AN OFFERING FROM THE BDO CENTER FOR CORPORATE GOVERNANCE AND FINANCIAL REPORTING

BDO SHAREHOLDER MEETING ALERT

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DEREGULATION, TAX REFORM, CYBERSECURITY AND NEW ACCOUNTING AMONG TOP ISSUES AT 2017 SHAREHOLDER MEETINGS

Almost daily reports of increasingly sophisticated cyber breaches, global economic concerns, historic changes to accounting standards, and growing anticipation for promised deregulation and tax reform are just a few of the topics being discussed in U.S. corporate board rooms. These issues and many more will make for an interesting annual Spring meeting season.

WHAT'S ON THE MINDS OF BOARDS?

BDO's Center for Corporate Governance and Financial Reporting once again reports on a variety of topics that corporate management and boards of directors should be prepared to address in connection with 2017 annual meetings. These issues reflect several themes pertaining to growing anticipation for promised deregulation, trade and tax reform under the new administration; readiness to execute on significant accounting standard changes; transparency of communications and disclosures related to cyber security, use of non-GAAP metrics, responses to whistle-blowing and conduct of shareholder meetings. Global economic and M&A concerns continue to confound many companies with international operations and global customer bases; as well as the scrutiny of director time, expertise and diversity relative to the boards they serve. Each of these issues may require significant time and attention by boards and management teams of companies of all sizes and across all industries. Where appropriate, topics have been aligned with additional pieces of thought leadership and/or learning opportunities for further consideration.

- **Trump Administration.** The most notable changes from our prior year **Shareholder Alert** stem from the 2016 U.S. election results and how the new administration under President Trump is positioning itself to work with congress. Early initiatives, primarily via Executive Orders, of the new administration have been widely-debated, but what isn't up for debate is that changes are coming in one form or another. Shareholders will want to know that management is staying abreast of how these potential changes can impact the company's bottom line and that contingency plans are in place to react accordingly. Specific issues that may be raised include:
    - **Deregulation.** The administration has promised an easing of regulations and, via issuance of a sweeping executive order, further SEC action on implementing certain rules from the 2010 Dodd-Frank Act are now in question. In a recent **alert**, BDO indicates that Acting SEC Chair Michael Piwowar has asked for companies to comment on implementation challenges they are facing with respect to the recently effective Dodd-Frank CEO Pay Ratio rule and he is also having SEC staff review the Act's controversial conflict minerals rule, both of which he **termed** "non-material disclosures" to the "Forgotten Investor" [the men and women of our country whom securities regulation is meant to serve and protect but so often has not]. Incoming Chair, Jay Clayton, is expected to try to ease Dodd-Frank corporate disclosure requirements and possibly other regulation and disclosures (e.g. under the Sarbanes-Oxley Act of 2002) that are believed to be too burdensome for small companies. This changing regulatory landscape needs to be monitored closely in order to plan effectively.
    - **Trade.** President Trump has already withdrawn the U.S. from the Trans-Pacific Partnership and he has been a consistent critic of North American Free Trade Agreement (NAFTA) and its impact on U.S. trade. Should the administration impose trade barriers and high tariffs, other countries are likely to retaliate and U.S. exports could suffer. Exporters and importers and those dependent on imports and exports need to monitor developments closely and plan for all possible contingencies.
    - **Tax Reform.** The Trump administration is promising the most comprehensive overhaul of the U.S. tax system since 1986. Akin to actions be taken to promote trade, tax reform designed as a "territorial approach" is focused on structural changes to address and enhance our ability to remain globally competitive and be more consistent with our major trading partners. Both House Republicans and the president want to cut the corporate tax rate and taxes on investment income. Additionally, they've each floated the idea of a border adjustment tax (a value-added tax levied on imported goods) to ease the burden for U.S. corporations while encouraging companies to keep or bring back operations to the states. However, unification and compromise on the part of congress will be needed to accomplish reform measures. Businesses need to stay informed of these proposals as they are developed and be ready to pivot their tax strategies – for both federal and state tax effects of these possible measures - to align with the final law. For more information, refer to BDO's recent **alert** "Overview of Potential U.S. Corporate Tax Reform: A Guide to the GOP House Blueprint."
    - **Presidential Tweets.** Boeing, Lockheed Martin, Nordstrom, Apple and multiple domestic and foreign car companies are just a few of the businesses that have been the target of tweets from both candidate and, now, President Trump. While the long-term impact of these targeted social media attacks isn't clear, businesses should review their foreign business interests, revisit federal contracts and have a rapid response plan in place to communicate how the company invests in America should the need arise.

    Response planning for Presidential tweets:

    - If you are a multinational company, understand you may be targeted for moving jobs out of the U.S. If you are a U.S. company, understand you may be targeted for outsourcing parts and labor.
    - Keep an updated fact sheet available about how your company has invested in America, whether it be via new offices, locations, hiring practices, charitable contributions, etc.
    - Have a rapid response team in place (e.g., CEO, Board Chair, Senior Communications or Public Relations Officer, General Counsel, etc.) and designated spokesperson in order to expedite quick approval of any media statements.
    - Any statements/communication in response to a Presidential tweet should be factual and non-confrontational. State your case in the most respectful way possible.

- **Cybersecurity** The SEC recently announced an investigation of Yahoo's failure to disclose a massive cyber-attack – involving 500 million accounts - for nearly two years. The ongoing investigation and unknown costs have contributed to the significant reduction of the purchase price in Yahoo's pending acquisition by Verizon. This incident highlights a weakness in corporate cybersecurity – the failure to share information on cyber-attacks with external entities – that threatens the safety of critical infrastructure and national security. In fact, a recent **BDO Board Survey** found that just one-quarter (27%) of directors say their companies are sharing information on cyber-attacks with entities outside of their business.

In 2011, the SEC issued **guidance** for public companies on how to disclose cyber-security incidents and, last year, the White House issued **Presidential Policy Directive 41** outlining how businesses can contact relevant federal agencies about cyber incidents they experience. BDO has developed several educational **programs** on cyber security and compiled a **series of critical questions** that boards should consider in discussions with management to elevate cybersecurity on the board's agenda. Knowing answers to these and other questions can better prepare boards when shareholders ask if the company has policies and controls in place, particularly for reporting material cyber-breaches to the proper authorities.

Effective March 1, 2017, a new cybersecurity regulation promulgated by New York's Department of Financial Services (DFS), which generally applies to financial institutions that do business in New York, raises the stakes for boards of directors and requires a written certification of compliance, signed by the Chairperson of the Board of Directors or a Senior Officer(s), certifying that: *"The Board of Directors ... has reviewed documents, reports, certifications and opinions of such officers, employees, representatives, outside vendors and other individuals or entities as necessary; To the best of [their] knowledge, the Cybersecurity Program of… complies with [the regulation]."*

During a recently held **webinar** "What Boards Need to Know About Cybersecurity (But May Be Afraid to Ask), BDO explored the NY DFS regulation along with significant legal, insurance, and overall emerging factors impacting the cyber landscape. As part of that discussion, a guest presenter from Diligent shared preliminary findings from their recent joint **survey** with the New York Stock Exchange (NYSE) regarding questions about cybersecurity posed to 350+ NYSE corporate directors.

So what else can companies do? In the face of growing market demand for information about the effectiveness of an entity's cybersecurity risk management program, the AICPA has formed an **initiative** and is currently developing auditing standards and a consistent approach to cybersecurity attestation to assist boards and management and other stakeholders. The subject matter of such a cybersecurity examination engagement will be composed of three key elements:

1. Management's narrative description of the entity's cybersecurity risk management program;
2. Management's written assertion that the controls implemented as part of the program were effective to achieve the entity's cybersecurity objectives; and
3. Practioner's examination report expressing an opinion about whether management's description of the entity's cyber risk management program and the effectiveness of controls within that program achieve the entity's cybersecurity objectives.

This continues to be an evolving area as the federal government and others continue to provide frameworks, best practices and incentives for sharing of information to help mitigate the risk of cyber attacks. Boards are advised to continue dialogue with management and their auditors/advisors about emerging practices while concurrently demonstrating oversight activities to shareholders.

- **New GAAP.** Public companies, with private companies following closely, should currently be preparing for the most historic accounting changes in decades. New accounting standards for revenue recognition (ASC 606) and lease accounting (ASC 842) will have a major impact on financial statements and profitability. Citing public company SAB 74 requirements for both interim and annual filings, the SEC continues to strongly remind companies they will be expecting increased disclosures in 2017 and beyond regarding the significance of the impacts of the new standards. Management, with board oversight, needs to communicate with shareholders, regulators and others on these changes, to avoid surprises when they impact financial statements.

  BDO continues to provide a variety of **resources** with respect to these significant standards including our **recent publications** and along with several upcoming revenue recognition **webinars** scheduled for May and June 2017 designed to prime management, boards, and the investor community on the significant changes under ASC 606. For more information, refer to BDO's **Revenue Recognition Resources**.

- **Non-GAAP.** Last Spring, with a growing majority of public companies using non-GAAP metrics in their financial statements, the SEC provided Compliance & Disclosure Interpretations (C&DIs) **guidance** on the appropriate use of these supplemental measures. In short, when providing non-GAAP disclosures in financial statements, management should communicate the reason for presenting the non-GAAP measure, be sure the information is not misleading or positioned as prominently as GAAP disclosures, and that the metric is applied consistently across reporting periods and across relative industries. The CAQ developed a **tool**, particularly for audit committees, to assist in assessing the appropriateness and reliability of management's presentation of non-GAAP measures. With the SEC already bringing charges against companies for improper use of non-GAAP measures, investors may want to know how the board is ensuring that management is following the SEC's new guidance on these disclosures. SEC Chief Accountant Wes Bricker **indicated** that: "*audit committee members should seek to understand management's judgments in the design, preparation, and presentation of non-GAAP measures and how those measures might differ from approaches followed by other companies. These discussions will require an understanding of the company's business model and how it is managed. For example, it is important to keep in mind that businesses operate in uncertain* *environments. If non-GAAP adjustments replace that business reality with smooth earnings over time, accelerate unearned revenues, or defer incurred expenses, those adjustments and disclosures should be evaluated closely under the C&DIs."*

- **Whistleblower Policies.** The Wells Fargo fake accounts scandal was a major news story in 2016. During the investigation, several of the bank's employees alleged that they had communicated concerns about intense pressure to meet unrealistic sales targets, but were ignored. Some employees even claimed that they were fired for calling the company's internal ethics hotline. These claims demonstrate that internal compliance programs only work in organizations that have created a responsive culture. A lack of response to an employee's concern about unethical behavior could ultimately lead, once publically disclosed, to the market perceiving that management and the board are not focused on the problem. Recent actions have been taken by the Wells Fargo board including conducting an independent investigation (results are due prior to their 2017 shareholder meeting) and eliminating bonuses and slashing equity compensation awarded to certain executives. However, several institutional shareholders may be calling for further action, including a look at the board composition itself.

  Given the prominence of the Wells Fargo case, shareholders may ask:

  - What the company is doing to communicate with employees about ethical standards?
  - Whether the board and/or audit committee receive regular reports on internal whistleblowing complaints?
  - What the board is doing to ensure that employee tips are not ignored or buried by management?

  In December, the **Antifraud Collaboration** featured a timely **webinar** "SEC Investigations – Are There Benefits to Cooperation and Self-Reporting" that discusses considerations for those charged with governance when weighing facts and circumstances and actions that need to occur from alleged wrong-doing within a company.

  Some further food for thought that should have boards and management teams focused in this area includes the increase in SEC enforcement activities **noted** in fiscal year 2016, which totaled 868 filed enforcement actions. Prior to stepping down earlier this year, former SEC Chair Mary Jo White **indicated** that one of the ways the SEC is approaching securities enforcement in through the increased use of data and data analytics to detect and investigate misconduct. *"…More than ever, the SEC is developing in-house innovative analytical tools to take advantage of today's data-rich environment. The result is that the number of cases we are able to originate in-house has risen dramatically."* Transformative use of data combined with increasing willingness of whistle-blowers to come forward is furthering the SEC's agenda to detect and prosecute unethical behavior. In fiscal year 2016, awards to whistleblowers surpassed $100 million and whistle-blower tips increased 40% from 2012 to 2016, with over 4,200 tips logged in FY 2016.

- **Virtual-Only Shareholder Meetings.** In recent years, virtual-only shareholder meetings – conducted online or over the phone - have grown in popularity. In 2016, 187 companies used the services of Broadridge Financial Solutions Inc. to hold virtual shareholder meetings, compared to just 28 in 2010. This trend isn't sitting well with all shareholders, as some groups have expressed concerns that the technology could be used to limit shareholder participation, allowing executives to cherry pick shareholder questions and avoid addressing critical issues. Given these concerns, boards that choose to conduct virtual-only shareholder meetings should consider communicating the cost savings and flexibility of the new technology, how it allows for more shareholders to attend the meetings and steps taken by the company to ensure full transparency.

- **Global Economic Concerns.** Investors are well educated on how inter-related the world's economies have become and are concerned how the UK's exit from the European Union and other countries movement towards national protectionism will impact U.S. businesses in foreign markets. Shareholders will want to know whether companies with exposure in these countries (e.g., facilities, sales operations, third-party arrangements, etc.) are prepared for worst case scenarios.

- **Director Expertise, Diversity and Time.** Boards and, more specifically, audit committees now grapple with issues ranging from cybersecurity to foreign corrupt practices to whistleblower claims. Shareholders may inquire whether the current audit committee has the appropriate experience, access to resources, and time to address these increased responsibilities. One of the fundamental SEC requirements of the audit committee is to have the necessary resources and the authority to fulfill its function. *"To be effective, an audit committee must have the necessary resources and authority to fulfill its function. The audit committee likely is not equipped to self-advise on all accounting, financial reporting or legal matters. To perform its role effectively, therefore, an audit committee may need the authority to engage its own outside advisors, including experts in particular areas of accounting, as it determines necessary apart from counsel or advisors hired by management…"*

  Shareholders may also push companies to be proactive in addressing the issue of board diversity, as the SEC has begun to look into existing company disclosures on the racial and gender composition of their boards and could make such disclosures a requirement in the future. Proxy advisory firm Glass Lewis issued **2017 proxy voting guidelines** which clarifies its approach to board evaluation, succession planning and refreshment considerations to one that focuses on *"the assessment and alignment of director skills with company strategy"* versus an approach that solely relies on age or tenure limits. They believe that *"a board can best protect* *and enhance the interests of shareholders if it is sufficiently independent, has a record of positive performance, and consists of individuals with diverse backgrounds and a breadth and depth of relevant experience."*

Additionally, effective for 2017, both Glass Lewis and **Institutional Shareholder Services, Inc. (ISS)** have indicated they would oppose non-executive directors who currently hold more than five board seats. Interestingly, **BDO's 2016 Board of Director Survey** found directors being even more conservative than proxy advisors in this regard. When asked about the issue of "overboarding", approximately three-quarters (74%) of directors indicated corporate boards should proactively limit the number of boards on which a director can serve. Of those in favor of setting limitations, more than three-quarters of directors (79%) would set more severe limits than the proxy advisors.

- **M&A Opportunities.** Despite the recent unsuccessful couplings of Kraft Heinz and Unilever and Aetna and Humana, in the current environment of reduced organic growth, businesses are expected to continue to turn to mergers and acquisitions to achieve growth in 2017. Shareholders will want to know if management is seeking out opportunities. Boards should ensure their companies are equipped with a well vetted communication plan with respect to their acquisitions and sound due diligence and integration policies for assimilating target businesses into a corporate culture supported by strong governance. Refer to BDO's **archived webinar** "M&A Execution: Planning with Post-Integration in Mind" and **practice aid** "Establishing Structures to Manage M&A Integration."

RESOURCES

Through our **Center for Corporate Governance and Financial Reporting**, BDO commits significant resources to keep our clients and contacts up to date on current and evolving technical, governance, industry, and reporting developments. Our thought leadership consists of timely alerts, publications, surveys, practice aids, and tools that span a broad spectrum of topics that impact financial reporting, as well as corporate governance. Our focus is not simply to announce changes in technical guidance, regulations or emerging business trends, but rather expound on how such changes may impact our clients' businesses. Through our various webinar offerings, we reach a broad audience and provide brief, engaging, just-in-time training that we make available in a variety of ways to meet the needs of your busy schedule. To begin receiving email notifications regarding BDO publications and learning events, visit **www.bdo.com/member/registration** and create a user profile.[1]

[1] If you already have an account on BDO's website, visit the **My Profile page** to login and manage your account preferences.