployment of technology. These programs will prepare the business to cope with ongoing change since digital business models typically adopt swifter evolution pathways.

Boards need to scrutinize the skills of the management team to ascertain whether they fit with the strategic direction of the business as it transitions to a digitalized business model. They also need to ensure that management has a strategy for monitoring how technology is being used within the organization, paying particular attention to the ethical issues associated with AI. Critically, the board should be sensitive to the ongoing impact of transformation on the organization's culture. Culture is now recognized as a critically important success factor for companies navigating through periods of intense change.



Without a strong emphasis on purpose and culture, change to digitalized business models may be achieved. Nevertheless, there is a risk that this change could come at the cost of long-term business success and sustainable value creation. Referring back to the organization's sense of purpose can be a useful way for a board to monitor whether the organization's digital transformation is effectively aligned with what it wants to achieve in the long term. In this way, the board can play a vital "sense-checking" role.

The pace of technological change is predicted to keep on accelerating in the future. For that reason, it is critical that board members continually educate themselves on technological advances. They should ask the management team to provide forward-looking and insightful reporting on all the technology-related initiatives taking place within the organization. This could be provided by a business transformation management committee.

Finally, the future success of an organization will rest on how well its board and management team exploit the exponentially larger data intelligence that can be harnessed through the power of technology. Those "future-fit" boards that are most effective at using data to inform their decision-making will be best at driving long-term value creation for the organization and its material stakeholders, including shareholders, employees and customers. They will be able to identify emerging megatrends and guide management to address the challenges presented. They will also support management through the process of developing more innovative business models, collaborating with new partners and incubating new ideas to realize competitive advantage.

Five key questions for boards

1. How well does the board understand the strategic opportunities that digitalization creates for the organization?
2. How can the board enhance its collective knowledge, composition and expertise so that it is fully able to engage with a large-scale business transformation strategy?
3. How does the board ensure it has good visibility over the organization's talent and cultural-readiness strategies, as well as its change management capabilities?
4. How are the organization, its board and its management team making effective and legitimate use of the significant data intelligence capabilities that new technologies can provide?
5. How sustainable is the organization for the long term? How are the board and management team working together effectively to steer the organization's strategic direction toward a future-fit and digitalized business model?

Risk management:

enhanced oversight of strategic opportunities and threats

Priorities for boards during COVID-19 and beyond |

Does your board have enough visibility of different emerging risks that could impact the organization?

The rapidly evolving business landscape requires boards to consider a multitude of emerging risks. As part of their digital transformation strategies, organizations are making greater use of new technologies, such as AI and the IoT. They are also generating huge volumes of data and collaborating with third parties that have their own processes, systems and ethical standards. On top of that, the COVID-19 pandemic has sparked a surge in email phishing attacks.⁹ The combination of all these factors significantly increases an organization's exposure to risks, such as allegations of algorithmic bias, cyber threats, breaches of data privacy and payment fraud.

⁹ "Threat Spotlight: Coronavirus Related Phishing," Barracuda Networks, 2020 (accessed via blog.barracuda.com, 6 May 2020).

6

The COVID-19 pandemic has highlighted the potential for unexpected risks to threaten staff wellbeing and productivity, disrupt supply chains and decrease revenues and profits.

Alongside the risks that are specifically posed by technology, the regulatory environment is constantly changing, raising the possibility that an organization may fail to comply with new legislation and incur attendant penalties or sanctions. Organizations are also under pressure to understand other factors that pose a threat to their long-term sustainability and business transformation strategies, including the risks posed by climate change, organizational culture and the competition for talent.

The COVID-19 pandemic has highlighted the potential for unexpected risks to threaten staff wellbeing and productivity, disrupt supply chains and decrease revenues and profits. It has also underlined the importance of reputational risk and how mismanagement of reputational risk can be highly detrimental to organizations' prospects in both the short and long term. Research by communications firm Edelman into brand trust and the pandemic found that, for nearly two-thirds (64%) of UK respondents, a company's response to the crisis would have a huge impact on their likelihood of buying from it in future. Already, a third (33%) had convinced other people to stop using a brand they felt was not acting appropriately.¹⁰

Having oversight of such a broad range of risks from a governance perspective is a real challenge for boards. In late 2019, the EY Center for Board Matters surveyed 500 directors and CEOs from around the world on the topic of risk. Several key findings highlight the importance of boards and the C-suite in mapping the whole risk landscape that their organizations face, including both

traditional and atypical risks. Today just one in five boards is "very satisfied" with their effectiveness in overseeing changes to the risk landscape and adjusting their organization's risk appetite accordingly. So, boards need to become more familiar with the changing global landscape of risk and ensure that they are getting access to new insights that present genuine threats to their organization, as well as strategic opportunities.

Almost three-quarters (73%) of boards believe their enterprise risk management system is good at managing traditional risks, but only 39% say the same about atypical and emerging risks. So, to get new insights, there is a clear argument for boards to review their reporting framework and adopt reports that reflect the changing risk landscape. This landscape demands different reporting structures and metrics, including reporting that relates to intangible assets such as culture, reputation and talent. At present, fewer than 20% of boards are extremely confident about their organization's reporting on new and emerging competitors and other market developments that could challenge organizational strategy and result in culture- and conduct-related risks.

To effectively oversee emerging risks and spot strategic opportunities, boards need to devote more time to discussing them. Potentially they might need to reorganize committee structures and schedules to facilitate this. Additionally, board members should assess whether the organization's C-suite and senior executives have the skills and competencies to address

¹⁰ *Edelman Trust Barometer Special Report: Brand Trust and the Coronavirus Pandemic*, Edelman (accessed via www.edelman.co.uk, 1 May 2020).



today's biggest strategic risks. It is vital that boards make use of both internal and external data pertaining to the organization in their decision-making. They would also benefit from engaging external expertise that can provide in-depth knowledge and advice around emerging risks and suggest solutions for managing them effectively.

Boards need a diversity of perspective and skills to fully understand the whole risk landscape. Depending on the organization's industry sector and business model, the board might therefore need to include members with specialist skills and knowledge in areas such as cybersecurity, health and safety, sustainability, talent, organizational change and regulatory compliance.

In today's fast-moving and volatile environment, where new risks are constantly appearing, it is essential that boards are actively supportive of their organization's risk management function. This function can harness the power of technology to enhance the identification and oversight of emerging risks. A wide range of technological tools may be used to identify, assess, monitor and predict risk. In particular, advanced analytical tools allow organizations to interrogate the data that they hold, and to quantify and model the risks they face with a view to enabling better risk mitigation and smarter decision-making.

Five key questions for boards

1. What are the biggest strategic risks, and opportunities – both traditional and atypical – that your organization faces today?
2. What role does the board play in the oversight of the risk identification process? Are the board and the executives aligned on the greatest strategic risks and opportunities?
3. How does the board get assurance that the organization's risk management and reporting is sufficiently comprehensive across the risk landscape to facilitate robust decision-making with the appropriate consideration of risk?
4. What can the board do to ensure that its current composition is appropriate? Are the right people and skillsets present on the board to ensure effective oversight of risk, and to harness new opportunities to further enhance the business model? Can their skills and knowledge be complemented with external expertise?
5. How is your organization using technology to better identify, understand and mitigate emerging risks? Is the organization upskilling its employees so they can design and use new technological tools and fully understand the data outputs generated?

Audit committee perspective:
understanding the CFO's expanding responsibilities

Priorities for boards during COVID-19 and beyond |

How can your audit committee strengthen the organization's governance by capitalizing on the CFO's expertise as a strategic partner?

The CFO's role as strategic partner to the CEO is being further cemented by today's rapidly changing business landscape. CFOs have valuable skillsets that organizations can draw on as they navigate through the COVID-19 crisis, rapid technological advances, an evolving regulatory environment and the heightened focus from stakeholders on how companies should create and measure value over the long term. As CFOs take on new responsibilities and expand their scope of influence beyond the traditional realm of the finance function, they need to redefine their relationship with the board, and more especially with the audit committee.

7





A development that has implications for the role of the CFO is the desire for expanded corporate reporting from stakeholders.

This reporting extends beyond periodic regulatory financial reporting to encompass broader reporting relating to how the organization achieves human, physical, financial, and intellectual value over the short, medium and long term.

In particular, investor appetite for wider reporting on how organizations perform with regard to holistic value creation is greater than ever before. There is increased acceptance that an organization's long-term survival depends on its performance, as well as how it conducts itself as an integral part of society. As a result, the CFO is expected to provide relevant and reliable information that fits with this context. Some commentators even suggest that the CFO role ought to evolve into more of a "chief value officer" – in mindset, if not in name.¹¹

As well as taking a broader view over value creation, CFOs are increasingly being required to provide forward-looking insights to boards and management teams. They are making use of emerging technologies, such as predictive analytics, and are acting as catalysts for change by providing information that enables companies to seize opportunities and mitigate risks in an era of uncertainty. These important new responsibilities are in addition to the activities that would have been the mainstay of the CFO's role in the past. These activities include managing the company's cash and liquidity, overseeing the financial reporting processes, and establishing and monitoring internal controls.

Just as the CFO's role is changing, the audit committee's role is changing as well. Today, audit committees are dealing with a broad range of issues and risks that extend beyond their traditional responsibilities, when it comes to financial reporting and internal controls. These issues and risks include cybersecurity, funding and liquidity, investor relations, M&A, taxation and regulatory compliance. So, it is more important than ever that the CFO has a strong relationship with the audit committee.

Recently, the COVID-19 pandemic has taken the oversight responsibilities of the audit committee to an even higher level. The crisis presents some significant financial reporting issues in areas such as asset impairment, contract accounting and going concern. Furthermore, the switch to remote working could hinder the effectiveness of internal controls within some organizations. Going forward, organizations will be under pressure to provide transparency about the impact of the crisis on their income streams and future

outlook. So, audit committees will need to consider when and how disclosures should be made. To provide more effective oversight and take better decisions during this time of crisis, audit committees will need access to more in-depth and more frequent internal reporting.

A strong relationship between the audit committee and the CFO is likely to exist when each understands what the other expects. Fortunately, there is common ground since both sides share the objective of ensuring that the organization delivers relevant and reliable information about the performance of the organization to the market, as well as its future outlook. This includes providing high-quality financial reporting, which is conveyed in periodic financial statements and related disclosures.

Trust is the bedrock of the relationship between the CFO and the audit committee. So, there needs to be a mutual commitment. The CFO must be free to discuss sensitive issues openly, and in a timely fashion, with the audit committee – in particular, the audit committee chair. At the same time, the chair needs to offer insights while being clear on what is expected of the CFO. It is also important that audit committee members can ask suitably challenging questions of the CFO and to know when they have received appropriately detailed and documented answers. Answers that are referenced to sound analysis and factual information are the best basis for robust decision-making by audit committees.

Today, more than ever, it is crucial that the company, and the CFO in particular, talks to the audit committee about risk. Naturally, conversations about risk should cover the reporting risks associated with the

¹¹ Mervyn King, Jill Atkins *Chief Value Officer: Accountants Can Save the Planet* (Routledge, 2016).

preparation of financial statements, such as the risk of misstatements, either through fraudulent reporting or by the incorrect application of accounting standards. It is also important to ensure that discussions cover the wider risk spectrum, including the risks associated with climate change, compliance, cybersecurity, insurance and litigation. This is especially the case when the organization's risk management functions report to the CFO, rather than to a separate chief risk officer. The CFO should maintain an enterprise-wide risk framework that enables regular management reporting on key risks. Comprehensive risk reporting will help audit committee members stay abreast of the main business risks that are relevant to their roles and functions.

Given the breadth of the CFO's responsibilities, audit committees need to understand the quality of the relationships that the CFO has, not only with the board and the CEO, but also with other members of the management team and senior-level executives.

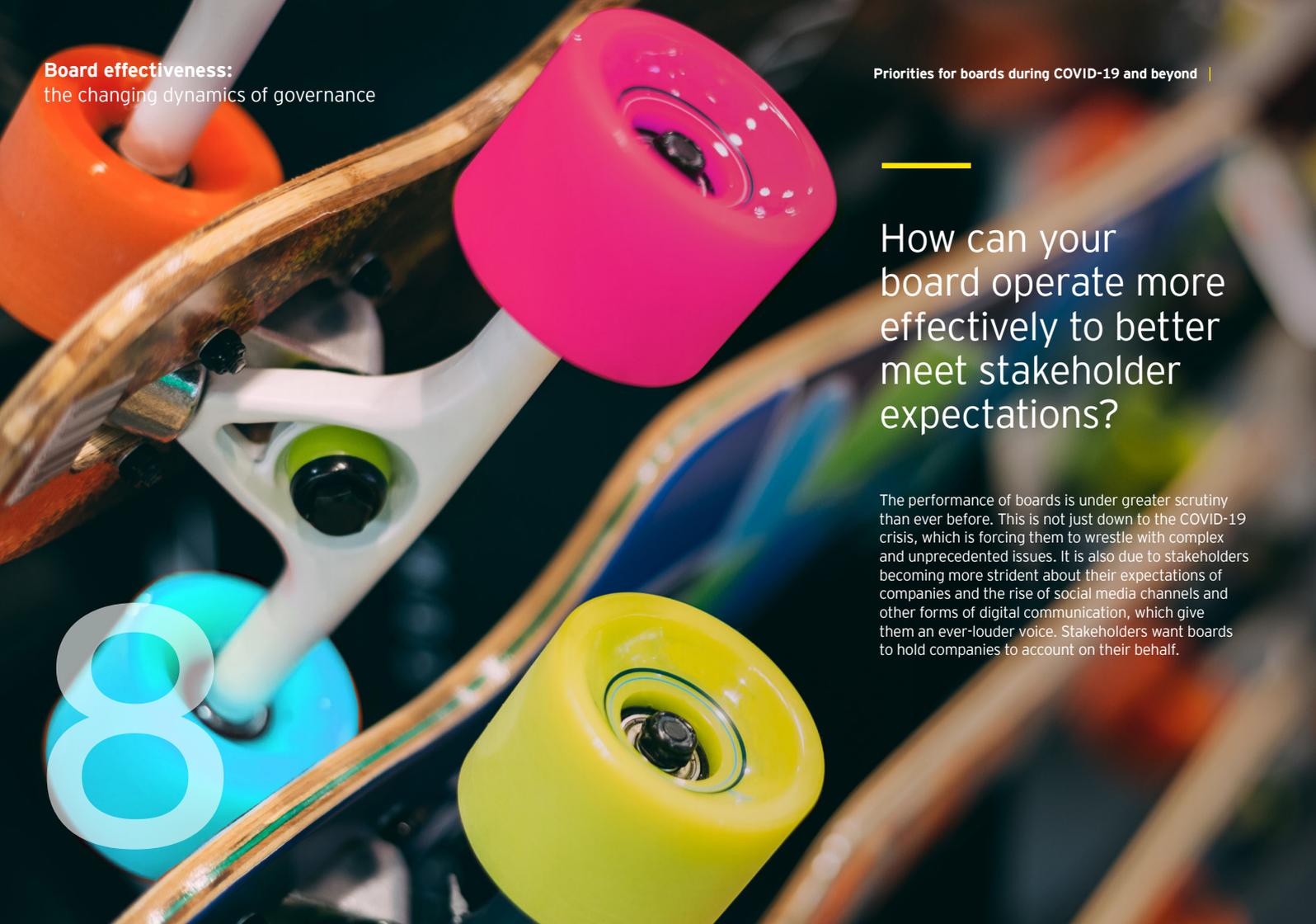
The audit committee can also support the CFO to ensure that the finance function can access the right talent to support the organization's objectives going forward. The finance function might, for example, benefit from having access to the skills of a data

scientist or a business analyst with climate knowledge. These professionals could undertake a robust scenario analysis that is the basis for the finance function's forecasts and projections, as well as the development of organizational strategy. The finance function might also find it useful to connect with cybersecurity experts in the development of internal controls.

Regular meetings between the CFO and the audit committee are essential. These meetings strengthen relationships and enable board members to engage the CFO on matters pertaining to the work of the finance function in a timely and constructive manner. The meetings can also be used as an opportunity for the audit committee and the CFO to hold deeper discussions on the various performance data underlying the company's reported numbers. Audit committee members can use them to gain a better understanding of areas where significant management judgment is applied – including key aspects of the organization's periodic financial and regulatory reporting. So, as well as covering important corporate reporting and accounting issues, the meetings should explore wider strategic issues that might have a short- or long-term impact on the performance and value of the business.

Five key questions for audit committees

1. How strong is the relationship between the audit committee and CFO? To what extent do openness and trust feature?
2. How does the audit committee effectively challenge the CFO, hold the CFO to account, and establish whether the CFO is performing effectively?
3. How is the CFO charged with ensuring the design and implementation of an appropriate risk framework to support regular and robust reporting on key risks? How effective is the CFO at sharing sound risk reporting and analysis with the audit committee?
4. How confident is the board that the organization's finance function has the right mix of skills and experience, or does it need to change the mix of personnel by recruiting additional talent?
5. How regularly does the audit committee meet with the CFO, and how far do these meetings cover both financial and more strategic issues?

A close-up, artistic photograph of skateboard wheels and trucks. The wheels are in various colors: orange, pink, cyan, and lime green. The trucks are white. The skateboard deck is made of light-colored wood. The background is dark and blurred.

Board effectiveness:
the changing dynamics of governance

Priorities for boards during COVID-19 and beyond |

How can your board operate more effectively to better meet stakeholder expectations?

The performance of boards is under greater scrutiny than ever before. This is not just down to the COVID-19 crisis, which is forcing them to wrestle with complex and unprecedented issues. It is also due to stakeholders becoming more strident about their expectations of companies and the rise of social media channels and other forms of digital communication, which give them an ever-louder voice. Stakeholders want boards to hold companies to account on their behalf.

8

In August 2019, an influential US business association, the Business Roundtable, acknowledged the growing influence of stakeholders when it released a statement in which it publicly abandoned the principle of shareholder primacy.¹²

Instead it argued that companies exist to serve a broad range of stakeholders. These stakeholders range from investors through to customers, employees, suppliers and the community.

When assessing the performance of the board, stakeholders will consider issues such as board composition and board member independence. They will also look at whether board members have the right skills, competencies and experience to perform the board's governance functions in line with the company's strategy. For example, if a company has embarked upon a major transformation program, there will be an expectation that at least one board director will have the related expertise.

Depending on the opportunities and challenges that a company faces – both in light of COVID-19 and generally – board responsibilities may need to be refocused on complex areas. These could include business strategy, cybersecurity, digitization, health and safety, and risk, including climate-related risk. Competent leadership is critically important to ensuring high levels of board performance and effectiveness, as well as strong relationships between board members.

It is essential that the board can operate as a team, regardless of its structure. Not only does teamwork enable the board as whole to perform its responsibilities effectively, it is key to addressing the rising trend of stakeholder activism. Various groups of stakeholders – most particularly, investors and regulators – are focused on gaining greater transparency through reliable disclosure practices and on the quality of governance.

Good relationships between board members come about when an atmosphere of inclusivity and trust prevails in the boardroom. The board will also have processes that encourage respect among serving board members. As a result, members will feel able to express different views or perspectives on issues that come before the board.

In the past, boards have tended to prize collegial cultures, yet a focus on collegiality should not inhibit debate or disagreement, or serve as an excuse for retaining underperforming directors. Constructive challenge underpins the relationship between board members and executives. It is also important that board members can seek out knowledge from management to further improve their own understanding, without encroaching on the role of the management team. There needs to be a smooth flow of information between the management and the board, with the board receiving information that is appropriate in terms of quality, quantity and timeliness. Tools such as board portals can help in this respect.

The chair plays a very important role in setting the agenda for board meetings, making sure the right topics are covered, and allocating enough time to discuss priority items. Aside from running meetings efficiently, the chair is also responsible for overseeing a regular program of board self-evaluations. These should include independent board evaluations to facilitate objective and developmental feedback on board effectiveness, as well as individual directors' perceptions of board effectiveness across a range of indicators.

¹² "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,'" Business Roundtable, 2019 (accessed via www.businessroundtable.org, 3 December 2019).



Other processes that support effectiveness include induction training for new directors and applying term limits to ensure that the board creates space for new appointments. Term limits will enable the composition of the board to evolve in line with company strategy. There should be a policy on board member rotations with a skills matrix available to inform members about board succession planning as board members retire or relinquish their positions.

While board effectiveness requires the board chairperson's ongoing attention, it also requires the ongoing attention of each and every board member. Just one non-performing board member can significantly disrupt the overall effectiveness of the board.

Achieving an appropriate degree of diversity within the board membership is an important criterion of overall board-effectiveness. Research suggests that boards that can demonstrate a broad range of perspectives are generally better placed than their less diverse peers to help companies seize market opportunities and manage risks.¹³

Progress has been made in recent years regarding gender diversity on boards. Increasing numbers of female directors are now serving. Nevertheless, women are still generally underrepresented on corporate boards and even more so at the executive level. Even where they are represented, they mostly hold non-executive roles. The number of women who occupy CEO and other executive or senior managerial positions globally is still extremely low.

Five key questions for boards

1. How confident are you that the board is composed of a diverse group of qualified and experienced directors who offer a range of experiences, perspectives and skills that support the organization to achieve its strategy?
2. What can the board do to recruit more women into both executive and non-executive roles?
3. Are board meetings run in an inclusive way that enables board members to make a full contribution and offer constructive challenge?
4. How can the board make more time in meetings to discuss the issues that are of most pressing importance to the organization?
5. How often does the board formally evaluate the performance of individual board members and the performance of the board as a team? Also, how does it ensure that these evaluations are objective – does it use independent third parties to conduct them?

¹³ *Different Is Better – Why Diversity Matters in the Boardroom*, Russell Reynolds Associates, 2009 (accessed via <https://www.russellreynolds.com>, 19 November 2019).

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

© 2020 EYGM Limited.
All Rights Reserved.

EYG no. 003909-20Gbl

BMC Agency
GA 1014244

ED None.

This material has been prepared for general informational purposes only and is not intended to be relied upon as legal, accounting, tax or other professional advice. Please refer to your advisors for specific advice.

ey.com

The views of third parties set out in this publication are not necessarily the views of the global EY organization or its member firms. Moreover, they should be seen in the context of the time they were made

Contacts

Jean-Yves Jégourel
EY EMEIA Assurance Leader
+33 1 46 93 61 75

Hanne Jesca Bax
EY EMEIA Leader Markets & Accounts
+31 88 407 1325