DIRECTORS QUARTERLY

Insights from the KPMG Board & Governance Institute

January 2020

Foreword

For many Boards, the new year and new decade got off to a rocky start as they face the impact of the Coronavirus, in addition to addressing challenges relating to geopolitical risks, climate change, economic uncertainty and business disruption.

Refreshingly, the recently held World Economic Forum in Davos focused on 'Stakeholders for a Cohesive and Sustainable world'. Boards should not feel alone as they navigate this uncertain world – as the ecosystem needed to create change is coming together. Governments, regulators, customers, employees and suppliers are demanding more from corporates in terms of long-term sustainability.

For these reasons, we have curated this Directors' Quarterly to focus on geopolitical risks, climate governance and key priorities for Boards and Audit Committees.

We hope you find this helpful as you consider your Board priorities for the year ahead.

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WHAT'S INSIDE

Geopolitical Risk Outlook 2020

What should you watch out for in 2020?

2020 is a tipping point. Geopolitical risks have been intensifying for nearly a decade, but we have yet to experience a true international crisis. Global trends have been strongly favourable, but that's now changing.

The following 10 geopolitical risks are most likely to play out over the course of the year:

1. **U.S. domestic politics**: In 2020, US is heading into a presidential election that could be contested by both sides, leading to legislative and economic challenges.
2. **"The Great Decoupling"**: China and the U.S. are cutting their technological ties, and in 2020 this may move beyond strategic tech sectors such as cloud computing, and 5G into broader economic activity.
3. **U.S.-China tensions**: Economic and security tensions are likely to intensify due to growing U.S. and China conflict.
4. **The influence of multinational companies:** Regulatory and trade restrictions will lessen corporates' impact on critical issues such as climate change, poverty reduction, and trade liberalisation.
5. **Pressure on India's Narendra Modi:** Social reforms by Prime Minister Narendra Modi may lead to more state-level oppositions challenging the central government. This will likely slow down India's economic growth.
6. **Geopolitical Europe:** European officials now believe the EU should defend itself more aggressively against competing economic and political models. This is likely to create regulatory and economic risks for other countries.
7. **Politics versus economics of climate change:** Corporations have to choose between commitments to reduce emissions and their own business interests. This is increasing the risks of economic disruptions and political instability.
8. **Tensions with Iran and the Middle East:** U.S. foreign policy toward the major Shia-led nations in the Middle East will create significant regional risks in 2020, to the detriment of the regional political and economic order.
9. **Latin America's instability:** Citizens in Latin American countries are angry about issues ranging from corruption, low-quality public services, to austerity measures. The intensity of protests will likely escalate and coupled with economic malaise, these pose 'clear and present' threats to regional stability.
10. **Turkey:** As US congressional sanctions will likely take effect in the first half of 2020, this will further strain the Turkish economy. State-owned banks may be ordered to intervene in the market, causing Turkey to face a significant risk of capital controls this year.

Source: Eurasia Group's Top Risks For 2020 (Read here)

Building effective climate governance

Extreme weather events, climate-related disasters and a series of international strikes and protests – these have been pressurising businesses to rethink their broader social responsibilities, particularly climate change. A growing number of regulators around the world are now considering incorporating climate risks into their supervisory frameworks. Christine Lagarde, for instance, as the new head of the European Central Bank, is advocating for climate change to be a "mission-critical" priority for ECB.

Climate change is a complex topic and for many time-pressured board members, their responsibilities around climate change remain unclear. To compound matters, there are several sustainability and climate reporting frameworks for companies, creating a confusing reporting landscape. While most companies have climate-related disclosures, they seldom report on the related financial implications.

The Task Force on Climate-related Financial Disclosures (TCFD), established in 2015 by the Financial Stability Board (FSB), seeks to harmonise climate reporting. The TCFD recognized climate change as a threat to the stability of the global financial system and is working to improve disclosure of climate-related financial risks by companies to their investors, lenders and insurers through its framework to calculate their exposure to climate risks. The global industry-led initiative is gaining traction, with existing frameworks such as Climate Disclosure Standards Board and CDP, aligning their methodologies with TCFD.

With more government regulation on the horizon and rising investor concerns over climate change, boards need to start tabling climate-change risks and opportunities as an agenda item in their boardroom discussions. It is important for board members to engage and to understand their responsibilities to shareholders and the wider stakeholder community.

To govern climate risks and opportunities effectively, boards need the right tools. At its 2019 annual meeting in Davos, the World Economic Forum (WEF) published guidance for corporate boards on how to establish climate governance at their companies. Some of the common questions board members may have on climate governance and a summary of the WEF guidance are as follows:

What is 'climate governance'?

Climate governance is the structure of rules and processes a company puts in place to manage its responses to the financial risks and opportunities of climate change. There are two primary types of climate-related financial risks for business:

- Physical risks, i.e. the risk that physical effects of climate change - such as hurricanes, floods, droughts and sea level rises - could seriously damage or disrupt the company's operations and/or supply chain, and therefore reduce its capacity to operate profitably or, in extremis, its ongoing sustainability.
- Transitional risks, i.e. the risk that the company fails to anticipate and navigate the regulatory and market transformations brought about by the global transition to a low-carbon, clean energy economy.

Climate risk in this context refers specifically to the financial risks the company and its shareholders face as a result of climate change. It does not refer to the risks society at large faces from climate change.

Why is climate governance a board responsibility?

Climate change is a potential strategic risk to companies, and it is therefore the duty of the board to identify and manage it in the same way as any other strategic risk.

Whether or not climate is specified as a fiduciary duty under the corporate governance code, directors have the duty to promote the success of the company and to act with due care, skill and diligence. Failing to identify, assess, deal with or disclose material climate risks is a potential failure of corporate governance.

Board members or their companies may expose themselves to legal action if they fail to identify, respond to or disclose material climate risks. The risk of exposure is particularly high for directors of companies that operate in sectors that are especially vulnerable to climate risks, namely energy; transportation; agriculture, food and forest products; materials and buildings and financial services.

What does the WEF guidance advise?

The climate governance guidance from WEF covers 8 principles:

1	Climate accountability on boards	The board should take responsibility for ensuring the company's long-term resilience to climate risks.
2	Command of the subject	Board should be properly informed about climate-related risks and opportunities and able to make relevant decisions.
3	Board structure	Board should implement the right board and committee structures to ensure that climate risks and opportunities are understood, managed and reported.
4	Material risk and opportunity assessment	Board should ensure that management fully identifies climate-related risks in the short, medium and long-term, assess their materiality, and takes appropriate action according to the materiality of the risks.
5	Strategic integration	Board should ensure that management factors material climate-related risks and opportunities into the company's strategy, risk management process and investment decisions.
6	Incentivisation	Board should align executives' incentives with the long-term success of the business.
7	Reporting and disclosure	Board should ensure that the company discloses its material climate-related risks, opportunities and strategic decisions to all stakeholders .
8	Exchange	Board should stay informed on current best practice in climate governance by maintaining dialogue with peers

On the 2020 Board Agenda

Drawing on insights from our work and conversations with directors and business leaders, we have highlighted some key issues that boards should note as they approach and execute their 2020 agendas.

STRATEGY (PERFORMANCE)

1 **Identify geopolitical risks and opportunities and incorporate a geostrategy.** Companies may need to invest more time and money in scenario planning and stress testing.

2 **Address sustainability and climate change risks.** Evaluate how climate-related risks and opportunities could affect the business in different scenarios.

GOVERNANCE (CONFORMANCE)

3 **Approach cybersecurity and data privacy holistically – as data governance.** Establish a holistic approach to data governance which encapsulates cyber security

4 **Build the talent in the boardroom around the company's strategy and future needs.** Recent changes to corporate governance codes require companies to strengthen director independence.

5 **Help set the tone and closely monitor the culture throughout the organisation.** Take a hard look at the board's own culture.

6 **Take greater ownership of tax-related issues.** Proactively and explicitly oversee tax risk and evolving tax requirements.

7 **Ensure that a robust crisis response plan is in place.** Ensure that management is weighing a broad spectrum of what-if strategic, operational and financial scenarios.

FUTURE PROOFING (TRANSFORMATION)

8 **Link boardroom discussions on strategy, risk and global disruption.** Ensure the enterprise risk management process is dynamic, relevant and connected to the company's strategy

9 **Build a governance framework for innovation.** Create that balance, where the current business exploits and innovation co-exists.

10 **Ensure a workforce transformation strategy and a robust leadership pipeline.** Ensure that workforce transformation is not lagging far behind technological transformation.

Click here to read the full agenda.

On the 2020 Audit Committee Agenda

Drawing on insights from our work and conversations with directors and business leaders, we have highlighted some key issues that audit committees should note as they approach and execute their 2020 agendas.

1 **Maintain (or regain) control of the audit committee's agenda.** Keeping it focused will require discipline and vigilance in 2020.

2 **Assessing the scope and quality of ESG disclosures.** The audit committee can encourage the board and management to reassess the scope and quality of the company's ESG reports and disclosures.

3 **Sharpen the company's focus on ethics and compliance.** The reputational costs of an ethics or compliance failure are higher than ever.

4 **Understand how technology is impacting finance talent, efficiency and value add.** Technological advances are opportunities for the function to reinvent themselves and add greater value to the business.

5 **Monitor corporate reporting as well as progress on implementing new standards.** Check that management adequately discloses known or reasonably estimable information relevant to the adoption of new standards in the FY 2019 financial statements.

6 **Reinforce audit quality by setting clear expectations for the auditor.** Probe the audit firm on its quality control systems and talent attraction and retention policies.

7 **Ensure internal audit is independent, adequate, effective and focused on the key risks.** Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed.

8 **Review quarterly reporting and continuously disclosures.** ACs on exempted companies may want to evaluate the pros-and-cons of QRs and be aware of amendments to continuous disclosures requirements.

Click here to read the full agenda.

Mark your calendar

KPMG BGI Directors Roundtable: Climate Change Risks
20 January 2020

Join us for an exclusive directors roundtable to discuss and debate the extent to which companies can evaluate the impact of climate change risks on their business and disclose the financial impact. A two hour roundtable featuring Cherine Fok, Director KPMG Sustainability Services and Lau Kam Yuen, Head of KPMG Governance & Risk.

Please contact Emilie Williams for details.

KPMG-SID: AC Pit Stop (Intangibles in a Tangible World)
13 February 2020

Join us for the SID AC Pit Stop focusing on the role of audit committees in assessing and evaluating intangible assets. Jamesey Laya, KPMG Partner will lead this session exclusively for audit committee members.

To register, visit *SID website*

SID-KPMG: Best Risk Management Award Briefing
3 February 2020

Join us for an event hosted by SID to highlight the approach taken for the Singapore Corporate Awards Best Risk Management Award category (evaluated by KPMG). Irving Low, Head of Advisory KPMG in Singapore will present the key attributes of risk management practices and disclosures. A panel of prominent directors and risk professionals will join in.

To register, visit *SID website.*

SID-KPMG: Board Risk Committee Chairmen's Conversation
21 April 2020

KPMG, together with SID, will host an exclusive luncheon session for Board Risk Committee Chairmen. The session will focus on discussing and debating the role of the BRC in evaluating the key risks and opportunities related to customer experience.

By invitation only. Please contact Emilie Williams for more information.

About KPMG Board & Governance Institute (BGI)

The KPMG Board & Governance Institute (BGI) champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programmes and perspectives — including KPMG's Audit Committee Institute (ACI) and more — KPMG BGI engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, KPMG BGI delivers practical thought leadership — on risk and strategy, talent and technology, globalisation and compliance, financial reporting and audit quality, and more — all through a Board lens. Learn more at http://kpmg.com.sg/bgi.

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