2022 board priorities

Shaping tomorrow’s agenda of EMEIA boards

EY Center for Board Matters
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The findings in this report are based on a survey of board members that we conducted in the winter of 2021. The survey gathered insights into their views on the strategic risks and opportunities facing boards, which have now changed dramatically since the start of the war in Ukraine and the deteriorating economic conditions and uncertainty it has created.

The authors of this report originally intended to release the 2022 EY Board Priorities at the end of February 2022, but decided to defer the release date because of prevalence of the war in every board discussion they have had since 24 February 2022.

While the authors understand that boards are right to focus more on current effects of the war, the seven priorities identified in the report may represent further fundamental developments shaping the future.
Where should your board focus in 2022?

Organizations today are operating in a business context that has evolved dramatically. With COVID-19 continuing to cause interruption, new ways of working have rapidly transformed operating models. Many organizations have adopted hybrid working—a flexible approach that is enabled by data, as well as by a plethora of technological tools and systems. These key topics are of relevance, irrespective of whether your organization is suited as a one- or two-tier board.

While these new ways of working have presented organizations with new opportunities, they have also created new risks, including cybersecurity threats. These risks demand that boards focus intensively on governance, risk and compliance (GRC) as a way to achieve organizational goals at a time of great uncertainty.

Furthermore, environmental, social and governance (ESG) issues are a boardroom priority due to the intensifying threat of climate change and rising stakeholder expectations—beyond nonfinancial reporting—that organizations will drive inclusive growth in an era of economic recovery. Society expects organizations to be driven by purpose, to live by their values and to take meaningful actions in response to the many challenges that we face. Culture and integrity are key. Organizations must maintain high ethical standards if they are to retain the loyalty of customers and employees, as well as attract investment capital.

To succeed in this demanding environment and to manage risks effectively, boards must bring a broad range of perspectives to their organizations. They must be composed of the right people, with the right skills from a wide variety of backgrounds. They must also make good use of their audit committees, which should focus on several key tasks to support the organization to build trust with its stakeholders.

To understand these challenges and their impact on the board’s priorities, we conducted the EY EMEIA Board Barometer 2022, a survey of board members across Europe, the Middle East, India and Africa (EMEIA). The survey gathered insights into their perspectives on the strategic risks and opportunities associated with these themes—topics that this publication explores in depth, such as:

• Corporate purpose and value statement
• Culture and integrity
• New ways of working
• Cybersecurity and internal controls
• Beyond sustainability reporting
• GRC transformation
• The audit committee of the future

We hope this publication will enable your board to address these priorities during 2022. Additionally, we wish your organization every success in the months ahead.
Corporate purpose and value statement

How is the board helping its organization to define purpose, mission and values?
The importance of corporate purpose has been underlined by the confluence of the health, economic, societal and environmental challenges that we face today. As society expects organizations to be a part of the solution to these challenges, organizations have an opportunity to put their purpose to work by taking meaningful actions. Customers, employees, and society want to interact with organizations that clearly define and live their purpose, and activate values in support of these efforts.

According to the EY EMEIA Board Barometer 2022, over four-fifths (81%) of board members believe that purposeful business and long-term value are relevant for today’s organizations. Meanwhile, 66% of European C-suite leaders and board members who responded to the EY Long-Term Value and Corporate Governance Survey, believe that the pandemic has increased stakeholders’ expectations that companies will drive societal impact, environmental sustainability and inclusive growth.1

So great is the power of purpose that it can be an important source of market differentiation. In fact, research suggests that consumers are four times more likely to buy from companies with a strong purpose.2 Another study shows that companies with high levels of purpose outperform the market by 5%-7% per year.3 Therefore, it is unsurprising that investors are paying increasing attention to ESG factors, including purpose, when evaluating companies as a part of their capital allocation processes.

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Decision-making should be aligned with the organization’s purpose, mission and values.

Implications for boards

Organizations that robustly define, and act on, their corporate purpose are not just safeguarding their reputations. By being clear about why they exist and how they plan to achieve their goals, they are positioning themselves for long-term success in a fast-moving business environment. If they are guided by their purpose, mission and values, organizations will be more effective at navigating change and disruption, and managing risk, while meeting the evolving expectations of their stakeholders.

Boards should be closely involved in the organizations’ process for defining and implementing their purpose, on the basis of the following four pillars:

1. Align leadership around your purpose
2. Engage employees in your purpose journey
3. Embed purpose in your customer experience
4. Anchor your strategy to your purpose

This means that the boards have to work with the management to ensure that these elements are effectively embedded in the organization’s strategic road map and used to inform decision-making over the long term. The organization’s purpose should also be deeply embedded into its culture. It should act as a foundation for the organization building trusted relationships with its stakeholders.

Recommended actions

Boards have to be actively involved in articulating the organization’s purpose, from which its mission and value statement will be derived. By setting the tone from the top, they will need to drive comprehensive discussions about their organization’s history, marketplace, performance, current culture and future potential. These discussions should encompass its strengths, weaknesses, opportunities and threats.

Outcome measurement and appropriate metrics are a good way for boards to monitor an organization’s progress against its purpose-driven goals. For example, the World Economic Forum’s Stakeholder Capitalism Metrics is a set of metrics that organizations can use to report against these indicators. These metrics are organized under four pillars that are aligned with the Sustainable Development Goals (SDGs) created by the United Nations (UN). The pillars are:

- Principles of governance
- Planet
- People
- Prosperity

When it comes to embedding purpose into the culture of the organization, the board can lead the way by setting the right tone at the top. It should provide effective oversight around purpose, mission and values, regularly discussing these topics at board meetings. The composition of the board should also reflect the board’s purpose and mission, as well as its stated ESG objectives, with board members being seen to live the values of the organization on a daily basis.
Decision-making should be aligned with the organization’s purpose, mission and values. The board should use purpose to inform decision-making in areas, such as culture, investment, external reporting and talent management. It should also link remuneration with executives’ success at achieving ESG objectives and delivering on the organization’s purpose. This may require compensation to be structured over longer time horizons than those that are applied today.

Finally, boards can help to ensure that purpose is clearly communicated to employees at every level of their organizations. However, purpose should not be presented as a framework to follow but rather as a direction to aspire to, with employees having the freedom to apply it within the specific context of their own roles.6

Five key questions for boards

1. How is the board working with the management to effectively define and implement the organization’s purpose? How often is the organization’s mission and value statement revisited by the board to address the changing business and societal environment?

2. What can the board do to provide more effective governance around purpose, its alignment with corporate strategy and integration into the human resources (HR) life cycle?

3. How can the board use purpose to support decision-making that will impact the organization’s strategy, both today and in the long term?

4. How can the board use metrics to monitor the organization’s progress against its purpose-driven goals?

5. To what extent does the board set the right tone at the top in relation to purpose and culture?
Culture and integrity

How is your board helping to maintain quality and high behavioral standards within your organization?
Key developments

Organizations know that their products and services, as well as the conduct of their people, are under greater scrutiny than ever before. Meanwhile, they are under pressure to deliver more, at a faster rate, to a larger market, in a more sustainable way, at a time when many supply chains are under considerable strain and there are notable skills shortages in certain sectors, such as logistics.

These developments bring corporate culture — or, in other words, how organizations are operating, creating value, motivating their workforces and making decisions — to the attention of key stakeholders. Aligned with the organization’s purpose and strategy for long-term value creation, culture is of critical importance across four stakeholder groups: employees, customers, shareholders and society.

COVID-19 raised awareness of shifts in the post-pandemic fraud landscape. Research by the Association of Certified Fraud Examiners, published in November 2021, discovered that 51% of anti-fraud professionals had uncovered higher levels of fraud since the start of the pandemic. Along with culture, a focus of stakeholder attention is therefore adherence to law and regulation (compliance), as well as adherence to agreed moral standards (integrity).

To address these challenges, as well as rising stakeholder expectations, organizations need to focus on maintaining high behavioral standards to attract and retain customers and employees, as well as investment capital. Having a culture of quality and integrity will also enable them to avoid regulatory fines, minimize the risks of reputational damage and prevent loss of market share.

Implications for boards

Research shows that organizational culture drives ethical behavior. Furthermore, the more that the employees of an organization perceive top managers to be trustworthy and ethical, the better that organization is likely to perform financially and the more attractive it will be to potential recruits. Boards that do not focus sufficiently on culture put the long-term sustainability of their organization at risk.

By setting the appropriate tone at the top and engaging with the management team, the board plays a crucial role in shaping and defining the organizational culture. Through their individual actions, board members can also personally define what integrity means in practice and set the behavioral standards for their organization.

While they are the custodians of their organizations’ culture, the day-to-day demands of governance — including regulatory compliance — mean that boards often end up prioritizing other issues. Yet, culture is a strategic issue that demands the time and attention of the board.

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9 “How a culture of integrity boosts the bottom line,” ideas for leaders website (accessed via www.ideasforleaders.com, 7 October 2021).
Recommended actions

Boards may focus on several areas for monitoring and supporting culture and integrity throughout the organization. These areas include the governance of the organization; leadership and management style; identifying if a “speak-up” culture exists; and the integration in the company’s HR life cycle – from business strategy through recruitment, development and retention, to the exit of employees. Monitoring of all these areas should be underpinned by performance measurement using quantitative data and KPIs.

In addition to monitoring and ensuring the alignment of culture and integrity KPIs with management performance, boards can be proactive about governing the culture of the organization in the following four ways:10

1. They can ensure that the corporate culture is aligned with the strategy and recognize when culture needs to evolve. Organizations are most likely to succeed in their corporate objectives when their strategy is inspired by their purpose and aligned with their culture. Boards should discuss how management teams define culture in the context of the organization’s strategy and what they are doing to close the gaps between the current and desired culture.

2. They can consider how the organization’s culture is communicated and reinforced. Boards can evaluate how culture is communicated throughout the organization, to reinforce a commitment to quality and ethical behaviors. This would include consideration of internal communications, as well as the onboarding process for new employees.
Culture and integrity

Five key questions for boards

1. What are the strengths and weaknesses of the organization’s current culture archetype, and does the current state fit to the preferred value and risk orientation of the organization?

2. How does the board’s composition and dynamics support the company’s commitment to fostering an environment and culture of diversity and inclusion, as well as enabling its broader purpose?

3. Does the board set the right tone at the top and pay a high level of attention to culture and integrity as a key impact factor on strategy implementation? How is the organization’s culture shifting to align with the changes in strategy?

4. Has the board discussed measurement and metrics that could be gathered and monitored to support the cultural fitness of the organization? Are those KPIs included in the regular reporting to the board?

5. What reporting should the board receive on culture-related issues and how can existing reporting be improved?

3. They can ask the management to measure and monitor progress on culture. Boards should ask for reporting on cultural trends, benchmarking to other entities or standards, reviews of behavioral trends, and surveys of risk attitudes and risk awareness. If they are not already doing so, boards could also consider regularly reviewing direct and indirect culture metrics such as employee pulse surveys, employee onboarding and exit interviews, and other customer surveys.

4. They can carve out enough time to discuss culture at board level. The EY Global Board Risk Survey 2021 found that nearly a third (32%) of EMEIA boards rarely or never talk about the culture needed to support their organization’s strategy at board meetings. Therefore, boards have an opportunity to make culture a regular agenda item, and use board meetings to engage with the CEO around what the management is doing to promote quality culture and integrity within the organization.
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New ways of working

How is your board monitoring the switch to a different talent management model?
New ways of working

Organizations are now navigating a changed business environment in which employees’ expectations have evolved significantly.

Key developments

Even before the outbreak of COVID-19, the working world had started to change dramatically. Organizations were making greater use of digital tools in the workplace, while supplementing their permanent workforce with the skills and talent of independent contractors and gig workers. It was also becoming more common for employers to recruit from different geographies and to offer their staff the opportunity to work remotely on a flexible basis.

While these trends existed previously, they were both accelerated and normalized by the pandemic, mostly due to the mass shift to remote working that accompanied government-imposed lockdowns around the world. As a result, organizations are now navigating a changed business environment in which employees’ expectations have evolved significantly around when, where and how they should do their work.

Having proven that they could work effectively in a remote environment, employees increasingly expect their employers to offer flexible working arrangements, and to provide them with the technological devices and software that will enable them to collaborate effectively.

Key results of the EY Work Reimagined 2021 survey

- 9 out of 10 employees want flexibility in where and when they work.
- One-third of the employees want their employers to offer shorter working weeks.
- On average, employees expect to work between two and three days remotely after the pandemic.
- 54% are likely to quit if they are not offered the flexibility that they want – with millennials two times as likely as baby boomers to quit.

Furthermore, the COVID-19 pandemic has accelerated skills shortages in most European economies, resulting shortages in skills becoming a major challenge to corporate strategy. Businesses are prioritizing talent management strategies, by effectively addressing development, recruitment, retention and well-being, and considering agile teaming, digitalization and flexibility as further influencing competitive factors.

Like employees, boards have learned to work in different ways. Rather than attending face-to-face board meetings, they have increasingly met via video conferences and web meetings. They have also prioritized agility, taking a more flexible approach to agenda setting, and investing in new digital tools that provide real-time information and insights.

Implications for boards

Due to the changed context, many organizations today are embracing hybrid working – an operating model that combines time worked on the organization’s premises with time worked at home. A hybrid model requires organizations to completely reimagine their approach to work. That affects everything – from their leadership and management, technological infrastructure and carbon footprint through to how they recruit, retain and develop their staff.

The new model also demands organizations to rethink how they engage with their people to maintain their desired culture and the standards of behavior that they expect. As they refine their strategies in these areas, boards have to ensure that talent management strategies are considered as a key competitive factor and a strategic priority for management.

Accordingly, boards should shift their focus from executive succession planning toward the overall human capital and talent management of the organization. This shift requires more frequent boardroom discussions and reporting by the Chief Human Resources Officer (CHRO). A shift of focus will also support their organization’s efforts to produce effective external reporting on its human capital strategy, as well as the stakeholder outcomes it aims to deliver. As a result, their organization will be better placed to meet its ESG requirements and its stakeholders’ expectations.

The new era of talent management also enhances the board’s monitoring duties with respect to risk oversight. This is because new ways of working are enabled by data, as well as a plethora of technological tools and systems – from cloud-based infrastructure to collaboration software and videoconferencing platforms.
NEW WAYS OF WORKING ARE ENABLED BY DATA
Talent management is essential for securing an organization’s human capital and culture.

**Recommended actions**

The shift of focus to talent management and new ways of working is an ongoing process that will keep presenting new risks to organizations, as well as new opportunities. The virtual and remote working experience during the pandemic has helped many organizations to enhance their corporate culture and productivity. Technology tools and collaboration platforms have proven to be effective. Organizations have also enhanced the employee experience by allowing colleagues to be more accessible and more visible.

Moving forward, organizations will need to define and measure talent management-related metrics, as well as the impact of human capital, in terms of their performance, innovation capabilities, and capacity to improve products, services, and customer experience. It is vital that boards monitor these KPIs against dimensions of employee experience and corporate culture, in order to accelerate strategy and minimize the costs associated with competing for talent.

To set the right tone from the top, boards must establish that talent management — especially employee engagement, experience and well-being — needs to be linked to purpose and strategy in order to enhance the organization’s long-term value. Boards can support management to steer beyond traditional metrics and focus on the key value drivers of human capital, such as the knowledge, skills and creative abilities that employees bring to the business. At the same time, boards can create accountability for how these talent management priorities and values are communicated and lived, including aligning executive compensation with these KPIs.

Boards will play an important role in helping management to challenge their own biases and traditional views of work, listen to their employees, and embrace a flexible, new work environment that addresses stakeholders’ expectations to achieve optimum performance, efficiency and competitive advantage.

As the digital revolution accelerates, machines will increasingly complement employees in the workplace. People will soon work alongside with digital solutions including sophisticated bots and connected machines that will perform mundane and repetitive tasks on their behalf. As a result, the workplace itself will become virtually unrecognizable from what we know today.

While this evolution should benefit employees in the long run, they might initially resist it — which could impact the effectiveness of digital transformation programs. When boards are monitoring their organization’s own transformation, they will want to pay close attention to risks associated with culture and talent, and compliance issues, along with any inherent technological challenges and cyber risks.

To provide effective oversight of risk in this new world of work and support the transformation of talent management, boards are likely to need to review their own composition. A board should be diverse and inclusive in perspective — with the right range of competencies, experiences and skills — to support the organization and its human capital as it evolves.

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12 “How companies can unleash the potential to reimagine work,” EY website, 2021 (accessed via www.ey.com, 18 October 2021).
Five key questions for boards

1. Has the board identified appropriate and meaningful talent management-related metrics? If so, how often is it reviewing and discussing these metrics with the CHRO in board meetings?

2. Do the board and management, as well as other senior leaders, understand the trends affecting the workforce of the future and their new ways of work? If so, are senior leaders driving the necessary shifts in culture, training and development? If not, has the support of external advisors, and the use of benchmark data and peer comparison been discussed as the workplace evolves?

3. Are the topics of talent management and new ways of working integrated into the board discussions about strategy and risk?

4. What role should technology play in the transformation of the organization toward new ways of working and how can the use of new tools be encouraged?

5. Does the board have the right mix of relevant skills, expertise, perspectives, and experiences that allows for effective oversight and direction of human resources and talent management?

The board should include individuals with in-depth knowledge of human resources and talent management, especially in areas, such as development, recruitment, retention and well-being. Its focus should embrace topics, such as agile teaming, diversity and inclusion, digitalization and technology, flexibility and employment law. There may also be a need to review the board’s operating model in terms of reporting (including reporting by the CHRO), risk oversight, management accountability and incentives, and committee delegation.

Strengthening board oversight of talent management will be a journey. A starting point for many boards may be to rethink their views on the board’s fundamental role in this area. In today’s disruptive information age, talent management is essential for securing an organization’s human capital and culture. It also helps organizations to adapt, innovate, and transform toward new ways of working. Talent management has moved beyond being a strategic asset, to become a strategic imperative, along with the new ways of work.
How can your board evolve cybersecurity oversight?
Key developments

Organizations continue to face the new wave of cyber threats. The EY Global Information Security Survey 2021 found a notable rise in disruptive and sophisticated cyber threats compared with the previous year’s research. More than half (58%) of cybersecurity leaders who responded to the survey said that their organization had experienced at least a 10% rise in disruptive breaches over the previous 12 months.

The mass shift to remote working that accompanied the pandemic is one reason for organizations becoming more vulnerable to cyber threats and other types of operational disruptions. Suddenly based at home and operating in pressured circumstances, many teams had to adopt new devices, systems and tools without having access to sufficient data or cybersecurity.

Frequently, the established internal control environments of organizations have proven to be inadequate for withstanding the challenges triggered by virtual and remote working. In some cases, they have even been circumvented altogether to get things done, creating opportunities for cyber threats. According to the EY Global Information Security Survey 2021, 81% of the executives said that the COVID-19 pandemic forced organizations to bypass certain cybersecurity processes or controls.13

Additionally, cyber breaches are increasing in quantity and quality, with initiators ranging from state-sponsored actors to organized crime groups, political and social activists, and individual opportunists. They are adopting new and more sophisticated strategies.

Implications for boards

Boards are acutely conscious of the huge financial, operational and reputational risks associated with cyber threats. Hence, nearly two-thirds (60%) of respondents to the EY EMEIA Board Barometer 2022 said that the topics of digital transformation and cybersecurity had increased in importance during 2021. Nevertheless, the constant stream of cyber threats makes it challenging and costly for organizations to keep up with the changes in technology, as well as best practices for protecting their business and the valuable data it holds.

Cybersecurity and internal controls

Shift in importance for digital transformation and cybersecurity in 2021

However, boards can speed up the process of bringing cybersecurity-related skills and experience to the boardroom. Usually, this will be through nominating new non-executive directors who bring experience from former roles – such as CIO, CISO or IT executive – to enhance board-level oversight of cyber risks.

Given the scale of the challenge – and the fact that many cybersecurity functions are underfunded or under-resourced – boards have increasing concerns about their organizations’ ability to manage cyber risks. According to the EY Global Information Security Survey 2021, just 9% of the boards were extremely confident that the cybersecurity risks and mitigation measures presented to them can protect the organization from major cyber threats – which was down from 20% in the previous year.

Therefore, many boards will be making effective oversight of cybersecurity one of their top priorities for the coming 12 months. This oversight will usually be operationalized by delegation to the audit committee, the risk committee or a technology committee.

Recommended actions

Continuous training and education throughout the organization – including at board and management level – are critical to combating cyber threats. The board should ask the management to explain how employees are being educated on cyber threats. It may also be sensible to set up a cyber awareness program.

As board members have access to commercially sensitive data, in the same way as the C-suite and other key personnel, they should be aware that they could be targeted by hackers. So, they should not use personal email accounts to discuss confidential issues pertaining to the organization and only use devices that have been approved by the cybersecurity team.

Additionally, boards should regularly request a comprehensive and independent assessment of the organization’s cybersecurity risk management program, using the internal audit function and seeking external third-party advice. A cyber-risk assessment will provide an overview of all the cyber-related risks that the organization faces, as well as an evaluation of existing cybersecurity controls and their documentation within the internal control system.

The assessment will help the board to identify the organization’s key infrastructure and digital assets, as well as third-party risks associated with service providers and the supply chain.

Once this assessment has been undertaken, the board can work with management to ensure the improvement of an appropriate and effective cyber-risk management program and corresponding internal controls. Further enhancement of enterprise resilience can be achieved by conducting rigorous simulations with third-party specialists, including the testing of recovery time and execution of escalation protocols.

Boards that want to further improve their oversight of cybersecurity could look at adopting a cybersecurity framework, such as the one created by the US National Institute of Standards and Technology (NIST). The NIST framework gives voluntary guidance consisting of standards, guidelines and practices that can help organizations to better manage their cybersecurity-related risks.

Unfortunately, even well-prepared organizations can fall victim to cyber breaches. So, boards should ensure that management has an incident response plan in place to facilitate a quick and effective response.

Source: EY EMEIA Board Barometer 2022

4% 37% 60%
Decreasing importance
Quite constant
Increasing importance

Five key questions for boards

1. Does the board understand the full suite of cyber risks that the organization faces and the potential to improve its internal control system, including cyber risks? Are devices, applications and home networks of board members, management and key personnel reviewed for an appropriate level of security?

2. What changes have been made to the internal control framework and cybersecurity monitoring procedures because of virtual and remote working? Is the potential to optimize technology and security operations regularly discussed at board level?

3. How adequately is the organization’s cybersecurity function funded and resourced, given the scale of today’s cyber threat? Is there a need for additional software, technology, personnel or other resources to augment existing controls?

4. Which contingency and response plans are in place for cyber breaches? How is management maintaining an effective incident response and recovery function?

5. Are security awareness protocols executed across the firm and how are the cyber-risk exposures of critical stakeholders, such as suppliers, determined? How are additional steps to achieve collaborative cybersecurity protection assessed?
How is your board responding to the opportunities and threats associated with the transition to net-zero?
**Key developments**

While investors and asset managers have increased sustainability reporting pressure on their portfolio companies in recent years, a confluence of further powerful forces is making sustainability a major agenda item for boards. Numerous extreme weather events that took place across the globe in 2021 have once again highlighted the increasing operational risks posed by climate change. At the same time, political and regulatory momentum is building behind the transition to a net zero economy. At the UN Climate Change Conference of the Parties (COP26), which took place in November 2021, countries pledged to reduce their greenhouse gas emissions and agreed to align the EU capital market and financial services sector with sustainability objectives through several initiatives, such as the EU Taxonomy Climate Delegated Act, the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Reporting Directive (CSRD).

The proposed CSRD will require companies that fall within scope – large businesses as well as listed small and medium enterprises (SMEs) – to disclose a wide range of information about their business models, strategy and supply chains. Its aim is to align sustainability reporting with financial reporting, so that financial firms, investors and the broader public can use comparable and reliable sustainability information. The directive will bring further responsibilities to boards and audit committees across Europe.

To complement these activities, the EU is planning a wider assessment of the corporate reporting ecosystem, including a review of the EU audit legislation. With its sustainable corporate governance directive, it is also proposing to reform corporate governance by clarifying directors’ duties, so that they are required to act in the best interests of the organization by pursuing long-term value creation and managing sustainability risks. The reporting requirements of the CSRD will, therefore, be underpinned by an obligation to carry out due diligence through embedding sustainability into the governance framework.

The efforts by the European Commission are underpinned by the mandate to the European Financial Reporting Advisory Group (EFRAG) to develop a draft set of European Sustainability Reporting Standards (ESRS) by mid-2022. Meanwhile, financial standard-setter – the IFRS Foundation – has launched the International Sustainability Standards Board (ISSB).

To achieve that same goal, with the UK setting a target to reduce emissions by 78% by 2035. Inevitably, politicians and regulators will require organizations to take purposeful actions that support the achievement of these targets. The European Commission is seeking to align the EU capital market and financial services sector with sustainability objectives through several initiatives, such as the EU Taxonomy Climate Delegated Act, the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Reporting Directive (CSRD).

Under the European Green Deal, the EU is aiming to be climate-neutral by 2050. The UK and Switzerland want
Implications for boards

Boards and audit committees will be crucial to drive the evolution of sustainable corporate governance. These new initiatives are likely to significantly expand their roles and responsibilities, so that they support their organizations to better manage their ESG risk exposure. ESG risks will vary according to the industry and countries that the organization operates in, as well as the nature of the organization itself. Organizations will be required to adopt strong governance and share high-quality information with a multitude of stakeholders.

It is clear from the EY EMEIA Board Barometer 2022 that boards recognize the need to focus on sustainability. The overwhelming majority (93%) thought the sustainability of their organization’s business model was a relevant concern, while 86% emphasized the importance of long-term value creation and measurement, and 81% prioritized operational and strategic ESG integration.

Sustainability-related issues most relevant for board members

In its Global Risks Report 2021, the World Economic Forum cites extreme weather, failure to take action on climate change and human environmental damage as being among the most likely risks of the next decade. Therefore, boards must effectively support, and provide oversight, for their organizations around decarbonization, reporting on key ESG metrics, transformation to manage associated ESG risk factors, actions toward a circular economy and other considerations that will impact the long-term value of their organization.

At the same time, investors and asset managers are more urgently demanding that their portfolio companies address business-relevant ESG risks and opportunities. A strong support for environmental and social shareholder proposals demonstrates the increasing willingness of investors to use their proxy votes to hold companies and individual directors to account on ESG matters, and against potential greenwashing. As investors grow more willing to vote against management, as part of a push to accelerate progress, engagement becomes more crucial as a way for organizations to understand investor expectations and voting rationale.

Yet, boards must go further than simply overseeing sustainability-related risks. It is also their responsibility to ensure that their organization fully integrates sustainability into its strategy and business model. This means using sustainability to create value through accelerated innovation, improved access to capital, better employee and customer engagement, and an enhanced reputation in the market. Fully embedding sustainability into strategy could even require the business to totally transform its traditional operating model.

While overseeing ESG risk management and strategy, the board will want to know that the organization is setting and monitoring appropriate targets – in areas, such as emissions reduction and staff retention – and communicating its achievements. It is key to have effective ESG reporting – which explains both how the organization is operating and how it is managing its ESG challenges.

ESG reporting enables organizational accountability around targets, and creates transparency for investors, civil society organizations, consumers, policy-makers and other stakeholders to evaluate ESG performance and the development of a responsible approach toward business. The concept of double materiality will reflect not just how ESG issues affect the business, but also how the business itself impacts society and environment. Boards should look to pursue the application of a multi-stakeholder approach when conducting materiality assessments.

Investors and asset managers are more urgently demanding that their portfolio companies address business-relevant ESG risks and opportunities.
Recommended actions

Going forward, boards should follow a holistic approach in terms of strategic opportunity and risk mitigation, and identify well-defined strategic priorities that drive long-term value. This approach requires organizations to recognize and combine major ESG trends and shifts, such as climate risk, decarbonization, energy transition, new ways of working, diversity and inclusion, good governance, and culture and integrity, as well as changing consumer behavior and stakeholder expectations.

Boards may need to review their composition and skills to enhance their competencies. Additional competencies around ESG will support the shift from a compliance perspective, on isolated sustainability or governance issues, toward a strategic mindset. As a part of this shift, it may be necessary to bring in external insights to the boardroom to boost the understanding of ESG-related trends that may affect the organization’s business, such as market-driven and regulatory developments, and further evolving stakeholder expectations. Shifting to a more strategic mindset will also require a deeper understanding of the ESG issues that matter most to the organization.

Boards also need to consider whether they should delegate ESG responsibilities to a dedicated sustainability committee or their audit committee. To support their oversight of ESG integration with strategy and risk management, boards might ask the audit committee to oversee the organization’s ESG disclosure processes and controls, and obtain assurance over ESG reporting.

In addition, boards should review the suitability and feasibility of any priorities set, and challenge management as to how the organization plans to deliver on these targets in practice. They should
also ensure that ESG-related metrics are transformed to measurable KPIs, and integrated into management priorities and executive compensation.

ESG reporting provides stakeholders with a more comprehensive view of how organizations are delivering and protecting value. ESG disclosures are also becoming an increasingly important dataset for mainstream investors who are integrating sustainability-related factors into their investment and stewardship decisions.

Boards should ensure that robust procedures are in place to facilitate both internal and external reporting, and that their organization has identified the reporting metrics that are most relevant to its sector, strategy and stakeholders. The stakeholder capitalism metrics, developed by the International Business Council of the World Economic Forum, are a good place to start.21

Five key questions for boards

1. How is the board kept up to date on regulatory, economic and societal developments related to ESG that could impact operations, risk and stakeholder support? Is ESG a regular item on the board’s agenda, and are clear management responsibilities assigned regarding driving and reporting ESG matters?

2. Has the board discussed the delegation of ESG oversight responsibilities to the audit committee or a dedicated sustainability committee to enhance board governance on ESG matters?

3. To what extent is the company taking the same approach to nonfinancial data as it is to financial data, in terms of measurement of performance metrics, integration of these metrics into executive compensation, disclosure processes, controls and external assurance?

4. To what extent is the company’s ESG reporting designed to meet regulatory expectations, aligned with leading external frameworks and underpinned by robust disclosure processes and controls?

5. Has a materiality assessment been discussed to support ESG risk, its integration with strategy and its impact on stakeholder relationships?
How can the board improve its risk oversight using modern, integrated GRC systems?
Key developments

Over the past year, organizations have faced a huge breadth of challenges as they have responded to the new ways of working, including a surge in cybersecurity incidents that have tested their internal control systems.

The COVID-19 pandemic, in particular, has demonstrated the importance of GRC systems for addressing critical situations, such as health risks, business interruption, breakdowns in supply chains and financial losses. Amid that, organizations have had to act fast and demonstrate agility in response to the challenges that they have faced.

They have also had to swiftly rethink their approach to operational resilience. Despite organizations increasing their expenditure on cybersecurity, 77% of the respondents to the EY Global Information Security Survey 2021 said their organization had experienced a rise in disruptive threats over the previous 12 months.22

Data breaches are a pervasive threat that pose regulatory and reputational risks to European organizations, in light of the General Data Protection Regulation. Organizations that have insufficient security solutions to protect their systems, networks and data can potentially be fined up to €20m or 4% of their annual global turnover.

Overall, the events of 2020–21 have highlighted that GRC underpins the achievement of organizational goals, effective emergency management and a culture of integrity during times of uncertainty. Furthermore, there is a necessity for organizations to adopt integrated GRC systems, which can be used to reshape the role of the board with regard to how it monitors the adequacy and effectiveness of GRC transformation. By adopting integrated GRC systems, and adjusting them as required, organizations are more likely to recover effectively from crises and transform potential problems into business advantages.

Implications for boards

Organizations often use different and isolated approaches for their GRC systems. This can undermine the board’s ability to provide effective oversight on risk and controls, and lead to potential risk exposures that might jeopardize the organization’s ability to continue as a going concern. It is not uncommon for GRC systems to be implemented, but not be adequately maintained or improved over the years that they are in use, until they eventually grind to a halt. When IT solutions are used, the tools may suffer from incompatible interfaces or insufficiencies when it comes to data exchange and matching. To support efficient prevention, detection and response around risk, it is key to have a harmonized and integrated approach for compliance, risk management, internal controls and internal audit, supported by an effective exchange of GRC-related information (for example, via a risk board or committee). Today, however, just 54% of board members believe that the board currently plays an active role in the risk identification process and continuous improvement of GRC systems, according to the EY EMEIA Board Barometer 2022.

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Boards’ current impact on GRC

Updates of well-known international GRC frameworks provide organizations with an opportunity to enhance and transform their GRC systems. In April 2021, the International Organization for Standardization (ISO) published a new certifiable standard for compliance management systems – ISO 37301. The standard explains, in detail, how organizations should configure their GRC systems to satisfy international legal norms and regulations and states that these systems should be “based on the principles of good governance, proportionality, integrity, transparency, accountability and sustainability.”

ISO 37301, which was designed by an international committee of professionals and experts, provides trust that risks are regularly assessed, business partners are screened (using a risk-based approach), the organization has a working system to raise concerns, and, in the name of non-conformities, the organization is improving its systems.

Furthermore, boards can use the COSO Enterprise Risk Management Framework, developed by the Committee of Sponsoring Organizations of the Treadway Commission, to evaluate their organization’s approach to risk management. This principles-based framework will enable boards to identify all the components of a comprehensive enterprise risk program. The framework was last updated in 2017 to highlight the importance of considering risk in both strategy-setting and business performance.

In addition, national guidelines and audit standards provide orientation to boards on management’s responsibilities regarding the design, implementation and continuous improvement of GRC systems as well as the board’s oversight responsibilities.

Recommended actions

Effective GRC systems require management to establish straightforward and documented processes, a uniform and (at least) annual risk assessment on the basis of qualitative and quantitative criteria, and consequent testing of systems and controls. Recent years have posed many challenges to risk management and internal controls. Constantly evolving cyber risks, new ways of working, constraints in global supply chains and geopolitical uncertainty have tested corporate resilience. These challenges should be viewed as opportunities to verify the effectiveness of GRC components, to foster continuous improvement efforts and to drive further integration toward a holistic GRC system environment.

It is the role of the board to monitor management’s performance against the strategic objectives of the organization, and to understand how risk and uncertainty are impacting the organization’s ability...
Five key questions for boards

1. Does the organization have integrated GRC systems, and are those connected with the organization’s purpose, values and culture? Do the tools used have adequate interfaces? Is there a risk committee established that discusses cross-functional risks?

2. Is there a need for the organization’s approach to risk assessment to evolve in response to the changing risk landscape? Has the risk register been updated in the last year?

3. Has the board recently questioned the reports provided by the organization’s GRC functions? Are significant risks reported individually? Are there any scenarios included in relation to the aggregation of selected risks that might jeopardize the existence of the organization?

4. To what extent are the current risk landscape and the organization’s risk appetite used to evaluate strategic decisions and key transactions?

5. Has one or more of the GRC systems been audited by a third party in the last five years? Does the board have sufficient benchmark knowledge to evaluate if their organization’s GRC systems meet the industry standards?

To achieve those objectives, GRC systems provide powerful insights into the areas where boards should focus. Regular, timely and comprehensive management reporting allows the board and the audit committee to continuously monitor the appropriateness of the design, and the effectiveness of GRC systems.

Furthermore, the board or the audit committee should be actively involved in the finalization of the internal audit plan, as well as monitoring follow-up measures on identified deficiencies.

The effectiveness of GRC systems heavily relies on the expertise of the internal audit and risk management functions. The complexity and scale of the current risk landscape demand knowledge sharing at every level of the organization. Therefore, boards should challenge management to invest in the resources and technological tools to improve shared risk intelligence throughout the business, with the objective of building an even more resilient organization in future.
How is the audit committee evolving, and what skills and experience do audit committee members need to perform their roles?
Key developments

The role of audit committees has evolved considerably in recent years. They continue to deliver confidence in their organizations’ financial reporting, as a part of their core oversight responsibilities. Meanwhile, most boards delegate a substantial portion of their enterprise risk management oversight to their audit committees.26

Audit committees must also consider the ever-growing reporting requirements, and the technological transformation of internal and external audit processes. Today’s audit committees are increasingly charged with growing requirements on organizations’ GRC systems, especially risk and compliance management, as well as oversight of nonfinancial reporting.

The requirements for accurate, robust and comparable ESG reporting are the result of investors, policymakers and other stakeholders demanding greater transparency around organizations’ objectives and operations, as well as how they manage their ESG risks. While several voluntary frameworks for reporting ESG information have been developed over the years, the European Commission’s proposed CSRD is set to make the reporting of key sustainability-related information mandatory for the EU’s large businesses, as well as its listed SMEs.

The risk landscape is broad and complex, with new and often unexpected risks emerging all the time. Therefore, audit committees are having to monitor an evolving range of risks and ensure that they fully understand the processes used by management to assess all the strategic risks facing the organization. These threats, which will often be integrated in comprehensive risk maps, range from geopolitical tensions, market trends and regulatory shifts to cultural issues, fraud, skills shortages, supply chain disruption and the pressures associated with digital transformation. During the COVID-19 pandemic, audit committees have needed to pay even greater attention to risks associated with liquidity and cyber threats, and more closely monitor their organization’s GRC systems.

While audit committees’ responsibilities have evolved substantially in recent years – especially since the reform of the EU statutory audit market in 2016 – they are likely to evolve even further in the future. The European Commission has initiated a review of corporate reporting for large companies in the EU. It is consulting on several areas that affect audit committees, such as board responsibilities for reporting, the liability of boards for reporting and current exemptions that enable some public interest organizations not to establish an audit committee.27 The European Commission intends to publish a proposal for EU audit and related reform before the end of 2022.

26 Audit Committee Realities: Insights from leading European boards, Tapestry Networks, 2019.
The audit committee of the future

Implications for boards

Against this background, it cannot be a surprise that, according to the International Federation of Accountants, audit committees globally “are under increasing pressure – both in terms of time and expertise – to oversee the major risks on their agendas in addition to fulfilling their core mandates.” The reality is that boards and audit committees have many competing demands on their time. They must balance long-term strategy-setting with short-term – but often urgent – challenges and ongoing compliance obligations. The audit committee, as a subset of the main board, is critical to the effectiveness of the board — since it bears key responsibilities on behalf of the board.

Currently, at least one member of the audit committee of a public interest entity in the EU is required to have competence in accounting and auditing, while some member states have already implemented stricter requirements (for example, two financial experts in the board and audit committee). The EU’s consultation on corporate reporting suggests that, in the future, boards are likely to need board members with corporate reporting expertise that relates specifically to areas, such as accounting frameworks, internal controls and sustainability reporting.28

Given the nature of the audit committee’s responsibilities, board members with these areas of expertise are also likely to be audit committee members.

Boards are under pressure to devote more discussion time at board meetings to ESG topics. One way to ensure that these topics are given the attention they deserve might be for the board to specifically delegate the task of monitoring ESG – and its associated risks. Audit committees could potentially play a key role in monitoring their organization’s performance against its ESG metrics. In this event, they should work closely with remuneration committees to ensure that executive remuneration packages are based on robust financial and nonfinancial metrics that support the long-term sustainability of their organizations.29 The EY EMEIA Board Barometer 2022 identified improved monitoring of their organization’s sustainability approach as the second most important priority for audit committees going forward, after improved monitoring of the organization’s resilience, business continuity management and emergency prevention measures.

Top four priorities named by board members to improve audit committee’s fit for purpose beyond 2022

1. Improve monitoring of the organization’s resilience, business continuity management and emergency prevention measures
2. Improve monitoring of the organization’s sustainability approach
3. Increase or extend diversity of audit committee members’ skills and competencies
4. Increase monitoring of audit quality

Source: EY EMEIA Board Barometer 2022

There is a growing demand from regulators and other stakeholders for organizations to have appropriate and effective risk management and internal control systems. Combined with an evolving risk landscape, the audit committee should ask itself whether its current monitoring efforts should be extended. Areas that are often neglected include determination of the company’s risk appetite, interactions between individual risks and proper analysis of the risks (individual or aggregated) that might jeopardize the continued existence of the company.

Audit committees are under increasing pressure to oversee major risks in addition to fulfilling their core mandates.
Recommended actions

In recognition of the audit committee’s expanding role, the board should ensure that the audit committee consists of a diverse group of individuals with a broad collective knowledge. This collective knowledge should encompass a wide range of more “traditional” competencies, such as financial reporting, regulatory compliance, risk management and internal controls. Furthermore, individual members of the audit committee, at least, should have specialist knowledge of cybersecurity, digitalization, the organization’s social and environmental impact, and the sector in which it operates. This specialist knowledge does not only allow for a professionally grounded skepticism, but it also fosters valuable input for strategy discussions. The audit committee members should benefit from training and continuous professional development — especially on new trends and regulations focused on the audit committee’s responsibilities — in the same manner that a board does.

The audit committee chair is a particularly important appointment, since the chair should not only bring specialist knowledge of the audit committee’s responsibilities, but also be an excellent facilitator with strong leadership skills.

Good audit committees will have healthy interpersonal dynamics, with the contributions of all members being heard and valued. They will build strong relationships with management and key function holders (such as the CFO, the Chief Risk Officer (CRO), the Chief Compliance Officer (CCO) and the Head of Internal Audit), ask critical questions of them, and provide comprehensive reporting back to the main board. Good audit committees are defined by their ability to challenge the organization’s management and external auditors, demonstrate intellectual curiosity and professional skepticism, and be courageous about taking tough decisions.

A vigorous discussion around risks is often still missing in many audit committees. Therefore, the committee should hold regular conversations on risk and review the organization’s risk map to gain a comprehensive understanding of the full spectrum of risks facing the organization and, how, if not properly managed, these might impact the organization’s ability to meet its strategic objectives. Additionally, the audit committee should perform stand-alone risk assessments on high-risk topics, such as liquidity, geopolitics, supply chains, and oversight of cybersecurity and data privacy.

33 “9 Traits of an effective Audit Committee,” ICAEW website (accessed via www.icaew.com, 6 December 2021).
Five key questions for boards

1. Is the audit committee prepared for upcoming challenges and regulations on nonfinancial reporting and broader ESG topics? Does it have sufficient specialist knowledge to assess the organization’s social and environmental impact?

2. Has the audit committee considered specialized training sessions for audit committee members to cover relevant topics in greater detail?

3. Does the audit committee have vigorous discussions about risks (such as cybersecurity, data privacy, geopolitics and supply chains) and the potential impact of those risks on the organization’s ability to deliver its strategy?

4. Is there a regular exchange between the audit committee — or at least, its chair — and the key function holders?

5. Has the audit committee considered whether it should have an evaluation of its effectiveness, separately from the board, but conducted with similar quality and depth?

Since they perform such a pivotal role, audit committees may want to consider how they can foster more robust communication and engagement, both internally and externally. For example, they could “walk the floor” to seek out the key function holders on a regular basis. They also have an opportunity to improve the organization’s transparency with investors and other stakeholders by increasing the voluntary audit committee disclosures. Audit committees could use these disclosures to provide more information around how they perform their oversight responsibilities, particularly in relation to sustainability and other areas of emerging risk.

Only an effective audit committee can handle the challenges associated with its growing to-do list. Board evaluations are nowadays a well-established practice, but it is rather rare to see separate evaluations for the audit committee, conducted with the same quality and depth. Consequently, opportunities to enhance the audit committee’s effectiveness could be missed. Audit committees could commission an external review of their effectiveness, using third parties to get an objective view on the committee’s work and dynamics, with a benchmark comparison.
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EYG no. 003396-22Gbl

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