Each year, the agenda for corporate board meetings at publicly traded companies seems to grow longer, as directors are challenged to stay abreast of the latest regulatory changes, financial reporting requirements and risk management concerns. In 2015, these changes are substantial in nature and in some cases – according to the directors – change is not always for the best.

The BDO Board Survey, conducted annually by the Corporate Governance Practice of BDO USA, was created to act as a barometer to measure the opinions of public company board members on a variety of important corporate governance issues. The 2015 BDO Board Survey, conducted in September of 2015, examines the opinions of 150 corporate directors of public company boards.

This year’s study reveals that public company directors are becoming increasingly involved in their companies’ cybersecurity efforts and how best to protect their digital assets from cyber attack. They also are spending a good deal of time preparing for the implementation of the “Cadillac Tax,” as well as new financial reporting requirements and proposed disclosure rules that impact areas ranging from executive compensation to the audit committee to political contributions.
MANAGING CYBER RISK

More than one-fifth (22%) of board members say their company experienced a cyber breach during the past two years, double the percentage of 2013 (11%). This increase has clearly spurred action in corporate boardrooms.

More than two-thirds (69%) of corporate directors report that their board is more involved with cybersecurity than it was 12 months ago, a noticeable jump from 2014 when 59 percent of directors cited an increase in time spent on digital security.

The vast majority of directors (87%) indicate that they are briefed on cybersecurity at least once a year - this includes one-third (33%) who are briefed at least quarterly. This represents a substantial increase from 2014 when 71 percent reported at least an annual briefing and only one quarter (25%) were briefed at least quarterly. Equally revealing, just 13 percent of board members say they are not briefed on cybersecurity at all, compared to 29 percent last year.

More than two-thirds (70%) of board members say they have increased company investments in cybersecurity during the past year, with an average budget expansion of 22 percent. Last year, just over half (55%) reported an increase in cyber-security investments.

At least one-quarter (28%) of board members say their company has purchased cyber insurance. This is almost triple the percentage (10%) that reported purchasing this coverage in 2014.
“This year's BDO Board Survey clearly shows that cybersecurity is moving up on the boardroom agenda. Corporate directors report that they are being briefed more often and they are responding with increased budgets to address this critical area,” said Shahryar Shaghaghi, National Leader of Technology Services for BDO Consulting. “Nevertheless, the survey also reveals that there is much work to be done in terms of implementation of cybersecurity mitigation strategies, as only one-third of board members indicate they have both identified and developed solutions to protect their critical digital assets. It is especially troubling that less than half of the 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.”

**Proactive Protection**
Although corporate directors’ engagement on cyber risk is clearly trending in a positive direction, there is still much work to be done in terms of putting formal strategies in place to combat cyber attacks and mitigate damage to digital assets.

When asked about formal risk assessments of their critical digital assets, just over one-third (34%) of directors report that they have completed documentation of their business’s critical digital assets and developed solutions to protect them, while a similar percentage (32%) say they’ve identified their critical digital assets, but a solution strategy is still in process. Approximately one-fifth (19%) of board members say they are still working to identify critical digital assets, while 15 percent indicate their company has done no work to identify and protect their digital assets.

Less than half (45%) of corporate directors say their company has a cyber breach/incident response plan in place, compared to one-third (34%) who do not have a plan.

More than a fifth (21%) of board members weren’t sure whether they had such a plan.

Just over one-third (35%) of directors say their company has developed cyber risk requirements that their third-party vendors must meet and only 5 percent of directors are aware of their company having to change a vendor due to cyber risk concerns. Since third-party vendors are one of the main sources of cyber attacks, these findings reveal a significant cybersecurity blind spot at the board level that needs to be addressed.

A majority of directors (59%) say they use in-house resources to assess and mitigate cyber risks, compared to 41 percent that utilize an external provider.
“Given proposals from shareholder activists for more transparency with regard to campaign contributions and a growing trend of companies self-reporting such information, board members appear to be getting more comfortable with the idea of mandatory disclosure of political contributions,” said Amy Rojik, Partner in the Corporate Governance Practice at BDO USA. “In contrast, directors are clearly not in favor of mandated disclosure of audit committee communications with the external auditor. This is consistent with the comment letters the SEC has received on this proposal, as boards are sensitive to how such disclosures may have the unintended consequence of chilling communications between their audit committees and the external auditors.”

**NEW/PROPOSED DISCLOSURES**

Board members were queried on their attitude toward several new or proposed accounting and reporting disclosure rules and standards:

**Political Contributions**
Since a 2010 U.S. Supreme Court ruling removed restrictions on political contributions, many shareholder groups have argued that businesses should disclose these contributions. Although some companies voluntarily disclose corporate political spending voluntarily, a majority (53%) of public company board members believe that the SEC needs to develop mandatory disclosure rules for corporate political contributions.

**Audit Committee – Auditor Communications**
When asked about the SEC concept release that would require disclosure of communications between the audit committee and the external auditor, an overwhelming majority (87%) of corporate directors believe such disclosures would have a negative impact on the audit committee-auditor relationship.

**CEO-Median Employee Pay Ratio**
Beginning in 2018, public companies will be required to report the ratio of median employee pay to CEO compensation. This 2018 requirement will report on 2017 compensation. 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.

When asked about their greatest concern with the CEO-median employee pay ratio disclosure, approximately three-quarters (74%) of corporate directors say they simply do not believe it is a meaningful or helpful measure. Other concerns cited by smaller proportions of directors are internal and external reaction to perceived high ratios (10%), unfair comparisons to other companies (8%), difficulty in identifying median employee pay (5%) and the inability to fully exclude non-U.S. employees that inflate the ratio (3%).

Reflecting a possible unintended consequence of this new disclosure, a majority of board members (58%) believe the CEO-median employee pay ratio disclosure could lead to companies outsourcing low-wage functions to third-party contractors.

There has been debate about the costs for companies to comply with the new pay ratio disclosure. According to a Wall Street Journal article, the SEC expects the 3,800 public companies affected to spend a combined $72.8 million to comply with the
“We are clearly seeing a greater awareness and dialogue among directors with respect to both pending requirements and proposed new rules related to executive compensation,” said Jim Willis, a Senior Director in the Compensation and Benefits Consulting Practice of BDO USA. “While board members are generally supportive of some regulations, such as the SEC’s proposed new rule requiring companies to claw back incentive pay when material errors necessitate a financial restatement, directors question the value of others, such as the CEO-median employee pay ratio.”

new CEO/median employee ratio disclosure. That translates into approximately $19,000 per company. When asked if they anticipate it will cost their company more or less than that figure to comply with the requirement, a majority (52%) of board members believe it will cost less, while just over one-quarter (27%) fear it will cost more. Approximately one-fifth of the directors (21%) were unsure of the costs.

Pay-for-Performance
Under the SEC’s proposed pay-for-performance disclosure rules most public companies will need to report the compensation for their CEO and other senior executives during the past five years compared to the company’s total shareholder return (TSR) during that same timeframe. Yet, half (51%) of corporate directors do not consider TSR to be an appropriate measure for company performance.

When asked if they intend to change their company’s incentive plan measures to include absolute and/or relative Total Shareholder Return?

- Yes
- No
- TSR is already a measure of our plan
- Do not have incentive plan measures

Source: 2015 BDO Board Survey

Claw Backs
Close to three-quarters (72%) of board members are in favor of the SEC’s proposed new rules requiring public companies to “claw back,” or recoup, top executives’ incentive pay if that pay was based upon financial statements later found to contain material errors. However, an even greater percentage (78%) of directors believe boards should be able to use their own discretion on whether to pursue claw backs from an executive.

Related Parties & Significant Unusual Transactions
Surprisingly, almost two-thirds (64%) of directors say their board or compensation committee has not been briefed by management on a new Public Company Accounting Oversight Board (PCAOB) standard (AS 18) effective for 2015 that requires auditors to more closely scrutinize executive pay and identify inherent risks, such as incentives that could reward management for decisions detrimental to shareholders.
“By the time Congress generally passes an extender package allowing bonus depreciation for the year, it is typically too late in the year to actually plan any additional capital expenditures. Thus businesses must make a decision on capital expenditures without knowing what incentives will actually be available. Similarly, it is difficult to enter into strategic research and development programs without knowing if you can count on the R&D tax credit each year,” said Doug Bekker, a Partner in the Tax Practice of BDO USA. “A permanent extension of these benefits would allow for a much greater degree of certainty in planning.”

TAX PLANNING

Tax Extenders
For several years, Congress has waited until the final weeks of the year to vote on more than 50 “tax extenders,” such as the research and development credit, Section 179 expensing and bonus depreciation. Better than three-quarters (77%) of board members believe the precarious nature of these credits, needing to be renewed each year, makes it difficult for their businesses to make long-term planning decisions and an identical proportion (77%) are in favor of making these credits permanent.

Cadillac Tax
The Cadillac tax, a provision of the 2010 Affordable Care Act that goes into effect in 2018, will place a 40% tax on health benefit costs paid by employers that exceed government-set thresholds of $10,200 for individuals and $27,500 for families. Forty percent of public company board members believe their company will be impacted by the “Cadillac tax” and approximately two-thirds (65%) of those affected are planning on making changes to their health benefits to avoid the tax.

When asked about specific changes they were considering, strong majorities cite a shift to higher deductible plans so that employees pay more medical expenses out-of-pocket (95%), dropping high-cost plan options (86%), adopting wellness and preventative initiatives to drive down costs (83%) and reducing the overall level of benefits offered (78%).

Consumption Tax?
Approximately half (49%) of corporate directors say they are in favor of replacing the corporate and personal income tax with a tax on consumption. Last year, just 40 percent were in favor of switching to a consumption tax.

“The increased interest in a consumption tax comes from frustration with the inherent complexity of other tax systems. The benefits of a consumption tax is that it is easy to administer and captures all segments of the economy. It also shifts the current compliance burden from the taxpayer to a fiduciary responsibility of the seller or service provider,” said Scott Hendon, a Partner in the Tax Practice of BDO USA.

“However, critics point out that a consumption tax is regressive since consumption consists of a lower percentage of your earnings at higher income levels. If special provisions are required to prevent the tax from being regressive, it could become as complex as our current system – thereby eliminating one of the primary benefits.”
ABOUT THE SURVEY

These are the findings of The 2015 BDO Board Survey, conducted by the Corporate Governance Practice of BDO USA, which examined the opinions of 150 corporate directors of public company boards regarding financial reporting and corporate governance issues. The survey was conducted in September of 2015 by Market Measurement, an independent market research firm, on behalf of BDO.

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