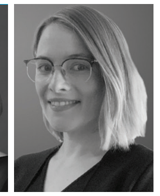
Identifying & reporting on ESG risks in the midst of a pandemic





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Snapshot

- Organisations are facing more scrutiny on their environmental, social and governance (ESG) risk reporting than ever before.
- A new generation of activists is using the courts and non-judicial mechanisms to raise complaints and force changes in behaviour. Institutional investors are requiring transparency and accountability. Regulators, shareholders and communities are mobilising to demand social and environmental responsibility.
- We reflect on four key reporting areas particularly affected by COVID-19 that require the focus and attention of organisations in order to meet ESG expectations and avoid reputational and financial consequences.

The emergence and spread of the COVID-19 pandemic and its subsequent impacts have created a unique set of challenges for business. Among them is identifying, assessing and addressing the particular risks and vulnerabilities that may have emerged as a result of extraordinarily disrupted supply chains, disconnection from colleagues, and shifts in the 'new normal'. These disruptions have amplified existing vulnerabilities in social inequalities and human rights issues, including racial and gender discrimination, and exposed risks to climate change.

Whether it's a result of the heightened sensitivities arising from the pandemic, or the ongoing steady increase in community and market expectation, organisations are facing more scrutiny on their environmental, social and governance ('**ESG**') risk reporting than ever before. A new generation of activists is using the courts and non-judicial mechanisms such as the OECD Contact Points to raise complaints and force changes in behaviour. Institutional investors are requiring transparency and accountability. Regulators, shareholders and communities are mobilising to demand social and environmental responsibility.

We reflect on four key reporting areas particularly affected by COVID-19 that require the focus and attention of organisations in order to meet ESG expectations and avoid reputational and financial consequences.

Supply chains and human rights

Melbourne University researchers have identified seven different types of supply chain risks that are possible to prepare for and mitigate. First among them are macro risks like natural disasters, disease, war and major economic downturns (Ass Prof William Ho, University of Melbourne, https://pursuit.unimelb.edu.au/articles/the-covid-19-shock-to-supply-chains)

The COVID-19 pandemic undoubtedly created significant disruption in the context of business operations and profitability, it has also come at enormous human cost.

The ILO estimates that working hour losses in 2020 were approximately four times greater than during the global financial crisis in 2009 and an equivalence of over 255 million full time equivalent jobs were lost. Women have been disproportionately impacted. The pandemic has also hastened the move toward consolidation and automation which carries ongoing impacts, particularly for low skilled workers who have witnessed decreased demand for their labour or are unable to attend their workplaces due to ongoing restrictions. (Simon Chandler: 'Coronavirus is forcing companies to speed up automation, for better and for worse', *Forbes*)

While some industries were closing down and laying off workers, the acceleration of production in areas of critical concern had its own human consequences, particularly in respect of health products and personal protective equipment. Global demand for quick delivery times, and 24 hour production ran high risks of labour exploitation, as staff work round the clock to produce vital products for hungry global markets.

These scenarios should influence how organisations think about, and report on their ESG risks and impacts. There is work to be done to support an inclusive and equitable recovery and to provide investors, shareholders and customers the confidence that any success through this difficult period is not born of human suffering. Such actions would not only indicate that organisations are prepared to further their business objectives consistently with the protection of and respect for human rights, but will also be good for business and sustainability by enhancing brand and reputation not only with investors and customers but also with suppliers who will prioritise those customers that look after them.

The Australian Border Force ('**ABF**') provided information about the impacts of coronavirus for entities required to report on their supply chain under the *Modern Slavery Act 2018 (Cth)* ('***MS Act***'). While their focus was on modern slavery, the guidance provides insight to the modern slavery risks that have arisen throughout the pandemic. In the modern slavery context ABF recommends that at a minimum, organisations should consider and report on how they have:

- identified the highly affected supply chains and learn how workers have been impacted. These considerations should include a gender analysis to understand any disproportionate impacts that may have occurred;
- considered supplier relationships, and how they are able to work with suppliers to minimise negative impacts on workers, at the same time as securing future supply chain stability;
- ensured that any risks of modern slavery or other human rights impacts are identified, assessed and addressed as part of any supply chain consolidation and review.

Organisations not required to report under the *MS Act* should consider incorporating into their ESG or sustainability reporting how they have engaged with their suppliers not only to reduce the risks of modern slavery but also to identify and address any other human rights or even environmental impacts that may have been exacerbated by COVID-19.

Racial and gender equity

The pandemic has also exposed fault lines in relation to social inequalities, including amplifying risks to racial minorities and women. Harvard Law School reports that in the United States, workers employed to perform low skill jobs have borne the brunt of the pandemic related lay-offs, with those workers traditionally comprised of minorities and people of colour. As well as losing their income, those workers lost access to health insurance coverage at a time when it was needed the most. On the other side of the coin, those same workers often fill the roles of those most exposed to COVID-19 – performing essential functions in aged care, health care, food manufacturing and distribution, delivery and logistics.

One report from the McKinsey Global Institute found that globally women's jobs were 1.8 times more vulnerable to crisis than men's jobs and while women make up 39 percent of global employment they account for 54 percent of job losses during the pandemic. In Australia, the Grattan Institute found that women 'copped a triple-whammy'. They lost more jobs than men, shouldered more of the increase in unpaid work – including supervising home-schooling – and they were less likely to get government support.

The most recent Women in the Workplace report of McKinsey & Co cites research which shows close to a 50 percent increase in company profits and share performance when women are well represented at senior levels of organisations (Dixon-Fyle, Dolan, Hunt, and Prince, 'Diversity wins: How inclusion matters,' May 19, 2020). And this year's ESG reporting should make specific reference to the particular initiatives that organisations have taken to address any emerging challenges to gender equality in their workforce, and in respect of their broader community engagement. The vulnerabilities exposed by the pandemic have illustrated the need for organisations to ensure the social governance appropriately reflects their efforts to manage such factors for their workers and suppliers and mitigate the ground lost in meeting diversity targets.

Integrity

COVID-19 has resulted in increased risks of corruption, and has seen warnings from the UN Secretary General, Transparency International, and business alike. The UN SG noted that 'The response to the virus is creating new opportunities to exploit weak oversight and inadequate transparency, diverting funds away from people in their hour of greatest need'. Transparency International's Chair Delia Ferreira Rubio has noted that 'Covid-19 is not just a health and economic crisis. It is a corruption crisis. And one that we are currently failing to manage.'

Consideration of governance risks is a focus of ESG reporting and there is broad agreement that the pandemic has heightened fraud, bribery and corruption risks. Simple acts like witnessing a legal document can become fraught if integrity processes are not complied with and usual chains of checks and balances are put to one side. More significantly, corruption-prone settings, such as certain mining developments, are seeing heightened risks of integrity breaches. Business leaders are recognising that remote working combined with rapid decision making in response to the fast moving environment provides opportunity for fraud, bribery and corruption. Organisations should ensure the controls they have in place are adequate for the current risk conditions, and report on their progress. Such reports should:

- establish and demonstrate a culture of compliance. Compliance culture starts with good leadership and organisations should demonstrate how they are setting the tone from the top;
- ensure mainstreaming of anti-corruption policies – transparency and accountability practices must be implemented, training conducted, and policies and processes must be followed;
- be clear on how you identify, assess, mitigate and address risks. This should include due diligence, and often third party due diligence, to ensure risks are being appropriately identified;
- outline a process of continuous improvement. Integrity programs must be comprehensive, and ongoing.

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Environment and climate change

Focus on climate change has not diminished during the pandemic, and in fact a number of new initiatives increase the need for thorough and thoughtful environmental reporting. The first among this is that ASIC plans to 'conduct surveillance to assess the extent to which product issuers are engaging in "greenwashing" that results in consumer harm' with a view to take misleading and deceptive conduct actions where greenwash is evident, particularly where retail investors could be misled (see: ASIC Corporate Plan 2020-2024). This carries significant risk for organisations and their directors and a new level of accountability in environmental reporting is foreshadowed.

In respect of climate change, ASIC considers that the Task Force on Climate-related Financial Disclosures ('**TCFD**') reporting mechanism is the most appropriate for listed companies and recommends specific rather than general disclosure (see: ASIC published Report 593 on reporting obligations). Investors want to see deep consideration of medium and long terms risks and an assessment of the physical impacts of climate change on business forecasts as well as the risks and costs of transition. These considerations should include among other things consideration of the entire value chain. For example:

- geography – is your business dependent on one geographic location that may be more or less vulnerable to the impacts of climate change;
- reliance on climactic conditions – for example agriculture, insurance or even tourism in some locations;
- interdependencies the business may have that create operational vulnerability e.g is a part of your critical supply chain sourced from an area prone to cyclone impacts; and
- strategic or operational initiatives designed to address identified risks and impacts.

If regulator and investor concerns were not sufficient motivation to complete thorough and diligent climate change reporting, organisations working to pressure business for greater action and more transparency on climate change initiatives are increasing pressure both in the courts, and in the domain of public opinion. See our recent article that covers human global trends in human rights and the environment (Gill, Gill-Herdman, Wynn-Pope 'Human rights in 2021: Key considerations for Australian businesses', 75 *Law Society of NSW Journal,* March 2021, 74-76) **LSJ**