The board and the C-suite

As part of its oversight role, a company’s board of directors typically selects the chief executive officer (CEO), sets the compensation of upper management and evaluates the performance of the company’s leaders. While the responsibilities and the roles of directors and management must be clearly understood and respected, there also must be a genuine and reciprocal relationship between the two groups. In this issue, we explore the dynamics of the board and C-suite relationship, including how roles have evolved, what leading practices are employed to improve communication and how directors and management can work together in a meaningful way to represent the interests of the shareholders.

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Beyond legal
The role of today’s general counsel at the company and with the board

No large company or board of directors is immune from concerns about regulatory compliance, legal risks and good governance practices.

The general counsel (GC) often plays an important role in advising management and directors on these difficult issues. GCs help assess risk and build compliance into the overall strategy of the company.

We talked with Deborah Platt Majoras, Chief Legal Officer and Secretary for The Procter & Gamble Company, about her experiences and how she views today’s GC role, including how the GC interacts with the audit committee and board. Following are excerpts from her discussion with Diane Larsen, a partner at Ernst & Young LLP and the Americas Assurance Markets Leader.

**Today’s GC**

**Diane Larsen:** Let’s talk about the evolution of the general counsel’s role. What’s changed over time, and how do you see that role today?

**Deborah Majoras:** My perspective includes my last four years at Procter & Gamble, plus the time I spent in private practice working with general counsels and the nearly eight years I spent on the enforcement side.

In that time, I’ve seen the GC’s role steadily evolve. Today, a general counsel has to be very proactive. We have to try to see around corners and anticipate issues before they arise. We also have to respond to new demands on the governance and compliance front – and do so without being overly reactive. Otherwise, we can send the company into a tailspin over each and every new external demand that comes our way.

GCs have to be very strong and agile business partners. It comes down to thinking broadly about our legal and governance responsibilities and getting them integrated into the company strategy. Over time, a GC can become a trusted advisor and exercise judgment that may go beyond just pure legal advice and really into what is the right thing to do.
I have heard some people imply that the job of a general counsel or corporate legal department is to “defend whatever it is that the company wants to do.” Nothing could be further from the truth. Our job is much broader than defending our company in litigation.

What we really want to do as general counsels is build good principles and practices into our business strategies and plans so that when new compliance or governance demands come up, we’re already exercising solid practices and are better positioned to be responsive.

**DL:** How much of your time is spent on regulatory efforts versus traditional litigation?

**DM:** There is no question that I spend a lot more of my time advising on issues and strategies to prevent compliance issues than I do focused on litigation or government investigations.

During tough economic times, we see less litigation with competitors because everybody has a greater incentive to try to work out the issues. On the other hand, we see shifts in the kind of cases that plaintiff lawyers want to bring. So, it’s not that the litigation isn’t there, but it’s certainly not what I spend the majority of my time doing; we have great lawyers who focus full time on litigation.

### Interactions with the board

**DL:** Given your focus on regulatory compliance matters, do you find yourself interacting more with the board and the audit committee?

**DM:** I do. The board generally, and the audit committee more specifically, have sharpened their focus on compliance issues. They’re asking if we have systems and processes in place to work to ensure good, strong compliance and how we are conducting investigations. They want to ensure that they and we are focused on the right compliance topics. The board is also more focused on governance issues overall, which is important.

We have several CEOs or ex-CEOs on our board, and they bring the benefit of their own experience in these areas. They help identify questions that should be asked and share their own good practices and successes in dealing with certain situations. Having a knowledgeable group of directors on these issues is very helpful.

**DL:** Do you regularly attend audit committee and board meetings?

**DM:** Yes. And I think most GCs today are attending the board meetings and most committee meetings — in particular, the audit, compensation and governance committee meetings. I think it’s a mistake to say that compensation is just an HR issue and audit is just a finance issue. There are a lot of issues and strands here that are tied in with one another.

Also, it’s important for a general counsel to have strong relationships with directors. GCs — especially those who serve as corporate secretary — help to shape the information that flows back and forth with directors.

“Our job is much broader than defending our company in litigation.”
Beyond legal

“Diversity breeds greater creativity, richer discussions and, ultimately, better decision-making.”

whether it is in committees or in the boardroom itself. I enjoy very much working with our board. It’s a really talented group.

**DL:** You recently joined the Board of Valero.

**DM:** Yes, I’ve only been to a few meetings, but it is interesting. I’ve learned so much from the P&G Board that I can now take to the Valero Board.

**DL:** It must be an interesting experience going on the other side of the table.

**DM:** Sure, and it’s a matter of thinking through what your role is. You obviously want to be a good and active board member, but you also need to recognize that you’re not part of the management team. It is absolutely a matter of role-definition.

**Board composition**

**DL:** Can you talk a little about board composition and diversity?

**DM:** I think diversity breeds greater creativity, richer discussions and, ultimately, better decision-making. And when I talk about diversity, I’m talking about it broadly. You have to go beyond physical characteristics, though certainly those do shape our world views and perspectives. You also have to consider varied experiences and not think of diversity as any kind of counting exercise. In the end, diversity of thinking is the goal.

**DL:** So, somebody like yourself, a lawyer by trade, is different from the traditional CEO or CFO board member and brings different views.

**DM:** Yes, that is certainly true. But I want to apply not only my legal and government enforcement experience but also what I’ve learned from my time working with the business at P&G. There are many ways to ensure diverse thinking.

At P&G, out of 10 outside directors, 5 of them are women. Of the males on the board, two are African-American and one was born in Mexico. Like I said, though, we need to go past physical characteristics, and these folks bring a lot of different and rich experiences to the table, which I think the company benefits from greatly.

**DL:** Can you talk about your relationship with the CFO?

**DM:** The relationship between the CFO and GC is critical because we deal with so many overlapping issues. I’m fortunate to work with a fabulous CFO, Jon Moeller, for whom I have enormous respect. We have developed a very cooperative and candid relationship. We consult frequently with each other, and that makes dealing with all of these governance and stewardship issues easier. And when executives have strong, cooperative relationships, it sets the right tone for our organizations.
What makes a great GC?

**DL:** Finally, what do you think makes a great GC in today’s environment? What are the kinds of skills that are most important?

**DM:** The baseline is legal knowledge and experience, which is necessary, but not sufficient. Beyond that, I think, first and foremost, are strong communication skills. I don’t just mean active communication. I mean active listening. It is a very important part of being a successful GC. Being responsive and agile, thinking with creativity and having good common sense, which includes people sense and organization sense, also are important.

We sometimes forget that legal issues and having a discussion with the general counsel or another lawyer can make people nervous. What we do is something of a mystery to folks and may cause some fear or concern. We need to be able to put ourselves in their shoes and think about ways to communicate that will be the most effective.

A general counsel also has to have the confidence to be able to stand up and veto something, if need be, and then also the sense to know when is the time to do that.

GCs have to be able to make decisions and judgments, sometimes quickly, without perfect information. But we have to be willing to make those decisions, live with them and move on. If a decision turns out not to be the right one, learn from that, adapt, and again, move on. Things are just moving very, very quickly.

It’s the sort of job where you have to have confidence not only in your own judgments but also in the judgments of your people because, of course, you can’t possibly make these decisions all on your own. We have 365 lawyers and 200 other legal professionals around the world, and I have a lot of trust in them, and that’s key.

Those are some of the attributes that help us do what we do, and as I look at general counsels whom I admire, those are skills that I’ve seen in them.
Trust and transparency
How boards can provide CEOs with a competitive edge

Editor’s note: The following article is based in part on a panel discussion that took place at the Ernst & Young Strategic Growth Forum® in November 2012. A video of the session, “Untapped value? Look to your board,” is available at ey.com/us/sgf.

When CEOs take full advantage of their relationships with board members, they can turn the knowledge, skills and networks of directors into a competitive edge. That process starts with a strong CEO-board relationship made up of the right people and based on transparency and full disclosure.

“The two most important characteristics for a CEO seeking to get the maximum leverage out of the board are trust and transparency,” says Kay Koplovitz, Chairman and CEO of Koplovitz & Co. LLC and founder of USA Network. CEOs and board members agree that open communication and honesty are the key ingredients to developing a relationship with the highest value for everyone.

CEOs also need to keep the flow of information open – they don’t have to wait for quarterly board meetings to discuss financial results and business results, Koplovitz says.

“Have calls between board meetings and tell them that this is what I’m thinking of doing and I would like some feedback,” she says. “Most board members won’t look at that as a weakness – they should look at it as a strength.”

The board and CEO shouldn’t feel like they’re on different sides of the table. Boards need to feel like they are part of the business and part of a team. CEOs can get the most from their boards by making sure that board members have the necessary information and knowledge.

An engaged board can be a competitive advantage because it allows everyone to use their skills and can lead to innovative ideas, better problem-solving and strategic decision-making.
“The two most important characteristics for a CEO seeking to get the maximum leverage out of the board are trust and transparency.”

Building the board

CEOs of public companies rarely get to pick their boards, but CEOs of private companies are more likely to have that opportunity. Whenever possible, CEOs should select board members who will help take the company to the next level.

Boards should be built with diversity of talent in mind. The CEO benefits when different aspects of the business are covered by directors with different skills and experiences. For example, some board members may have financial expertise; some may be experts on good governance; still others may be better versed on technology or marketing. Having a broad set of capabilities covered by different board members helps the CEO and the company be better prepared to deal with a broad range of issues and challenges when they arise. “You never play a baseball game with nine pitchers, so don’t do that on your board,” explains Lorrie Norrington, a former CEO and current director.

Cultural and gender diversity are also important. Less than 20% of Fortune 500 board directors are women, but companies with a higher percentage of women on their board outperform companies with fewer women in a number of ways. “Diversity can open the dialogue in a new way and away from group think,” Koplovitz says.

Norrington adds that it’s important for board members to reflect the company’s customer base: “Make sure people who are living the experience of your customers are at your table.”

Finally, it’s important to think about where you want to take the company next. What are the skills you’ll need at the table in three to five years to achieve the company’s strategic goals? As Koplovitz puts it, “Let’s face it. Business is a lot about human capital. It’s about who you access and who you know.” Think about the kinds of skills you want around the table in the future because you’re building a team.

Length of service

There is growing support for the practice of annual director elections, according to Dennis Wolf, Chief Financial Officer and Executive Vice President of Fusion-io, Inc. Annual director elections can encourage board members “to add value better and faster and get directors to commit once a year” to helping make the company better, he says.

On the issue of term limits, Doug Bowers, President and CEO of Square 1 Bank, says there are very few members or employees who can be in for the long term. “Being a board member is time-consuming and requires dedication. You have to be in the game big or everybody loses,” he says.
“You never play a baseball game with nine pitchers, so don’t do that on your board.”

Norrington adds that the number one thing is to be objective, and it’s very difficult if you don’t impose some sort of time limit. If you’ve been on the board for 15 years, can you really be objective?

Getting the most from the board

CEOs also need to recognize more than just the printed skills of board members. They need to dig deeper to find out about any informal skills or interests, too, so that they can call on them where appropriate.

Bowers says it’s imperative for CEOs to find the “sage” on the board – someone who can provide an even voice and put things in perspective.

Big benefits can be obtained when CEOs and board members share and use each other’s connections. Norrington says she’s surprised how few people use LinkedIn to tap into this vast network of connections, which can prove very useful in certain situations, such as developing new business or identifying new board members.

CEOs that tap the expertise, talent and networks of board members help move their companies forward and achieve business goals. And everyone gains a competitive edge by capitalizing on the knowledge and connections of others.


Questions for the board to consider

- Do the board and CEO have an open and transparent flow of communication, including between board meetings?
- Is there a plan or strategy in place to create a more diverse board and one that reflects the company’s customer base?
- How often does the board discuss succession planning for directors and CEOs? Are multiple candidates on the list depending on the circumstances and timing of the need?
- If annual elections are not already in place, how do board members feel about them? Should they be considered?
- Are the members of the board and the CEO sharing their contacts or using networks such as LinkedIn to do so?
CFOs in high demand
Addressing the board’s increasing need for financial skills

Of the 800 finance leaders surveyed for Ernst & Young's recent report, *CFO and beyond: the possibilities and pathways outside finance*, 79% agree that CFOs are more in demand than ever for board-level roles because of their financial knowledge.

Our research found that over the past decade, the percentage of board members with a finance background has increased significantly. In 2002, for example, just 8% of board members at 347 of some of the world’s largest companies were current or former CFOs. A decade later, that share had climbed to 14%. This shift is even more evident on the audit committee. In 2002, just 19% of audit committee chairs were experienced CFOs. In 2012, the percentage rose to 41% (see Figure 1).

The CFO appeal

There are three main reasons why finance leaders are becoming more common on corporate boards: the challenging macroeconomic environment, the expanding scope of the CFO role and the changing regulatory requirements.

1) **Challenging macroeconomic environment:** Financial markets are still highly volatile and banks are facing acute funding pressures. CFOs have the knowledge and experience to help companies navigate this complex economic environment and make the right strategic decisions.

2) **Expanding scope of the CFO role:** Over the past decade, CFOs have assumed a much broader, more strategic set of responsibilities. This has significantly increased the contribution they are able to make as a director. The core

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![Figure 1: CFO representation on boards](image-url)
technical and finance skills that once dominated the role are now just one small part of the abilities that finance leaders must possess. As a result, boards and nomination committees increasingly see CFOs as much more than simply experts in reporting and accounting standards.

3) **Changing regulatory requirements:** In many countries, changes to the regulatory environment have increased the demand for finance expertise on boards. For example, public companies listed in the US must disclose whether they have at least one “financial expert” independent of management on their audit committees. If they do not have this expertise in place, they have to explain why. In the UK, the Corporate Governance Code states that the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. This need for recent and relevant experience means that CFOs are in particular demand for directorships. Our research shows that, between 2002 and 2012, the likelihood that a CFO would also be a director increased significantly. In 2002, 36% of CFOs from the largest companies we surveyed held a director role at another company. By 2012, this percentage had increased to 46%.

**Should CFOs serve as directors on other company boards?**

While most CFOs recognize the benefits of taking on roles as directors, more than 40% think it is inappropriate to do so. Strict corporate governance legislation has led to an increase in the time required to be an effective director. More than half of CFO respondents estimated that they could spare only five hours or less per week on a supplementary role. In reality, the demands are typically much greater.
Additionally, board directors are often personally liable if it can be demonstrated they have neglected their executive duties. For some CFOs, the demands of their core responsibilities are too great, and the risk of overstretching themselves too significant.

**The upside**

Despite these factors, the leading CFOs we spoke to talked about using their board experience to enhance their performance as a CFO. Understanding board dynamics from the other side is the principal benefit according to 75% of the surveyed CFOs. Most CFOs spend a lot of time engaging with their own board members, but it is only by sitting on the other side of the table that they can fully understand how the boardroom works.

A second key benefit, according to more than half of the surveyed CFOs, is the opportunity to gain exposure to another company or industry. This exposure enables them to learn lessons that have valuable applications in their core role. Experience in a different sector is seen by many CFOs as valuable, with the opportunity to gain new knowledge and use leading practices from other industries. Also, when a CFO serves on the board of a large, well-respected company, there is a “halo effect” that benefits the organization where the CFO serves in an executive role.

**Looking ahead**

As companies grapple with the aftermath of the financial crisis and the divergent growth trajectories of developed and rapid growth markets, they want executives and directors who can provide comfort and confidence in an uncertain world. The CFO’s unique combination of analytical, technical and strategic capabilities means that they are arguably very qualified to provide it. However, they should choose the role carefully – and at the right time – so they can effectively manage the balance between the demands of the role of CFO and the role of board member.

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**Questions for the board to consider**

- Does the board have a policy regarding the company’s executive team members (e.g., CEO, CFO, GC, chief operating officer) serving on outside boards to further develop their skills?
- Has management disclosed to the board the executive team’s outside board directorships?
- Does the board limit the number of outside directorships for its executive team?
Financial reporting and regulatory update

Preparing for year-end reporting

Heading into year-end financial reporting season, companies and their audit committees need to have a clear understanding of current reporting matters and pay close attention to the current focus of the Securities and Exchange Commission (SEC) and standard setters.

The SEC’s current hot topics

In recent comment letters, the SEC staff has questioned disclosures that may conflict with SEC rules or accounting requirements, as well as disclosures the SEC staff believes could be enhanced or clarified. The resolutions vary; for example, some registrants sufficiently support their existing accounting or disclosures, and others agree to expand disclosures in future filings or amend previous filings.

Revenue recognition: gross versus net

Reporting revenue on a “gross” or “net” basis relates to whether a company should report revenue based on:

- The gross amount billed to a customer because it has earned revenue from the sale of the goods or services
- The net amount retained (i.e., the amount billed to a customer less the amount paid to a supplier) because it has earned a commission or fee

The issue often arises with companies that sell goods or services over the internet, but it can also be found in many other business models.

Revenue recognition: multiple-element arrangements

The SEC requests that companies expand their accounting policy disclosures on multiple-element arrangements to provide more information about certain types of contracts or transactions. Companies also should discuss whether the multiple-element arrangements guidance applies to their transactions.

The overall disclosure objective of the multiple-element arrangement accounting guidance is to provide qualitative and quantitative information about the significant judgments and the changes to those judgments that affect the timing or amount of revenue recognition. The SEC staff frequently requests that companies expand their
disclosures to provide a detailed explanation of how estimated selling price is determined, including a discussion of any factors, trends, inputs, techniques or assumptions used in the company's analysis. Companies also must disclose how consideration is allocated to the separate units of account within multiple-element arrangements.

**Income taxes**
The SEC asks companies about the realizability of deferred tax assets and the related disclosures in both the financial statements and MD&A. In particular, the SEC staff often questions the realizability of deferred tax assets recorded by companies that have recognized consecutive annual losses or a significant loss in the current year. The SEC staff also frequently asks questions about the positive and negative evidence that was considered during a reporting period when a valuation allowance was initially recognized, reversed or significantly changed, as well as the reason why such a change was not readily apparent.

**Management’s Discussion and Analysis (MD&A)**
In recent meetings with the SEC staff, users of financial statements focused on their ability to understand uncertainty in a company's financial statements. Many pointed to the critical accounting estimates as the best place to obtain that information.

The SEC expects companies to provide analysis of the uncertainties involved in making the accounting estimates as of the financial reporting date, including the variability that is reasonably likely to result until the uncertainty is resolved.

The SEC staff has noted that companies' disclosures in MD&A about critical accounting estimates are often too general — companies should not merely repeat disclosures already included in the significant accounting policies note to the
Financial reporting and regulatory update

financial statements. Instead, they should provide insight into management’s judgments about accounting policies that are subject to the most uncertainty and complexity. Some typical examples include fair value measurements of certain financial assets, goodwill and valuation of private equity for stock compensation purposes for initial public offering (IPO) companies.

Other areas
Segment reporting continues to be an area of focus in SEC comment letters. The SEC staff often considers disaggregated information to be better for users of financial statements, frequently questioning registrants about their conclusions that operating segments are economically similar so that they can be aggregated into reportable segments. The SEC staff also requests that registrants provide more robust analysis of their segments in their MD&A.

After an increase in recent years, the SEC staff continues to comment on loss contingency disclosures. While the SEC staff has said that it has seen improvement in the disclosure of loss contingencies, their focus on evaluating and enforcing compliance with existing disclosure requirements is expected to continue.

For registrants with foreign operations, the focus on disclosure continues. In particular, the SEC has been questioning the tax effects of operating in foreign jurisdictions, including the effects on liquidity of indefinitely reinvesting foreign earnings. Registrants also have been asked to provide more detailed disclosures about their exposure to European debt and debt issued by municipalities.

Joint projects update
The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) continue to work on their joint projects. The Boards completed
Financial reporting and regulatory update

For registrants with foreign operations, the focus on disclosure continues.

several projects in 2012 (e.g., balance sheet offsetting, fair value measurement, other comprehensive income, IASB consolidation guidance) and are focusing on their major projects of financial instruments, revenue recognition and leases. Final standards on revenue recognition are expected in the first half of 2013, as is a second exposure draft on leases.

The Boards also are jointly re-deliberating the insurance contracts project. While consolidation accounting was once a joint project, the FASB proposed only limited changes to its consolidation guidance. Accordingly, certain differences between US generally accepted accounting principles and International Financial Reporting Standards will not be eliminated. Also, the Boards have been reviewing guidance about consolidation accounting for investment companies.

Certain projects, such as broad financial statement presentation, financial instruments with characteristics of equity and emissions trading schemes, have been reassessed as lower priorities. Further action is not expected in the near term.

### Questions for the audit committee to consider

- Has the audit committee reviewed sensitive year-end accounting and reporting matters with management and the auditors?
- Are the company’s publicly available communications about the business consistent with its segment disclosures in the financial statements?
- Does the company have all of the resources that it needs to analyze and begin to implement the new guidance expected from the Boards’ joint projects?
Effectiveness and accountability in the boardroom
Kellogg School of Management, Corporate Governance Program
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CFO and beyond

CFO and beyond is based on a worldwide survey of 800 CFOs; a study of the career paths of group CFOs at 347 of the world’s largest companies (annual revenues greater than US$5b) over the past decade; and a series of interviews with leading CFOs, governance experts and academics.

To access a copy of CFO and beyond, go to www.ey.com/cfoandbeyond.

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