



Factories and Fraud in the PRC: How Human Rights Violations Make Reliable Audits Impossible

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Good morning, and welcome to today's hearing, which will look at the use of so-called "social audits" by companies whose supply chains originate in the People's Republic of China to cover up the existence of forced labor in those supply chains.

Back in the early 2000s, I read a book called [IBM and the Holocaust: The Strategic Alliance Between Nazi Germany and America's Most Powerful Corporation](#). I recall how shocked I was at the time at what the book revealed about an American corporation's complicity in aiding and abetting the Nazi regime, placing bottom-line greed over concern for humanity, and turning a willing blind eye to the implications of their work.

Nor was IBM was alone in this – [books](#) have been written about the ties the white shoe law firm Sullivan & Cromwell had with the Nazis, for example. But I took some comfort in knowing that was in the past.

Surely if there was evidence today of an evil regime’s abuse of human rights – for example, the mass-scale detention of a despised ethnic and religious minority in concentration camps, forcing them to toil as practical slaves to produce goods for export – American corporations would shudder and shun any complicity with that.

Fast forward to today, however, and that is precisely what we see – corporate complicity in the grossest of human rights violations. Our last hearing revealed, for example, how Thermo Fisher Scientific, whose DNA markers have been used by police in the Tibet and Xinjiang autonomous regions to compile databases of the DNA of *millions* of Tibetans and Uyghurs, has also been implicated in the forced harvesting of [human organs](#).

While Thermo Fisher Scientific may be the corporation whose behavior most closely mimics that of IBM before the beginning of the Second World War, our hearing today focuses on those manufacturers, suppliers, importers and retailers whose supply chains in China are tainted by reliance upon forced labor to

achieve the lowest prices, yet who seek to rely on social auditing companies to obscure and whitewash that reliance.

We have known about corruption in the audit industry for a long time.

Back in July 2012, I held a hearing where Li Qiang, the Founder of China Labor Watch, testified as to audits. He said not only are audits conducted in China ineffective, but he said “they are actually corrupt.” He went through examples of how auditors for corporations such as Apple ignored unfavorable facts, such as with regard to inadequate worker safety processes. He gave several examples of the bribing of auditors, so that auditors’ reports would not require the investment of millions in improving conditions in factories and plants.

Today, using the fig leaf that audits provide, corporations seek to convince consumers, regulators and perhaps even their own consciences that their supply chains are clean and compliant with U.S. law, including the provisions of the Uygur Forced Labor Prevention Act, or UFLPA, and section 301 of the Trade Act, both of which prohibit the importation of goods made with forced labor.

In a nutshell, however, as our witness Scott Nova will testify, “Social auditing, in practice, involves giving unqualified people inadequate time to pursue an unrealistic objective they have no incentive to achieve.”

In a country such as the People's Republic of China, where independent labor unions do not exist, social controls prevent the free exchange of information, and recently-passed national security laws make the disclosure of information that portrays China in a bad light a national security offense, social audits are particularly laughable.

But beyond aiding and abetting the human rights abuses that forced labor entails, companies whose supply chains are tainted also undercut American manufacturers at home, such as in the textile industry, whose ability to produce quality goods at an affordable price is undercut by importers who drive costs down by essentially utilizing slave labor. Such labor may come from prisons in the Chinese *laogai* system, or from Uyghurs detained in so-called "Vocational Skills Education and Training Centers," or otherwise assigned by Poverty Alleviation Through Labor Transfer Programs to toil elsewhere in China.

These corporations profit from the sweat of the brows of Uyghurs and other labor abuse victims in China, while beggaring their fellow Americans seeking to earn a decent wage in factories in the United States.

I look forward to hearing our witnesses expose the deception inherent in the use of social audits to whitewash corporate complicity in labor rights abuses.

I would like to receive input on regulatory and legislative gaps that they think need to be plugged.

I also would like to hear their thoughts in particular on enforcement of existing legislation, like UFLPA.

And I also would like to suggest that our securities laws – in particular, our 1934 Securities Exchange Act, and Rule 10b-5 promulgated under it – be put to greater use.

That rule, as people are aware, prohibits “*any* untrue statement of material fact,” as well as any omission of material fact.

As we go through annual reports and offering statements of publicly-traded corporations, we should ask whether they are disclosing to their shareholders, and potential shareholders, that their supply chains may indeed be compromised by forced labor, in violation of US law.

Are they disclosing the potential loss of goodwill and harm to reputation which a company revealed to be benefitting from forced labor in their supply chain may undergo, to the detriment of share price?

To date, many corporations seem to be relying on these social audits to shield themselves from potential liability – social audits which today’s hearing, along with the good work which has been done by several of our witnesses, will

be shown to be works of near fiction when it comes to accurately portraying the state of labor in the People’s Republic of China.

Compliance departments take note.

As well as the law and accounting firms that sign off on corporate disclosures.

Following this hearing, I intend to write to the Securities and Exchange Commission, and I invite my Commissioner colleagues to join me, to ask that they review disclosures by publicly-traded companies to assess whether they contain any material misstatements or omissions with regards to forced labor in their supply chains – and if they do, take enforcement action against them, levying fines.

While the SEC proposed rules in May 2022 to clarify how investment funds may promote adherence to voluntary “Environmental, Social and Governance,” or ESG, standards – another fig leaf utilized by corporations to signal their virtue to consumers but which remain untethered to objective criteria – this is only a tentative first step which emphasizes the “E” in ESG and is addressed to investment funds, doing little to confront the issue of forced labor in supply chains.

Further, if corporations are not policing themselves, and the SEC is slow in responding, then I hope the plaintiffs' bar will help discipline these companies, seeking to recover any loss in shareholder value that results exposure of corporate auditwashing.

Finally, I also anticipate a future hearing whereby we invite auditing companies – such as the Löning company implicated in the Volkswagen scandal that we shall hear about shortly – whistleblowers and lowest-price retailers such as Walmart to testify.

With that I turn to our witnesses...