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On the 2020 board agenda

KPMG Audit Committee Institute

Drawing on insights from our conversations with board directors around the world, we highlight the following priority issues for boards to consider as they approach and execute their 2020 agendas.

- **The environmental emergency** can no longer be ignored in the context of environment, social and governance ('ESG') and long-term strategic thinking.
- **Balancing the interests of society at large** and shareholder return has become inevitable in strategy discussions.
- **Emerging and disruptive technology** will continue to ramp-up and put risk management systems and the workforce to the test.
- **Geopolitical turmoil** requires the related disruption, strategy and risk to be hardwired together.
- **Cyber security and data governance** requires a rigorous, risk-based and holistic approach.
- **Corporate culture** needs to be embedded in strategic discussions, risk management and compliance, performance, and the incentives driving these activities.
- **Diversity and inclusion** should record fare against the company's own goals, its strategy and its risk profile.
- **Succession planning** is a dynamic and ongoing process. Be ready and prepared to deal with planned or unplanned change.
- **Talent pipelines** should align with strategy, technology advances and forecast needs for the short – and long-term.
- **Shareholder engagement** continues to increase – with boards being held increasingly accountable for performance and greater transparency.
- **Crisis readiness and response plans** allow companies to weather crises faster and better.

Prioritizing board agendas will be particularly challenging in 2020 as stakeholder voices continue to drive a sharper focus on how the company is being positioned for the future. Combined with concerns about the economy and geopolitical turmoil, the year ahead will require a careful balance of near-term focus, mid-term agility, and long-term thinking.

Environmental emergency

Employee and consumer activism regarding Environment, Social and Governance (ESG) issues are growing exponentially, but none more so than over the question of the environment.

Institutional investors have long emphasized their expectations for companies to explain how they are addressing environmental issues in the context of long-term value creation, and while the volume of disclosure has certainly increased, action has been limited.

Now, as increasingly visible activist groups expand throughout the millennial population and beyond, their voice has become impossible to ignore by policy makers and companies.

There are many frameworks for reporting on the issue. So while the volume of information being presented is significant, and growing, ensuring it is focused, relevant, material and comparable is a challenge.

Alongside the need for long-term planning and retrospective reporting, the importance of short-term action must not be underestimated. There is clearly a growing acceptance of what were previously seen as extreme opinions held only by marginal groups.

Balancing interests of society at large

Corporate growth and shareholder return still require the essentials – managing key risks, innovating, capitalizing on new opportunities, and executing on strategy – but the context for corporate performance is changing quickly and, perhaps, profoundly.

Mounting societal issues – such as territorialism, income and taxation inequality, the climate emergency, diversity and inclusion – coupled with poor government solutions, continue to heighten expectations for companies themselves to address the gaps and rethink their responsibility to society – changing the conversation from "Is it legal?" to "Is it right?"

A growing number corporate governance codes around the globe introduced 'sustainable value creation' as a new fundamental basis, as many would now accept that a successful company must not only generate value for shareholders, but also develop an 'inclusive' approach to balance the interests of the wider society. Companies who fail to deliver on a societal sense of purpose will ultimately lose the licence to operate from key stakeholders – as with diversity and inclusion, this is not a political correctness issue, but rather an essential component for sustainable long-term growth.

Boards should seek to understand the interests and expectations of stakeholders' and to present in the annual report sufficient information on issues of societal concern and even relevant indicators thereof It is not yet clear how boards will report in practice – certainly as it relates to previously undisclosed and sometimes sensitive matters. The starting point is likely the identification of both the key stakeholders and how they have been engaged, as well as how the company defined and had regard to the issues of societal concern – considering the impact of that regard in strategic decision making and the governance of the company.

"2020 is a tipping point. We've lived with growing levels of geopolitical risk for nearly a decade, but without a true international crisis. Outside of geopolitics, global trends have been strongly favorable. That's now changing."

Eurasia Group – Top Risks 2020[1]

[1] https://www.eurasiagroup.net/issues/Top-Risks-2020

Emerging disruptive technology

As digital technologies such as AI, data-analytics and Blockchain, inter alia, continue to advance – both in capability and in application – their impact on risk assessment – both in terms of disruption as well as protection solutions – becomes as increasingly important as it is a complex multi-faceted challenge.

Nearly 80 percent of board members surveyed in our 2019 Global Audit Committee Pulse Survey indicated that their companies' risk management processes are not fully robust – being unable to identify emerging and disruptive risks.

Now more than ever is the time to firmly pose questions around this, and just as importantly to follow up robustly on the proposed actions. Are the company's risk management processes adequate to address the speed and disruptive impact of these advances, and to assess the continuing validity of the key assumptions that are the basis for the company's strategy and business model? Tomorrow's competitors are likely to be different than yesterday's.

Where disruptive technology is identified as a risk management opportunity does the business have the right skills to deliver on it? Understanding the risks and opportunities posed by technologies is a long way from being able to actively manage or leverage them which requires skills rarely found in current management but typically prolific within the millennial population.

Geopolitical turmoil

On top of growing nationalism, cyber attacks, and the threat of various looming (trade) wars and other geopolitical conflicts, combined with an absence of global leadership and the deterioration of international governance (the so-called 'G-Zero world'), will continue to drive global VUCA[2]. As Eurasia Group's founder and president Ian Bremmer has noted, this environment 'will require more investment in scenario planning and stress testing. It also means drawing up contingency plans to shorten supply chains, cutting long-term fixed costs, and limiting business exposure to political relationships that have considerable potential to go south.' Check out Eurasia's 2020 top risks to stay ahead of the curve.

Help management reassess the company's processes for identifying the risks and opportunities posed by continuing political struggles, geopolitical disruption and their impact on the company's long-term strate.

Is there an effective process to monitor changes in the external environment and provide early warning that adjustments to strategy might be necessary? Help the company test its strategic assumptions and keep sight of how the big picture is changing: connecting dots, thinking differently, and staying agile and alert to what's happening in the world. In short, disruption, strategy, and risk should be hardwired together in ongoing boardroom discussions.

Cyber security and data governance

In our conversations with directors, it is clear that some companies may need a more rigorous, holistic approach to data governance – the processes and protocols in place around the integrity, protection, availability and use of data.

Boards have made strides in monitoring management's cyber security effectiveness with for example greater IT expertise on the board and relevant committees, company-specific dashboard reporting to show critical risks and more robust conversations with management focusing on critical cyber security risks, operational resilience, and the strategies and capabilities that management has deployed to minimize the duration and impact of a serious cyber breach. Despite these efforts, given the growing sophistication of cyber attackers, cyber security will continue to be a key challenge.

Data governance overlaps with cyber security, but it is broader. For example, data governance includes compliance with industry-specific privacy laws and GDPR, which govern how personal data – from customers, employees or vendors – is processed, stored, collected, and used.

Data governance also includes the company's policies and protocols regarding data ethics – in particular, managing the tension between how the company may use customer data in a legally permissible way with customer expectations as to how their data will be used. Managing this tension poses significant reputation and trust risks for companies and represents a critical challenge for leadership.

To help develop a more rigorous approach around oversight of data governance:

— Insist on a robust data governance framework that makes clear how and what data is being collected, stored, managed, and used, and who makes decisions regarding these issues.

— Clarify which business leaders are responsible.

— Reassess how the board assigns and coordinates oversight responsibility for both the company's cyber security and data governance frameworks, including privacy, ethics and hygiene.

[2] Volatility, Uncertainty, Complexity, Ambiguity

Corporate culture

Does the company make it safe for people to do the right thing? Headlines of sexual harassment, aggressive sales practices, insider trading and other wrongdoing continue to put corporate culture front and center for companies, shareholders, regulators, employees, and customers.

Boards themselves are also making headlines – particularly in cases of self-inflicted corporate crises – with investors, regulators, and others asking, 'Where was the board?'

Given the critical role that corporate culture plays in driving a company's performance and reputation – for better or, as evidenced by #MeToo, for worse – year-over year, we have seen boards taking a more proactive approach to understanding, shaping, and assessing corporate culture.

The boards should be clearly responsible for oversight of corporate culture. Our set of leading practices for boards to discharge their responsibility related to corporate culture should go well beyond, tasking the board to ensure that the culture is supportive of the realization of its strategy and that it promotes responsible and ethical behavior.

Getting culture right requires a laser focus on the tone at the top and zero tolerance for conduct that is inconsistent with the company's values and ethical standards, including any 'code of silence' around such conduct.

Be sensitive to early warning signs and verify that the company has robust whistle-blower and other reporting mechanisms in place and that employees are not afraid to use.

Understand the company's actual culture (the unwritten rules versus those posted on the notice board); use all the tools available – surveys, internal audit, hotlines, social media, walking the halls and visiting facilities – to monitor the culture and see it in action. Recognize that the tone at the top is easier to gauge than the mood in the middle and the buzz at the bottom. How does the board gain visibility into the middle and bottom levels of the organization? Make sure that incentive structures align with strategy and encourage the right behaviors, and take a hard look at the board's own culture for signs of groupthink, complacency and/or discussions that lack independent or contrarian voices. Focus not only on results, but the behaviors driving results.

Diversity and inclusion

Given the demands of today's business and risk environment, boards must increasingly focus on aligning their own composition with the company's strategy, both today and with a longer-term view.

The world has arguably changed markedly faster than boards, and the need for relevant experience, diversity and inclusion in the boardroom continues to be front and center for investors, regulators, and other stakeholders. How does your boardroom set of skills, experience and diversity record fare against the company's own goals, its strategy and its risk profile?

The journey to meet quota related to gender diversity is moving in the right direction over the last few years. But can the same be said about diversity at large? Do today's boards reflect the society we live in? Do they reflect the international markets in which they operate? And the changed workforce and their interests?

The increased level of investor and regulator engagement on this topic highlights concern over the slow pace of change in boardrooms and points to the central challenge with board composition: a changing business and risk landscape.

Addressing competitive threats and business model disruption, technology innovations and digital changes, cyber risk, and global volatility requires a proactive approach to board-building and board diversity – gather sufficient expertise in the company's areas of activity as well as sufficient diversity of skills, background, age and gender. International diversity is especially important for businesses operating across many different markets.

It is clear that board composition and diversity should continue to be a key area of board focus in 2020, as a topic for communications with the company's institutional investors, proper disclosure in the annual report and positioning the board strategically for the future.

> "The global economy is faced with a 'synchronized slowdown', the past five years have been the warmest on record, and cyberattacks are expected to increase this year – all while citizens protest the political and economic conditions in their countries and voice concerns about systems that exacerbate inequality."
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> *Børge Brende, President, World Economic Forum, in the WEFGlobal Risks Report 2020* [3]

[3] http://reports.weforum.org/global-risks-report-2020/preface/

Succession planning

Few board responsibilities are more important than hiring and firing the C-suite – a reality that continues to hit the headlines, particularly if the board is caught flat-footed. Given the VUCA and disruptive business and risk environment, it is essential that the company has the right CEO in place to drive strategy, navigate risk, and create long-term value for the enterprise. The board, in consultation with the CEO, should also appoint and dismiss the other C-levels taking into account the need for a balanced executive team.

The board should ensure that the company is prepared for a CEO change – planned and unplanned. CEO succession planning is a dynamic and ongoing process, and boards must always be thinking about developing potential candidates and planning for succession should start the day a new CEO is named. How robust are the board's succession planning processes and activities? Are succession plans in place for other key executives?

Succession planning is a dynamic and ongoing process, and boards must always be thinking about developing profiles for potential candidates. Planning for succession should start the day a new C-level or board member is named.

Talent pipeline

Clearly linked to the importance of having the right C-suite is having and retaining the talent required – from the top down through the ranks – taking into account more and more digitalized and technology driven ways of working.

The challenge is significant: leaders will need to identify the new skills and capabilities that will realistically be required in the future, those current employees willing and able to be upskilled and retrained will need to be identified. New talent will need to be attracted, retained and integrated into the business and new ways of working will need to be developed and formalized.

Also, investors are becoming more vocal about the importance of a talent development program. Companies will face an increasingly difficult challenge in respect of talent at all levels. Any talent plan should align with strategy and future needs. Which talent categories are in short supply and how can they be recruited and maintained? More broadly, as millennials and younger employees join the workforce in large numbers and talent pools become globally diverse, is the company positioned to attract, develop, and retain top talent at all levels?

Shareholder engagement

Shareholder engagement continues to be a priority for companies as institutional investors increasingly hold boards accountable for company performance and demand greater transparency, including direct engagement with independent directors. They continue to challenge the board with tough questions around the broad topics in this agenda as well as specifics around their role in company strategy and risk evaluation, and the findings from their own board assessment.

In order to ensure they have the full picture, boards should request periodic updates from management about the executive level engagement practices: Do we regularly engage with our largest shareholders and understand their priorities? Do they have access to the right people? What is the board's position on meeting with investors? And perhaps most importantly, is the company providing investors with a clear, current picture of its performance, challenges, and long-term vision?

Be mindful of the company's vulnerabilities to activist investors. Activism need not be short-term nor undermine the board's strategic thinking – done properly it can help focus the strategy and drive enhanced corporate governance. Play the role of activists by looking at the company from the outside-in and prompting change from within to benefit shareholders.

Also expect investors to focus on how companies are adapting their strategies to address the economic and geopolitical uncertainties and dynamics shaping the business and risk environment in 2020.

Crisis readiness and response

Even the best-prepared companies will experience a crisis, and companies that respond quickly and effectively tend to weather crises better. Crisis readiness goes hand-in-hand with good risk management – identifying and anticipating risks and putting in place a system of controls to help prevent crises or mitigate their impact.

In addition to cultural risks, we are clearly seeing an increased board focus on key operational risks across the extended global organization. Help ensure that management is weighing a broad spectrum of what-if scenarios – from supply chains and the financial health of vendors to geopolitical risks, natural disasters, terrorist acts, and cyber threats. Is the company's crisis response plan robust and ready to go? Is the plan actively tested or war-gamed? Does it take into account the loss of critical infrastructure? Does it include communications protocols?

About KPMG's Audit Committee Institutes

KPMG's Audit Committee Institutes provide audit committee and board members with practical insights, resources, and peer exchange opportunities focused on strengthening oversight of financial reporting and audit quality and the array of challenges facing boards and businesses today - from risk management and emerging technologies to strategy and global compliance.

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