



BoardroomDirect

Update on current board issues - Fall 2010



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We are pleased with the enthusiastic response we received to the first edition of our *BoardroomDirect* quarterly newsletter launched in July. The response reaffirms our commitment to provide you with information and our insights on current board issues to assist you in discharging your responsibilities. We would welcome your feedback on this edition and on the topics you would like us to address in future editions. Please use the "Submit feedback" button at the end of this publication to send us your thoughts.

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Issue in focus: Proxy access rule delayed

Proxy access continues to be a contentious issue. After years of debate, the SEC adopted a proxy access rule on August 25, 2010. The Commissioners voted 3-2 along party lines to enact the rule, expressing strongly divergent views about its appropriateness. The rule was to be effective for the upcoming proxy season, with a three-year deferral period for smaller companies.

On September 29, the US Chamber of Commerce and the Business Roundtable filed a legal petition to challenge the proxy access rule. The petition states, among other things, that the SEC failed to follow legally required procedures by not properly assessing the rule's effects on efficiency, competition, and capital formation. On October 4, the SEC agreed to delay implementation of the proxy access rule until the case is decided. An SEC spokesperson indicated that the legal issues may be resolved by late spring. Based on this timing, proxy access will be delayed, at a minimum, until the 2012 proxy season for calendar year-end companies. Non-calendar year-end companies may have to adopt the rules later in 2011.

While the path forward for proxy access has been temporarily blocked, and may change depending on the outcome of the legal proceedings, this new development shines a bright light on the importance of directors strategizing with management on how best to engage their large shareholders on this issue. Directors also can take advantage of the deferral to consider with management whether the company is prepared for a proxy access situation, whether existing director eligibility criteria are appropriate, and if enhancements are needed to director qualifications disclosure in the proxy

statement, among other items. Directors should not lose sight of the fact that shareholders and hedge funds can still use conventional methods to launch a proxy fight as evidenced by a number of high-profile cases that are currently in the news.

On a related note, in a separate initiative, for the first time in 30 years the SEC is focusing on improving the general operations of the US proxy system. In July 2010, the SEC released a wide-ranging concept release on the US proxy system, which seeks comments on three general areas: (i) accuracy, transparency, and efficiency of the voting process; (ii) communications and shareholder participation; and (iii) the relationship between voting power and economic interest. The role of proxy advisory firms is one of the issues the SEC is addressing.

Comments on the concept release are due October 20, 2010, but it is not expected that we will see changes this proxy season. Directors should encourage management to participate in the public comment process and make certain its voice is heard on relevant issues to improve the way that shareholders are informed and vote.

We recommend the following resources for additional insight on proxy changes:

- [SEC: Order For Stay of Effect of Commission's Facilitating Shareholder Director Nominations Rules](#)
- [Weil, Gotshal: SEC Adopts New Rule Mandating Proxy Access](#)
- [SEC: SEC Votes to Seek Public Comment on U.S. Proxy System](#)

Audit committee issues

FASB: Board changes and their implications on the future accounting landscape

Robert Herz retired from the FASB, effective October 1, 2010, following more than eight years of leading the FASB's standard-setting efforts as its chairman. Herz has been a strong advocate for US GAAP / IFRS convergence and instrumental in driving forward the Board's technical agenda. He also has been a strong supporter of fair value accounting. While a search for Herz's replacement is conducted, Leslie Seidman, a two-term Board member, will serve as the acting chairman.

At the same time that Herz announced his retirement in August, the Financial Accounting Foundation (the Foundation), the organization that oversees the FASB, announced that the five member FASB would be increased to a seven member Board by early 2011. It was just two years ago that the board's size was decreased from seven to five. The Foundation's rationale for the reversal is that the increase will enhance the FASB's investment in the convergence agenda.

We expect the FASB to continue with "business as usual" until the new board members begin their work.. However, since the projects underway were deliberated during the tenure of the current five-member board, the road ahead is uncertain. Add three new Board members into the mix, and it is reasonable to question whether tentative decisions reached by the board on current projects will change once the new board members are in place and whether the current board will delay making decisions on significant new matters until then. It also remains to be seen how the board changes will impact the future landscape of accounting standard-setting and whether, collectively, the FASB and IASB will again need to modify their strategies and the timeline of their work plans.

Convergence: Exposure drafts issued on key projects that will have broad implications for companies

A number of key exposure drafts have been issued; we highlight the most important ones below.

Revenue recognition: One objective of the proposed standard is to harmonize guidance for all companies, thereby eliminating industry specific revenue recognition guidance. As a result, companies in almost all industries will be impacted.

Leases: The key objective of the proposed standard is for assets and liabilities relating to lease contracts to be reported on the balance sheet. There would no longer be an operating lease classification.

Loss contingencies: The FASB re-exposed its controversial proposal to enhance loss contingency disclosures. Feedback on the original proposal in 2008 resulted in public outcry, with respondents claiming that it would put companies engaged in legal disputes at a significant disadvantage. While the July 2010 proposal appears to be an improvement over the

original proposal, changes in certain areas may not be sufficient to address concerns raised. Comment letters received thus far on the 2010 proposal have not been supportive and near-term passage may prove challenging.

IFRS: Status update

In the near term, convergence is expected to continue in key areas. We continue to believe the US will move towards IFRS at some point. The SEC actively sought public comment from investors and preparers this summer on the US's conversion to IFRS, demonstrating its promised transparency and stated willingness to listen to the views of companies and financial statement users. Public updates by the SEC on its IFRS work plan are expected and we will report on those updates in future editions. Meanwhile, IFRS adoption continues outside the US and multinational companies should remain focused on the impact of those adoptions to the extent relevant to them.

IRS: Final guidance issued on reporting uncertain tax positions

On September 24, 2010, the IRS issued final guidance for reporting Uncertain Tax Positions (UTP) in tax returns. Audit committees may wish to discuss with management how companies are beginning the needed analysis and planning to comply with the rules.

Under the new rules, companies may limit their qualitative disclosure to a description of the relevant facts and information that would apprise the IRS of the tax position. They will have to rank all disclosed positions based on the size of the tax reserve, identify any positions where the reserves exceed 10% of total UTP reserves, and disclose unreserved UTPs if a reserve was not recorded because the company expects to sustain the position through litigation. These requirements are substantially less in scope than what had been proposed, which would have required more specific and detailed qualitative and quantitative disclosures. Companies with total worldwide assets equal to or exceeding \$100 million must file Schedule UTP with their calendar year 2010 income tax returns (or fiscal year returns that end in 2011), with staggered phase-in dates for smaller companies.

CAQ: Report on deterring and detecting financial reporting fraud

On October 6, 2010, The Center for Audit Quality (CAQ) released its report, *Deterring and Detecting Financial Reporting Fraud - A Platform for Action*. The report is the result of discussions and interviews with stakeholders – including board and audit committee members – who have an interest in the integrity of financial reports. The report provides a number of ideas for reducing financial reporting fraud risk, as well as suggested actions. The report is part of a longer-term strategic effort to pro-actively address the "expectations gap" by enhancing stakeholders' understanding of fraudulent financial reporting and reasonable assurance as they relate to the preparation and use of financial statements.

PCAOB: Response to the audit committee communications proposal

In March 2010, the PCAOB proposed an auditing standard *Communications with Audit Committees* that would establish additional requirements for communications between auditors and audit committees. The original comment period ended in May, but after considering feedback, the PCAOB extended the comment period to October 21, 2010. The PCAOB also hosted a roundtable in September at which audit committees, investors, preparers, auditors, and others were invited to provide additional feedback. Sentiment at the roundtable was mixed – some believed that the proposed requirements would be burdensome and preferred a more principles-based standard, while others supported the proposal. Audit committees should take advantage of this extended opportunity to voice their opinions. We will continue to report on the status of this important proposed auditing standard in future editions.

We recommend the following resources for additional insight on these audit committee issues:

- [PwC: The Quarter Close – Directors edition: A look at this quarter's financial reporting issues](#)
- [PwC: IRS modifies final schedule UTP and instructions for reporting uncertain tax positions](#)
- [CAQ: Deterring and detecting financial reporting fraud](#)
- [PCAOB: Proposed auditing standard, *Communications with Audit Committees*](#)

Issues in brief

Executive compensation: Limited provisions of Dodd-Frank effective this proxy season

There are several executive compensation provisions in the Dodd-Frank Act (the Act), including, among other things, say on pay, compensation committee and advisor independence, compensation clawback policies, and a new disclosure for the calculation of the ratio of total CEO pay to that of median employee pay. With the exception of say on pay, which has

an effective date embedded in the Act, many of these provisions will not be effective for the upcoming 2011 proxy season. The SEC recently disclosed its tentative schedule for rulemaking that the Act requires, and many of the compensation-related provisions have proposed rule adoption dates that run into the middle of 2011.

That being said, boards, compensation committees, and audit committees should begin thinking about the impact of these provisions. For example, consider how much of the pay package should continue to be incentive-based, and whether incentive pay should be based on measures other than financial (e.g., productivity). In addition, gathering information for the CEO to employee pay ratio calculation won't be easy. Directors also should ensure their companies are providing input to the rulemaking and analyzing how potential rules could impact them.

We recommend the following resources for additional insight on executive compensation:

- [PwC: To the Point: Say on Pay – What you can learn from the international experience](#)
- [Pearl Meyer & Partners: Summary of Clawback Policies Under Dodd-Frank Reform Act](#)
- [Morrow & Co.: SEC Posts Schedule for Implementation of Dodd-Frank](#)

M&A: Avoiding earnings surprises

If you are the director of a public company that is planning a merger or acquisition, are you fully informed about how pending deals are expected to impact earnings? Certain important aspects of deals are often overlooked, leading to unpleasant surprises down the road. Fortunately, these can be avoided by recognizing danger areas, understanding management's approach to developing acquisition-related information, and discussing whether the level of analysis performed is appropriate.

Learn more about avoiding earnings surprises:

- [PwC: TS Insights – Directors edition: Avoiding earnings surprises](#)

Resources, webcasts, and events

Board member and audit committee member events

Given the significant changes in regulations and corporate governance, continuing education programs are important components of board and audit committee effectiveness. PwC offers programs that can help directors further understand their roles and enhance their technical knowledge to carry out their responsibilities effectively. [Click here](#) for additional information, topics, and dates.

Thank you

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