



On the board's agenda | US 2018 Proxy Review

Investors and other stakeholders continue to push for greater proxy statement disclosure of both new and existing topics. Robust, quality information is essential to upholding investor confidence and the optimal functioning of our capital markets. In response, companies have generally increased voluntary disclosures.

A particular area of focus is the evolving nature of the company-independent auditor relationship and the ways in which audit committees execute their duties in this changing environment. This may include the ways in which the audit committee evaluates, selects, and oversees the independent auditor, as well as methods for the oversight of risk and the company's financial reporting processes. Deloitte's work with audit committees suggests that many companies go well beyond the minimum satisfaction of the committee's duties but may not discuss their processes in the proxy statement.

Our analysis of the S&P 100 companies demonstrates that companies¹ are indeed voluntarily increasing disclosures included in the proxy, albeit at a slower pace in some

areas. 2018 results show that disclosures did not increase by more than 10 percent in any areas covered, except for one, though 80 percent of the areas analyzed saw an increase in disclosure over last year. The greatest year-over-year percentage increase occurred in disclosures on the audit committee's role in the oversight of cybersecurity, which increased by 13 percent since last year. Other key observations include increases in disclosures around audit committee practices, specifically discussion of management judgments and/or accounting estimates, which increased 6 percent, and the audit committee's review of significant accounting policies, which rose 4 percent. However, the analysis demonstrated only a 2 percent increase in the discussion of issues encountered during the audit. Under the phase-in of the new PCAOB requirements for audit reports, auditors of large accelerated filers will begin to disclose critical audit matters (CAMs) for fiscal years ending on or after June 30, 2019. This new requirement may drive an increase in company disclosures in related areas. A summary of these data points and other highlights of this year's analysis follows on the next two pages.

¹ The 2018 analysis included all sections of the most recent annual proxy statements filed as of May 31, 2018. Because the composition of the S&P 100 changes annually, the companies analyzed in 2018 differed from those covered by the 2017 analysis; two of the companies in the 2018 analysis were not included 2017 analysis.

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Oversight of the independent auditor

Discussions around how the audit committee appoints and evaluates the independent auditor increased in several areas

10% increase

Audit committee evaluates the independent auditor

6% increase

Audit committee consideration of changing or regularly rotating the independent auditor

8% increase

Tenure of the independent auditor

5% increase

Steps to be taken if majority of shareholders do not ratify the independent auditor

Investors seek more clarity as to the reasons for and benefits of auditor retention.

[78% of companies explicitly state the retention of the independent auditor is in the best interest of the company and its shareholders.]

Common considerations taken into account by the audit committee and cited in the proxy include:

- External data relating to audit quality and performance of the firm and its peers
- Firm independence
- Appropriateness of fees
- Familiarity with the company's business operations, accounting policies, and internal control over financial reporting
- Firm's industry expertise
- Impact to the company of changing auditors

7% increase

Why the audit committee decided to reappoint the independent auditor

Increased disclosures around independent auditor oversight may be reasonable given the PCAOB's new auditing standard, which substantially expands the auditor's report.

The key changes to the auditor's report under the standard are:

- Standardized ordering and inclusion of section headers, with the opinion section appearing first.
- Enhanced descriptions of the auditor's role and responsibilities, including a statement regarding independence requirements²
- Communication of critical audit matters (CAMs)
- Disclosure of auditor tenure — The year in which the auditor began serving consecutively as the company's auditor

Disclosure of critical audit matters (CAMs) is permissible on a voluntary basis but will not be required until audits of fiscal years ending on or after June 30, 2019 (for audits of "large accelerated filers") or December 15, 2020 (for audits of all other companies to which the requirements apply).⁴

Audit committee oversight of risk

Area where the analysis saw the largest year-over-year percentage increase

Discussion of the audit committee's role in the oversight of cybersecurity, which increased 13% from 2017 (30 to 43%) **13% increase**

7 Number of companies which disclosed that cyber risk oversight responsibilities are shared between the audit committee and either the full board or another committee⁶

The increase may be due in part to disclosure guidance issued by the SEC in February 2018 reminding companies of the need for disclosure on the board's role in risk oversight if cybersecurity risks are material to a company's business.⁷

Audit committee practices

6% increase Discussion of management judgments and/or accounting estimates increased 6% (from 34 to 40% since last year)

Audit committee review of significant accounting policies rose **4% increase** 4% (from 57 to 61% since last year)

Although the disclosure will not be required for another year, audit committees are encouraged to discuss the potential content of the CAMs with their auditors.⁵

This may be a reflection of the coming disclosures on critical audit matters (CAMs) which include, according to the PCAOB, matters arising from the audit of the financial statements that have been communicated or were required to be communicated to the audit committee and that

(1) relate to accounts or disclosures that are material to the financial statements and

(2) involved especially challenging, subjective, or complex auditor judgment

8%

Companies that disclosed that their audit committees discussed issues encountered during the audit (2% increase since last year)

Areas with little to no change



Composition and role of the audit committee

Example: Roles and responsibilities of the audit committee had a 0% change



Audit committee practices

Example: Audit committee discussions about the financial statements before earnings announcements (1% increase)

Summary results of analysis

Disclosure in the proxy statement	Category	2018 S&P 100 companies	Percentage change from 2017 to 2018	2017 S&P 100 companies	2016 S&P 100 companies	2015 S&P 100 companies
01. Audit committee has more than one financial expert	Composition	84%	-2%	86%	88%	76%
02. Financial literacy of audit committee members	Composition	69%	3%	66%	63%	59%
03. Roles and responsibilities of the audit committee	Responsibilities	100%	0%	100%	100%	100%
04. Information about the charter beyond its existence	Responsibilities	74%	1%	73%	71%	77%
05. Topics of discussion by the audit committee	Audit committee practices	96%	0%	96%	100%	100%
06. Audit committee review of significant accounting policies	Audit committee practices	61%	4%	57%	56%	47%
07. Additional disclosure about significant accounting policies	Audit committee practices	25%	-1%	26%	27%	28%
08. Discussion of management judgments and/or accounting estimates	Audit committee practices	40%	6%	34%	32%	28%
09. Audit committee review of earnings/annual report press release with management and the independent auditor	Audit committee practices	34%	2%	32%	30%	20%
10. Audit committee discussions about the financial statements before earnings announcements	Audit committee practices	26%	1%	25%	21%	18%
11. Audit committee evaluates the independent auditor	Audit committee practices - auditor appt, eval	71%	10%	61%	59%	61%
12. Why the Audit committee decided to reappoint the independent auditor	Audit committee practices - auditor appt, eval	48%	7%	41%	42%	35%
13. Audit committee or its chair involved in the selection of the auditor's new lead engagement partner	Audit committee practices - auditor appt, eval	77%	4%	73%	73%	71%
14. Tenure of the independent auditor	Audit committee practices - auditor appt, eval	79%	8%	71%	67%	64%
15. Retention of the incumbent independent auditor is in the best interest of the company and its investors	Audit committee practices - auditor appt, eval	78%	1%	77%	79%	73%
16. Audit committee consideration of changing or regularly rotating the independent auditor	Audit committee practices - auditor appt, eval	81%	6%	75%	75%	74%
17. Steps to be taken if majority of shareholders do not ratify the independent auditor	Audit committee practices - auditor appt, eval	82%	5%	77%	78%	80%
18. Audit committee compensates the independent auditor	Audit committee practices - auditor comp	84%	6%	78%	80%	77%
19. Audit committee approves the audit engagement fees	Audit committee practices - auditor comp	69%	6%	63%	65%	40%
20. Audit committee is responsible for audit fee negotiations	Audit committee practices - auditor comp	19%	1%	18%	21%	23%
21. Audit committee sets the compensation for the independent auditor	Audit committee practices - auditor comp	10%	0%	10%	6%	7%
22. Responsibilities of the independent auditor	Audit committee practices - auditor rsp	69%	4%	65%	69%	68%
23. Audit committee discussion with the independent auditor regarding the scope of and plans for the audit	Audit committee practices - auditor rsp	63%	3%	60%	63%	62%
24. Discussion of the issues encountered during the audit	Audit committee practices - auditor rsp	8%	2%	6%	6%	7%
25. Separate meetings between the audit committee and the independent auditor	Audit committee practices - auditor	69%	4%	65%	67%	68%
26. The audit committee is responsible for the oversight of risk	Responsibilities	99%	0%	99%	96%	
27. Discussion of the audit committee's oversight of the company's financial reporting processes	Responsibilities	96%	5%	91%	88%	
28. Discussion of the audit committee's role in the oversight of cybersecurity	Responsibilities	43%	13%	30%	27%	
28a. Number of companies which disclosed that cyber risk oversight responsibilities are shared between the audit committee and either the full board or another committee ⁸	Responsibilities	7				
29. Discussion of the audit committee's role in overseeing the internal audit function	Responsibilities	93%	4%	89%	85%	
30. Discussion of the actions the audit committee has taken during the prior year	Responsibilities	46%	1%	45%	43%	

The changes from 2017 to 2018 are color coded to highlight: ■ Decrease in disclosure reported from 2017 to 2018 ■ No changes in the disclosures reported from 2017 to 2018 ■ Increase in disclosure reported from 2017 to 2018

⁸ New data point added this year as a result of additional analysis

Conclusion

While voluntary disclosure is increasing, the pace in some areas continues to be measured. The areas where increased disclosure was observed this year could be viewed in the context of new or upcoming regulatory requirements. Though it remains to be seen how investors will view the information required through those new or expanded disclosures, investors and other corporate governance advocates will likely continue to push for expanded disclosure.

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