



# Boards and The Grinch

## Audit Insights

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### How boards can help keep the grinch out of holiday supply chains

“How could it be? It came without ribbons, it came without tags. It came without packages, boxes, or bags...it came despite supply chain snags,” laments the Grinch this holiday season.

This year, consumers, retailers and producers of consumer goods share increased anxiety over the continued supply chain disruption from COVID-19. In fact, [more than half of consumers](#) report being concerned about shipping delays and stockouts. Fortunately, the Grinch will have one less opportunity to steal the festive season away, as supply chain disruptions appear to be abating. Restocking [demand is increasing](#). Freight rates, while still elevated, [have declined](#). Likewise, port congestion is [starting to ease](#).

However, the disruption we’ve been experiencing over the last 18 months is not just a blip. According to the KPMG 2021 [CEO Outlook](#), 80 percent of U.S. CEOs said protecting their partner ecosystem and supply chain is just as important as building their own organization’s cyber defenses. With such focus on supply chain resilience, what’s the role of the board and audit committees, which provide essential oversight of an organization’s activities and reporting?

Well, a clue may lie in the Grinch’s own eventual epiphany: “What if Christmas... doesn’t come from a store. What if Christmas...perhaps...means a little bit more!” For boards and audit committees, this means continuing to monitor their organization’s progress on Environmental, Social, and Governance (ESG) engagement and ensuring that risks and opportunities are managed to drive the creation of long-term value.

### ESG and supply chain resilience for consumer goods

ESG engagement focuses on developing a sustainable and ethical supply chain, which builds operational resilience. Climate change, for example, poses significant risks to a supply chain, including flood, fire, and wind to migrating labor and depleted raw materials. An ESG lens on supply chains can help an organization avoid these disruptions. Likewise, lax oversight of labor rights and raw material usage may result in enforcement actions that generate operational and reputation challenges. Lastly, regulations are increasing across the globe. Organizations must ensure their supply chains don’t get caught in the crosshairs.

### The role of boards and audit committees in promoting supply chain resilience

Today, pressure from investors and regulators is putting companies' supply chain sustainability practices under a microscope, requiring more enterprises to [increase transparency and disclosure of practices](#) and activities in their supply chains. And public concern around the social impacts of supply chains has never been higher.

There is significant pressure from all angles (e.g. investors, regulators, shareholders, customers and employees) to transform supply chains with an ESG lens. Now, audit committees will not set or operationalize ESG strategy. However, by engaging on both financial and sustainability reporting, they can help an organization actively tell their ESG story, while helping to ensure their organization is meeting the demands of markets and regulators.

Advancing the ESG agenda isn't divorced from 'value'. In fact, many companies are recognizing that initiatives that drive significant performance improvements also drive significant ESG advances, including supplier collaboration, visibility, and supply chain mapping.

To that end, heading into the holiday season, a few key questions can help boards and audit committees better understand the company's supply chain risks and where it is on its ESG/sustainability journey.

## **1. What's for dinner?**

The family table may be the final destination for the holiday turkey, Santa's cookies and milk, and the pancakes and OJ consumed after opening the presents that the Grinch unsuccessfully attempted to steal, but chances are the ingredients used to make them were supplied from locations as disparate as down the street and across the globe.

The non-alcoholic beverage industry, which is dominated by large, international companies, needs access to large volumes of clean water, which is being stressed world-wide. A focus on water management and issues can lower risk and operating costs. And agricultural products are often sourced from third-party growers, so organizations manufacturing, distributing and packaging consumer and industrial products need to manage the risks within the supply chain to ensure there's enough food on the table.

For audit committees, SASB standards provide metrics including percentage of total water consumed in each region with High or Extremely High Baseline Water Stress, products sourced that are certified to a third-party standard and adherence of suppliers' social and environmental responsibility, that can be used as a guide for operations and reporting.

## **2. Is there a toy trade-off?**

Although consumer goods companies have long been focused on supply chain challenges, the industry's reliance on a multi-tiered system of suppliers, subcontractors, and part-time workers poses ongoing complications. In particular, the toy and sporting goods industry is particularly exposed, because of its reliance on manufacturing in emerging markets where labor protections and regulations are weak and inconsistent.

Likewise, a failure to avoid or mitigate labor violations can result in supply chain disruptions, reputational damages, and enforcement penalties. In fact, many toys and sporting goods companies are already working with suppliers through audits, partnerships, and increased oversight.

For audit committees, it's important to understand that strategy and assess the potential reporting requirements and the necessary operational changes needed to assure the data potentially reported. Looking at SASB standards, there are multiple quantitative measures, including the number of facilities audited to a social responsibility code of conduct and the non-conformance rate within a supply chain.

### **3. Is that sweater sustainable?**

The family may be purchasing winter jackets for ski trip or just picking up the annual tie for the impossible-to-gift family. Either way, they are engaged in the global supply chain. For the apparel, accessory, and footwear industry, the industry's global supply chains contribute significantly to environmental challenges through water consumption and pollution, as well as air pollution.

In preparation for enhanced scrutiny and regulations around the globe, companies are working to ensure they maintain operational agility by decarbonizing their entire supply chain.

For audit committees, the SASB standards outline a few areas for potential focus. One priority is reviewing whether key suppliers completed the Sustainable Apparel Coalition's Higg Facility Environmental Module assessment – pioneered by the apparel industry – to understand the supply chains impact on carbon emissions, water usage, and more.

Apparel is not alone in this focus. In addition to labor practices, the toy and sporting good industry faces similar challenges with the use of plastics. The America's Plastic Makers committed to the goal of creating a circular economy in which 100% of plastics packaging in the U.S. is reused, recycled, or recovered by 2040. Audit committees should understand a company's strategy for a circular supply chain that reduces waste and the requisite reporting demands.

## **ESG should top the Audit wish list**

As outlined above, ESG engagement has the potential to truly strengthen supply chains to deliver operational agility, while building trust with stakeholders. Audit committees can help make sure Christmas is always merry for consumer goods businesses, consumers, and investors by making sure companies prove they are enacting measurable change.

The Grinch may have been thwarted this year, but for many companies the ESG journey is just beginning. Boards and audit committees can engage now to accelerate progress.



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