

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

# BDO SHAREHOLDER MEETING ALERT



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## TAX REFORM, CYBERSECURITY, BOARD REFRESHMENT AND EXECUTIVE MISCONDUCT AMONG TOP ISSUES AT 2018 SHAREHOLDER MEETINGS ACCORDING TO BDO USA, LLP

A return of volatility to the stock market, executive misconduct, seemingly endless reports of cyber breaches, global economic concerns, demands for transparency, and historic changes brought about by the new tax law are just a few of the topics being discussed in corporate board rooms around the country. These issues and many more will make for an intriguing annual meeting season this Spring.

## WHAT'S ON THE MINDS OF SHAREHOLDERS?

BDO's **Center for Corporate Governance and Financial Reporting** recently reports on a variety of topics that corporate management and boards of directors should be prepared to address in connection with their 2018 annual meetings.

Several issues examined this year largely reflect the race to understand broad-reaching impacts and opportunities created by the Trump Administration: The U.S. Tax Cuts and Jobs Act has unleashed a host of questions as to how company strategies are being formulated around M&A, capital investment and asset disposition activities along with operational decisions designed to enhance long term shareholder value. Promises of de-regulation remain but perhaps have yet to be fully realized, as evidenced by the newly effective pay ratio disclosure. Cross-border trade ramifications abound as countries, including the U.S., UK, and others, take "protectionist" stances.

Also notable for 2018 are themes relating to corporate accountability and compliance including: board responsiveness to executive misconduct and cyber-breaches, board refreshment, implementation readiness for significant accounting standards, and other global economic concerns.

**BDO USA, LLP** has compiled the following list of topics that corporate management and boards of directors should be prepared to address in connection with 2018 annual shareholder meetings:

### TAX REFORM

The new tax law is having far-reaching impact on tax reporting/planning and financial statement reporting. The lower corporate tax rate increases the competitiveness of doing business in the U.S., which may encourage corporations to reconsider the U.S. as a focal point for their business activities. Corporate "after tax" cash flow is expected to increase, which may impact decisions related to capital investment and employee wages. Shareholders will be eager to hear how the new law has and will impact corporate strategy. Refer to BDO's recent [Tax Reform and Your Board's Role webinar](#) and our most recent insights within our [BDO Knows: Tax Reform site](#).

## M&A OPPORTUNITIES

The reductions to the corporate tax rate and tax on repatriation of foreign earnings are expected to provide businesses with motivation to pursue mergers and acquisitions in 2018. Shareholders will want to know if management is seeking out both:

- ▶ **Sell side opportunities** to dispose of assets that no longer align with corporate goals but that could yet yield favorable returns. For example, an accelerated depreciation provision through 2022 for qualified tangible property is available for both newly purchased assets as well as those acquired through acquisitions. Thus, strategic buyers looking to offset their own tax burdens, or financial buyers looking for faster returns on investment, may find asset acquisitions an enticing strategy. Furthermore, the new corporate tax rate of 21% not only has enhanced after-tax earnings and cash flow but creates a more competitive global rate enhancing the attractiveness of U.S. targets for cross-border transactions.
- ▶ **Buy side opportunities** that can enhance strategic growth. Many are pointing to multinational repatriation as a source of funding for acquisitions. However, increased M&A activity might not be as significant as expected given pre-existing favorable market conditions of low interest rates and substantial corporate cash reserves. Companies may consider turning instead to large-scale buy backs of shares. However, companies like [Apple](#) have announced plans to reinvest in the U.S. If acquisitions are being contemplated, boards should ensure that such are properly vetted, and that management has sound integration policies in place to assimilate target businesses into a corporate culture supported by strong governance. Buyers should also be aware of other potentially troublesome elements in the new tax law, like interest expense limitations which are applied broadly to many businesses and may affect the economics of the deal.

These are just a few considerations for businesses looking to transact. For additional insights, refer to BDO's recent [blog](#). Facts and circumstances will need to be reviewed carefully to fully value the merits or deterrents for each deal. Companies are further advised to clearly communicate how their investment decisions translate to shareholder value.

## GLOBAL ECONOMIC CONCERNS

President Trump's plan, announced in late February, to impose high tariffs on imported steel and aluminum prompted angry responses from U.S. allies around the globe and generated warnings of an international trade war that could harm U.S. exports. Investors are concerned how the movements by the U.S. and other countries towards national protectionism will impact U.S. businesses in foreign markets. Shareholders will want to know how boards are proactively addressing management's operational decisions in this area.

We have touched on several other trends in the U.S. above that are each components of an inter-related global trend. Some additional key areas that may be top of mind to shareholders include:

- ▶ Changing labor markets – The significant impacts of technology advances – e.g., analytics, artificial intelligence, etc. – can lead shareholders to be asking: What are corporations doing to address these changes? What investments are needed? How is the labor market being re-educated?
- ▶ Social media exposure – On the one hand, social media provides an instant news source, making the world a more accessible space; while at the same time can result in false reporting (“fake news”) that can wreak havoc on corporate reputations.
- ▶ Geo-political risk and terrorism create uncertainty and fear in the market that may raise concerns in sectors of the globe that are deemed as “hot spots” for unrest.
- ▶ Environmental risks – extreme weather, pollution, water crisis, etc. – are creating significant challenges to companies with affected operations or operations that are potentially leading to environmental harm.
- ▶ Risks brought about by the interconnectivity of the “Internet of Things” (IoT) and cybersecurity – may represent potential global vulnerability to infrastructures: financial, healthcare, transportation, etc.

## CYBERSECURITY

Equifax, Uber and even the SEC are just a few of the high-profile institutions to fall victim to cyber-attacks in recent months. These incidents damage company reputations and lead to tens of millions in remediation and legal costs. Given the prominence of this topic, shareholders may want to know whether the company is:

- ▶ Critically assessing cyber-breach response plans to mitigate damage from attacks.
- ▶ Emphasizing the need to report breaches in a timely fashion. Companies are taking too long to report incidents. The Equifax breach has led to lawsuits in more than 100 courts across the country, many citing the company's slow response in reporting the breach. In May, the [European Union's General Data Protection Regulation](#) is slated to take effect and companies that fail to report breaches that involve personal data will face a fine of up to 2% of global annual revenue or €10 million (\$11.77 million), whichever is higher. **Note:** We strongly encourage directors to read the SEC's [interpretive guidance](#) released in February 2018 in order to assist public companies in preparing timely and transparent disclosures to investors about cybersecurity risks and incidents.
- ▶ Vetting management reports on any cyber-breaches with external experts to ensure the company is getting the best advice.
- ▶ Establishing cyber-risk management requirements for third-party vendors – a major source of cyber-attacks.
- ▶ Sharing information from cyber-breaches with external entities. The [2017 BDO Cyber Governance Survey](#) found that just one-quarter (25%) of directors say their companies are sharing information gleaned from cyber-attacks with external entities – a practice that needs to become more prevalent for the safety of national security.

Refer to [BDO's Cybersecurity Report](#) for the latest on cyber threats.

## EXECUTIVE MISCONDUCT

Steve Wynn, Harvey Weinstein and Roger Ailes are just a few of the executives who have fallen in recent months following allegations of sexual harassment in the workplace. Although the damage to victims may never be able to be fully calculated, for businesses, it can cost millions, from settling with victims to lasting damage to the company brand. Given the prominence of the #MeToo activism movement in the media, shareholders may want to know that the board and management are setting the correct tone at top and creating a culture where all reports of harassment are taken seriously. In many cases, the slow response to allegations of employees highlight the need for businesses to have robust no tolerance policies and document their reactions to charges of misconduct in a timely fashion.

## BOARD REFRESHMENT/DIVERSITY

A year ago, the SEC began to look into company disclosures of the ethnic, racial and gender composition of public company boards and whether it should make such disclosures a mandatory requirement in the future. This included a [recommendation](#) by the SEC Advisory Committee on Small and Emerging Companies to require companies to describe the extent to which their boards are diverse, and to include in that disclosure information regarding the race, gender and ethnicity of each member. Under new Chairman Jay Clayton, the SEC is continuing to monitor the issue. More recently, BlackRock, the world's largest money manager, stated that companies in which it invests should have at least two women on their boards. As this issue is likely to become increasingly prominent, shareholders may push companies to be proactive in addressing the issue of board diversity. As there is always resistance to change, companies should consider using the following tools to encourage board refreshment:

- ▶ **Tenure Limits.** Continuity is a valuable asset to any board, but it can also be a clear detriment to independence. Moreover, when you have directors serving for 20 odd years, it is difficult to refresh and tackle challenges like diversity in a timely fashion. Tenure limits and mandatory retirement ages can be useful tools to gracefully move directors out the door.
  - ▶ **Skill Set Reviews.** Defining a matrix of notable gaps in skills required in the coming years can sometimes help boards focus on which directors may have overstayed their welcome. Highlighting emerging operational risk areas requiring additional oversight such as human capital and talent management, technology, digital and content marketing as well as social media, can help further identify potential desired skillsets and needed perspectives to create a balanced board.
  - ▶ **Limits on Board Seats.** According to the National Association of Corporate Directors (NACD), public company directors spend an average of 245 hours a year on their board duties and the time commitment continues to grow. Given this trend, companies should consider limiting the number of boards on which their directors may serve.
  - ▶ **Composition Reviews.** Timely reviews as to the adequacy of board composition through the lens of diversification and independence, can be a powerful tool for a board in carrying out its oversight responsibilities. Good business sense encourages boards to bring in new members to better reflect the gender, age and racial mix of their customers. Refer to the recent [NASDAQ Governance Clearinghouse article](#) that summarizes ideas from business leaders on how companies can overcome barriers to diversity in the boardroom.
- We urge directors to review proxy voting guidelines issued by proxy advisory firms [Institutional Shareholder Services \(ISS\)](#) and [Glass Lewis](#) that have specific recommendations on these and many other governance matters. The NACD Blue Ribbon Commission issued a timely publication ["Building the Strategic Asset Board"](#) as a guide encompassing evolving governance practices and tools related to board leadership; composition and succession planning; recruiting and onboarding; evaluations; continuing education; tenure-limiting mechanisms; and communications. Additionally, BDO has several available archived programs: [Director Diversity – Striking the Right Balance In the Boardroom](#) and [Board Leadership: How to Onboard Your Board](#). These programs examine many of the topics outlined above and provide anecdotes from well-respected directors that may resonate with you.

## NEW GAAP

Public companies are currently dealing with the most historic accounting changes in decades. New accounting standards for revenue recognition (ASC 606/ IFRS 15), effective for 2018 reporting cycles, followed by lease accounting (ASC 842/ IFRS 16), and credit loss and financial instrument standards (ASC 326 & 825 / IFRS 9), will each have a major impact on financial statements and profitability. Management, with board oversight, needs to communicate transparently with shareholders and other stakeholders as to how these changes will impact financial statements.

In terms of preparedness, the SEC staff has highlighted the importance of appropriate planning for changes to processes, controls and systems, each of which is essential for fulfilling the new reporting and disclosures. The staff expects registrants to provide the estimated impact of the new standards in their SAB 74 disclosure to allow investors to understand the effects. The staff emphasized that preparers should be able to articulate all relevant facts and demonstrate a comprehensive analysis of the different accounting alternatives in arriving at a reasonable judgment related to each transaction. Refer to [BDO's Flash Report: SEC SAB 74 Disclosures and Controls for New Accounting Standards](#).

There are many lessons to be learned from the adoption of ASC 606 that can and should be applied to the other pending standards that will be quickly following within in the next 12 to 24 months. Audit committees, of both public and private entities, should ensure not only that the accounting has been done properly and new disclosures are being provided but that transparency into the process undertaken by management and the resulting financial information is easily understood by analysts and the investing communities. Equally as important is the consideration of the controls that support the accounting and reporting for these new standards. Directors should be prepared to respond to stakeholder questions about the company's state of readiness for adoption.

BDO continues to provide a variety of resources with respect to implementation of "new GAAP" including [publications](#) and [educational programming](#). For more information, refer to [BDO's Revenue Recognition Resources](#).

## SUSTAINABILITY.

Shareholder proposals on environmental, social and governance ("ESG") issues have taken on new significance and boards should be prepared to listen. Last year, close to two-thirds of Exxon Mobil shareholders [approved](#) a proposal to require the company to measure and disclose how regulations to reduce greenhouse gases and new energy technologies could impact the value of its oil assets. Other shareholder groups have expressed similar interest in increased disclosures on sustainability matters (e.g. climate change, corporate social responsibility, etc.) and corporate directors have become increasingly receptive to the issue of providing sustainability metrics in financial statements. In the [2017 BDO Board Survey](#), a majority (54%) of directors believed that disclosures regarding sustainability matters are important to understanding a company's business and helping investors make informed investment and voting decisions.

Disclosure reporting on sustainability has traditionally been thought of as a "large" organization affair. Global regulations and reporting frameworks in this area abound. However, greater attention in this area is trending in the media as well as in the individual investor and institutional investor communities. As a result, more and more progressive mid-cap and small-cap companies are seeing the potential need to share more with the public about what they are doing to address ESG concerns.

Global regulations, such as the [EU Non-Financial Reporting Directive in Europe \(2014/95\)](#) effective in 2018 for larger companies with over 500 employees, continue to increase, as does the assortment of sustainability reporting frameworks and standards, such as the [Global Reporting Initiative \(GRI\) Standards](#) that companies can consider. In the U.S., the [Sustainability Accounting Standards Board \(SASB\)](#) has established itself as a private sector organization that sets industry-specific standards for corporate sustainability disclosure, with a view towards ensuring that disclosure is material, comparable and decision-useful for investors.

Sustainability measures are non-financial measures that do not fall under the same financial system of controls and thus, do not lend themselves to the traditional scope of financial statement audits. So, as the counter balance to market demands for disclosure of nonfinancial data, in 2017 the AICPA issued an [attestation guide](#) providing guidance to auditors who are engaged by companies to provide market assurance on these metrics. It's safe to predict there will be much more to come on the ESG reporting front.

## DEREGULATION

The Trump administration has made deregulation one of the pillars of its agenda. According to the [Unified Regulatory and Deregulatory Agenda](#) published by the White House Office of Management and Budget (OMB), the administration withdrew or delayed 1,579 planned regulatory actions in 2017.

In 2017, the SEC Chairman Clayton, a Trump appointee, outlined his intent to focus on capital formation activities to help businesses raise money they need to grow and provide more ways for “Mr. and Mrs. 401(k)” to participate in the growth of small and medium sized companies. Refer to [BDO's 2017 SEC Year in Review](#) for further information. Shareholders will want to know that management is closely monitoring this changing regulatory landscape in order to plan effectively.

## CEO/MEDIAN EMPLOYEE PAY RATIO

Despite emphasis on deregulation above, corporate executives and boards may be in for a rough ride this proxy season. The new [SEC rule](#), established under the Dodd-Frank Act, requiring public companies to disclose the ratio of the CEO's compensation to that of the median employee in all annual reports or proxies becomes effective in 2018.

The pay ratio rule incorporates estimates and assumptions into the calculation, which may increase speculation of management bias. The SEC adopted [interpretive guidance](#) to assist companies in their efforts to make their pay ratio disclosures, while also alleviating concern over compliance uncertainty and potential liability. The guidance reinforces that the SEC is looking for consistency, reasonable basis, and good faith estimates. The SEC further updated its [Compliance & Disclosure Interpretations \(C&DIs\)](#) to reflect the Commission's guidance and issued separate [interpretive guidance](#) to help registrants understand how they can utilize statistical sampling and estimates in making their pay ratio disclosures. The guidance provides hypothetical examples related to the use of sampling and other reasonable methodologies.

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.

These are just some of the many issues that shareholders care about and may bring forth in 2018 and beyond.

## 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.

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