

SUPPLY CHAIN SUSTAINABILITY ASSESSMENT

Current market practice insights

**CORPORATE GOVERNANCE
JANUARY 2022**

HIGHLIGHTS

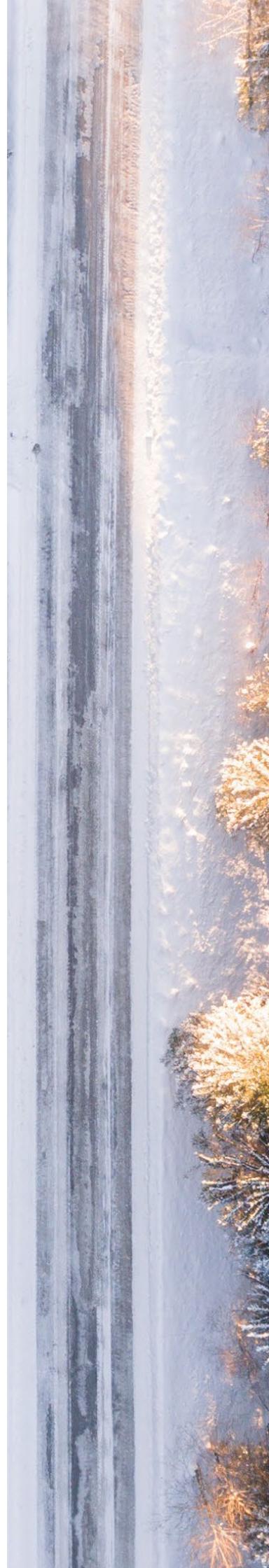
This paper explains what supply chain due diligence is and how supply chain assurance works. Accountancy Europe interviewed members to understand how they help businesses to manage supply chains. Our interviews show that accountancy firms, including small and medium-sized accountancy networks and associations, are increasingly prepared to review the sustainability of supply chains. We discuss market practices with three expert representatives of smaller accountancy firms. We consider what is needed for reliable and robust assurance on the supply chain, including:

- common standards and methodologies for high quality assurance
- the qualities, expertise, capabilities and skills assurance service providers need
- ethical requirements, including independence standards

This reveals a market trend for professional accountants, from firms of all sizes, to support businesses with the application of due diligence requirements.

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INTRODUCTION

This paper explains what supply chain due diligence (SCDD) is and how supply chain assurance works. Accountancy Europe interviewed members to understand how they help businesses manage supply chains.

Our interviews show that accountancy firms, including small and medium-sized networks and associations, are building up their capacity to provide supply chain assurance. We discuss market practices with three expert representatives of smaller accountancy firm networks.

This reveals a market trend for professional accountants, from firms of all sizes, to support businesses with the application of due diligence. In our interviews, we also explore the qualities, expertise, capabilities and skills professionals need.

This publication explains current market conditions and helps readers to assess the potential benefits of SCDD assurance considering the EU new rules on mandatory environmental and human rights due diligence.

Assurance providers also rely on their own network of international talent, along with databases and internal systems or information. The accountancy profession has long-standing experience working with experts in the fields of engineering, science, and corporate social responsibility.

Jens Poll, Chair, European Group of International Accounting Networks and Associations

We work as professional accountants, which means having an inquiring mind, standing your ground or challenging management about difficult situations. This is not only a compliance check exercise.

Jean-Luc Barlet, Partner, Mazars

WHAT IS SUPPLY CHAIN DUE DILIGENCE?

[Due diligence](#) is the process through which companies identify, prevent, mitigate, and account for how they address actual and/or potential adverse impacts on human rights and the environment. The due diligence process affects a company's entire value chain. This means operations, products and services, business relationships and supply chains.

[UN Guiding Principles on Business and Human Rights](#) recommend businesses to consult with affected stakeholders, independent experts and civil society to help them to assess their human rights impacts accurately. Businesses need to integrate findings from these assessments across relevant internal functions and put in place appropriate policies and processes.

The due diligence process is a key part of decision making and risk management for businesses. The [OECD Due Diligence Guidance](#) lists five steps to effective due diligence:

1. establish strong company due diligence management systems 
2. identify and assess risks of adverse impacts along the supply chain 
3. design and implement a strategy to respond to the risks identified 
4. check the effectiveness of due diligence, including through independent third-party assessment 
5. communicate and report yearly on supply chain due diligence 



Labour rights violation is one example of the human rights risks that companies may be exposed to. We monitor if companies have the appropriate business processes.

*Vijay L Narasimhan,
Director, HLB Sustain CSR*

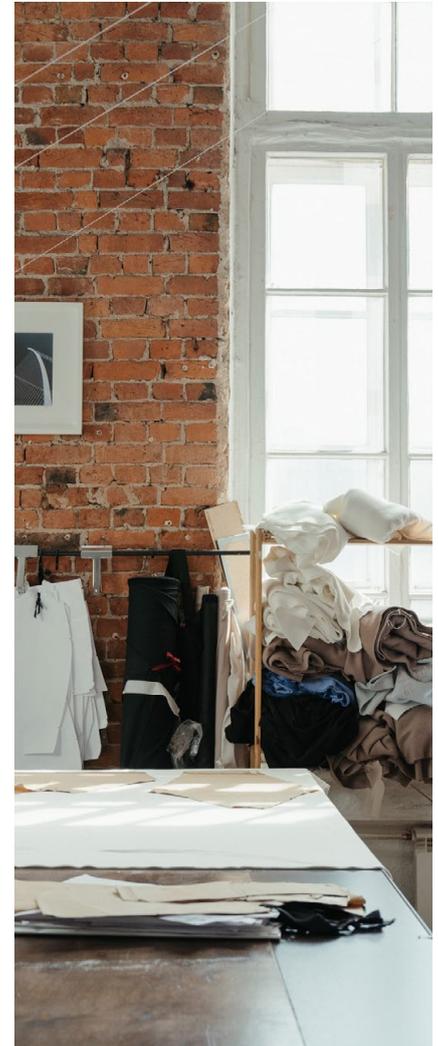
WHAT ARE THE BENEFITS OF SUPPLY CHAIN DUE DILIGENCE?

The supply chain is an important part of risk management and of governance for many companies.

Among the benefits supply chain due diligence can offer are:

- improved collaboration with suppliers
- better product quality
- innovation
- meeting customers' and stakeholders' expectations
- reduced risk of negative publicity
- increased attractiveness to investors and creditors
- more resilient supply chains
- better management of business risks, including liability, regulatory, reputation, and market risks

Supply chain due diligence can also help meet investor and asset manager demands for clear and transparent information about company sustainability. The recent EC proposal for a [Corporate Sustainability Reporting Directive](#) (CSRD) includes a requirement for companies to report on: i) the due diligence process ii) adverse impacts and iii) response.



Collaboration with a third-party assurance service provider on mitigating risks can increase an enterprise's competitive advantage, by streamlining resources and enhancing expertise, opening up new markets and clients.

Vijay L Narasimhan

French stakeholders have acknowledged that assurance improves the quality of reporting. We are committed to further developing our sustainability reporting and assurance skills.

Jean-Luc Barlet

HOW CAN WE ASSESS THE EFFECTIVENESS OF SUPPLY CHAIN DUE DILIGENCE?

There are several ways to assess the effectiveness of SCDD. One option is to carry out active monitoring, usually through an internal audit. This may be appropriate in lower-risk circumstances, or when used alongside other monitoring processes. Active monitoring also includes visits to sites where suppliers operate.

Outsourcing or the use of independent third parties, such as assurance providers, are alternative forms of assessment. This approach usually means commissioning independent assurance, but it is also possible for instance to work with agreed-upon procedures or certification.

Assurance providers need to understand the client's business and industry [...] and have experience auditing. Technical knowledge of laws and regulatory matters affecting the supply chain is also crucial.

Vijay L Narasimhan



Assurance service providers are required by their professional ethics to be objective and critical in their assessment of evidence. Independence is key to promoting confidence in their objectivity.

Jens Poll

INDEPENDENT ASSURANCE

As SCDD's importance grows, stakeholders will expect to know that businesses have sound internal processes to support due diligence. An independent third-party assessment can enhance confidence that a business meets due diligence requirements.

The three expert interviews below showcase market practices for SCDD assurance. We also explore what is needed for reliable, robust supply chain assurance, including:

- a common methodology and standards
- appropriate skills and expertise for service providers
- ethical requirements, including independence standards

AGREED-UPON PROCEDURES

The company can ask a third-party service provider to carry out specific procedures and report on the results. This could, for instance, mean a series of visits to several supplier sites. These services can show if and how due diligence has been used at each site.

Such agreed-upon procedure type of services do not give an opinion on the findings and do not provide assurance. They report on facts, in line with procedures agreed in advance.

The report and its findings are not public and are intended to help companies make decisions based on facts collected on site.

CERTIFICATION

Standards agreed by the International Organisation for Standardisation (ISO) may be used for the certification of management systems, to assess risks at supplier plants. Certification shows that specific requirements have been met. It cannot however provide assurance on criteria beyond what is included in each ISO standard. For some company-specific due diligence processes, there may be no ISO standard.

The high level of competence involved in financial audit applies to the work of auditors and audit firms in other types of assurance engagements as well. Reliable and robust SCDD assurance means offering broad and diversified expertise and practical experience.

Jens Poll



ASSURANCE AND SUPPLY CHAIN DUE DILIGENCE - MARKET INSIGHTS



INTERVIEW WITH JEAN- LUC BARLET (FRANCE)

Jean-Luc Barlet (JLB) is a partner at Mazars in France, delivering audit and accounting, tax, financial advisory and consulting services, with a department specialised in sustainability reporting.

France is one of the few EU countries that makes supply chain due diligence mandatory for companies. Can you tell us what the French law requires?

JLB: Indeed, we have a national due diligence requirement for companies in France, as part of the 2017 French Corporate Duty of Vigilance Law. Large companies within the scope of this law need to implement a vigilance plan, including measures to identify and prevent potential risks to human rights and the environment occurring because of business activities. This includes activities of the company itself, suppliers or subcontractors, subsidiary companies, and others.

This vigilance plan must include:

1. risk mapping, to identify, analyse, and rank risks
2. regular assessment of subsidiary, subcontractor and supplier situation in line with the risk mapping
3. action to mitigate risks and prevent serious violations
4. alert mechanism to flag potential or actual risks
5. monitoring to evaluate effectiveness of measures

The Duty of Vigilance Law applies to tier 1 suppliers. Risk analysis helps to develop measures suitable to the suppliers' products, services, location, and so on. Tier 2 suppliers may also be affected, depending on their risk-exposure. This could mean a code of conduct, a supply chain due diligence assessment, or encouraging supplies to improve business practices.

Is there an obligation for supply chain due diligence to be assured?

JLB: The Duty of Vigilance Law does not include mandatory verification. Companies are obliged to publish their vigilance plan. Each company is also required to show that it has undertaken vigilance plan actions, and that actions are also in place at group and supplier level.

Therefore, we are not asked to audit or review the vigilance plan as such. Nevertheless, when vigilance plans are published with non-financial information, we review the information disclosed. This does not however include reporting on the relevance or effectiveness of vigilance plans.

At the same time, a company may choose to ask an auditor to assess the supply chain's sustainability.

This assessment would include i) reviewing whether processes are in line with guidelines, and ii) collecting evidence to support the company's performance.

What assurance procedures do you use?

JLB: As a member of the [IFAC Forum of Firms](#), our assurance system is based on quality management standards ISQC/ISQM¹ and on the International Standard on Assurance Engagements ISAE 3000, both from the International Audit and Assurance Standards Board (IAASB), and on the Code of Ethics issued by the International Ethics Standards Board (IESBA), as well as on technical guidance published by the French national professional institute.

How do you share your professional opinion with the company? Do you make sure that improvements proposed are put into place?

JLB: We share our professional conclusion with the company through a long form report. This includes an opinion, information about the scope of work performed, and comments on the key risks identified.

In the report we also give recommendations and suggestions for improvement. We work as professional accountants, which means having an inquiring mind, standing your ground or challenging management about difficult situations. This is not only a compliance check exercise.

Follow-up is then the responsibility of management, who requested the assessment.

France is one of the frontrunners in promoting sustainability reporting and assurance. How has this experience helped you in your work on SCDD?

JLB: France has promoted sustainability reporting since its inception. The 2014 EU Non-Financial Reporting Directive began to streamline non-financial reporting. France was one of three Member States opting for mandatory sustainability information assurance.

Accreditation and guidance have helped us to develop expertise in sustainability assurance, and by extension in SCDD.

French stakeholders have acknowledged that assurance improves the quality of reporting. We are therefore committed to further developing our sustainability reporting and assurance skills.

¹ The International Standard on Quality Management 1 (ISQM 1) strengthens firms' systems of quality management through a robust, proactive and effective approach to quality management. The standard encourages firms to design a system of quality management that is tailored to the nature and circumstances of the firm and engagements it performs. ISQM 1 applies to all firms that perform engagements under the IAASB's international standards. <https://www.iaasb.org/publications/international-standard-quality-management-isqm-1-quality-management-firms-perform-audits-or-reviews>



INTERVIEW WITH VIJAY L NARASIMHAN (UK)

Vijay L Narasimhan - Director, HLB Sustain CSR, part of HLB network supporting businesses with sustainability and Corporate Social Responsibility (CSR) advisory services.

What is the focus of your assurance methodology? How do you identify areas of risk or concern?

VLN: A typical assurance methodology focuses on end-to-end value generation, including financial benefits, service improvement and risk management. We use tailor-made questionnaires to perform assessments of tier-1 and tier-2 suppliers. As part of this process, we develop recommendations for business' transparency and resilience.

The following three stages help us to identify areas of risk or concern:

1. understand the business, its goals and aspirations
2. identify gaps in key business processes, based on past experience and research
3. analyse gaps to find causes of potential harm and recommend preventive measures

Does your assurance procedure cover only tier 1 subcontractors?

VLN: Assurance procedures are developed on a case-by-case basis, depending on the complexity, proportionality, and criticality of operations. We use a risk scorecard system and can also use the assurance procedure for tier 2 suppliers² for critical processes, to ensure proper risk mitigation.

Is assurance most often a one-off or a recurring engagement?

VLN: We usually carry out SCDD assurance on a recurring basis. Because fraud or breakdown on a vulnerable supply chain can cause reputational damage and disruption, recurring assurance engagements are encouraged. This can ensure that all risks are recognised, properly mitigated, or eliminated.

How do you communicate your professional opinion? Do you ensure that improvements you propose are put into place?

VLN: We publish reports that identify risks and propose recommendations for improvements. Labour rights violation is one example of the human rights risks that companies may be exposed to. We monitor if companies have the appropriate business processes and act consistently with the applicable principles of

companies Business and Human Rights policy to address these issues. It is important that these policies are amended from time to time to reflect the dynamic nature of human rights issues.

We also perform regular monitoring and update key indicators, using a scorecard and risk matrix. This helps to ensure that proposed improvements are completed. Tracking improvement can also be part of a subsequent audit.

Some organisations have a supply chain or procurement board. This is a useful place for collective discussion and assessment. These boards may approve the proposed improvements and risk mitigation actions.

We also communicate supply chain policy and the Standard Operating Procedure (SOP) to the different stakeholders across most supply chain tiers.

Do you rely on information from other experts or third parties to support your assurance report? Can you give some examples?

VLN: Indeed, assurance providers can enrich their datasets by engaging with external experts for support. In some cases, we reach out to third parties for specific information. This may include, for example, access to databases of information about Know Your Counterparty (KYC) or Anti-Money Laundering (AML).

² Tier 2 suppliers supply materials to tier 1 companies in the same supply chain.



These databases are a useful source of information for support of assurance reports. In addition, for checks on company owners and directors, assurance providers can for instance make use of business financial analysis by Dun & Bradstreet or Companies House.

What skills and expertise are required to conduct an effective assurance assignment on supply chain due diligence?

VLN: Assurance providers need to understand the client's business and industry, as well as the company supply chain and environment. They should be financially literate and have experience auditing. Technical knowledge of laws and regulatory matters affecting the supply chain is also crucial. This includes knowledge of end-to-end supply chain related processes, such as financial processes purchase-to-pay/procure-to-pay (P2P), order to cash (OTC), record to report (R2R), and ABC analysis, a method of inventory categorisation.

This is particularly important where there are significant geographical or other differences between suppliers and companies. Specific knowledge about circumstances and laws in the foreign country, including tax, AML, and KYC rules, and

an area of specific expertise such as complex environmental matters, may also be essential.

As well as technical skills, "soft skills" are crucial. Key soft skills include the ability to build trust and confidence, and to get buy-in from stakeholders, as well as negotiating capacity, or an analytical, investigative mindset.

What additional skills will the accountancy profession need in the future to meet emerging needs for SCDD assurance?

VLN: Climate change and sustainability are gaining wider press coverage. Their growing importance shows the need for awareness of sustainable and green procurement. This also highlights the need for clarity about the whole procurement value chain, including an understanding of the UN Sustainable Development Goals (SDGs), and of how company activities impact the environmental, social and governance (ESG) performance of a supplier and partners.

In addition, cybersecurity and the General Data Protection Regulation (GDPR) are becoming important risks to be managed. Future skills are therefore also likely to include an understanding of GDPR rules and the vulnerability of IT systems and networks, as most data will be on the cloud.

The future professional will also need to be proficient in the use of automatic tools for data analytics and the presentation of data in an easy-to-read consumer format.

Do you have any suggestions for improvements regarding assurance procedures?

VLN: The scope of SCDD must expand in line with new technologies. This will help to improve transparency, monitoring, risk management, control, and consumer involvement. Companies will be pushed to include a QR code on all their products, providing information about suppliers and improving awareness of supply chains. Partnership, commitment, and resilient sustainability strategies along the whole supply chain are necessary for socially and environmentally responsible business practices.

Collaboration with a third-party assurance service provider on mitigating risks can increase an enterprise's competitive advantage, by streamlining resources and enhancing expertise, opening up new markets and clients. We need to automate information collection from publicly available sources, simplifying the screening, verification and monitoring of business partners' compliance.

INTERVIEW WITH JENS POLL (GERMANY)

Jens Poll (JP) is Chair of the European Group of International Accounting Networks and Associations (EGIAN). Jens is also a member of the supervisory board of a production company based in Germany with international activities on all five continents.

What does your supply chain assessment involve?

JP: Our assurance procedure mostly covers tier 1 suppliers, sometimes extending to tier 2 and 3. We normally use an auditor for these engagements, which are mainly recurring assurance procedures, following a risk assessment in line with International Standards on Auditing ([ISA](#)).

What standards and methodology do you use?

JP: Our service providers, mostly auditors or professional accountants, carry out assurance engagements in line with the International Standard on Assurance Engagements 3000 ([ISAE 3000](#)), issued by the International Auditing and Assurance Standards Board (IAASB), an independent Board of the International Federation of Accountants (IFAC).

ISAE 3000 requires an assurance provider to conclude whether sufficient and appropriate evidence of adherence to the applicable requirements has

been obtained and to issue a clear written report. The assurance provider needs to check if there is enough evidence and whether this evidence is relevant and reliable.

What does it mean in practice to conduct an assurance engagement in accordance with ISAE 3000?

JP: In accordance with ISAE 3000, all assurance engagements are subject to strict ethical principles and rules, including about independence. Assurance service providers are required by their professional ethics to be objective and critical in their assessment of evidence. Independence is key to promoting confidence in their objectivity. This generally means the ability to act with integrity and to exercise professional scepticism.

Assurance providers will therefore take very seriously any threat to their independence. They will put in place appropriate safeguards to preserve that independence or, if this is not possible, refuse the engagement.

In practice, applying professional judgement and scepticism means a determination to do the right thing. As such, accountants and auditors have a responsibility to act in the public interest, and not simply to comply with legal requirements

or to meet the needs of an individual client or organisation. Furthermore, statutory auditors are subject to strict rules defined by EU law, such as the Audit Directive and Regulation.

What ethical requirements do you consider are essential for assurance services to be effective and reliable?

JP: Fundamental ethical principles require assurance providers to act with integrity, objectivity, confidentiality, professional competence and due care, and professional behaviour. The aim is to ensure that no threat to objectivity undermines the quality of service. Therefore, before accepting any assurance engagement, the practitioner will consider whether there are any ethical factors that should lead them to decline.

How do you ensure the quality of assurance services?

JP: Assurance services should be provided within the framework of a dedicated quality management system. An assurance service provider applying ISAE 3000 must have a quality control or quality management system in place, to ensure engagement is carried out to consistent high standards.

ISAE 3000 specifically refers to the International Standard on Quality Control 1 (ISQC 1) and

International Standard on Quality Management 1 (ISQM 1), which sets requirements for quality systems. It is possible to abide by other standards, for example requirements that are set out in law or in other guidelines. These alternatives must however be at least as demanding as ISQC 1.

Which competencies, expertise and attributes should the assurance professional have?

JP: The high level of competence involved in financial audit applies to the work of auditors and audit firms in other types of assurance engagements as well. Reliable and robust SCDD assurance means offering broad and diversified expertise and practical experience.

Where there is a large supply chain, involving many suppliers across several countries, the assurance provider must have staff with the necessary skills, meeting tight reporting deadlines.

Often supplier activities are very technical, for example monitoring emissions from a chemicals plant. In this case, the assurance provider must make sure that enough expertise is consistently available across multidisciplinary teams.

It is important to use the skills of both internal and external experts to deliver an effective assurance. External experts may include national and European organisations and agencies, NGOs, and industry expertise. Assurance providers also rely on their own network of international talent, along with databases and internal systems or information. The accountancy profession has long-standing experience working with experts in the fields of engineering, science, and corporate social responsibility, among others.

Where an expert is involved, assurance providers must also ensure that his or her work is appropriate, and that the necessary evidence is obtained.

Assurance providers must work closely enough with the expert to be able to take responsibility for the final work.



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