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Internal Audit of CSR strategies

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ABSTRACT: Companies from the entire world are more and more concerned about sustainable development, social responsibility, adopting CSR programs according their stakeholders expectations. This situation can lead first of all to a company image improvement and attractiveness and on the other hand can involve significant risks and opportunities to the organization.
In this respect, the internal audit activity according to the International Professional Practices Framework (IPPF) has to identify major risks and to provide assurance to the company stakeholders, board and company' management.
This paper tries to design planning and implementing process related to internal audit of CSR strategies and programs.

KEYWORDS: CSR, internal audit, risks, assurance, stakeholders.

Introduction

According with *World Business Council for Sustainable Development*, Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

In the same mode, a definition is provided by *European Commission; Employment & Social Affairs* who consider Corporate Social Responsibility a concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment.

Regarding these definitions we appreciate that the emergence of corporate social responsibility today is a new guideline to follow for conducting business in an uncertain and changing world. In the post-Enron era, the number of companies reporting their social and environmental impact on society has increased. CSR involves the increased recognition today by all kind of companies that reports information not only for shareholders, but for all the stakeholders who are impacted by the company's behavior. These include employees, customers, suppliers, governments, and non-governmental organizations. In this approach of social responsibility, stakeholders also could include socially responsible investor organizations, consisting of investors who make investment decisions using various social and ethical information.

In this context, Corporate Social Responsibility had to join business operations with social values, companies can be profitable while at the same time minimizing their negative impact on stakeholders.

CSR integrates the interests of stakeholders all of those affected by a company's conduct into the company's business policies and actions.

CSR focuses on the social, environmental, and financial success of a company the triple bottom line, with the goal being to positively impact society while achieving business success.

Some organizations follow a "Triple Bottom Line" reporting strategy, which covers Economic, Environmental and Social Responsibility. In the meantime other organizations focus on Economic and Corporate Social Responsibility, where the environment is included under the CSR concept.

Depending on the organizations risk profile, globalization and maturity, it may include some or all of the following elements within CSR objectives: Ethics, Transparency, Environment, Health & Safety, Corporate Governance, Human Rights, Community Investment.

1. CSR and internal audit necessity

In this context, social responsibility is a major concern for management from a reputation risk perspective. Typically, reputation risk is associated with fraudulent reporting, regulatory actions against a company, or misconduct of individual officers (for example, personal tax fraud). But the scope of social responsibility has been expanding continuously to include several aspects that are perceived by the public to be the social impact of business actions. Communities understand the impact of corporate influences in the local dynamics of their marketplace and international human rights organizations help consumers to stay informed of possible corporate transgressions that may or may not be unfounded.

As recently as five years ago, CSR was perceived as an either-or proposition. If a company attempted to address stakeholder concerns, it might be perceived as impacting the company's profitability. More recently, studies and actual practice have shown that critical stakeholders -- including customers, employees and socially responsible investor organizations - are actively looking for permission to do business with socially responsible companies. Increasingly, the value of those companies long term is seen as dependent upon their ability to meet these expectations. Furthermore, a significant percentage of many companies' value today is made up of "good will," an asset easy to lose and difficult to regain. In consequence, companies that recognize this fact are increasingly seeing the need to take appropriate steps to minimize their negative impacts on stakeholders and thereby protect their valuable reputations and good will.

Social responsibility is concerned with doing "the right thing" and also protecting the reputation of an organization beyond short-term considerations of profit maximization. Ethics and social responsibility are closely related and can be either an asset or a liability. An organization's management/board members should understand social responsibility as both a public duty and a necessity of long-term organizational value.

In today's global economy public pressure from expanded coverage by news agencies, close monitoring by NGOs, etc makes any organizational miscue a potential major issue. Adverse news can lead to a number of consequences like loss of investor confidence, devaluation of stock prices, expensive damage mitigation effort, inability to attract talent, boycott by consumers, etc.

To help protect an organization against these risks the internal audit should include a review of social responsibility. Although this became a new area of analysis, that can raise awareness of risks.

The scope of internal auditing within an organization may regard actions such as the efficacy of operations, the reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with laws and regulations.

Internal auditing frequently involves measuring compliance with the entity's policies and procedures. However, internal auditors are not responsible for the execution of company activities; they advise management and the Board of Directors (or similar oversight body) regarding how to better execute their responsibilities.

Organizations use a variety of approaches to enhance the credibility of their reports. Organizations may have systems of internal controls in place, including internal audit functions, as part of their processes for managing and reporting information. These internal systems are important to the overall integrity and credibility of a report.

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."[http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing]

2. Providing assurance by Auditing CSR

Internal Auditors might be involved in CSR at a variety of levels. For example, internal auditors might facilitate or advise management on CSR self-assessment activities, internal Auditors might be involved in auditing CSR programs, either as individual components of the audit plan, or as a broad based review of how CSR is managed, and whether the company is achieving its CSR objectives, internal auditors might become involved in coordinating or participating in CSR Report verifications (assurance audits) or assurance relating to controls over public disclosures of financial and non-financial information relating to CSR, or any of the CSR elements.

As part of the risk assessment and audit planning process, the chief audit executives considers the CSR risks and whether to include all or part of the processes in its audit universe and audit plans. The chief audit executives also should be aware of CSR issues in order to respond to any special requests by the board or senior management.

In order to design a good internal audit process, International Professional Practices Framework (IPPF) Issued by International Institute of Auditors (IIA) [http://www.theiia.org/guidance/standards-and-guidance/ippf/definition-of-internal-auditing] identified some risks related to CSR activities. According to IPPF, organizations are exposed to a variety of risks associated with CSR activities. The board and management are responsible for performing a risk assessment and determining what is important to their organization and the controls they will implement to manage those risks. The chief audit executives should understand these risks and use that knowledge when considering CSR activities in the audit universe, audit plan and audit approaches. Internal auditors should understand these risks to help them develop appropriate audit procedures. A part of these risks are:

- **Reputation -** The organization's brand or reputation could be damaged due to violations of law or principles, errors or omissions in disclosed CSR information, under-performance compared with objectives/targets, or the appearance of indifference to social issues. If activists believe an organization is being unresponsive to their concerns, they may become shareholders to introduce resolutions relating to their CSR agenda. Organizations have the opportunity to enhance their reputation by behaving in a socially responsible manner and involving stakeholders in decisions that affect them.
- **Compliance -** Organizations may fail to comply due to the extent, complexity, and volume of regulations relating to the environment, health and safety, employment, governance, political contributions, conflict of interest, fraud, etc. Compliance risk also arises from contractual obligations with third parties, such as customers, unions, or employees, and from voluntary adoption of standards. Compliance risk increases for organizations operating in multiple countries.
- **Liability-** Liability risk exists when contracting for CSR terms and conditions and ensuring third-party compliance. Activists or specific classes/special interest groups may take legal action for alleged harm done by the organization
- **Operational -** Risk arises from the CSR "pressure points" for the organization's manufacturing processes, products, services and impact on the environment. Other examples of potential risk scenarios include: under-performance of other targets due to inappropriate CSR strategies, or over-emphasis on CSR strategies; failure to integrate CSR objectives into processes, or to educate staff appropriately; failure to develop well-controlled systems for CSR initiatives; risk associated with reporting CSR activities and results (e.g., inaccurate or incomplete information and poor communication and reporting strategies). In addition, international organizations may find it challenging to apply the same standard in multiple countries.
- **Stock Market -** Organizations may lose investors, or limit their pool of investors, if they do not qualify for Socially Responsible Investment or similar funds.
- **Employment Market -** Employees want to work for organizations that respect their rights, have a culture of integrity, and commit to social and community concerns.
- **Sales Market -** Customers might boycott products or services for environmental or social issues. Organizations have an opportunity to increase sales and advertising if they are recognized by "socially responsible consumer" groups.
- **External Business Relationships -** Customers, suppliers, or partners could violate CSR terms and conditions, principles, or laws, yet the organization could be included as a wrongdoer by association. Developing and monitoring the controls over and within external business relationships may be a challenge for some organizations.

Also, an organization's social responsibility initiative may include many component programs addressing both internal and external considerations including:

- Donating Funds & Resources – management should ensure that donations are carefully reviewed and based upon sound judgment.
- Project Implementation – companies often embark on large CSR projects that are aimed at delivering high Brand or business impact. These projects may typically run over a long time horizon and involve significant investment of time and resources, both monetary and people. Setting of clear objectives, adequate resourcing, effective monitoring and independent review of project performance are critical to success.

- Communications – establish effective plans to communicate to employees and the public to describe the organizations actions and the related impact to the community.
- Social Responsibility Analysis – organizations can allocate dedicated resources to identify, evaluate, and research social responsibility issues.
- Managerial Policies & Decision Support – all organizational levels and objectives should incorporate social responsibility plans. These intentions may be included in policy and procedures, statements to the public, marketing campaigns, and made transparent to the public. Management decisions should incorporate social responsibility considerations especially those that directly impact the community.
- Research & Development – organizations can conduct research into alternative methods or approaches to operations or products that reduce or remove undesirable impacts or byproducts.
- Government Program Participation – companies collaborate with government agencies to provide research on issues often along with their industry competitors.

Reputation risks associated with lack of adequate social responsibility programs should be considered during annual audit planning. The Internal Audit function is well positioned to help identify the issues that the organization may not be addressing adequately.

To help this kind of interventions for identify the risks and manage them thru internal audit, international organizations have established some standards for conducting assurance or verification audits:

- Institute of Social and Ethical Accountability has issued his AA1000 Assurance Standards;
- The Federation des Experts Comptables Europeens has published several CSR assurance standards papers;
- Social Accountability International has established the SA 8000 standards, and has certified companies who can perform Social Accountability audits of businesses or manufacturing facilities
- International Audit and Assurance Standards Board (part of IFAC) has issued IASE3000 - Assurance engagements other than audits reviews of historical financial information

The internal audit activity may choose to evaluate the CSR programs as a whole and determine whether the organization has adequate controls to achieve its CSR objectives. This option would likely require a significant allocation of resources because of the broad scope of the subject. Such an audit is not likely to be done to develop the first opinion on CSR controls; rather the chief audit executives would develop a one- to three-year plan to obtain sufficient and reliable information about the various elements of CSR within the organization.

There are many approaches to auditing CSR controls, including:

1. Separate audits of each element of CSR that are further refined into audits of these subjects at the corporate office, subsidiaries, and with external business relationships. Management processes can be evaluated based on internal control or quality frameworks, such as COSO, ISO, etc., or compliance with customer expectations (contractual obligations).

2. Audits of CSR programs related to each significant stakeholder group affected by CSR activities that are further refined into audits of these subjects at the corporate office, subsidiaries, and with external business relationships.

3. Bundling of subjects, such as the:

• Workplace: employer of choice, health and safety, environmental management practices, diversity and equality, training and development, ethics, governance, and human rights.

• Marketplace: product quality and safety, responsible advertising and sales, responsible supply chain management, product development and testing practices, product stewardship, disclosure practices, and privacy.

• Environment: responsible air, water, land, waste, animal, and energy use and regulatory compliance.

• Community: philanthropy, local economic support, capacity building, volunteerism, and stakeholder engagement.

4. Audits of the internal controls over risk management, recording, measuring, and reporting of CSR activities within each department or function that is covered in the audit plan.

5. Assurance audits of public disclosures of financial and nonfinancial information related to CSR or any of the individual CSR elements. Most organizations with stated CSR objectives provide public information about their approach and results.

6. Audits of third parties for contractual compliance, including compliance with CSR terms and conditions.

A proactive role may also be taken. For example, internal auditors could perform a review as part of a supplier pre-qualification process.

Upon completion of the CSR-related audit programs, an opinion of the overall CSR controls can be developed.

Senior management or the board may choose to publicly state that it relies on its internal controls to produce reliable information for public reporting. Management might also ask the chief audit executives to provide a statement for the CSR report, saying that the internal audit activity has provided assurance on the information contained in the report. The chief audit executives should ensure that the elements of the Formulating and Expressing Internal Audit Opinions Practice Guide have been reviewed before issuing an opinion about the organization's CSR program.

Any internal audit activity that collectively lacks the appropriate skills and knowledge should not undertake an internal audit, facilitation, or consulting engagement. Specific CSR competencies could include expertise in regulations, management systems and best practices relating to the environment, health and wellness, safety, science and engineering, ethics, community investment, employment, human rights, working conditions, and governance. Language and other communication skills are also important considerations when discussing sensitive issues, such as working conditions or ethics violations, and for designing surveys.

Teaming internal auditors with internal subject matter experts is useful; it provides an opportunity for the auditors to learn the subject, and for other employees to learn more about a logical approach to evaluating process effectiveness and internal controls. The subject matter experts should not be members of the area being audited. They could be employees in similar departments of subsidiaries or other divisions. If the organization hires an external service provider to provide assurance on CSR reports, the chief audit executives should consider the benefits of loaning a member to the assurance team.

Such benefits can include internal auditor training opportunities, the lessons learned on the project stay within the organization, and the internal auditor can assist the team in accessing information more efficiently due to his or her knowledge of the organization.

In order to develop an audit program, internal auditors must formulate some questions regarding the role of CSR audit. The following elements include concepts to help internal auditors think through various subjects when developing the audit program. Because the audit scope and program are based on a risk assessment for the organization, some of these concepts are specifically to each organization.

- **Consider the proliferation of CSR information that the organization produces**. Are the messages consistent and current in public reports, speeches, and handouts/presentation materials and on the organization's Web sites? How is disclosure and updating controlled? Are the messages relevant to the organization's mission, goals, objectives, and commitments?
- **Has the organization made a decision to report information consistent with reporting standards, such as the Global Reporting Initiative?** Can the information be compared with the organization's competitors or industry peers?
- **How are CSR strategies and priorities established and communicated?** How are they integrated into decision making and approval processes (e.g., budget, appropriations, mergers, acquisitions, and joint ventures, performance evaluation and bonuses, leadership training, and stakeholder relations)? What takes precedence when there are competing objectives?
- **Is the organizational structure of CSR responsibilities and authority documented for all elements?** Are responsible positions staffed with experienced and qualified individuals?
- **Is the organization signatory to voluntary standards of performance?** Why or why not? Were the standards adopted by management, or by the board? How are they integrated into management practices? How is compliance monitored in the organization?
- **How does the organization manage compliance with local and international laws? Does the organization meet standards required for inclusion in environmental or social investment funds?** Why or why not?
- **Can the CSR — especially environmental or human rights — activities of external business relationships impact the organization's reputation?** If yes, then contracts should include CSR performance terms and conditions, and compliance should be tested. The internal audit activity may be involved in such tests or receive reports on results of tests done by others.
- **Can the CSR activities of customers impact the organization's reputation?** Would the organization refrain from selling products to organizations with irresponsible or unsustainable

practices? Does it provide programs to encourage or facilitate customers to be responsible with its products?

- **How well controlled are the mechanisms put in place for capturing CSR information and developing and reporting performance metrics?** What spreadsheets are used, and are there adequate spreadsheet controls to ensure complete, accurate, and timely information?
- **If the organization publishes a CSR report:**
  - Is the disclosure process for CSR results as rigorous as for financial reporting?
  - Does it contain clear messages that are aligned with the company's vision and commitments?
  - Does it contain balanced reporting (i.e., the good with the bad), performance measures, and trends?
  - Does it help the reader understand the issues and the organization's accountabilities?
  - How does the organization's CSR program compare with others?
  - Has it competed for awards? Has it received recognition in other benchmarking programs?
  - How good is the CSR report? Has it been benchmarked by independent organizations?
  - Has the organization asked for feedback? What did the feedback say, and what was the organization's response?

Using these themes, internal auditors could set the ***objectives*** of their audit, like follows:

1. Through the use of inquiry and gathering evidence, gain an understanding of the Company's risk identification, response plans, and internal control techniques surrounding the corporation's social responsibility program.
2. Perform testing and analysis on sample of social responsibility programs to determine compliance with related management policies and intent.
3. Identify control weaknesses and make recommendations for improvement to social responsibility program components, or individual program operations.

With these objectives sets, the audit program could be ***planned*** in four steps:

1. Planning meeting
   a. Conduct a planning meeting to discuss scope, approach and timing.
   b. Determine timeframe of period to be examined.
   c. Consider the areas to be included such as: communications, donation programs, social responsibility expenditures, compliance with regulations, etc.
   d. Determine the appropriate auditee contact(s).
2. Obtain sufficient understanding of the audit area:
   a. Determine if an internal audit of this area has been done previously. Utilize any previous work products for training and development of the current plan.
   b. Obtain and review the policy and procedures for social responsibility programs, including available roles and responsibilities.
   c. Use self-assessment material, if appropriate, to have the auditee or program managers evaluate their own control environment prior to the audit.
   d. Develop a risk profile for the Social Responsibility area.
3. Work with the auditee as to the scope, approach and timing of the audit and detailed document request.
4. Review any known best practices for the social responsibility area, and incorporate them into the audit work and audit report.

After planning the audit, this could be ***developed*** in order to obtain an report of CSR internal audit, looking for following problems:

1. Conduct an entrance meeting re-establishing the scope and timing of the review. Establish a schedule for status meetings and open-communication protocol.
   - Determine scope of social responsibility areas to be included & consider components based upon donation amounts, nominal resource values, and centralization of operational procedures.
   - Arrange verification procedures for remote locations as required.
2. Based upon interviews discussing several significant social programs related to the entity over recent quarters, determine if programs were developed to address such issues.

- Determine the reason for not participating if no action was taken.
- Based upon interviews with the CSR Head, Ethics Officer and other Director level personnel, including input from management, select several programs to evaluate.

3. Obtain some documents like: Organizational chart for social responsibility function(s); Policies and procedures for social responsibility programs and management involvement efforts; Policies and procedures for approved charities, partner organizations; Signature authorization list; Program management procedures, etc.
4. Gain an understanding of procedures for social responsibility program expenditure processing: requisition requests, approval limits listing, vendor approvals/changes, vendor invoices, expense reimbursements, petty cash and imprest accounts; Evaluate the adherence to spending limits policies and procedures; Consider walk-through of purchase requisition through payable processing to determine reasonableness of processing personnel's knowledge of procedures, limits, and audit trails accordingly.
5. Observe and document (via flowcharts) the social responsibility management processes.
6. Meet with managers responsible for the selected social responsibility programs. Determine current budgets, planned activities and program objectives, communication and reporting, other promotions and programs, document the approval obtained, analyze the adequacy of the approval in comparison with Company Policy & Procedures.
7. For selected social or large philanthropic projects, perform a review of expenditures. Determine if all expenditures are related to the stated program.
8. Meet with the third-party charitable organization receiving the funds, resources, or actions to determine the impact. Evaluate the impact of the company's social efforts with recipients, local news organization, and the charitable community (trade publications).
9. Evaluate the compliance with related laws and regulations
10. Examine the progress of each social responsibility program compared to beginning stated objectives.
11. Evaluate the communication programs concerning social responsibility programs.
12. Consider the level of senior management support for social responsibility programs.

The final step of CSR internal audit program is to ***report***, action witch can be set in two steps:

1. Reporting – Draft: prepare preliminary draft of the audit report using the standard format. Ensure appropriate auditee reviews draft and that any action items have been discussed with auditee.
2. Reporting – Issuing draft
   (a) Issue preliminary report to management. At this point management/auditee should agree on the timing for implementing any action items identified and agreed to in the report. Responsibility for implementation should also be assigned.
   (b) Validate the accuracy of all audit report content.
   (c) Update permanent file with new details about the process, people, and controls for future use.

Conclusions

Internal auditors, thanks to their international association, can use a guideline in planning, developing and reporting CSR internal audit, according to the growing importance of this area. Auditors who have a thorough understanding of corporate responsibility and sustainability, including trends, requirements, and tools, have a competitive advantage within their audit function.

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