ESG in government contracting: The new compliance imperative

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ESG in government contracting: The new compliance imperative

- New federal ESG procurement rules are expected to impact 6,000 entities representing 86% of the government's annual contract spend.
- Understanding the rules can help contractors avoid disruption and assess the cost impact on current and future bids.
- Federal contractors should begin thinking about what data and infrastructure will be necessary to track and report required sustainability metrics.

Recent executive actions and proposed rules signal momentous changes to ESG requirements for government contractors. We're seeing two major trends for companies to pay attention to. First, regulatory scrutiny and enforcement has ratcheted up for long-standing requirements (e.g., employee and supplier diversity rules). Second, new mandates in areas such as supply-chain transparency and climate risk disclosure are emerging.

Sustainability requirements in federal procurement are rapidly evolving

January 2022
The FY22 NDAA Sec. 848 places a ban on government procurement of products produced in the Xinjiang Uyghur Autonomous Region of China

February 2022
EO 14063 requires all U.S. government departments and agencies to use project labor agreements on certain federal construction projects

March 2022
Labor Department proposes changes to Davis-Bacon Act regulations that would provide more frequent, accurate wage updates

July 2022
The GSA announced they would look into new regulations to reduce single-use plastic

August 2022
OFCCP issues revised pay equity audit guidance that signals intent to ramp up intensity and scope of their reviews

October 2022
End Human Trafficking in Government Contracts Act is signed into law

November 2022
New proposed FAR rule: Disclosure of Greenhouse Gas Emissions and Climate Related Financial Risk

Decmber 2022
Preventing Organizational Conflicts of Interest in Federal Acquisition Act signed into law

Case in point: Recent, massive spending bills (including the Infrastructure Investment and Jobs Act and the Inflation Reduction Act) stress support for underserved communities and diverse suppliers, but with enhanced rigor related to the White House's Justice40 Initiative. Meanwhile, a proposed amendment to the Federal Acquisition Regulation (FAR) would establish a groundbreaking regime for climate-related risk disclosures.

In 2022, the government announced a marked increase in the number of enforcement actions and settlements emanating from ESG compliance topics, including small business subcontracting and organizational conflicts of interest. Government contractors need to remain vigilant as they monitor requirements and risks across the evolving sustainability compliance landscape.

Key ESG developments federal contractors should be tracking

E

Disclosure of Greenhouse Gas Emissions and Climate-Related Financial Risk (November 2022): Proposed FAR amendment that would require federal contractors to disclose certain climate-related financial risks and greenhouse gas (GHG) emissions data

E

Reducing Single-use Plastics and Packaging in Federal Procurement (July 2022): Proposal to promote eco-friendly materials and packaging

E S

Justice40 Initiative (January 2021): As part of EO 14008, this initiative set a goal that at least 40% of the overall benefits of the following federal investments flow to disadvantaged communities: climate change, clean energy and energy efficiency, clean transit, affordable and sustainable housing, training and workforce development, remediation and reduction of legacy pollution, and the development of critical clean water and wastewater infrastructure

E

Minimizing the Risk of Climate Change in Federal Acquisitions (December 2021): Proposed FAR amendment focused on considering GHG emissions in federal procurement decision-making including bidder preferences for achieving reductions in emissions

S

OFCCP's DIR 2022-01, Pay Equity Audits (August 2022): Revised audit guidance with broader scope and usage of advanced analytics, as well as the requirement for contractors to comply fully with document request lists, failure of which may trigger investigations

S

FY22 National Defense Authorization Act, Sec. 848 (January 2022): Bans federal procurement from the Xinjiang Uyghur Autonomous Region of China

S

End Human Trafficking in Government Contracts Act (October 2022): Directs agencies to refer contractors for suspension and debarment upon credible allegations of human trafficking, which can include charging of recruitment fees, withholding of identity or immigration documents, provision of substandard housing and more (see FAR 52.222-50 Combating Trafficking in Persons)

G

Preventing Organizational Conflicts of Interest in Federal Acquisition Act (December 2022): Mandates enhanced conflict-of-interest disclosures and monitoring in federal contracting

E Environmental
S Social
G Governance

More than mere compliance requirements, these actions stand to fundamentally change how government contractors operate, which products and services may be successful in the federal marketplace, and whether they can compete for federal funds in the future.

FAR climate risk disclosure rules are imminent

On November 14, 2022, the FAR Council published a proposed climate rule that's expected to affect almost 6,000 entities representing approximately 86% of the federal government's annual contract spend. The rule, which implements federal policy under EO 14030, would impose various new climate risk requirements depending on a company's volume of government business. Facing the strictest requirements are "major" contractors, defined as those receiving more than $50 million in federal contracts in the prior federal fiscal year. "Significant" contractors are those receiving between $7.5 million and $50 million.

Basic requirements. Under the proposal, both major and significant contractors would have to disclose annually their Scope 1 and Scope 2 greenhouse gas (GHG) emissions. Major contractors would, in addition, have to disclose Scope 3 GHG emissions, describe their climate risk assessment process and any risks identified, and develop science-based emission-reduction targets (to be validated by a third-party organization, SBTi).

The use of science-based targets is a key distinction between the proposed FAR rule and the proposed SEC rule in that the SEC proposal would require only that public companies disclose climate-related targets they have already set. It does not require companies to set such targets.

Proposed FAR annual GHG emissions disclosure

Emissions category	Scope 1	Scope 2	Scope 3
What's included?	GHG emissions from sources that are owned or controlled by the reporting company	GHG emissions associated with the generation of electricity, heating and cooling or steam, when these are purchased or acquired for the reporting company's own consumption but occur at sources owned or controlled by another entity.	GHG emissions that are largely a consequence of the reporting entity's operations but occur at sources other than those owned or controlled by the entity.
Who's affected?	Significant and major contractors	Significant and major contractors	Major contractors only

Rule applicability. Currently, there are proposed exemptions for certain organizations such as nonprofit research entities, higher education institutions and certain racially/ethnically diverse owned organizations, but no exemptions based on contract type. Disclosure requirements may differ based on business size or non-profit status for major contractors.

Importantly, compliance with this FAR rule impacts a government contractor's responsibility determination. Outside of the compliance risks, the inability to report accurate information or meet goals in line with the US government could cause companies to lose their ability to bid on or win federal contracts.

Take action to secure a competitive advantage

Government contractors should not underestimate the financial risks of losing access to the federal revenue stream—with a record $689 billion in federal contract spending in FY 2022 and further growth expected from recent major spending bills—or the reputational and enforcement risks of ESG noncompliance. Accordingly, ESG deserves an important place in every federal contractor's compliance program.

Corporate leaders and their teams should consider the following actions:

- **Designate an ESG compliance owner.** Identify the appropriate owner(s) of sustainability compliance specific to government contracting regulations and confirm communication and alignment across other ESG owners within the organization for other reporting and disclosure requirements (e.g., SEC).
- **Understand how the evolving rules affect your business.** Evaluate the sustainability compliance landscape with special attention to new and emerging rules, and analyze how these rules impact different areas of the business.
- **Review compliance posture and capabilities.** Determine if you have the organizational resources and capabilities to identify, address and report on these requirements effectively.
- **Develop risk monitoring capabilities.** Build out or enhance a compliance monitoring program focused on ESG risks to identify and evaluate potential false claim risks associated with improper representations and reporting to the government.
- **Assess third-party exposure.** Pay special attention to third-party risks, particularly within the supply chain, and determine whether effective safeguards, monitoring and reporting procedures are in place.
- **Plan for operational and cost impacts.** Developing or enhancing your ESG compliance program will likely result in operational impacts across different functions, and the increased cost of compliance should be appropriately captured within your cost structure to improve recovery from the government.

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