

New SEC Proxy Disclosure Rules Provide CAEs with Extraordinary Opportunities to Reinforce Internal Auditing's Vital Role in Achieving Effective Risk Management

New regulations by the U.S. Securities and Exchange Commission (SEC) require registrant companies to publicly disclose substantial new information about a wide range of governance activities. These game-changing rules present CAEs with unique opportunities to spotlight internal auditing's vital role and professional expertise in supporting board and management efforts to achieve and sustain effective risk management practices.

In general, the SEC's rulemaking requires future proxy and information statements to provide analysts and investors with additional information about:

- The board's leadership structure and role in risk oversight.
- The relationship of the organization's overall compensation policies and practices to enterprise risk and risk management.
- The background and qualifications of directors and director nominees.
- Past or ongoing legal actions involving executives, directors, and director nominees.
- The consideration of diversity in the process by which directorship candidates are considered for nomination.
- Stock and option awards to executives and directors.
- Potential conflicts of interests of compensation consultants.

The new rules also require reporting results of shareholder votes within four business days and make substantial changes to the valuation of some stock-based awards to executives.

CAEs must act quickly to respond to these regulations — including a unique opportunity to establish the importance of audit opinions on the adequacy and effectiveness of risk management processes as well as audit reports on the accuracy of other SEC-required disclosures as compliance best practices. The enhanced disclosure rules are effective for proxy solicitations and other reports filed with the SEC on or after Feb. 28, 2010, and each organization's initial filing will be carefully scrutinized by the agency, the analyst community, and investors alike. Moreover, the tone and substance of the initial filings will serve as benchmarks for future reporting.

IIA President and CEO Richard Chambers and management of The Institute's Audit Executive Center convened a select group of thought-leading CAEs to develop a list of 10 actions CAEs should take now to establish internal auditing as an integral part of the new proxy disclosure process for the long-term future. These actions are:

1. Thoroughly familiarize yourself with [the SEC's 129-page rulemaking](#) (PDF) and [related transition guidance](#). You can jumpstart this process by reading the agency's [Dec. 16, 2009, press release](#) on this topic and by watching SEC Chairman Mary Schapiro's [related presentation](#) (WMP video).

2. Determine who in the organization is spearheading the new disclosure process and meet with them to determine whether the process is appropriate, repeatable, and comprehensively documented.
3. Meet with the person drafting the disclosure on the board's role in risk oversight and ensure that:
 - a. The activities of the board and board committees, including the audit committee, are accurately stated.
 - b. The related activities of internal auditing are accurately described.
4. Review the appropriateness of the determination of whether the organization's broad compensation policies and practices — not just those that apply to senior executives — might create risks that “are reasonably likely to have a material adverse effect on the company” and, therefore, require disclosure.
5. If such disclosure is required, review the draft and gain assurance that the language is appropriate and appears to adequately address SEC requirements. Moreover, consider suggesting inclusion of specific language concerning internal auditing's role in assessing the completeness and accuracy of disclosures related to the organization's risk management practices.
6. Carefully consider the need for further, formal internal audit testing of the organization's risk management processes. If appropriate, suggest disclosure of the outcomes of this testing — including an opinion on the overall effectiveness of the organization's risk management processes.
7. Keep senior management and the audit committee thoroughly apprised of your activities.
8. Produce a written audit report documenting your disclosure-related activities.
9. Review your audit plan to ensure it adequately covers organizational activities related to the SEC's disclosure requirements.
10. Discuss with the audit committee additional ways that internal auditing could assist the board in fulfilling its required oversight of risk management.

Like requirements of the U.S. Sarbanes-Oxley Act of 2002, the SEC's new disclosure rules soon will become a way of life for public companies. Similarly, they provide opportunities for internal auditing to add value to the organization. Internal auditing can significantly assist an organization and its board in complying with these rules by providing objective assurance that risk management processes are designed and functioning properly. However, the decision to seize these opportunities must be made by each individual CAE.