What to know about civil rights audits

Q&A with Ronald Machen

KPMG Board Leadership Center

In the aftermath of the murder of George Floyd and others, many companies made public statements on and commitments toward social justice. During the proxy season that followed, shareholders began filing proposals requesting that companies conduct civil rights or racial equity audits in an apparent effort to hold issuers accountable for those commitments.

In 2021, the year such proposals debuted, 13 were filed and none received majority support. In 2022, at least 40 companies received such proposals during the proxy season. Eight received majority support and a number of others were withdrawn—in some cases, following negotiations with the proponent. Some of those companies have already announced plans to conduct an audit.[1]

Before shareholder proposals were filed on this subject, a handful of large companies had conducted civil rights audits or reviews in response to publicized reports of discrimination. For example, in 2016, Airbnb conducted an audit after hosts and guests reported they were discriminated against due to their race, sexual orientation, and gender identity when attempting to book listings.[2] Interest in these audits over the last two years has grown, even absent such public incidents. Against the backdrop of this larger movement and the push for stakeholder primacy, these audits may be viewed as a means for companies to demonstrate their commitment to upholding civil rights and racial equity through an examination of their policies, practices, and impact on internal and external stakeholders.

To gain more insight about such audits and the board's oversight role, the KPMG Board Leadership Center (BLC) spoke with Ronald Machen, partner and co-chair of the White Collar Defense and Investigations Practice at WilmerHale and lead author of *How to Advance Corporate Diversity in Compliance with the Law*, a toolkit for companies dedicated to improving diversity and addressing systematic bias while minimizing legal risks.

Ronald Machen

Below is an edited excerpt of the conversation.

KPMG BLC: Is there a difference between the terms "racial equity audit" and "civil rights audit"?

Ronald Machen: Among companies conducting these audits, some are terming them "civil rights" audits while others are terming them "racial equity" audits. However, there is a distinction. The term "civil rights" is generally understood to be a U.S.-based term that encompasses protection from discrimination on the basis of race, sex, sexual orientation, religion, disability, and other protected classes. Civil rights audits are thus understood to evaluate a company's impact on all groups that have been historically subject to discrimination—including, but not limited to, on the basis of race and sex. Racial equity audits, on the other hand, are more specifically focused on a company's impact on groups that have been historically subject to discrimination on the basis of their race. And while the term "audit"—or "assessment," which is sometimes used—is not a defined term in this context, at bottom it means an examination of the impacts of a company's internal and/or external practices.

[1] Tania Faransso and Andrew Stauber, 2022 Proxy Season Review: Increased Shareholder Focus on Racial Justice, Wilmer Cutler Pickering Hale and Dorr LLP, June 9, 2022.

[2] Laura W. Murphy, Airbnb's Work to Fight Discrimination and Build Inclusion: A Report Submitted to Airbnb, September 8, 2016.

BLC: Could you talk about the purpose of a civil rights or racial equity audit and how companies may benefit from conducting such an audit?

Machen: Today, it's routine for companies to say they're committed to DEI [diversity, equity, and inclusion], but how do you demonstrate that? Companies often will need to take a step back and evaluate their policies and practices to determine whether they are actually promoting DEI internally and externally. Unintentionally, a company's policies and practices might be tainted by implicit bias that is not apparent but that has an adverse impact on the hiring, promotion, and retention of diverse talent throughout the organization. The NFL's Rooney Rule, for example, was adopted to ensure that at least one diverse candidate was considered when hiring for head coaching positions. This was done because even when those who are making hiring decisions are not engaging in intentional discrimination, implicit bias and other factors could be hindering progress on the DEI front.

After the murder of George Floyd, many companies made statements on racial equity, including commitments to donate money to and to promote equity-focused causes. However, the question has become whether those companies actually fulfilled their promises for promoting a fair and inclusive workplace as well as a more inclusive and just society at large. To answer these questions, organizations are starting to examine not only whether they have followed through on their own commitments but also whether the initiatives they have undertaken have had the desired impact. A civil rights or racial equity audit may help a company evaluate how it is doing in meeting its public commitments—not just to its own internal workforce but to its external stakeholders, such as its customers, franchisees, and suppliers.

Among companies undertaking these audits, it is typical to engage a third party—usually a law firm—to conduct the audit. There is a lot of value in this. A third party, particularly one that has civil rights expertise and relationships with the civil rights community, can bring credibility to the audit. And, importantly, a law firm can conduct the audit under privilege to protect the results of the audit from discovery in litigation.

BLC: Generally speaking, what types of mandates have you worked on? How might the focus of these audits vary by industry?

Machen: The particular focus of an audit depends on the nature of the company's business. It also depends on the specific issues the company is trying to address. An audit may include internal components—such as examining policies and practices with respect to a company's workforce—and external components, with a focus on the company's impact on external stakeholders. Internally, an audit might look at workforce policies and procedures, talent management processes, and internal DEI efforts. The question is whether a company is living up to what it has said it is doing and engaging in efforts to meet the goals it has set for itself. Many companies have stated a goal of developing an inclusive and diverse workforce but in order to do so, they must first understand where the gaps are within your organization and then come up with a plan to resolve them. For example, is a significant percentage of the workforce composed of persons of color but only a small percentage of company leadership? An audit may help companies identify areas such as these for improvement and ensure that there are policies and practices in place to address those areas going forward.

In addition, an audit will often examine a company's impact on external stakeholders—including suppliers, franchises, customers, and shareholders. For example, an audit might assess a company's efforts to promote diversity among its suppliers. Or, an audit may look at customer experience—whether the company is creating an inclusive experience for its customers. A tech company may need to consider the impact of its products and platform on consumers, including by looking at any bias in artificial intelligence, whereas a financial services company may need to look at its lending and investment business lines through an equity lens.

Every company is unique, and we work with our clients across an array of industries to identify and scope audits based on their specific business, as well as any relevant issues they are facing as an organization.

BLC: What do you think has prompted the increase in interest for civil rights/racial equity audits this past proxy season? What have you heard from clients about what their shareholders are asking for in regard to civil rights audits?

Machen: It's not surprising that we began seeing proposals for civil rights and racial equity audits during the 2021 proxy season, following George Floyd's murder and the momentum of the Black Lives Matter movement. In fact, many of the proposals we saw in 2021 and 2022 explicitly referenced recent events in explaining the basis for the proposed audit.

The shareholder proponents that have been most active in this space have made clear that they view these audits as a way to identify and remedy any adverse impacts of a company's business, and to keep companies accountable for statements and commitments they are making to the public regarding equity and inclusion.

BLC: What steps can boards and management teams take to protect civil rights and racial equity at their companies? What should board members seek to understand about these issues at their companies and how they fit into the broader picture about demands for greater transparency and accountability on DEI, bias in AI, corporate culture, etc.?

Machen: Companies should consider their options for proactive engagement. They shouldn't wait for shareholder proposals to engage with these issues. And they shouldn't assume that, if a proposal for an equity audit has failed, they won't face another proposal next proxy season. This trend is not going away.

Companies may want to voluntarily consider conducting an equity audit—even when they haven't yet received a shareholder proposal or when a proposal has failed. Doing this voluntarily gives a company the flexibility to control the scope and timing of an audit.

At a minimum, companies should focus on getting their house in order. They should ensure that any statements or commitments they are making on ESG are consistent with their practices, think through any areas of the business that require review through an equity lens, and get the resources in place to address issues that arise.

Companies should also pay close attention to sentiments among shareholders, particularly institutional shareholders who might have made public statements on these issues recently. Companies should establish an open dialogue with shareholders to prevent unanticipated criticism. Ideally, companies should not be hearing about shareholder concerns for the first time when they receive a shareholder proposal. Instead, there should be ongoing communication and engagement so that companies have visibility into any concerns that are percolating. This engagement should be year-round so that there are no surprises leading up to the proxy season.

BLC: How involved is the board in determining whether to conduct a civil rights audit? What do you recommend the board and management consider when weighing this decision? What is the board's role in ensuring the audit is carried out effectively?

Machen: Every situation is different but if a company is conducting an audit as a result of a shareholder proposal, the contours of the audit are typically negotiated with management. Management will report to the board and provide updates on the audit, but the board will generally take a hands-off approach.

For any audit, the board and management should ensure that the third party that conducts the audit has a commitment to civil rights issues and understands the civil rights community.

BLC: What are the risks to conducting a civil rights/racial equity audit that the board should consider?

Machen: One risk is that external stakeholders may be critical of the audit and its scope—and may demand that the company do another audit. There is also the risk that the audit will result in findings that are less than flattering. As I mentioned, one consideration is whether the company that wishes to perform the audit should do so in a privileged setting in order to prevent the full audit results from being discoverable in any ongoing or subsequent litigation.

BLC: How do you foresee civil rights/racial equity audits evolving going forward?

Machen: We don't see this trend dissipating any time soon. We expect to see continued momentum for shareholder proposals of this kind, particularly given the success of these proposals during the 2022 proxy season. And we expect that the key shareholder proponents in this space will remain active, and that institutional investors will remain focused on this issue.

As we saw in the 2022 proxy season, we expect that some companies will engage in negotiations with shareholder proponents and ultimately conduct an audit, rather than risk facing a successful vote. And we expect that other companies will consider conducting a voluntary equity audit in the hopes of preempting future proposals and retaining more flexibility to control the scope and timing of an audit.

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