Investor perspectives and compliance oversight

Members of the Northeast Audit Committee Network (NEACN) met in New York City on June 27, 2019, for discussions on investor perspectives, corporate disclosures, and board oversight of compliance. NEACN members also viewed live demonstrations of EY's fraud detection and prevention tools in the Chelsea wavespace facility. This *Summary of Themes* provides a brief overview of the meeting.[1] *For the full roster of meeting participants, please see the list on page 4.*

Investor perspectives and corporate disclosures

Members exchanged views on the recent trends in corporate disclosures and investor engagement with Ray Cameron, head of investment stewardship, Americas, at BlackRock. A few highlights emerged from the conversation.

- **Proxy season and 2019 priorities.** Mr. Cameron discussed BlackRock's support for long-term value creation for its clients. He said, *"We are coming up on the tail-end of this proxy season and we have engaged with over 2,000 companies globally. Ninety percent of our equity assets under management are in index funds, so by definition we are long-term, patient capital. If traditional active investors are unhappy, they can sell their shares. We express our support through proxy voting."* He discussed the firm's priorities for 2019, including: governance, corporate strategy and capital allocation, compensation related to the long-term health of an organization, environmental opportunities, i.e., climate risk and plastic waste, and human capital management. One member asked, *"Where are the biggest gaps with long-term vision?"* Mr. Cameron responded, *"Human capital management disclosures. Companies are not sure what to disclose because these critical reporting metrics are still emerging. So that is where we see the biggest gaps and widest dispersion in conversations with companies."*
- **Engagement.** BlackRock's goal is not to be too prescriptive but to understand how a company is approaching issues important to BlackRock as an investor, and how its policies and practices position the company for long-term growth. When asked what prompts BlackRock to seek an engagement, Mr. Cameron said, *"We are one of the top three shareholders of virtually every public company. Our policy is to engage first and give companies time to remedy situations before voting. We receive a lot of incoming requests for meetings, for example in situations where a director may be over boarded. We have a prioritization model for engagements, which helps us allocate our time during proxy season, but is especially useful during the off season."* One member asked, *"Are you meeting with*

directors or just management?" Mr. Cameron said that, typically, engagement has historically been with the company's management, but increasingly directors are becoming an important part of those conversations. He also noted that while many companies have reacted positively to BlackRock's engagement and progress has been made around many governance issues, board composition —beyond gender diversity—is one area where there is still significant work to do.

- **Disclosures.** One member said, *"Good disclosures have the ability to tell the company's story in a visual way with digestible content. Over the past 10 years I have found the proxy has become a very usable tool to accomplish this."* Mr. Cameron added, *"One thing we look for is alignment across reporting vehicles. You would be surprised at how many companies highlight one material risk in one report and exclude it in others. We use key word search technology and artificial intelligence to check for consistency."* Members asked for examples of companies with strong disclosures that they could reference to better understand good practice. Mr. Cameron suggested members view Coca-Cola's CSR report which provides well laid out and digestible graphs, UPS's employee engagement which has a dual-class share structure exclusively for employees, and Travelers for good proxy disclosures highlighting governance practices of the board, climate risk, and human capital management.

Board oversight of compliance

Effective compliance programs help companies avoid both distraction and value destruction. NEACN members explored compliance practices with Joel Katz, former chief integrity and compliance officer at Resideo, and Matt Swaya, former chief ethics and compliance officer at Starbucks.

- **Transparency and tone at the top.** Both guests emphasized the importance of being transparent with employees when dealing with compliance misconduct. Mr. Katz said, *"We never shied away from our problems and were transparent about any compliance issues we encountered, and the actions taken to remedy the transgression—even if it made our lawyers cringe at times. We found that employees appreciated being treated like adults and if they were left to create their own narrative about situations, the outcome was usually far worse than the truth."* Mr. Swaya stressed the importance of the organization's culture: *"One of the most important things we did was reinforce a 'speak up' culture around compliance. We had many campaigns surrounding the notion of speaking up, and the benefits for everyone involved, and we eased fears of retaliation. Leadership must set the tone at the top and ground the organization in doing the right thing."*
- **Technology and training.** Mr. Katz challenged members to find any large company that was not using machine learning, AI, or other technologies in the compliance space today. He added, *"The tools are getting better but there needs to be a risk-based approach to*

technology implementation. The tools can produce a huge number of false positives so management and the board need to consider the time and resources it would take to address those issues when making decisions." NEACN members were also interested in training and communication throughout the organization. Mr. Swaya said, *"We hired someone internally from HR who started out as a barista, so she had a great understanding of our stores. Through her deep understanding of the business, she was able to communicate with various levels of the organization and create world-class training programs."* Mr. Katz added that an effective compliance training program should be *"interesting, relevant, and useful."* He discussed creating a fictional character, *"Griffin Peabody,"* who would get into trouble with the company's compliance program. Creative training programs that were more than just check-the-box resonated with employees. *"The humor got through to people. Some people hated it, but most people loved it and couldn't wait to see Griffin's next adventure,"* he said.

- **Tight links to other departments.** Members and guests viewed a close working relationship between compliance and other related functions as being critically important. Mr. Katz discussed steps his company took to ensure a smooth cross-functional rapport: *"In my experience, compliance will say the biggest impediment to success in their role is HR, and HR will say the opposite. To combat this, we started a compliance log meeting to ensure compliance, HR, legal, finance, internal audit, and our external auditors were sharing information readily and clear on their responsibilities. We found having structure in place helps."* One member agreed and added, *"We include all the gatekeeping functions in our audit committee meetings. We find it helps foster relationships."*
- **The role of the board in compliance oversight.** Members were interested to learn what types of interactions with management signal a robust compliance program. Mr. Katz described his approach when presenting to the audit committee, *"I would lead with the things that most concern me. Regulatory changes, trends of interest, investigation data, and how to keep employees engaged in the compliance program."* Mr. Swaya added, *"I would ask your chief compliance officer if they have all the resources they need to get their job done at every audit committee meeting. I would also want to know that the CCO understands the business and where it is headed. It's hard to understand risk areas if you don't know the business."* Members and guests stressed the importance of meeting with the chief compliance officer or equivalent in executive sessions, to ensure that they are being candid. Mr. Katz said, *"Many compliance officers are called in to speak with the board with their CEO present. That is not best practice—you want to ensure you have a one-on-one.*

Meeting participants

The following NEACN members attended all or part of the meeting:

- Bert Alfonso, Eastman Chemical Company
- David Brown, EMCOR Group
- Bill Creekmuir, Party City
- Brian Ford, Clearway Energy
- Art Garcia, ABM Industries
- Mary Guilfoile, Interpublic Group
- Paul Joubert, Ares
- Christie Kelly, Park Hotels & Resorts
- Lew Kramer, L3Harris Technologies, Inc. and Las Vegas Sands Corp.
- Doug Maine, Alumnus
- Craig Owens, The J.C. Penney Company and Dean Foods Company
- JoAnn Reed, American Tower, Mallinckrodt, and Waters Corporation
- Tim Yates, CommScope

EY was represented by the following:

- Herb Engert, New York Office Managing Partner
- Rich Jeanneret, Americas Vice Chair
- Bud McDonald, Connecticut Office Managing Partner

Endnotes

[1] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.