# Addressing the "S" in ESG

Forensic & Integrity Services

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Building a better working world

Part 1 in the Forensics "S" in ESG series

## Now

Historically, through Corporate Sustainability Reporting, companies have embraced a range of topics, often on a voluntary basis. Environmental, social and governance (ESG) reporting changes the tone to a more mandatory, regulated framework with significant penalties for non-compliance or worse, false reporting. For several years, in response to increased regulator, shareholder, and employee attention and expectations, companies have shifted focus to ESG reporting. Much of this attention has centered around measuring environmental impact and progress against a company's stated environmental goals. Equally important is attention around the "S" in ESG.

While environmental issues dominate the public debate, they are not the only part of ESG receiving close attention from stakeholders. Lawmakers and regulators around the world continue to raise expectations on companies through new laws like the US's "End Human Trafficking in Government Contracts Act of 2022" and the "Uyghur Forced Labor Prevention Act"; the EU's proposed "Corporate Sustainability Due Diligence Directive" and "EU Forced Labor Product Ban"; and the changes to the US "Customs Trade Partnership Against Terrorism – Trade Compliance Handbook" which require a social compliance program to mitigate forced labor risks. Also, regulators are looking to laws already on the books such as the Trafficking Victims Protection Act (TVPA) of 2000 that sets a broad prosecutorial focus on trafficking issues and the National Defense Authorization Act (2013) that requires governement contractors to certify no party to federal grants will participate in or support human trafficking. Through the Corporate Sustainability and Reporting Directive, the EU mandatory financial and non-financial reporting on "S" issues is already underway.

Thinking about how to define and measure social progress raises the question of organizations' relationships with their workforce, society and politics. Companies' "S" focus largely appears to be on diversity, equity and inclusion (DEI) metrics. While the focus on DEI issues is certainly important, other social issues such as forced labor, trafficking and modern slavery are additional risk areas to be considered in an effective compliance program.

## Next

In the Forensic & Integrity Services practice of Ernst & Young LLP, we have seen a dual focus from some clients: how to drive business through social measures and how to manage the risks posed by the increased attention to social activities — specifically, their company's relationships with its employees, contractors and third-party supply chain (workforce ecosystem).

Most industries face human rights risks through their workforce and especially where the workforce performs manual or physial efforts. As a result, many industries facing increased risks include manufacturing, consumer products, agriculture, health care and technology, construction, offshore drilling, and real estate due to the manual labor required in these industries.

As countries announce human rights-driven regulations, business leaders everywhere should ask themselves how they want to approach social measures. Will they be focused on the risks of human rights viloations in its workforce ecosystem? Will they treat social measures as a growth driver for the business? Or will they devise a journey which evaluates both the risks and the benefits to the business over time?

Some companies quickly identify the supply chain as the main area of concern instead of first examining their own operations. We recommend companies first evaluate the possibility of human rights violations within their own operations and then continue their analysis outward toward understanding their supply chain. Leading practice recommends to also assess risk within the supply chain, including the possibility of human rights violations such as forced labor, since the company is ultimately responsible to the relevant regulators. Additionally, we recommend companies develop a sound understanding of supply chain participants and enforce audit rights over those deemed high risk. It is important that companies not ignore their own employees and contractors in the process of assessing the risk.

## Beyond

As a result of increased focus on ESG by regulators and newly passed laws or reengaging with existing workforce laws, the chief compliance officers of our clients have been asking more questions about the role compliance should play in both assessing this risk and monitoring the control structure to prevent and detect violations.

We have seen red flags for companies with workers on their payroll, those paid through staffing agencies and contract manufacturers in the company's supply chain. As a first step, we recommend that you assess your company's human rights risk, keeping the following examples of red flags in mind:

- Are regulatory requirements across jurisdictions understood?
- Are foreign workers' passports held, preventing them from leaving the country?
- Are the workers who reside in dormitories living in unsafe or unsuitable living conditions?
- Are there "classes" of workers who are paid different rates for the same work or skill?
- Are underage, migrant workers involved in restricted, dangerous jobs in the US and beyond?
- Are workers unable to leave jobs because of debts they were forced to assume in getting hired?

Based on the results of the risk assessment, each company will assess if additional evaluation and/or considerations are necessary for improvements in its own workforce or in its supply chain to achieve its desired state in regards to the "S" of ESG.

The next parts of our social series will focus on how to effectively monitor a company's operations and supply chain for human and business rights risks from a regulatory and compliance view. Subsequent topics include data analytics, investigations, governance, supply chain due diligence, and counterparty requests for human rights certifications.

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