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

BDO SHAREHOLDER MEETING ALERT

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MERGERS & ACQUISITIONS, CURRENCY RISK, CYBERSECURITY, BOARD COMPOSITION AND EXECUTIVE COMPENSATION AMONG TOP ISSUES AT 2016 SHAREHOLDER MEETINGS

A highly volatile stock market, stagnant wages, global economic challenges, a strong U.S. dollar and a presidential election like no other are just a few of the factors contributing to a growing feeling of uncertainty in corporate board rooms around the country. This unsettled climate should make for an interesting annual meeting season this spring.

TOP OF MIND SHAREHOLDER TOPICS

The following represent those topics that corporate management and boards of directors may want to be prepared to address in connection with their 2016 annual meetings. These reflect individual as well as inter-related areas of corporate financial and operational risk and strategy that 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.

M&A Opportunities

Dell and EMC, Dow and DuPont. Heinz and Kraft Foods, Pfizer and Allergan, and Charter and Time Warner Cable are just a few of the deals that made 2015 a record year for mergers and acquisitions (M&A). With continued low interest rates, reduced organic growth and volatile capital markets, businesses are likely to continue to pursue inorganic growth via acquisitions in

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2016. Shareholders will want to know if management is active and thoughtful in seeking out opportunities and that sound due diligence is being performed on potential targets. It is critical for proper vetting to occur prior to the transaction to ensure alignment with company goals and strategies to avoid surprises during the onboarding process. Boards should further ensure their companies are equipped with sound integration policies for assimilating target businesses post-acquisition into a corporate culture supported by strong governance.

On the other side of the coin, shareholders of potential "acquirees" will expect boards to hold management accountable in shoring up financial statements and enhancing governance practices to either ward off unwanted interest or to maximize shareholder value should such a transaction be both desirable and acceptable.

Fairness opinions are a vehicle that can assist boards with their fiduciary responsibility regarding M&A transactions in evidencing the quality of the due diligence performed in relation to appropriately pricing a deal. Boards should consider obtaining a fairness opinion from an independent provider to protect the interests of the shareholders.

For more on these topics and other key issues to consider when contemplating an M&A transaction, refer to an upcoming M&A series of programming to be offered through BDO's *Center for Corporate Governance and Financial Reporting*.

Cybersecurity

As cyber-attacks and data breaches at major businesses have become commonplace in the news, investors are now well aware of the damage these events can have on a business's brand and market value. Shareholders may want to know whether the company is being proactive in:

- documenting the business's critical digital assets and developing solutions to protect them
- putting cyber-breach response plans in place to mitigate damage from successful attacks
- establishing cyber-risk management requirements for third-party vendors and other external relationships

BDO's 2015 Board Survey indicated that while cybersecurity has moved up on the boardroom agenda and more corporate funds are being allocated to addressing cyber risk, only one third of board members have both identified and developed solutions to protect their critical digital assets. An equally troubling finding was that less than half of directors believe their company has a cyber incident response plan in place and only one-third have cyber risk requirements for third-party vendors – a major source of cyber-attacks.

As you consider the questions to be asking of management, we encourage to you to refer to BDO's related archived programming and publications:

- **Managing Risk: Elevating Cybersecurity to the Board**
- **Managing Risk in Cyberspace**
- **Data Breach Essentials**
- **Cyber Security Board Primer**

Foreign Currency Risk and Market Volatility

Apple, Kellogg and Avon are among several businesses that have recently reported an adverse impact on their bottom line from foreign exchange swings. Shareholders will be interested to learn whether management has hedging strategies in place to protect against currency exposures.

Along a similar vein, volatility in stock markets around the globe continues to affect choices that shareholders make and put increasing pressure on companies to perform. Boards must ensure their management teams are taking positions that safeguard companies in the key areas that drive their business, both domestically and abroad.

The natural resources industry, by way of example, faces many obstacles but also opportunities as prices continue to fluctuate. Boards need to closely oversee the other aspects of operations as oil and gas prices trend downward in terms of debt management practices and relations with financial institutions. Stronger, more diversified companies within the market may see opportunities to snap up smaller, struggling companies to expand operations and geographic reach when prices begin to rebound and normalize. Refer to **BDO's 2016 Energy Outlook** for further information.

Global Economic Concerns

Investors have become well educated on how inter-related the world's economies have become and are concerned how slow growth in China, the UK's potential exit from the European Union, and unstable economic conditions in Greece, Venezuela and other markets impact U.S. businesses. Shareholders will want to know whether companies with exposure in these countries (e.g., facilities, sales operations) are prepared for worst case scenarios.

Political Contributions

The 2016 presidential election has dominated the news and brought increased attention to the political spending of corporations. Boards should be prepared for increased shareholder scrutiny of political donations, lobbying activities, and contributions to industry associations that lobby on their behalf. In a recent Harvard Business Review **article**, authors cite "our conversations with company leaders have revealed a knowledge gap on the depth and breadth of risks involved as well as the oversight needed. These risks extend to a company's reputation, its employee relations, its customer and shareholder relationships, its legal footing, and attainment of its business strategies."

In keeping with our theme in this publication on the public and regulator focus on transparency and increasing trends by companies in voluntarily providing relevant and timely information to stakeholders, boards should be assessing the opportunity and risk in disclosing their political campaign funding strategies.

Board Diversity

The SEC has begun to look into existing company disclosures on board diversity and just may consider a mandatory requirement for businesses to provide more specific information about the composition of their boards. Investors may push management to be proactive in addressing this issue before it becomes a requirement.

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In a recent keynote address, SEC Chair Mary Jo White indicated the importance of diversity on boards. She points out that while there are current rules regarding directors' experiences, backgrounds, and diversity, these do not define diversity and only require a board to indicate whether it considers diversity, and if so, how it does. Questions from the public have arisen as to whether such rules are strong enough and whether they really are giving enough useful information to interested investors about the racial, ethnic, and gender composition of boards. Chair White has asked the SEC staff to study current disclosures in this area with an eye towards whether additional guidance or rulemaking may be needed.

Director and Board Committee Expertise

Boards and, more specifically, audit committees continue to grapple with a multitude of issues beyond complex financial reporting ranging from cybersecurity to foreign corrupt practices to whistleblower claims. Shareholders may inquire whether the current audit committee has the appropriate experience to address these increased responsibilities. They may also inquire whether the company should have a separate risk committee composed of the proper expertise to provide oversight of these varied areas.

Annual review of board charters coupled with focused and honest self assessments of current individual board members via board evaluations allow for organizations to continue to align corporate strategy and governance needs with resource needs and identify any existing gaps that may need to be addressed. In a recent discussion with several audit committee chairs on how to build an effective audit committee, BDO explores these and other issues faced by boards and audit committees.

Overboarding

As responsibilities of corporate directors continue to grow, so does the time commitment necessary to serve on a public company board. According to the National Association of Corporate Directors, public company directors spend an average of 278 hours a year for each board served – a jump of 46 percent from just ten years ago (191 hours). Given this trend, beginning in 2017, proxy advisory firms ISS and Glass Lewis have each indicated they will oppose non-executive directors with more than five board seats. Some businesses have already adopted more stringent rules, limiting their directors to no more than four board seats. Companies should consider addressing this issue proactively or risk raising the ire of shareholders. Refer to BDO's publication on Proxy Voting Policies Focus on Overboarding for further information.

CEO/Median Employee Pay Ratio

In August 2015, the SEC issued the final rule to implement the Dodd-Frank mandate that will require public companies to disclose the ratio of the CEO's compensation to that of the median employee in all annual reports or proxies beginning January 1, 2017. Media reports of high ratios are sure to garner attention, so companies would be wise to mitigate any negative press by proactively communicating the benefits of their performance focused executive compensation models to shareholders ahead of time.

One of several topics visited in BDO's Board Survey and discussed during a recent What's on the Minds of Boards presentation, when asked if their boards had begun to take steps to comply with this new requirement, directors were split. A large minority (43%) are familiar with the new requirement but have taken no actions, while a similar percentage (39%) are already preparing pay ratio calculations for internal planning purposes – though they will not disclose the ratio prior to the required disclosure date. Relatively few (8%) say they are planning to disclose the pay ratio calculation prior to the mandatory disclosure date. Surprisingly, 10 percent of the directors say they are still unfamiliar with the requirement.

Pay for Performance

The SEC has a pending proposal that will require U.S. public companies to disclose the relationship between executive compensation paid and the company's financial performance. The proposal will require a new proxy table that shows (over a multi-year period) compensation actually paid to the CEO and the average compensation actually paid to other named executive officers compared to the company's total shareholder return ("TSR") during that time. An additional table will require a comparison of the business's overall TSR relative to the TSR of its peer group. Although an effective date for this new disclosure has yet to be determined, management should be monitoring TSR relative to those of its peers and be prepared to respond to any shareholder inquiries on the topic. Refer to the BDO 600 2015 CEO and CFO Compensation Survey which takes a look at compensation practices of CEOs and CFOs of 600 mid-market public companies across a variety of industries.

Leveraging Data and Information Governance

Two terms that seemingly have been widely overused: data and innovation. But does the board understand how management is leveraging the vast amount of data at its disposal to inform on how operations are functioning relative to competitors? Is management taking advantage of creative modeling of large data sets to proactively plan for opportunities and disruptions in business cycles?

The data revolution has provided companies with a wealth of information to draw on when making business decisions and interacting with customers. Moving forward, insights derived from sophisticated analysis of high-volume data will increasingly be a key component to identifying opportunities and avoiding risks. Information governance can be challenging for companies from a time and resources perspective but is extremely critical for helping management remain in the know about their business. Investors may be interested to learn what the company is doing to leverage data for strategic planning and risk management. Refer to BDO Consulting's Business Case for Information Governance and look forward to upcoming programming in this area.

Proxy Access

General Electric, Apple, Citigroup and McDonald's were just a few of the companies that changed their corporate bylaws in 2015 to allow large stockholders (typically 3% of shares) who have held shares for a minimum of three years to put forth nominees to the companies' board. According to proxy advisory firm ISS, approximately 21% of S&P 500 companies have now adopted new proxy access rules, up from just 1% in 2014. Given the rapid spread of proxy access, shareholders are likely to ask whether the company will be adopting similar proxy access plans. Boards that are slow to comply may risk the ire of proxy advisers that often oppose the re-election of board members who ignore measures with popular support.

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Succession Planning

Succession planning is one of the board's most important responsibilities. In a modern world, where workers are highly mobile, it is becoming increasingly important for companies to structure their hiring and retention practices to ensure they continue to have sources – both internal and external, as necessary – for high supply of quality leaders. Shareholders will want to know whether the board has a succession plan in place and a diverse pool of candidates identified, if needed, for all C-level positions and board members as well. For more information to aid in planning consider these BDO tools:

- Perspectives on Executive Succession
- Planning, Succession Planning Discussion Guide
- Executive Assessment Results and Development Plan

Transparency of Audit Committee Oversight

2015 saw increased interest in enhancing transparency of governance practices through disclosure. The SEC issued a concept release aimed at considering enhancements to currently required audit committee disclosures related to the oversight of the external auditor. A strong majority of comments from audit committee and auditor respondents[1] to the proposal advocated a voluntary, principles-based approach to additional disclosures versus a mandated rules-based approach.

The Center for Audit Quality (the CAQ), along with Audit Analytics, issued the 2015 Audit Committee Transparency Barometer identifying upward trends in 2015 reporting by public company audit committees with respect to voluntary, enhanced disclosure around external auditor oversight, an important facet of the audit committee's broader financial reporting oversight role. According to the Barometer, these efforts by audit committees to enhance their disclosures are encouraging, given the importance of meaningful, tailored information for investors and other stakeholders.

So, as more companies opt to go beyond what is publicly required to be disclosed, boards should discuss what type of additional information shareholders may value and consider whether the company wants to make any voluntary disclosures in those areas. They should further remain alert to developments in this area as the SEC continues to digest the information gathered and more broadly considers the work of the CAQ and others in this area in contemplation of potential further disclosure rulemaking.

1 Refer to BDO's Comment Letter on the SEC's Request for Comment available here.

Internal Controls

In speeches, comment letters and direct outreach to audit committees, both the SEC and the PCAOB continue to focus on internal controls over financial reporting (ICFR). Given that emphasis, shareholders may inquire whether any weaknesses or deficiencies in controls identified by management or the auditors have been disclosed and properly addressed.

In his remarks before a recent UCI Audit Committee Summit, SEC Chief Accountant James Schnurr reminded attendees that appropriate disclosure of a material weakness is important because it can aid investors in assessing the potential impact to the financial statements of the material weakness. He went on to say that boards, particularly audit committees, are in a unique position to gain valuable insights into both management's financial reporting process and internal controls and the work performed by the independent auditor. Both he and the PCAOB, in their Audit Committee Dialogue, encourage audit committees to engage their auditors regarding matters such as the auditors' risk assessment decisions, selection of key controls, and approach to testing these controls in the context of existing guidance from the SEC and the PCAOB.

We encourage boards to be engaging both management and their auditors in robust discussions in these and other areas that impact the quality of financial reporting.

This is just a sampling of some of the more prevalent, broadly applicable issues that are top of mind for shareholders as we continue on through 2016 and management and boards prepare for annual shareholder meetings.

RESOURCES

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 quarterly email updates, 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.[2]

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

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