



2011

FAIR LABOR ASSOCIATION INDEPENDENT EXTERNAL MONITORING REPORT

COMPANY: New Balance Athletic Shoe, Inc.

COUNTRY: Peru

FACTORY CODE: 970058531J

MONITOR: Grupo de Monitoreo Independiente de El Salvador (GMIES)

AUDIT DATE: November 17-18, 2011

PRODUCTS: T-shirts

PROCESSES: Cutting, Sewing, Quality Control, Packing, Exporting

NUMBER OF WORKERS: 285

Company Comment: Upon receiving this report, we immediately engaged our vendor in Peru who had placed the goods in this factory, and we began the remediation process. On Jan. 17, 2012 we visited the facility in order to investigate root causes and to get assurances from factory management that they would address all findings. For several months afterwards, we worked closely with this supplier to develop and implement a remediation plan and to address the findings. However, due to significant and long-standing production problems, quality issues, and other business concerns, our sourcing team gave notice to the Peruvian based vendor, and in turn they notified factory management, that New Balance would no longer be placing purchase orders there and none has been placed as of March 2012. Recognizing the importance of responsible transitions, New Balance provided notice to factory management of this intent well in advance and worked closely with management on a gradual order reduction plan to help the factory plan for the change and seek orders from other customers. We also tried to engage with other buyers in the facility to improve compliance communication, but as the factory was a third tier contractor, it was not sourcing directly with major labels and we were unsuccessful in getting them to implement full corrective actions. Even so, some notable progress in terms of payment of retroactive overtime and 'aguinaldos' due to workers was made as a result of our efforts. However, one consequence of this transition was decreasing New Balance leverage over time, which reduced our ability to bring positive change on some of the more challenging issues as our production was ending. We have therefore concluded all action on the CAP.

For an explanation on how to read this report, please visit the FLA website [here](#).



CONTENTS:

Wages, Benefits and Overtime Compensation: Holidays, Leave, Legal Benefits and Bonuses 3

Wages, Benefits and Overtime Compensation: General Compliance Wages, Benefits and Overtime Compensation..... 5

Wages, Benefits and Overtime Compensation: Accurate Calculation and Recording of Wage Compensation..... 7

Harassment or Abuse: Discipline/Review of Disciplinary Action 8

Code Awareness: 9

Code Awareness: 10

Code Awareness: 11

Health and Safety: Machinery Maintenance and Worker Training 12

Hours of Work: Time Recording System 13

Wages, Benefits and Overtime Compensation: Holidays, Leave, Legal Benefits and Bonuses

WBOT.5 Employers shall provide all legally mandated holidays, leave, benefits and bonuses, such as official holidays, annual leave, sick leave, severance payments and 13th month payments, to all eligible workers within legally defined time periods. In addition, all leave and bonuses shall be calculated correctly. (S)

Noncompliance

Explanation: There are several noncompliances with regard to benefits:

- 1) Legally, the factory must grant 2 Gratifications per year to all employees. However, management did not provide documentation that proves the payment of the Gratifications corresponding to July 2011. Interviews with the workers revealed that the Gratifications are not paid in their entirety, that is, employees received their payments partially, instead of 1 whole monthly salary, as the law requires.
- 2) The last CTS had not been paid by the time the audit was carried out. The CTS should be accredited to the employee's bank account twice a year, in May and November. The last CTS should have been deposited by November 15, 2011; however, factory had not made such deposit into the employee's bank accounts by this time.
- 3) Based on Art. 29 of the Constitution and Arts.1, 2, 5, 6 and 7 of the Legislative Decree N° 892, all companies of the private sector, which reports annual profits to the Superintendent of Tax Administration (SUNAT) must let their employees participate in the sharing of such profits. In this case, the factory has not complied with this law. The Profit Sharing should be made affective by April 30, 2011.
- 4) Employees with 4 or more years of service at the workplace have the right to a Life Insurance Policy provided by the employer. This is established by the Arts. 1, 2 and 7 of the Legislative Decree N° 688. The factory has not provided such policies to its eligible workers.
- 5) Auditors confirmed that the factory has made delayed payments of vacations. Employees who are entitled to vacations did not receive the relevant payment on time. This was confirmed by a review of a sample of records of 5 cases. In these cases, the factory paid the vacation after the 1-month vacation period.



Plan Of Action: Upon receipt of FLA final report findings, immediate email and phone conversations between brand compliance and factory management began. Brand arranged to send its own auditor to the factory to verify findings and to ensure remedial action has taken place. Follow-up verification audit was conducted on January 17, 2012.

Deadline Date: 01/13/2012

Supplier CAP: In regards to items 1 and 2, legally mandated bonus pay, due workers twice a year and equivalent to 1 month's salary, is to be paid the first week of December 2011. In regards to vacation pay due to workers, this has been retroactively paid. In regards to item 3, Profit sharing due in April 2011, factory does not agree as they say 2010 profits were minimal. In regards to item 4, life insurance for workers with 4 or more years of employment, the factory currently cannot afford to get this insurance, but will continue to seek opportunity to do so in the future. In regards to item 5, impartial vacation payments had been made, but as of December 31, 2011, all payments are current.

Supplier CAP Date: 01/14/2012

Action Taken: Supplier implemented some corrective actions, including making good on legally mandated bonus payments. However, after extensive engagement between brand and supplier, supplier decided not to continue cooperating with Corrective Action Plan (CAP), claiming they were financially unable to meet additional compliance demands.

Plan Complete: No

Plan Complete Date:

Follow-up Plan of Action: On January 17, 2012, New Balance conducted a verification audit and found that the employer had already begun to correct findings. At that time, however, factory management asked for more time to bring the factory into full compliance, especially in regards to payment of additional benefits and retroactive vacation payments to workers. While the factory afterwards reported that additional improvements had been achieved, a second in person meeting request and factory visit with factory management, scheduled for March 2, 2012, was refused, as factory claimed they were not financially capable of correcting all issues identified in the audit.

Wages, Benefits and Overtime Compensation: General Compliance Wages, Benefits and Overtime Compensation

WBOT.1 Employers shall comply with all local laws, regulations and procedures concerning the payment of wages and benefits, including overtime compensation. In any case where laws and the FLA Code are contradictory, the standard that provides the greatest protection for workers shall apply. Where provisions are lacking, employers shall take measures to reasonably accommodate matters concerning the payments of wages and benefits, including overtime compensation. (S)

Noncompliance

Explanation: 1) Factory does not take into account the Family Allowance ("Asignación Familiar") when calculating the overtime. According to Arts. 10, 11 and 12 of the Supreme Decree 007-2002-TR and Arts. 23, 24 and 25 of Supreme Decree 008-2002-TR, the overtime rate must be calculated over the base of the incomes the employees have received, which not only means ordinary salary but also other legal benefits paid as the Family Allowance ("Asignación familiar").

2) As the time recording system at the factory is not adequate, it was not possible to verify that all overtime work is compensated accurately (please see details in HOW.6).

Plan Of Action: Factory was requested to submit sample copies of payroll, which would indicate that overtime calculations took into account the total earnings of the workers. A verification audit, to be conducted by New Balance's internal auditor, will take place on January 17, 2012.



Deadline Date: 12/24/2011

Supplier CAP: Factory agrees to immediately make overtime payments based on total earnings, base salary, plus any production bonuses.

Supplier CAP Date: 12/31/2011

Action Taken: Factory has been unable to comply with this finding, alleging that they cannot afford to do this under the current pricing model. Factory has agreed to factor this additional operating expense into future orders.

Plan Complete: No

Plan Complete Date:

Follow-up Plan of Action: Brand could not continue remediation process as business relationship ceased in early 2012.



Wages, Benefits and Overtime Compensation: Accurate Calculation and Recording of Wage Compensation

WBOT.17 All payments to workers, including hourly wages, piecework, benefits, bonuses, and other incentives shall be calculated and recorded accurately. (S)

Noncompliance

Explanation: Factory does not formally record the payment of bonuses that employees receive for achieving production goals. Salary payroll does not register the bonuses; therefore factory excludes this amount of money when calculating and paying social security contributions and other legal benefits.

Plan Of Action: It was requested of supplier that they accurately record all production earnings of workers. A verification audit, conducted on February 17, 2012 confirmed that all bonuses are now being recorded.

Deadline Date: 12/31/2011

Supplier CAP: Factory agreed to properly record all bonus earnings and to include the same in all calculations with regards to benefits to workers.

Supplier CAP Date: 03/03/2012

Action Taken:

Plan Complete: No

Plan Complete Date:

Follow-up Plan of Action: Brand could not continue remediation process as business relationship ceased in early 2012.

Harassment or Abuse: Discipline/Review of Disciplinary Action

H&A.3 The disciplinary system shall include possibilities for workers to have disciplinary action imposed on them reviewed by someone at a higher managerial position than the manager who imposed the disciplinary action. In addition, such a system shall include the ability of a worker to appeal and/or question any disciplinary action against him or her and/or have a third party of his or her choice present when the disciplinary action is being imposed. (P)

Noncompliance

Explanation: Factory discipline procedure does not include the possibility for employees to make appeals. Workers also don't have the opportunity to have a third party of their choice present when disciplinary action is being imposed.

Plan Of Action: Factory has been asked to develop disciplinary policy and procedures that permit workers to file appeals if they are not in agreement with company actions. The policy should also give the worker, when the subject of a disciplinary action, the right to have a third party representative of their choice present.

Deadline Date: 02/17/2012

Supplier CAP: Factory will consult with legal experts to determine best practice for disciplinary policy, procedures and practices. The factory agrees to work on a plan to present to New Balance.

Supplier CAP Date:

Action Taken:

Plan Complete: No

Plan Complete Date:



Code Awareness:

GEN.1 Establish and articulate clear, written workplace standards. Formally convey those standards to Company factories as well as to licensees, contractors and suppliers.

Noncompliance

Explanation: New Balance has not made any effort to convey clear written workplace standards to the supplier factory.

Plan Of Action: Post both FLA and New Balance Code of Conduct posters, in appropriate language, on each floor and where workers have easy access to them. Additionally, supplier has been asked to provide a written plan for workers' rights training.

Deadline Date: 01/21/2012

Action Taken:

Plan Complete: No

Plan Complete Date:



Code Awareness:

GEN.2 Ensure that all Company factories as well as contractors and suppliers inform their employees about the workplace standards orally and through the posting of standards in a prominent place (in the local languages spoken by employees and managers) and undertake other efforts to educate employees about the standards on a regular basis.

Noncompliance

Explanation: New Balance has not ensured that the factory informs their employees about the workplace standards. New Balance Code of Conduct has not been provided to the factory.

**Plan Of
Action:**

**Deadline
Date:**

**Action
Taken:**

**Plan No
Complete:**

**Plan
Complete
Date:**



Code Awareness:

GEN.3 Develop a secure communications channel, in a manner appropriate to the culture and situation, to enable Company employees and employees of contractors and suppliers to report to the Company on noncompliance with the workplace standards, with security that they shall not be punished or prejudiced for doing so.

Noncompliance

Explanation: The Company has not developed any communication channel that allows workers to confidentially report instances of noncompliance with the workplace standards.

**Plan Of
Action:**

**Deadline
Date:**

**Action
Taken:**

**Plan No
Complete:**

**Plan
Complete
Date:**



Health and Safety: Machinery Maintenance and Worker Training

H&S.18 All production machinery, equipment and tools shall be regularly maintained and properly guarded. Workers shall receive training in the proper use and safe operation of machinery, equipment and tools they use. Employers shall ensure safety instructions are either displayed/posted near all machinery or are readily accessible to the workers. (S)

Noncompliance

Explanation: From a sample of 3 production lines in the first floor of the [Name of factory building], it was observed that some sewing machines are missing broken-needle protectors.

**Plan Of
Action:**

**Deadline
Date:**

**Action
Taken:**

**Plan No
Complete:**

**Plan
Complete
Date:**

Hours of Work: Time Recording System

HOW.6 Time worked by all workers, regardless of compensation system, shall be fully documented by time cards or other accurate and reliable recording systems such as electronic swipe cards. Employers are prohibited from maintaining multiple time-keeping systems and/or false records for any fraudulent reason, such as to falsely demonstrate working hours. Time records maintained shall be authentic and accurate. (P)

Noncompliance

Explanation: It was observed that the working hours are not recorded accurately. Factory time tracking system automatically set the departure time of all employees at 5:30 p.m. However, gathered information shows that it is a frequent practice that employees work up to 7:00 p.m. or 8:00 p.m. In fact, the days auditors were on site at the factory, it was confirmed that workers continued working after 5:30 p.m.

**Plan Of
Action:**

**Deadline
Date:**

**Action
Taken:**

**Plan No
Complete:**

**Plan
Complete
Date:**

**Action No
Verified:**
