Directors Quarterly
Insights from the Board Leadership Center
July 2020

Pivotal months ahead

As we bring you this edition of Directors Quarterly, companies and their boards face the rare confluence of three seismic events—COVID-19, deep-seated social unrest, and a global recession—that are likely to change business and society in dramatic, and permanent, ways. The spotlight on corporate America’s leadership is bright—and continues to intensify—as employees, customers, and communities watch how businesses respond.

To that end, we share insights from our conversations with directors and business leaders about how they are helping their companies navigate the uncertainty and disruption, address stakeholders’ mounting expectations, and prepare for the new reality ahead.

Also in this issue, Eurasia Group Founder and CEO Ian Bremmer offers his view on the current geopolitical landscape and what to watch for in the third quarter. We look at trends from the recent proxy season, including the current and potential impact of COVID-19 on annual shareholder meetings, proposals, and engagements as boards and investors start planning for 2021. We offer suggestions from lead directors on maintaining a strong board/CEO relationship, which may be even more critical given the pressure to deliver results in an environment unlike one we’ve seen before. And EqualAI’s Miriam Vogel discusses bias in artificial intelligence and how boards can help root it out.

Finally, our financial reporting and auditing update highlights the impacts of COVID-19 on US GAAP financial statements and other developments that companies should have on their radars this quarter.

We hope you find this edition of Directors Quarterly helpful as you guide your organization through the challenging—and pivotal—months ahead.

Scott Flynn
Leader
KPMG Board Leadership Center
What’s our current geopolitical trajectory?

We are in the depths of the worst global economic contraction since the Great Depression of the 1930s. But what’s making this a lot more dangerous is that it coincides with the “geopolitical recession” that I have written about before. COVID-19 was inevitably going to be an epic global challenge. But the reason that there has not been more international cooperation in dealing with it is only tangentially linked to the disease itself.

It is the result of the fact that it hit us at a moment when the guardrails of the global order were already coming apart. International institutions had been structurally weakened through a combination of benign neglect and deliberate attack, great power rivalries had been dividing the world into camps based on competing world views, and societies were growing ever more polarized by a social media–fueled breakdown in civil discourse.

The coincidence of COVID-19 and the geopolitical recession is what makes this moment so challenging.

In 2008, the onset of the global financial crisis saw the United States take the lead in elevating the G20 from finance ministers talking shop to heads of government addressing the crisis. That brought around the table a much more representative set of global leaders than did the G7, which only includes the advanced industrial democracies. And China stepped up to the plate with a massive stimulus package that both sustained domestic growth in—and stimulated—a weak global economy. Global politics worked in 2008 and a worldwide depression was avoided.

In today’s crisis, geopolitical tensions are exacerbating the challenges of dealing with COVID-19. China and the US have clashed over the origins of the virus, while hard-liners in both countries have sought to politicize patriotic nationalism to promote decoupling of both the economic and political ties between the two. It’s not as if there was a shortage of flashpoints before the virus: the race for dominance in 5G, competing geopolitical priorities in several regions, particularly South and East Asia, and the balance of trade. Charting a course through the pandemic is undoubtedly harder with so many pre-existing fault lines and getting resolution on any those issues, in turn, is going to be significantly more challenging in a post-COVID world.

But there still may be something of a silver lining here. It is the kind of crisis that touches on all the critical political issues of the day—inequality, social safety nets, healthcare, global cooperation ... all the things that the world has been struggling with and failing to make enough progress. Take climate and environmental, social, and governance issues for instance; early signs are that we’re set to avoid the mistakes of the post-2008-2009 stimulus, which locked in energy and emissions-intensive growth pathways. Several countries, including Germany and South Korea, have announced big green stimulus packages and I expect more to come. So, I am not a total pessimist here.

What’s driving the current trends?

The current global contraction is unlike any the world has ever witnessed. It is the cumulative result of virtually all major countries going into economic lockdowns in order to minimize the health costs from COVID-19. This was the right thing to do. But it has put all political leaders into a very tough spot, balancing health concerns and a desire...
to minimize the economic costs. The fact is it’s a lot easier to shut an economy down than to restart it, especially when political leaders do not feel they have the time to wait out the disease. In this context, all politics are national, and having another country to blame can make for good domestic politics.

Crises have a habit of exacerbating pre-existing trends, and that’s true on several geopolitical fronts. For instance, pandemic relief efforts such as the supply of personal protective equipment (PPE) opens another front for China to expand its diplomatic and economic influence with Belt & Road countries. But that’s happening at the same time as several countries had already been growing wary of China’s direct and indirect influence, creating the conditions for a grand showdown in areas like 5G and advanced manufacturing with huge tail risks for companies and investors.

The same is true when it comes to state support for strategically important sectors. Pre-crisis, several countries had already been tilting towards guarding their key sectors like technology and energy more closely through investment screening, state aid, and trade controls. Now, the potential for shortages of key commodities—PPE most obviously, but also food and some manufactured goods—is further hardening those positions. Nowhere is that more apparent than in the case of vaccines where whichever country develops the “killer app” first is unlikely to make it available as a global commons but instead prioritize its own access, even to the point of exclusivity.

Whilst there’s considerable political debate on whether these are the right decisions to take, one advantage that presidential incumbents have over challengers is a far greater ability to shape the political landscape through policy action. So, I expect to see a lot of activity along these lines in the coming months as leaders try and make the most of the bully pulpit in a time of crisis.

**What should you watch out for in the next quarter?**

On COVID-19, the third quarter of 2020 will bring the first signals of what the shape of the economic recovery will be. A couple of things to watch: First, will employment pick up enough to offset the scaling back of government support programs? Second, will the inevitable uptick in COVID-19 cases that restarting economies will generate be so serious that people remain afraid to go out to stores and restaurants and cancel their summer vacations?

On US-China, the two issues to watch are whether the US goes ahead full bore with the proposed restrictions on technology exports and whether the “Phase One” trade agreement remains in place. So far, US actions on Chinese technology have been limited, specific, and targeted, as the administration remains focused on leveling the playing field with China for US exports. But that restraint could quickly come undone if the China hawks in the administration win the case that a harder line on both technology and trade issues is necessary to meet primary national security aims.

For China, facing a weak external market makes continued access to the US more important to its own recovery. That’s meant a carefully calibrated response so far, including best-efforts purchases of US goods under the Phase One trade deal. But that could all change if the US or its allies act more forcefully on China’s red line issues, including Taiwan, Hong Kong, and the South China Sea.

Finally, it will definitely be worth watching the political and social change underfoot from the death of George Floyd. In any year, the scale of protest action we’ve seen would be deeply significant; in an election year with an already deeply divided electorate, its importance can hardly be overstated.

Feel free to write to me, bremmer@eurasiagroup.net, if you want to go deeper on any of this or talk about a topic I didn’t have space to cover.

*The views and opinions expressed herein are those of the author and do not necessarily represent the views and opinions of KPMG LLP.*
Current quarter financial reporting matters

Coronavirus—The impact on accounting and financial reporting. The effects of COVID-19 are far-reaching and will continue to affect businesses, work environments, and our daily lives for the foreseeable future. The outbreak also has had an unprecedented effect on US GAAP financial statements.

CARES Act. On March 27, 2020, the president signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act, a $2 trillion coronavirus response aid package aimed at providing financial relief for individuals and businesses most impacted by COVID-19. As discussed in detail in the KPMG Quarterly Outlook, the CARES Act includes a number of provisions that also may significantly affect companies’ financial reporting under GAAP. We highlight two provisions:

— Government assistance. The Act provides direct government assistance through new and repurposed existing programs. These programs target a variety of companies, including air carriers, airport operators, healthcare providers, higher education institutions, and agricultural producers. The assistance may comprise varying forms of support, including favorable loans (some or all of which may be forgiven) and loan guarantees, payroll and payroll tax support, and reimbursement of healthcare-related expenses and/or lost revenue. Loans and grants obtained under these programs generally impose significant restrictions on the recipient and some require that it issue to the US Treasury stock warrants or other equity interests. Companies receiving government assistance in the form of grants will need to determine the appropriate guidance to account for them.

— Income taxes. The Act provides income tax relief, including: allowing carryback for net operating losses (NOLs); temporarily permitting companies to offset 100% of taxable income with NOLs (versus 80% before the Act); temporarily increasing the interest deductibility threshold from 30% to 50% of adjusted taxable income; accelerating refunds of any remaining alternative minimum tax carryforwards to the 2019 tax year from 2020 and/or 2021; and changing the depreciable life of qualified improvement property to 15 years, which makes it eligible for bonus depreciation.

Calendar-year-end public companies generally have recognized the effects of the changes in tax law in income from continuing operations as they have reported on the interim period that includes the March 27 enactment date. However, the new provisions may have an ongoing impact as judgments and estimates change with changing forecasts of the effects of COVID-19. For example, a company’s assessment of its valuation allowances and tax planning may shift based on actual results in the coming months.

SEC disclosure guidance related to COVID-19. On April 8, US Securities and Exchange Commission (SEC) Chairman Jay Clayton and Director of the SEC’s Division of Corporation Finance Bill Hinman issued a joint public statement that emphasized the need for robust disclosures about the current and future effects of COVID-19. They emphasized that a company’s disclosures about the effects of COVID-19 should provide as much information as practicable about its current state of affairs and future outlook, including: current operating and financial status, and strategy to assess, plan for, and address the effects of COVID-19; progress of its response efforts to COVID-19; and potential impact to operations and financial condition as the efforts to fight COVID-19 progress.

Examples of expanded disclosures include income statement and balance sheet effects; current liquidity position and expected financial resource needs; impact of COVID-19 on operations; company efforts and policies to protect the health and well-being of its workforce and customers; receipt of financial assistance under the CARES Act or similar programs; and the nature, amounts, and effects of financial assistance to the extent it materially affects, or is reasonably likely to have a material effect on, the company’s financial condition or operating results.

Companies are encouraged to provide robust, forward-looking disclosures—and those that do may avail themselves of the safe-harbor rules for such statements. Given the uncertainty in the current business environment, good faith attempts to provide investors and other market participants with appropriately framed forward-looking information would not be expected to be second guessed.
**Going concern.** Management must assess at each reporting period whether the conditions and events raise substantial doubt about a company’s ability to continue as a going concern within one year after the date the financial statements are issued or available to be issued (the “look-forward period”). The severity and prolonged effects of COVID-19 may significantly affect those assessments.

If substantial doubt is initially raised about the company’s ability to continue as a going concern, management must disclose conditions and events that raised substantial doubt, management’s evaluation of the significance of those condition or events or obligations, and management’s plans to alleviate the substantial doubt. If substantial doubt exists, this fact should be explicitly disclosed.

Although the look-forward period is one year, it may be appropriate for management to provide additional disclosure about the potential effect of known conditions and events that may occur beyond one year. These incremental disclosures are often required to be disclosed in accordance with other US GAAP requirements or SEC rules and regulations.

**Asset impairments.** As part of the overall analysis of the financial reporting impacts of COVID-19, companies may need to assess the recoverability of goodwill and other assets, including receivables and contract cost assets, inventory, indefinite-lived intangible assets, long-lived assets, and equity method investments. Goodwill is tested for impairment on an annual basis. However, goodwill must be tested between annual tests if an event occurs or circumstances change to indicate that it is more likely than not that an impairment loss has been incurred (triggering event). A company may need to test goodwill and other assets (e.g., long-lived assets, equity method investments, inventory) for impairment at the same time. If so, a company must perform impairment testing in a set order.

**Financial statement disclosures.** With the uncertainty and complexity in forecasting and accounting for the current and potential effects of COVID-19, adequate disclosure in the financial statements is critical. This may include disclosures about the going concern (ASC 205-40), risks and uncertainties (ASC 275), unusual items (ASC 220-20) and subsequent events (ASC 855). SEC filers also are required to make additional disclosures.

**Income taxes—Revisiting the valuation allowance.** Companies that are experiencing unexpected ordinary losses due to COVID-19 or capital losses due to its effect on the markets should determine whether those conditions result in the inability to realized deferred tax assets (DTAs). A valuation allowance is required for DTAs if it is more likely than not that all or some of the assets will not be realized. A company recognizes a change in the valuation allowance in an interim period through its estimate of the annual effective tax rate if the change relates to DTAs originating during the year or DTAs existing at the beginning of the year that are expected to be realized as a result of current year ordinary income. Otherwise, a company generally recognizes a change in the valuation allowance entirely in the interim period of the change.

**Other current quarter developments**

**SEC amends acquisition and disposition disclosures.** The SEC issued a final rule to assist companies in making more meaningful determinations of whether an acquired or disposed business is significant and to improve information that investors receive about acquisitions and dispositions of businesses. The rule amends Regulation S-X for acquisitions and dispositions of businesses, including real estate operations, and adds new Rule 6-11 for investment companies and business development companies. The final rule is effective on January 1, 2021.

**SEC and PCAOB issue joint statement on risk disclosures in emerging markets.** The SEC and PCAOB are constrained from providing regulatory oversight and enforcement of non-US companies and their management in emerging markets, including China. These agencies have issued a joint statement urging companies to disclose financial reporting and other risks associated with operations in these markets.

For more detail about these and other issues potentially affecting you in the current period or near term, see the KPMG Quarterly Outlook.
Seismic events are putting strategy, resilience, social responsibility to the test

The rare confluence of three seismic events—COVID-19, deep-seated social unrest, and a global recession—poses unprecedented challenges for companies and boards in the weeks, months, and perhaps years ahead. Few companies, if any, will come through these challenges thinking or operating the same as before—and every company’s strategy, resilience, and responsiveness to its stakeholders’ expectations will be put to the test.

As many of the directors and business leaders we’ve spoken to recently have emphasized, the stakes are high: much of corporate America is at an inflection point, there’s no playbook for many of the issues companies are now grappling with, and boardroom leadership will be pivotal to the outcome.

While each of these events poses a unique set of challenges for business leaders and boards, they are interrelated in at least one important respect: they all highlight a range of social issues that have long been unaddressed or ignored, and they put an even brighter spotlight on corporate social responsibility.

Just what is the company’s role and responsibility in society? Are companies doing enough to make real and lasting changes to combat systemic bias and racism? Are workers at every level valued as essential drivers of long-term corporate value? These questions have gained new urgency alongside the challenges of restarting and operating in a post-COVID-19 environment.

To understand how boards are addressing these crises simultaneously, we spoke with lead independent directors, hosted a series of virtual meetings with board and business leaders, and surveyed more than 300 directors. Five major themes emerged, which we highlight here to help boards focus their oversight and calibrate their boardroom conversations in the weeks and months ahead:

— In the near term (6–12 months), COVID will continue to redefine business as usual for nearly all companies—and their boards—regardless of industry, size, or geography. All leaders are dealing with significant disruption and uncertainty and will continue to grapple with how to reopen, the implications of managing remote workforces, accelerating digital transformations, building more resilient supply chains, and strengthening connections with customers.

— Boards are asking whether their companies are doing enough to make real and lasting changes to combat systemic bias and racism. CEOs and board members of leading American companies interviewed recently acknowledge the painful reality that the country—and corporate America—have not made enough progress and that there is still much work to be done. How effectively is the company using its financial resources, influencing public policy, and leading by example—“walking the walk”?

— Boards are encouraging their management teams to plan now for the longer term (12–24 months) when companies will begin to recover. As consumer demand bounces back for many companies, jobs are restored or created, general anxiety eases, and the new reality takes shape, it will be critical for leaders to understand the trajectory of the COVID-19 virus and the recovery path for the sector, be nimble, and have a vision for the new reality so they can assess their current positioning and adjust their strategies and business models to eventually thrive.

— With the view becoming clearer in hindsight, boards are beginning to focus on gaps and areas for improvement revealed by the COVID-19 outbreak. From the company’s crisis readiness, enterprise risk management (ERM) processes, and business continuity plans to the board’s understanding of the company’s strategy and risk profile and its working relationship with the CEO, boards are reassessing critical issues and processes impacting the board’s effectiveness and the company’s governance and decision-making going forward.

— Boards are encouraging their management teams to consider the implications of COVID-19 for business and society more broadly. What is the company’s purpose? What is its responsibility and commitment to each of its stakeholders—shareholders, employees, customers, supply chain, and the communities in which it operates? What environmental, social and governance (ESG) issues are critical to the company’s long-term success?

Watch for additional insights on these themes and our survey at kpmg.us.com/blc.
While the immediate impact of COVID-19 on the 2020 proxy season was the rapid and unexpected shift to virtual annual meetings for US companies, the effects on operations, disclosures, engagement, and shareholder proposals are likely to be more apparent in the months and years ahead.

“The impact next season will be profound,” said Pamela Marcogliese, partner, Freshfields US LLP. Joining KPMG Board Leadership Center (BLC) Senior Advisor Stephen Brown on the BLC June webcast, Marcogliese said that she expects shareholder proposals related to human capital management (HCM) and other environmental and social (E&S) issues to continue to gain traction in the coming year, amplified by COVID-19 as well as the renewed focus in the US on social justice issues as a result of the death of George Floyd.

Shareholder proposals
While the number of filings was highest for governance proposals related to shareholder rights and board structure and composition this proxy season, support increased year over year for E&S proposals on issues including political activity/lobbying, climate change, and HCM. An analysis of Russell 3000 companies by Institutional Shareholder Services (ISS) found that, when compared to 2019, fewer E&S proposals went to a vote this year—with a higher share of proposals that did go to a vote receiving majority support. According to Marcogliese, many proponents were willing to withdraw their proposals after issuers committed to making progress on climate-related issues.

Additionally, many large institutional investors and asset managers have expressed support for the framework offered by the Task Force on Climate-related Financial Disclosures as well as material nonfinancial metrics from the Sustainability Accounting Standards Board.

ESG shareholder proposals
Shareholder proposal filings by category and subcategory January 1, 2020–June 1, 2020

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Source: ISS, Freshfields, LLP
According to Marcogliese, the new and more informal US Securities and Exchange Commission (SEC) process for responding to no-action relief requests this proxy season garnered less attention than was initially anticipated due to the focus on COVID-19. Still, the SEC formally by letter or informally concurred with 111 out of 208 issuer requests to remove shareholder proposals from the proxy, according to Freshfields.

Of 468 directors and C-level executives surveyed during the webinar, 27 percent said that they expect a more significant discussion of workplace diversity and pay equity in upcoming disclosures and proxy statements as a result of COVID-19 and other issues, while another 27 percent said that they expect a re-evaluation of risk factors and competitors.

Shareholder proposals related to HCM disclosure, including worker safety and well-being and talent retention, were already an increasing focal point of investors—and the impact of COVID-19 is expected to intensify scrutiny of company responsiveness to those issues. A proposed amendment to Regulation S-K that would require a principles-based discussion of material HCM-related measures or objectives could also prompt more voluntary disclosure.

Of directors and C-level executives surveyed during the webinar, a combined 61 percent said that they were “satisfied” (40 percent) or “very satisfied” (21 percent) with their companies’ disclosures related to HCM issues as a result of COVID-19.

Proposals calling for the separation of the chair and CEO roles resurface every proxy season but rarely receive majority support. In many cases, investor concerns about the board’s leadership structure may be satisfied by the appointment of a lead independent director. However, Brown noted that those proposals appear to “have become more targeted and more personal,” and may increase next year as a way for investors signal unhappiness with board accountability.

Brown also said that he expects greater scrutiny of executive compensation and long-term incentive packages in light of COVID-19. “It’s an area where investors are now extremely knowledgeable, given their experience with say-on-pay votes over the past several years.”

“It’s an interesting question for boards, and compensation committees in particular, as they balance incentive goals while being mindful of more difficult workforce decisions management had to make,” said Marcogliese.

**Annual meetings**

The quick pivot to virtual-only meetings by many US companies wasn’t without challenges. Marcogliese noted challenges related to beneficial owners not being permitted to ask questions, technical difficulties related to registration and audio, insufficient time to ask questions, lack of identification of shareholders asking questions, and allegations of management cherry-picking questions.

While some companies will revert to in-person meetings when it is safe for people to gather, Marcogliese expects that companies that choose to continue with virtual meetings will be asked to focus on how to make them “as close as possible to in-person meetings in terms of participation, voting, and mechanics.”

Of directors and C-level executives surveyed, 33 percent said that they expect a return to in-person meetings, with optional virtual attendance, while another 33 percent said that they expect a significant shift to virtual annual meetings exclusively.

**Upcoming shareholder engagement**

“COVID-19 has crystalized issues around human capital management for shareholders,” said Marcogliese. “It has been and will be top of mind in engagements throughout the year—health and safety, executive compensation, diversity, furloughs, and layoffs. It’s critical that, as a board, you take a step back and talk about what matters, what is important to the company, and especially how the company communicates its actions.”

“Look at shareholder proposals and how they have been voted. This tells you something about your constituency,” said Brown. “Read what the trends are. And be aware of the views of other stakeholders who have become very active on issues such as the environment and health and safety. Their views are increasing in importance and relevance.”

Marcogliese says companies should have frameworks for approaching these issues heading into the next proxy season. “Think about them strategically, divorced from the specific issue at hand. Involve management and key constituencies in the discussion and ensure that board oversight is carried out,” she said. “Be proactive.”
As many boardroom leaders know from experience, achieving that “healthy tension” in the boardroom—where the board is a resource to the CEO and management team while maintaining objectivity, independence, and skepticism—isn’t easy. It’s also clear that striking that critical balance will only become more challenging and more important given the mounting complexity of the business environment and the tremendous pressure on boards and CEOs to deliver results.

The challenges resulting from COVID-19—growing social unrest, economic and geopolitical uncertainty, and investor demands to hold CEOs and boards more accountable for performance—all place possible strains on the board/CEO relationship. Earlier this year, we interviewed several lead directors to better understand their role in maintaining a strong board/CEO relationship. And while these interviews were conducted prior to the COVID-19 outbreak and the wave of social unrest, the areas of focus that they emphasized have likely become even more critical:

— Insist on candor and transparency, which are key to building a culture of trust and confidence. The CEO sets the tone for management’s engagement with the board and committee leaders, and the board’s expectation is that “there will be no surprises from management.” At the same time, management should expect no surprises from the board. To help ensure open and productive discussions, the lead director should draw out any concerns and communicate them to management before the board meeting to give management an opportunity to address them.

— Set clear expectations that the board’s role extends beyond compliance and monitoring, and includes ongoing engagement in strategy, exposure to the organization’s talent, and serving as a resource for the CEO and management. The emphasis on the board’s fiduciary and compliance responsibilities often overshadows its responsibility to serve as a strategic resource to the CEO and senior management team in creating long-term value. “There are probably a lot of CEOs who don’t view the board as a resource or as adding value. That’s a core job of a lead director—enabling the board to be a resource to the CEO, and getting the CEO to see the value there.”

— Ensure that the CEO and board agree on how the firm will be run. The Business Roundtable Statement on the Purpose of a Corporation, coupled with investor demands for companies to develop their own statements of purpose, raises the stakes for the board and the CEO to agree on the company’s purpose and how it will take stakeholder considerations into account in its efforts to create long-term value.

— Assess whether the board’s composition and culture enable it to serve as a resource for the CEO and management. “Skill sets are only part of the equation. It’s also about culture. Do we have people who understand their role, which is to provide oversight and advice? That’s different than taking the board discussions down a personal path. The lead director needs to counsel directors who may be undermining the desired culture.”

— Insist that the CEO take the lead in driving the right relationship with the board. The CEO should set the tone and help build a relationship of trust with the board—and within the board—and to help make the board more productive and efficient on the issues that are most critical to the company’s long-term success, such as strategy, risk management, talent, management succession, and the culture throughout the organization.

— Consider how the lead director, as the point person for the independent directors, can facilitate a healthy board/CEO relationship. The lead director should meet with the CEO between board meetings—either telephonically or in person—to determine which of the issues that the CEO is managing need to be shared with the board. Additionally, while there is no one-size-fits-all approach to executive sessions, timely feedback to the CEO will help reduce stress on the part of CEO and management.
Hallmarks of a healthy board/CEO relationship

— Candor and dealing with the facts—a culture of trust and confidence among the board and CEO and management team

— Regular communications between the CEO and board (e.g., at least monthly letters from the CEO) and between the CEO and the lead director (e.g., at least monthly phone calls/meetings)

— A continuous testing of strategy1

— Board exposure to talent below the C-suite to understand management’s capabilities and identify future leaders

— Free flow of information between the CEO/senior management and the lead director, and between senior management and their respective committee chairs

— Good boardroom dynamics, as well as director confidence in the lead director and committee chairs that the collective views of the board are being heard and considered

— A healthy relationship between the lead director and the CEO—where both want the same thing, for the company to be successful—and both recognize that “this is business” and consider the optics.”

These and other recommendations for lead directors are explored in more detail in our white paper, Under pressure: Maintaining a strong board/CEO relationship.

For more resources for board leaders, visit KPMG’s Lead Director Initiative.

1 See Facilitating the board’s engagement in strategy from the KPMG Board Leadership Center.
Leading into the future

A board lens on resilience, recovery, and the new reality

Our June 9 Virtual Directors Roundtable focused on the outlook for the global economy, business, and the future of work in a world being reshaped by COVID-19.

The event included:

— A discussion with Ian Bremmer, Founder and President, Eurasia Group and GZERO Media, and Constance Hunter, KPMG US Chief Economist, on the economic and geopolitical factors driving business and boardroom discussions as companies mobilize toward recovery and build the resilience critical to long-term performance.

— A conversation with Derek Thompson, Staff Writer, The Atlantic and Chip Bergh, President and CEO, Levi Strauss & Co., about his views about how current events are affecting business.

— A panel discussion, moderated by Thompson, on how COVID-19 has accelerated the future of work with Tracy Keogh, CHRO, HP, and Sarah Kaplan, Distinguished Professor, Gender and the Economy, Rotman School of Management, University of Toronto.

To watch the replay, visit boardleadership.kpmg.us.

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Founder and President, Eurasia Group and GZERO Media

Constance L. Hunter
Chief Economist, KPMG US

Sarah Kaplan
Professor, Rotman School of Management

Tracy Keogh
Chief Human Resources Officer, HP

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The trifold challenge of the COVID-19 outbreak, sudden economic fragility, and increased focus on social justice in the US has placed a spotlight on the use of artificial intelligence (AI) as an enabler of decision-making.

As AI moves to the frontlines of how businesses and government interact with customers and communities, understanding the process for how AI is developed and deployed becomes even more critical for boards. In particular, to what extent is bias—conscious or unconscious—built into the strategy, development, deployment, and outcomes of AI-enabled processes? What assurance does the board have that the company’s AI process effectively evaluates the potential for bias in the data set, on the programming team, or even in the task that the AI is designed to enhance?

For insight on the challenges related to debiasing AI, the KPMG Board Leadership Center (BLC) interviewed Miriam Vogel, president and CEO of EqualAI, a nonprofit focused on reducing unconscious bias in the development and use of AI. Vogel is also an adjunct professor at Georgetown Law, where she teaches technology law and policy. She spent several years in US government, including as associate deputy attorney general and a senior policy advisor to the White House.

BLC: Bias in AI exists across the value chain—from strategy to talent to data to outcomes. From your perspective, where is bias most pernicious or hardest to observe?

Vogel: An algorithm is like an opinion—bias enters from the moment a person frames the question that the AI program is intended to solve, and each step thereafter. Bias enters through each of the human touchpoints. It can enter through the product design, training data, the work of the development team, and in the testing. Unfortunately, bias can be equally pernicious and hard to detect at each of these touchpoints. Perhaps the hardest challenge is that it can emerge—and be sustained—even with good intentions. We’ve seen this in healthcare, for example, with AI-based training data leading to race-based inequities in care for patients. When designing products for the boomer generation, products have often failed, according to the MIT Age Lab, because they were targeted to the ‘elderly,’ while according to The Pew Research Center, only 35 percent of people age 75 or older consider themselves ‘old.’ These are mistakes that caused harm to patients and companies’ bottom lines, respectively, that would have benefitted from alternate perspectives in the design and testing stages.

On the bright side, bias can also be tested for or detected at each of these touchpoints. Doing that requires the right mindset and a diverse set of perspectives to widen the lens of your perspective.

BLC: From your experience, how can corporate boards challenge or assess how the company is tackling bias in its use of AI across the enterprise?

Vogel: Board members are in the best position to help ensure that their company avoids the harms of biased AI. I would argue that it is embedded in their fiduciary duty as part of their responsibility to help ensure that the company avoids harms and liabilities. In this realm, harms could range from the physical harms of an AI-driven machine—for example, an unmanned vehicle that cannot detect persons of color with reliable precision—to the harms that could impact their brand, employee morale, or legal liability. Boards should understand how the company’s leadership is...
ensuring that AI has been tested—and that it has done so repeatedly, which is necessary given that AI learns new patterns and, thus, biases over time. The board’s support—or motivation—for leadership’s attention to this issue is also critical because we have seen that this process only works when the top levels of leadership are committed to rooting out bias in AI.

Board members can start by asking questions: What are we doing to assess the bias in our AI systems? How are we ensuring diversity of perspectives in the design, development, and testing of these programs? How often do we test for bias? What is our strategy for identifying and addressing bias in our AI programs? You can also find third parties, like EqualAI, to help your company take on these challenges.

**BLC:** AI and related technologies, such as machine learning and robotic process automation, are often based on proprietary algorithms and data sets. How would you build greater transparency into AI processes while protecting intellectual property?

**Vogel:** Ideally, we would have a standard set of requirements, for instance in the form of a nutrition label, so that users of the data and/or AI program on which it is built would know the gaps in representation and would be able to account for them. This is also an area where government or nonprofits can play a role in creating guidelines so that boards and corporate leadership are clear on expectations and protections.

**BLC:** What industries or sectors do you see as most challenged by bias in AI? What are some discussions or levers that boards can pull to help move these companies forward?

**Vogel:** AI has become omnipresent in our personal and work lives, and as a result, I think most industries are now facing the challenge of bias in their AI. This is a clear, known challenge for companies creating AI programs, but it is likewise a problem for those consuming the AI programs. Bias in AI is a well-documented concern in the credit and mortgage lending space, but can equally inhibit efforts to build diverse teams at companies using AI for hiring and employee evaluation. Boards can continue to demand diverse candidates on slates for hires and especially for promotions to help ensure there are broader perspectives in each of the human touchpoints of the AI lifecycle.

A 2016 report by McKinsey found that women made up 37 percent of entry-level roles in technology but only 25 percent reached senior management roles and 15 percent reached the executive level. And these percentages are even smaller for racial and ethnic minorities. So focusing on diversity in retention and promotion is even more important. AI in the hiring space could be growing this problem exponentially.

Ensuring there are candidates of different gender, age, geographic origin, and so forth can help ensure a broader set of questions are asked at each of the human touchpoints of AI creation. The board can help to ensure that AI is built by and for a broader cross-section of our population to reduce liability but equally important, to ensure that products are as popular in rural and middle states as on the coasts, and that women, who by some estimates drive 70–80 percent of all consumer purchasing, through a combination of their buying power and influence, are being considered in the design and marketing of products.

**BLC:** The Federal Trade Commission (FTC) recently published a notice regarding the use of AI in consumer-facing business decisions. What do you see as the role of government and other standard setters regarding the use of AI?

**Vogel:** Government should be industry’s partner on this. The FTC guidance was on point. It is critical that the government outline the expectations and clarify liabilities now, while AI is being built. Five years down the road when AI systems have been more integrated into systems and organizations, it will be much more complicated. We should advise companies as they build and buy AI programs now because it will be a much larger burden to expect companies to unravel the systems they’ve built years down the line.

**BLC:** Final thoughts?

**Vogel:** Bias in AI stems from bias in humanity. It is rooted in our survival, helping us decide when to cross a busy street or trust a potential partner, but the unconscious biases are what need to be checked—in both humans and machines—to help ensure they are serving our needs and values, not undermining them. I have found that the best way to address unconscious bias is to bring diversity of thought to the table. In the future, there will be AI programs that will help us identify and address bias in AI and related challenges, but these programs will also require diversity of thought and perspectives to build them effectively. And, at the end of the day, they will not eliminate the need for humans to routinely check to help ensure the new patterns that the AI program learns are in line with expectations and legal compliance. We are all constrained by the limits of our imagination, so the more perspectives we include at each stage of the process, the better our AI and related products will be.

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