KPMG

Directors quarterly

Insights from the Board Leadership Center

April 2016

Focusing on What Counts

Signals that the Fed is unlikely to raise interest rates as swiftly as previously anticipated point to a challenging year ahead. A mixed global economic outlook (modest U.S. growth, a recovering eurozone, slowing growth in China, and struggling emerging markets) and big lingering questions will make for an interesting global landscape of risk and return: Will the U.K. "brexit" the eurozone? How will U.S. elections play out and shape pivotal policy decisions—tax reform, healthcare, energy, trade agreements, and immigration? How resilient will countries and markets be in the face of ongoing geopolitical unrest and terrorism? Coupled with relentless technology change and innovation, and heightened investor expectations, the road ahead will clearly require thinking differently and ever-deeper engagement in the boardroom: Is the board—and the business—focusing on what counts?

In this edition of *Directors Quarterly*, we highlight how boards are tackling these and other challenges, as discussed recently at our Audit Committee Issues Conference. We also share insights on a host of issues shaping boardroom discussions—cyber security, M&A, financial risk management, and more.

Among other timely financial reporting and auditing developments, our update from the Audit Committee Institute (ACI) highlights two new accounting standards from FASB: Revenue Recognition and Leases (effective in 2018 and 2019, respectively)—both of which have significant implications not only for accounting practices, but technology systems, reporting processes and controls, and financial management resources. We also offer thoughts on key challenges facing audit committees of global companies (from culture to talent in the finance organization) and considerations for enhancing audit committee disclosures.

Finally, we're pleased to welcome Jose Rodriguez to the Board Leadership Center in his new role as ACI's Partner in Charge and Executive Director. Jose brings more than 30 years of experience to our ongoing dialogue on audit committee and board effectiveness.

We hope you find this edition of *Directors Quarterly* helpful in navigating the opportunities and uncertainties ahead.

Dennis T. Whalen

Leader
KPMG Board Leadership Center

Beyond Status-quo Thinking

Insights from San Francisco

Dialogue at KPMG's 12th Annual Audit Committee Issues Conference shed light on the challenges and priorities shaping audit committee and board agendas—from economic turbulence, geopolitical risk, technological transformation, and business model disruption to shareholder expectations and the regulatory environment.

Thinking beyond the status quo will be crucial for boards to help their companies stay agile and competitive as they maneuver the rapidly changing business landscape. And it will be more important than ever for audit committees to stay focused on their core oversight responsibility—financial reporting integrity.

Directors and business leaders from around the globe met February 1st and 2nd in San Francisco to discuss how the unprecedented speed of innovation and technology breakthroughs are demanding new ways of thinking and a new level of engagement by boards.[1]

[1] *Comments made by attendees at the February 1–2, 2016 conference in San Francisco are included, unattributed, under the Chatham House Rule.*

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Beyond Status-quo Thinking

Insights from San Francisco

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"Staying compliant requires a solid defense," observed Dennis T. Whalen, head of the KPMG Board Leadership Center, "but staying competitive requires a sharper focus on offense. Bringing strategic insight into the boardroom conversation will hinge on spending time outside the boardroom—understanding customers and assessing corporate culture—and making strategy and leadership part of every board discussion."

Economic uncertainty and geopolitical risk

The mixed global economic outlook leaves companies exposed to a host of potential risks, including unexpected events that may have extreme consequences, according to Constance Hunter, KPMG Chief Economist, who discussed the challenges of an increasingly connected global economy. A major concern is the uncertainty surrounding decelerating growth in China, but Hunter said, "Pay close attention to what's happening in leveraged countries, sectors and companies, especially if the Fed continues on a rate hiking path."

The geopolitical risk environment is more volatile than ever, with profound implications for business strategies. Most notably, the alliance between the United States and Europe is at its weakest point in the last 75 years, according to Ian Bremmer, president and founder of the Eurasia Group. China—and its government, business, and trade policies—have become even more influential in the global economy. "We are living in a world in which there is no longer a U.S.-led global architecture. And companies can't just invest following a geopolitical risk model," he said. He indicated that, unlike advanced economies, emerging market economies face far greater risk of societal disruption (e.g. growing unemployment and income inequality) resulting from rapid technological advances. "Most emerging markets countries are too poor and too brittle to handle the risk," he said.

Disruptive innovation and thinking differently: The changing boardroom conversation

As they grapple with understanding evolving customer needs, new ways of leveraging existing technologies and assets, and the potential impact of the digital records that surround people, organizations, processes, and products—known as "Code Halos"—companies should ensure that their innovation efforts do not lose sight of their overall strategy and value proposition to customers, one longtime Silicon Valley executive and director said. "As directors, we want to help ensure that strategy is at the center of the discussion and every decision is consistent with that strategy. The board's job is not to select [technology and innovation] winners and losers; it's to make sure the CEO has a clear strategy that is well supported."

Given the volatility and uncertainty in the business environment—as well as technological advances and changing customer tastes and demographics—an important question is how boardroom discussions need to change if the board is to add value. The board's role in strategy is evolving from an "annual review and concur" model to a continual dialogue—monitoring execution, engaging with management on an ongoing basis, and helping to connect strategy, risk, and long-term value creation.

This greater board engagement in strategy may require "a transformation in director skills and experience," said one director. "It's critical that boards assess composition and succession planning based on the skill sets that will be most relevant to the company's strategy in the next three to five years."

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Lynne Doughtie, Chairman and CEO, KPMG LLP

Ian Bremmer, President and Founder, Eurasia Group

Dennis T. Whalen, Leader, KPMG Board Leadership Center

Beyond Status-quo Thinking

Insights from San Francisco

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Cyber security: Moving beyond prevention

Assessing how the company is managing cyber security risk is high on the list of the board's priorities, and one of the board's biggest challenges. Rather than focusing on trying to prevent cyber breaches, "companies would be better served by focusing their efforts on making sure they can respond quickly and appropriately to a cyber incident when it occurs—and it will occur," noted one director. Organizations should be evolving their mind–set on cyber risk from prevention to rapid detection and response. An incident response plan with a blueprint for communicating information in a timely manner to investors, regulators, and customers is critical.

Panel members emphasized that cyber risk is increasingly viewed as a board-level oversight responsibility, rather than one that belongs solely to the audit committee. A key question is how to structure board and committee oversight responsibilities for cyber risk—taking into account the technical expertise and time commitments of the full board and its committees.

The audit committee's core oversight responsibilities

It is critical for audit committees to stay focused on their most important oversight responsibilities: financial reporting, internal controls over financial reporting, as well as directing the internal and external audit functions. Panel members discussed financial reporting, auditing, and tax developments that audit committees should have in their sights.

Readiness for FASB's new revenue recognition and lease standards. The FASB has deferred the effective date of the new revenue standard by one year—until January 1, 2018 for calendar year-end public companies. Panelists noted that the new standard, which will change the way many companies recognize revenue from customer contracts, will have a significant impact across the company—from business terms, conditions, and contracting processes to systems, data, and accounting processes. Companies should use the additional transition time to finalize implementation plans, identify areas that require close attention, and implement any necessary changes to processes, systems, and controls.

Country-by-country (C-by-C) tax reporting. The impact on multinationals will be profound, with significant implications for tax compliance and reporting functions, transfer pricing policies, tax audits and controversies, and reputational risk. The first C-by-C reports will relate to fiscal years beginning on or after January 1, 2016, with the report due one year later. Audit committees of multinationals will want to assess their company's readiness in terms of systems and process changes, transfer pricing strategies, and communications plans.

Reinforcing audit quality. Audit committees should pay close attention to SEC and PCAOB initiatives to improve audit quality and enhance communications. The PCAOB initiatives include the Board's ongoing inspection process, its audit quality indicators (AQI) project, and the auditor's reporting model effort. A 2015 SEC Concept Release considered revisions to the Commission's audit committee reporting requirements. The SEC is considering whether rulemaking is appropriate.

"It's important for audit committees to stay apprised of, and perhaps participate in, all of these initiatives, and assess how their audit committees are helping to maintain audit quality," said one panelist.

Activists as change agents in the boardroom

While views are mixed on whether activism is good or bad for shareholders, it's clear that companies are increasing their engagement with activists, and the investor community more generally, to better understand the company's vulnerabilities and opportunities through an investor lens.

Panelists noted that while some activists are short-term focused, others are focused on the long term, and can add value because of the resources and focus they bring to the table. One activist investor noted, "We're not looking for problems to fix. We are looking for the best business models. We come in through the front door." Panel members noted outreach and a willingness from independent directors to seek input from shareholders directly, rather than obtaining those views as filtered through management and investor relations. In short, one panel member said, "There is a greater interest on the part of management and boards to understand investor views, priorities, and concerns." ■

Audit committee and financial reporting update

From the Audit Committee Institute

Four key challenges for global audit committees

The increasing volatility and complexity of the global business and risk environment—conflict in the Middle East, slowing growth in China and emerging markets, volatility in commodity prices and currencies, interest rate uncertainty, and more—raises an important question for every global audit committee: How is this global volatility and uncertainty affecting the committee's agenda?

Based on what we're hearing from audit committee members of global companies, we offer the following observations:

What is staying the same on global audit committee agendas. Job number one for every audit committee is financial reporting integrity, so the committee's core responsibility remains the oversight of financial reporting and internal controls over financial reporting, as well as directing the external and internal auditors—which is critical to audit quality. That is a big undertaking for every audit committee, but it is particularly challenging for audit committees of complex, global organizations.

What is changing. The globally connected world in which companies operate—with its complex legal and compliance environments, integrated supply chains, cybersecurity risks, and unprecedented volatility—requires audit committees to know more about that world, and to make sure their companies are built to operate in this business environment. That is an increasingly difficult challenge, which the audit committee shares with the full board. We see global audit committees reassessing whether they have enough time and the right expertise—thinking about which board committees are best suited to oversee which risks (and reallocating oversight responsibilities as appropriate), leveraging nontraditional resources to gain a deeper understanding of certain risks, and engaging in more global travel to see things first-hand and connect with the people on the ground.

What are the key challenges facing global audit committees today? We would highlight four:

Culture. Critical to the success of every global company is establishing a nonnegotiable set of global values around compliance, safety and how the organization treats people. Keys to meeting this cultural challenge are tone at the top of the foreign operation, control and accountability built into the organizational structure, upfront communication, and proper incentives and rewards.

Talent in the finance organization. Quality financial reporting starts with the CFO, but requires a strong team on the ground in the markets the company serves, supported by traditional corporate roles—controller, chief accountant, internal audit, and treasury functions. Success here requires the right people, both local and expatriates, and their ability to work together.

Rodriguez Named Head of KPMG's Audit Committee Institute

Jose R. Rodriguez has joined the KPMG Board Leadership Center, to serve as the partner in charge and executive director of the Audit Committee Institute. Based in Greensboro, N.C., Jose has served large, multinational and mid-sized companies, with a primary emphasis in the consumer markets and retail industries. With KPMG for over 30 years, he has been an Audit partner since 1995 and also serves as an SEC Reviewing Partner and Foreign Filing Partner.

"As I've seen firsthand, the audit committee's job is becoming more challenging by the day, given the complexity of business issues and risks facing companies and ever-rising expectations of investors and regulators," said Rodriguez. "As a resource for sharing the latest practices and understanding emerging trends, ACI will continue to play a pivotal role in the dialogue on audit committee effectiveness – whether it's through our audit committee peer exchanges, annual Audit Committee Issues Conference, or one-on-ones with audit committees. It's an exciting time to be leading the ACI."

Jose currently serves as Ombudsman for KPMG LLP and previously served as Chief Operating Officer for KPMG International's Global Audit practice, a member of KPMG International's Global Audit Steering Group, the Office Managing Partner of KPMG International's Global Services Center in Montvale, the Audit Professional Practice Partner for KPMG LLP's East Region, and the Southeast Area Audit Professional Practice Partner. Jose has also served as lead director and a member of KPMG's Board of Directors.

Maintaining a sound global control environment. With supply chains extending across continents and operating across different cultures and legal frameworks, corporations face ever-greater challenges addressing the increased risks that these extended operations present—e.g., financial reporting and internal controls, the increased risk of fraud and corruption, inferior product quality, and corporate responsibility issues, such as human rights, fair labor standards, and sustainable environmental practices.

Legal and regulatory compliance. A critical role for a global audit committee is to help ensure that its company's ethics and compliance programs keep pace with globalization,

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Four key challenges for global audit committees

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technology, and new business models. The risk of fraud and corruption tends to increase when companies move quickly to capitalize on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across longer supply chains. Factor in the Foreign Corrupt Practices Act and the Securities and Exchange Commission's whistleblower program in the United States, the Bribery Act in the United Kingdom, and the sheer volume and scope of new regulations, and it is pretty clear why compliance is a top challenge.

Twitter, YouTube, and Facebook have effectively put every company in a fishbowl, so the company's culture and values, commitment to integrity and legal compliance, and brand reputation are on display globally, all the time.

Given these challenges, the depth and breadth of the global audit committee's engagement is more important than ever—spending time outside the boardroom, visiting company locations around the world, talking to people in their own offices and workplaces, and developing a first-hand point of view of the organization's culture, talent, controls, and more. ■

Financial reporting & auditing update

In February, the FASB issued its final lease accounting standard, which requires lessees to account for most leases on-balance sheet – a significant change from current U.S. GAAP. While the standard is not effective until 2019 for U.S. public companies with a calendar year-end, all companies may adopt the new leases standard immediately. This allows companies to adopt the new lease accounting standard before they adopt the new revenue standard. The FASB expects to issue three additional standards about revenue within the next few months. These new standards are expected to be the last amendments to the new revenue recognition model before it becomes effective January 1, 2018, for U.S. public companies with a calendar year-end. Meanwhile, public companies also are considering the implications of new standards that become effective in the first quarter of 2016. Below, we summarize these and other accounting and financial reporting developments potentially affecting you in the current period or in the months ahead. (For more detail about these and other issues, see *KPMG's Quarterly Outlook* and related *KPMG Defining Issues*.)

Current Quarter Financial Reporting Matters

Accounting Standards Effective for 2016. Public companies must adopt several new standards in 2016, including standards about consolidation, presentation of debt issuance costs, cloud computing arrangements, hybrid financial instruments, and certain share-based payments. For a list of all standards that companies must adopt in 2016, see the Appendix on Recent Accounting Standards in *KPMG's Quarterly Outlook*.

SEC Staff Areas of Focus. SEC staff recently highlighted a range of topics of focus and frequent comment, including various aspects of company internal control over financial reporting; non-GAAP financial measures; segment identification and disclosure; income tax disclosure; fair value disclosure; oil and gas price declines; predecessor financial statements; and international reporting matters, including loss of foreign private issuer status and Venezuelan operations (i.e., consistent use of appropriate exchange rates and deconsolidation evaluations).

Upcoming Financial Reporting Matters

Preparing for the New Revenue Standard. In 2015, accounting standard setters, regulators, financial statement preparers, auditors, and investors continued to discuss application questions about the new revenue standard. Despite those activities, preparers' overall progress on developing an implementation plan has been slower than some had originally anticipated. A recent KPMG poll indicated that only 29 percent of the respondents had a clear implementation plan for the new standard, and only 12 percent have completed (or have nearly completed) assessing the effect of the new standard.

Expectations for Preparers

At the AICPA National Conference in December 2015, the Deputy Chief Accountant of the SEC's Office of the Chief Account (OCA) stressed that the implementation efforts by companies may be lagging. Understanding the accounting changes by undergoing a gap analysis is only the beginning of the implementation assessment. In addition to identifying the accounting changes, the new standard requires additional judgments and estimates and significantly expanded disclosures. Many companies will need to develop revised accounting policies; reorganize accounting and business processes; potentially reconfigure IT systems; and implement new internal controls. During the AICPA National Conference, the SEC Chair stated that management's ability to fulfill its financial reporting responsibilities significantly depends on the design and effectiveness of ICOFR. Therefore, it is critical that companies consider the internal control implications early in the process when developing an implementation plan for the new standard.

Companies should make it a high priority to develop a change-management strategy that involves detailed implementation plans and impact assessments that they can discuss with audit committees, executive management, and auditors. Companies also should allocate sufficient, qualified resources to complete the work on a timely basis.

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Financial reporting & auditing update

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SAB 74 Disclosures
The Deputy Chief Accountant of the OCA stated that companies should provide more detailed disclosures about the expected effect of the revenue standard on the company's financial statements. If the effect is unknown, preparers should communicate that fact and the expected completion date of their assessments. The Division of Corporation Finance staff reiterated that it expects disclosures to evolve and become more refined as companies begin to implement the new standard.

FASB Progress
The FASB recently issued a final standard that addresses principal/agent considerations by clarifying that the assessment is based on the control principle in the standard. Within the next few months, the FASB expects to issue three additional final standards that will amend and clarify the new revenue standard. Once finalized, these amendments and clarifications are expected to be the last amendments to the new revenue recognition model before it becomes effective.

Putting Leases on the Balance Sheet. In February 2016, the FASB issued its new lease accounting standard, which requires lessees to recognize most leases, including operating leases, on-balance sheet via a right of use asset and lease liability. Lessees are allowed to account for short-term leases (i.e., leases with a term of 12 months or less) off-balance sheet, consistent with current operating lease accounting. The new standard also makes a number of other changes to lessee accounting, which are discussed in *KPMG's Quarterly Outlook.*

Changes to the lessee accounting model may change key balance sheet measures and ratios, potentially affecting analyst expectations and compliance with financial covenants. Companies also may be required to upgrade or modify their IT systems to capture all lease activity and the lease data necessary to apply the new standard. Additionally, companies may need to revise their accounting processes and internal controls to ensure timely identification of events requiring revisions to lease accounting.

In contrast to lessee accounting, the new standard does not make extensive changes to lessor accounting; however, as discussed in *KPMG's Quarterly Outlook*, the Board did change certain aspects of the lessor accounting guidance that lessors should be mindful of.

The new standard is effective January 1, 2019, for public companies with a calendar year-end. Private companies have a one-year deferral. All companies may adopt the new standard immediately.

The new standard requires a modified retrospective transition, which means that both lessees and lessors will apply the new guidance at the beginning of the earliest period presented in the financial statements. However, lessees and lessors may elect to apply certain practical expedients on transition.

New Accounting for Equity Investments and Financial Liabilities. The FASB recently issued the first of three standards related to accounting for financial instruments. The new standard will significantly change the income statement effect of equity investments and the recognition of changes in fair value of financial liabilities when the fair value option is elected. The standard is effective January 1, 2018, for public companies with a calendar year-end. Private companies have a one year deferral. Certain aspects of the standard may be adopted early.

The FASB is completing work on its impairment project and expects to issue the final standard in the second quarter of 2016. The Board also completed its initial deliberations on the hedge accounting model and expects to issue an exposure draft on hedge accounting in the second quarter of 2016. ■

Considering the audit committee's disclosures

Amid increasing focus by investors, regulators, and other stakeholders on the role and responsibilities of the audit committee, and potential regulatory action to expand mandatory disclosure requirement, audit committee reporting is evolving. In particular, there is a movement toward voluntary, enhanced disclosure around external auditor oversight, an important facet of the audit committee's broader financial reporting oversight role. As a result, companies may wish to take a fresh look at their audit committee reports and consider whether any enhancements could help investors better understand the processes and work that the committee does in carrying out its oversight responsibilities.

The heightened focus on audit committee disclosure culminated in the July 2015 publication of a 55-page SEC Concept Release seeking comment on possible revisions to audit committee disclosures. The concept release focuses on the audit committee's reporting of its responsibilities with respect to its oversight of the independent auditor, the audit committee's process for auditor selection, and its consideration of the qualifications of the audit firm and certain engagement team members when selecting the audit firm. Many of the current disclosure requirements—which exist principally in Item 407 of Regulation S-K—were adopted in 1999, prior to the passage of the Sarbanes-Oxley Act, which significantly changed the audit committee's role and responsibilities.

Some issuers already go beyond the reporting requirements. The Center for Audit Quality's *2015 Audit Committee Transparency Barometer* provided examples of enhanced disclosures from the proxies of companies in Standard & Poor's Composite 1,500.

The SEC received almost 100 comment letters on the concept release, many of which supported a voluntary framework to enhance disclosures. But concerns have been raised that mandatory disclosures can become boilerplate, which could have a chilling effect. "The message in most of the comment letters was, 'there's been some pretty good movement with voluntary disclosures…but if you put this into the rules, you'll get boilerplate,'" said Dennis T. Whalen, head of KPMG's Board Leadership Center.

The Commission's consideration of this topic comes as the PCAOB is engaged in its in own standard-setting initiatives, which could also result in additional disclosure about auditors and their work—the Board's transparency rules, which if approved by the SEC, would require, among other things, disclosure of the name of the engagement partner for each issuer audit[1]; proposed changes to the auditor reporting model, and the potential use of audit quality indicators.

In a survey by KPMG's Audit Committee Institute, 8 percent of those polled said their board/audit committee has expanded the audit committee report, and 16 percent said they were considering doing so in light of SEC interest. As some comment letters responding to the SEC's Concept Release observed, improving transparency does not necessarily mean additional disclosure, but rather better communication—for example, to explain the robustness and effectiveness of the audit committee process. Others suggested that as part of the committee's consideration of whether to add any additional information to their disclosures, it may be helpful to engage with the company's largest shareholders to determine whether the information would be useful.

Areas for potential enhanced voluntary disclosures:

Audit firm selection/ratification, including discussion of the audit committee's considerations in recommending the appointment of the external audit firm as well as the length of time the audit firm has been engaged.

Audit firm compensation, including discussion of how non-audit services may impact independence, a statement that the audit committee is responsible for fee negotiations, an explanation provided for a change in fees paid to the external auditor, and a discussion of audit fees and their connection to audit quality

External auditor evaluation/supervision, including a discussion of criteria considered when evaluating the audit firm, and disclosure of significant areas addressed with the external auditor.

Audit partner selection, including a statement about engagement partner rotation and a statement that the audit committee is involved in selection of the audit engagement partner. ■

More from the Audit Committee Institute at *kpmg.com/aci*

[1] *See PCAOB Adopts Rules Requiring Disclosure of the Engagement Partner and Other Accounting Firms Participating in an Audit, from KPMG's Financial Reporting Network, published Dec. 18, 2015.*

M&A as a growth strategy

As companies continue on a quest for growth, they'll need to determine how mergers and acquisitions fit into their strategy. A desire to enter new lines of business, expand their customer base, and extend their geographic reach are the main factors expected to drive deals in 2016, according to results of a survey of more than 550 dealmakers by KPMG and FORTUNE Knowledge Group.

M&A is expected to be most significant in those industries where the market for disruption is highest: technology (70 percent), followed by pharmaceuticals/biotechnology (60 percent), healthcare providers (47 percent), and media/telecommunications (42 percent), according to KPMG's 2016 M&A Outlook Survey. While megadeals may make headlines, middle-market deals are expected to dominate the M&A landscape in 2016. Sixty-eight percent of respondents say their deals will be valued at less than $500 million. Nearly eight in 10 of those polled expect the United States to be the most active market.

Most executives surveyed expect to see multiple acquisitions on their corporate agendas. Over 90 percent of dealmakers said they intend to initiate at least one acquisition in 2016, compared with 82 percent of those surveyed a year earlier, while 81 percent anticipate executing two or more mergers (versus 64 percent in 2015) and 42 percent expect to initiate five or more (compared with 27 percent previously).

When asked which factors are most important when evaluating a target, strategic fit (67 percent), growth potential (56 percent) and the target's valuation and investment return (44 percent) ranked as most important, while cultural compatibility ranked as least important (15 percent).

To create the most successful deals, deal makers should focus on execution. The following are some consideration to keep in mind:

View targets in real-world context and get the valuation right. Focus on identifying the correct strategic partner and getting the valuation right. Global economic factors also need to be considered.

Optimized due diligence and early tax planning are key. The ability to uncover and analyze deal data–in the compressed timeframe of the deal–is critical to understanding areas that require further analysis to make the best business decision.

Well-executed integration plans are critical to realizing full deal value. The most important post-close issues should be revealed and addressed during due diligence, including those surrounding human resources, information technology and tax.

"Directors have a unique opportunity to help their companies meet strategic goals through M&A," says Dan Tiemann, U.S. Group Leader, Deal Advisory and Strategy at KPMG LLP.

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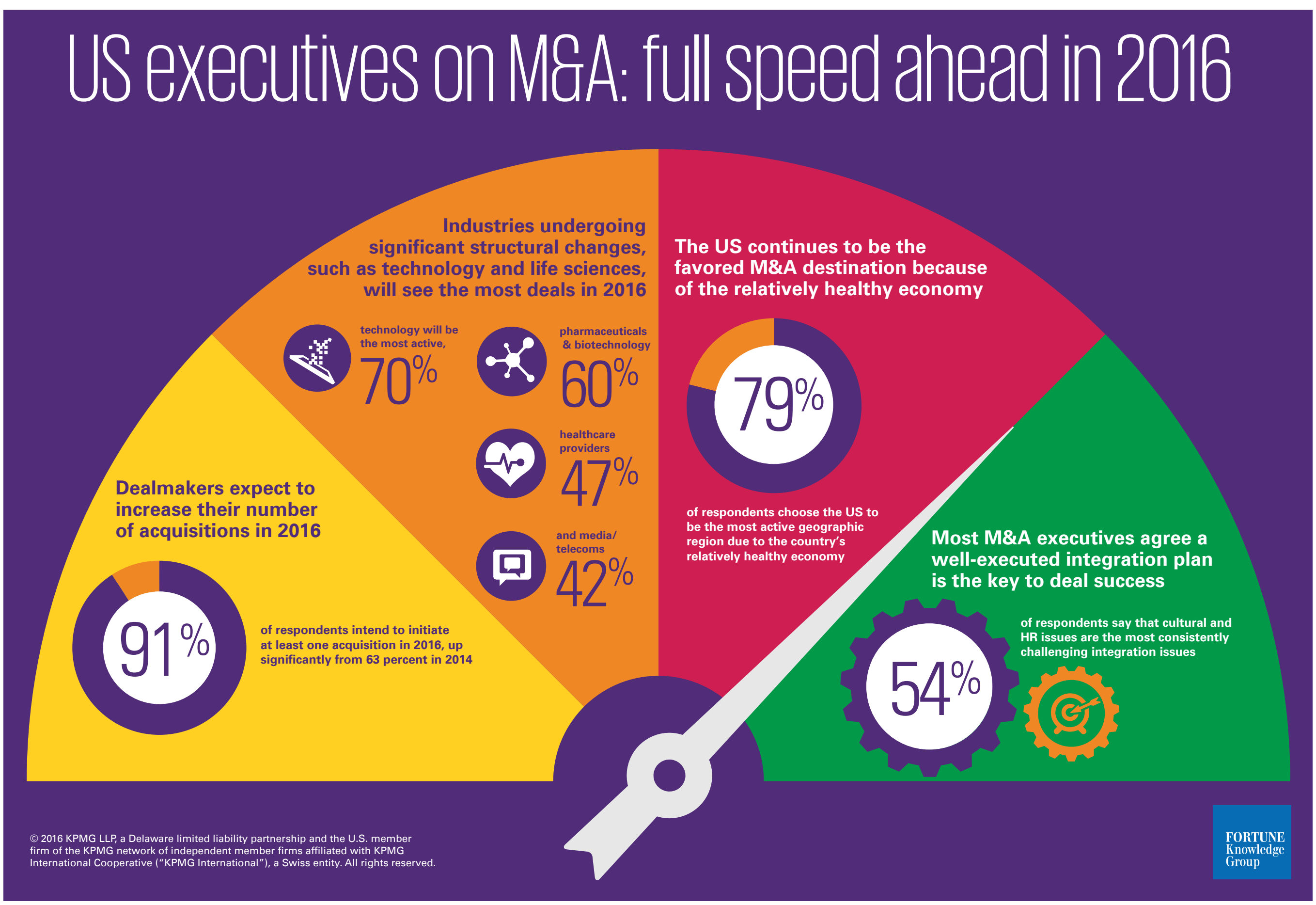

M&A as a growth strategy

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"Frequently, a board is comprised of directors who have worked on many more acquisitions than the management team, and their experience can add value to the M&A process."

According to the KPMG 2016 M&A Outlook Survey of over 550 deal professionals, the most important factor for deal success is a well-executed integration plan (39 percent), followed by the correct valuation (31 percent), and effective due diligence (18 percent).

In a separate survey by the KPMG Board Leadership Center, one in three directors said their board could be more involved in shaping M&A strategy and in evaluating deals proposed by management.

"Understanding the levers that management can pull to navigate a successful deal is critical," says Dennis T. Whalen, Leader, KPMG Board Leadership Center. "The board should have a clear picture not only of what it takes to get the deal itself completed, but how operational and financial metrics of success will be assessed."

Based on our conversations with directors who have served on numerous boards and worked through scores of M&A transactions, KPMG offers the following suggestions on the role that the board can play in the M&A process, and how it can help the company capture more value—and minimize the risk of failure:

- Test alignment of the deal with the company's strategy, and challenge the value creation potential of the deal.
- Be sensitive to possible management bias and maintain the board's objectivity—don't fall in love with the deal.
- Closely monitor key aspects of the due diligence process before approving the deal.
- Consider the implications of the evolving tax climate.
- Examine the post-merger integration plan in detail, and track performance against the plan.
- Ensure the company has a rigorous M&A process and the right M&A leadership.

Find the complete M&A report at ***www.kpmgsurvey-ma.com*** and read KPMG's report on the role of the board in M&A at ***www.kpmginfo.com/role-of-the-board/***. ■

Guarding against fraud in the age of social sharing

Companies are increasingly vulnerable to business e-mail compromise, an emerging fraud threat, as executives become more active on social media and their devices permeate the Internet of Things.

Social media has emerged as a double-edged sword as companies and their employees assess what works for their business and where the pitfalls lie. A key challenge the board is to help ensure that management (often spearheaded by marketing and closely supported by legal, HR, compliance and IT) has in place a social media governance framework that effectively addresses the range of internal and external risks.

Moreover, according to the FBI, more than 7,000 U.S. companies have been victimized by e-mail fraud scams since the end of 2013, with total dollar losses exceeding $740 million. Small and mid-sized companies are the most frequently targeted, and the average loss is $130,000.

What should chief information officers (CIOs) do to minimize the risk to companies and their employees?

As a practical matter, CIOs need to know that there is no surefire way to protect fraud through business e-mail compromise. No matter how high companies build their firewalls, scam artists will find a way to climb higher. So it's important that CIOs make sure their companies have cyber insurance policies that protect against wire fraud. We've found that most don't, and only a handful do.

In addition, CIOs should drive efforts to:

– Make sure employees and senior executives, in particular, receive social media training that is updated regularly in response to the constantly changing landscape.

– Provide employees with free access to security tools and capabilities such as password vaulting.

– Put stronger controls in place around the finance functions, such as strengthening protocols around wire transfer requests.

– Create intrusion detection system rules that flag emails with extensions that are similar to company email but not exactly the same.

– If possible, register all Internet domains that are slightly different than the actual company domain.

– Conduct robust threat modeling.

– Establish duress indicators, including incident reporting via confidential means.

Finally, it's important to regard cybersecurity efforts as an ongoing challenge. With billions of new devices coming online every year, what we know today about security may not necessarily be as relevant tomorrow.

A version of this article by Greg Bell, KPMG's service leader for Information Protection, first appeared in CIO. ■

Cyber security: A strategic risk

Whether customer data, intellectual property, or the data necessary to run the company, keeping data safe is no longer an afterthought for most organizations. There's a growing recognition among companies and boards that cyber security poses an enterprise-wide risk. And since cyber security is closely tied to customer loyalty and trust, as well as innovation, a breach can seriously undermine consumer confidence and damage brand reputation.

So it's not surprising that nearly a third of more than 1,200 CEOs surveyed listed cyber security as the issue that has the biggest impact on their company today, according to a report by KPMG titled, "Cyber Security: A Failure of Imagination by CEOs." One in five CEOs polled indicated that they are most concerned about information security. Operational and compliance risk were listed as the top risks. But cyber risk, if uncontrolled, can quickly become an operational issue and a regulatory issue.

"Many senior executives don't appreciate the level of technology that is embedded in their products," says Malcolm Marshall, KPMG Global Head of Cyber Security. "Nor have many C-suite executives thought through the creatively devious ways that cyber criminals might exploit their products or services." Cyber crime is not as well understood as conventional crime. Ultimately, it's a question of product integrity and reputation, which is a board-level concern.

Developing a Framework for Cyber Risk

Many organizations already have a framework for assessing enterprise risk, but still treat cyber risk differently than other risks. "That is a mistake," Marshall explains.

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Cyber security: A strategic risk

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Every organization should have a framework for analyzing cyber security and ideally, that framework should be integrated into an organization's existing enterprise risk framework. Existing frameworks include The Framework for Improving Critical Infrastructure Cybersecurity in the United States, Cyber Essentials in the United Kingdom, or the international standard ISO27001—the most common framework adopted globally. "The choice of framework matters far less than how it's integrated and implemented," says Marshall. "The key is that it becomes part of the mainstream of risk management within the organization."

There is also a question of who is ultimately responsible for cyber security within the organization. Someone at the board level and a C-level executive who is not the CIO should be given a wide responsibility to look at how cyber is integrated in the business from a risk point-of-view and also from an opportunity perspective. This sends the message that security is not just an IT issue.

Find the full report at *KPMG.com.* ■

The payoff of better financial risk management

Are there particular areas where private company directors believe they could do more or know more to better oversee financial risk? If so, how much could improving governance of financial matters factor into overcoming the traditional private company valuation discount, which is frequently applied due to a lack of liquidity and limited financial transparency? Getting beyond the discount requires private companies to take a hard look at governance structures and processes, financial controls, and, conflicts of interest

Private Company Governance: The Call for Sharper Focus, our recent survey done with Forbes Insights, attests to these issues. Private company boards need to assess if the costs of greater rigor in financial risk management pay off in terms of market valuation or access to capital: Would improving financial processes, information flow to the board, and talent within the finance organization be effective enough? Or does the company need to take a look at how today's data-driven reporting and business intelligence technologies might contribute to performance, and at what cost?

We surveyed 154 private company directors across more than eight industries, with revenues from $100 million to over $5 billion. More than half of the respondents said that they wanted their board to hear more about financial risk management, outranking treasury and capital allocation decision, tax issues, and credit decisions.

Within financial risk oversight, respondents' top concern was attracting and retaining talent within their finance groups (19 percent) and then financial expertise on the board (14 percent). Yet, nearly one-third of respondents indicated that their board had little ongoing input regarding succession planning within the finance organization with 17 percent saying the process was ad hoc and 14 percent leaving decisions to management.

"The greater the alignment of your management structure to your strategy; the more discipline in the reporting; the better your controls; the more you are functioning in ways similar to a public company; the more prepared you are to handle new investors and capital," independent public and private company director Marjorie Bowen told Forbes.

Other findings from the survey include:

- Thirty-six percent of respondents viewed budget and/or resource constraints as the greatest challenge to board effectiveness, even before conflicts of interest and/or related party transactions (28 percent) and over representation of controlling shareholders (25 percent). "Engaging a slate of experienced and independent executives in strategic planning, financial analysis, audit and other committees, takes time and money," said Bowen. "It's work for the owners and managers to keep the board informed and collaborating."
- In terms of how big data and analytical tools (D&A) can help impact how decisions are made in the boardroom, 41 percent said they can help to spot trends hidden in the data; 38 percent said they support management in allocation of resources, and 36 percent said D&A can aid internal audit and risk management.
- Thirty-two percent of directors surveyed see network security as the greatest challenge over the security of financial information, twice as much as internal or employee-related risks (which have traditionally been the greatest source of financial information leakage and theft or fraud).

As highlighted in this survey, directors clearly see room to close some gaps in governance and strengthen the board's contribution to the business—whether it's improving information flow related to financial risk or helping to fine-tune the talent pipeline in the finance organization, and mitigate some of the factors that contribute to the "private company discount."

As another private company director told Forbes, the owners of private companies have a choice. "You can be a humble business leader, wanting constructive feedback and guidance from a highly competent, honest and open network or you can do whatever you think is right without feedback," he said. "The latter isn't scalable—governance matters."

Salvatore Melilli

Salvatore Melilli is the national audit industry leader, Private Markets, for KPMG LLP in New York. ■

Mark your calendar

WomenCorporateDirectors Global Institute, New York
(May 3-5)

Beginning with the Family Business Governance Institute on May 3rd, the WomenCorporateDirectors Global Institute will include panels, discussions, and roundtables on technology, talent, culture, oversight and investor activism, among other topics. The Visionary Awards Dinner will be held on May 4th.

Find more information and register at *womencorporatedirectors.com.*

Spring 2016 Director Roundtable Series
(Mid-May to mid-June)

To be held in approximately 20 cities, the Spring Roundtable—*Focusing on What Counts: How High-Impact Boards are Connecting Dots and Delivering Value Find*—will explore the critical factors in raising the board's game in an increasingly challenging, complex, high-expectations environment. As they deepen their engagement in strategy, talent, culture, and more, what does an "active director" look like and do?

Find more information and register at *www.kpmg.com/blcroundtable.*

NACD Cyber Summit, Chicago *(June 15)*

NACD, The Internet Security Alliance, and expert cyber security thought-leaders will equip directors and management with the knowledge needed to foster cyber resiliency and confidently oversee cyber risk management. This highly interactive event will use case study simulations and expert led dialogue to help directors and executives work together to develop better tools for creating organization-wide cyber resiliency.

Find more at *NACDonline.org.*

KPMG/NACD Quarterly Audit Committee Webcast
(June 23)

The quarterly webcast from KPMG's Audit Committee Institute will include financial reporting and corporate governance updates.

Find more at *kpmg.com/blc.*

Selected Reading

- **Toward a Value-Creating Board** *(McKinsey)*
- **Proxy Season Trends and Action Items** *(DLA Piper)*
- **Corporate Culture and Performance** *(The Wall Street Journal)*
- **How Internal Audit Can Add Value** *(KPMG)*
- **Private Company Governance Survey** *(KPMG)*

(To receive articles like these from Board Leadership Weekly, go to kpmg.com/BLCregister, to create an account and choose "Audit Committee and Board Governance.")

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute and Private Markets Group, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers actionable thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at KPMG.com/BLC.

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