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THE INSTITUTE OF ENVIRONMENTAL  
MANAGEMENT AND ASSESSMENT

Corporate Social  
Responsibility:  
A guide to good practice

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# Corporate Social Responsibility: A guide to good practice

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August 2007

Prepared by csrnetwork on behalf of the IEMA

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Serra Pelada (Hill of Gold) gold mine is one of the richest and largest deposits of alluvial gold ever found. It is located 270 miles south of Belem on the Amazon delta. The mine is controlled by the State which distributes the 'barrancos' (six meter squares of soil) to the various owners 'garimperos' (gold diggers or fortune hunters) according to their seniority. The 'garimperos' are only allowed to dig vertically into the earth in order to avoid encroaching on other diggers. Whenever gold is found it is placed in sacks by workers, called 'mudhogs' and taken to a sifting and sorting area belonging to the owner. In 1985, 50,000 'garimperos' and their workers entered the gold mine every day. The site had serious environmental impacts including deforestation, and water pollution from mercury used in the mining process.

# Foreword

CSR can be a daunting brief to take on. It potentially touches so many aspects of what an organisation does, from environmental management to labour standards and community relations to ethical sourcing. If you've been given responsibility for CSR, it will probably take you well outside your natural areas of expertise.

That is why this practical how-to guide promises to be so useful. I've worked with the authors and have found that they combine expertise in CSR with down-to-earth advice. Their guide explains the key CSR concepts and, crucially, shows how to get good practices up and running in your organisation. It is a welcome addition to the growing library of books about CSR.

**Catherine Holmes**

Communications Manager  
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# Acknowledgements

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**John Brady**

Editor

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# Introduction

## 1.1 Setting the scene

Corporate social responsibility (CSR) has come in from the cold. Once a phrase used almost exclusively by pressure groups, non-governmental organisations, niche consultancies and a handful of pioneering but unconventional corporations, it now sits firmly on the mainstream business agenda. In boardroom discussions, investor presentations, annual general meetings and the media, CSR is common currency.

Nevertheless, there is still a fog of confusion surrounding what CSR is. To some, it means compliance with corporate legislation. To others, it is about charitable giving. A vague notion of ‘ethical business’ is sometimes used to try to explain CSR. Thankfully, in the past few years, a much more certain and increasingly widely accepted definition has emerged – and it is one that underpins this guide.

CSR is about how organisations align their values and behaviour with the expectations and needs of their stakeholders – not just their customers and investors, but also employees, suppliers, communities, regulators, special interest groups and society as a whole.

CSR demands that a company be accountable to its stakeholders for managing its social, environmental and wider economic impacts in a way that maximises the benefits and minimises the downsides.

And this is not just an issue for big business, particularly since the Companies Act 2006 introduced a requirement for company directors (including in private companies) to be aware of their company’s social and environmental impacts.

With CSR having become so fundamental to business, opportunities are opening up for managers willing and able to take it on. If you can act as the catalyst for making your company more responsible and accountable, you can make a name for yourself in your organisation. And more importantly, you can help your organisation make a positive contribution in the wider world.

Businesses that engage seriously in defining responsible business practice will inevitably find opportunities to enhance their reputation by telling their

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story externally. But it needs to be this way round – communication of CSR should be like the cherry on the cake. There is nothing for the cherry to sit on unless you also have baked the cake – which means designing and implementing an effective CSR strategy. Unfortunately, some companies have jumped on the bandwagon, projecting a CSR ‘position’ that runs too far ahead of their actual practice. This is both misguided and risky because stakeholders see through spin.

Smart companies – those that have embedded social, environmental and ethical management practices at the heart of their businesses – are the ones that will ultimately gain greatest benefit from CSR. It will enable them to better foresee changing attitudes and expectations so that they can develop the products and services that will meet society’s future needs.

This guide aims to show you how to accomplish this. While much has been written about the concepts of CSR, and about companies who are ‘doing’ CSR in one way or another, we have focused here on creating a practical step-by-step guide to setting up and implementing a CSR programme.

It covers all the essentials – from drawing up a strategy to managing performance on a day-to-day basis. It can be used as a guide to setting up a CSR programme from scratch, and also points the way for more advanced practitioners to become leaders. The general approaches described are applicable whether you work for a large corporation or an SME (small to medium-sized enterprise).

This introduction goes on to state the business case for CSR, explain the model of CSR used in this guide, and set out the key CSR issues for different stakeholder groups and industry sectors.

The chapters that follow then outline what you need to do in each of the six key areas of a CSR programme: strategy, stakeholder engagement, governance, performance management, public disclosure and assurance. In each chapter, we provide a case study, and we also follow a fictional company, AZ Mining, through its establishment of a CSR programme.

## 1.2 Why bother with CSR?

Why should your organisation bother with corporate social responsibility? Why go to the effort of behaving as a good corporate citizen and measuring and reporting your activities and performance?

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To many companies, it's just too much like hard work, or else it's an unwelcome distraction from what they see as the real business of business: making a profit. But what these organisations do not realise is that they are probably already exercising their corporate social responsibilities to some extent, and so the transition to proactive and structured management of CSR is not as great as they think. Moreover, CSR is not just about doing the right thing by fulfilling duties to society; it is also the smart thing to do because being responsible and accountable brings significant commercial advantages.

**Profit:** Several studies have shown a direct correlation between socially responsible business practices and positive financial performance. A 1997 DePaul University study found that companies that have a clear commitment to ethical principles do better financially (based on annual revenues) than companies that don't. An 11-year Harvard University study, published in 2004, found that 'stakeholder-balanced' companies showed four times the growth rate and eight times the employment growth than companies that were shareholder-only focused.

**Access to capital:** The rise of socially responsible investment (SRI) means that companies committed to CSR often have access to capital that others do not. The Dow Jones Sustainability Index, the FTSE4Good Index, the Morley Fund Management Sustainability Index, the Business in the Community Corporate Responsibility Index and others analyse companies' CSR activities. Investors turn increasingly to these indices before committing their funds. And according to Eurosif, by 2006 the SRI market in Europe was estimated to be worth up to €1 trillion, representing as much as 10 to 15 per cent of total European funds under management. This is a 36 per cent growth since 31 December 2002.<sup>1</sup>

Also, fund management companies are becoming more vocal and assertive about their expectations regarding corporate responsibility, which they are increasingly seeing as being fundamental to companies' risk profiles.

**Lower operating costs and greater efficiency:** Improved management systems for non-financial issues do not automatically result in greater cost. Many environmental initiatives improve operational efficiency by reducing waste production and water usage and increasing energy efficiency. In the human resources arena, flexible scheduling and other work-life initiatives result in reduced absenteeism and increased retention of employees and save companies money through increased productivity and reduction of hiring and training costs.

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1 [www.eurosif.org](http://www.eurosif.org)

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**Enhanced reputation:** So much of a company's reputation is based on trust among its stakeholders. A strong reputation in environmental and social responsibility can help a company build this trust – as long as it is the result of deeply ingrained policies and practices, and not just corporate lip service to CSR.

A strong CSR programme can also help cushion a company's reputation from damage. Non-governmental organisations and local communities are far more willing to defer protests and action against a company as a result of an incident if it is evident that the company has genuinely worked hard to prevent it happening in the first place, and has in place solid management practices for rectifying the situation – quickly – and for avoiding a repeat.

**More sales:** Research has shown that consumers not only want good and safe products, they also want to know that what they buy was produced in a socially and environmentally responsible way. A CSR Europe/MORI study in 2000 found that a company's commitment to CSR was important to 70 per cent of European consumers buying a product. In addition, one in five would be willing to pay more for products that are socially and environmentally responsible, and one in six shoppers said they frequently buy or boycott products because of a manufacturer's reputation.

**Greater productivity and quality:** Efforts to improve working conditions, lessen environmental impacts or increase employee involvement in decision-making often lead to increased productivity and reduced error rate. For example, companies that improve working conditions and labour practices among their suppliers often experience a decrease in merchandise that is defective or can't be sold.<sup>2</sup>

**Improved recruitment and retention:** A company's dedication to CSR can help to attract and retain employees. People are no longer concerned just about promotion and salary; they want to work for a company that is run in accordance with their own values and beliefs. After Novo Nordisk launched its Values in Action programme, which aligns its business objectives with sustainable development, it saw a five per cent drop in staff turnover. More generally, 78 per cent of employees say they would rather work for an ethical and reputable company than receive a higher salary.<sup>3</sup>

**Lower risk and more effective risk management:** The more a company is committed to CSR, the less it is exposing itself to risks, for example:

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2 Business for Social Responsibility, [www.bsr.org](http://www.bsr.org)

3 CSREurope, [www.csreurope.org](http://www.csreurope.org)

# Introduction

- risk of damage to corporate reputation, for example as suffered by Nike in connection with allegations that it was using sweatshop labour;
- financial risk, for example unanticipated costs for installing new pollution abatement technology or paying fines for non-compliance with labour legislation;
- environmental risk, for example being required to re-engineer products to remove a newly controlled substance; and
- legal risk, for example failing to anticipate and plan for new legislation relating to disabled access to premises.

**New commercial opportunities:** At its best, good CSR practices will build trust in your company and open up new lines of dialogue with your stakeholders. This interaction creates new insights into society's emerging expectations and, harnessed effectively, should help to fuel innovation processes. For example, mobile telecommunications company Vodafone responded to challenges about unequal access to its services by developing new banking services in sub-Saharan Africa based on SMS texting.

## 1.3 The elements of CSR

Any good CSR programme is made up of six key elements, as shown in Figure 1.1. These are the main management processes that any responsible company should adopt. A chapter of this guide addresses each of these elements – a structure that is based on that used by the Accountability Rating<sup>TM4</sup>.

The Accountability Rating is a benchmarking tool developed jointly by leading CSR consultancy csnetwork (authors of this guide) and the not-for-profit international think-tank AccountAbility<sup>5</sup>. It provides a unique insight into how large companies are responding to the challenge of putting responsible practices at the heart of their business. The methodology for the Rating is based upon both organisations' experiences of working with companies, and draws significantly upon the AA1000 framework standard developed by AccountAbility.

Every year, the Rating is applied to the world's largest companies, and the main findings and a ranking of companies are published in Fortune magazine. In 2006, a wide variation in performance was noted – from companies with leading-edge sustainability practices to those who do not appear to be engaging with CSR challenges in any meaningful way. The Rating also provides a rich resource of good practice, and a method for on-demand benchmarking of corporate accountability.

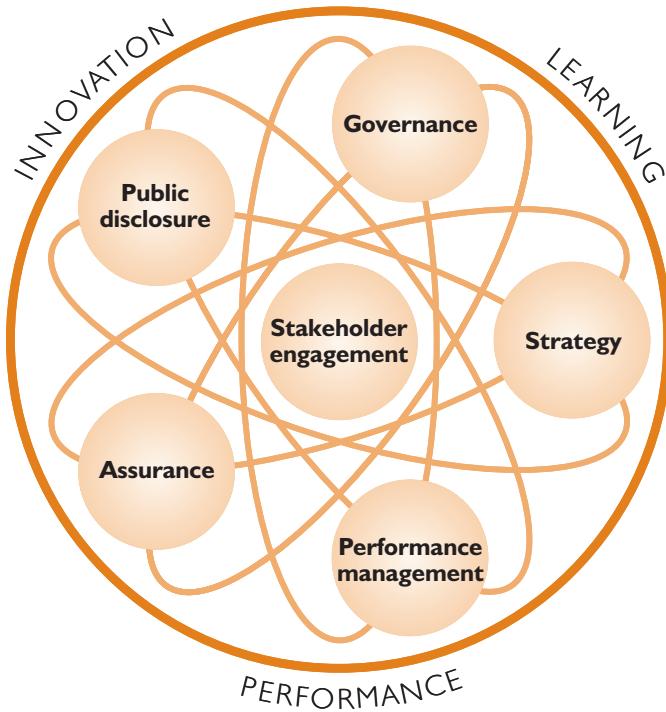
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4 [www.accountabilityrating.com](http://www.accountabilityrating.com)

5 [www.accountability21.net](http://www.accountability21.net)

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Figure 1.1 The six key elements of CSR



**Strategy:** Your CSR strategy is the starting point for your CSR programme, and provides the framework for managing your organisation’s CSR challenges. For an effective CSR strategy, you need to know what the most important – or material – non-financial issues are for your organisation, and ensure these inform the company’s high-level decisions and plans. If the actions you’re taking in the name of corporate responsibility aren’t linked to the core business strategy, you might as well not bother.

**Stakeholder engagement:** Stakeholder engagement is about your organisation engaging with its stakeholders so it can identify its key responsibilities to society, and about how it responds to those views.

**Governance:** Governance concerns how the organisation considers its material non-financial issues at senior levels, for example by ensuring you have a Board director accountable for each of these issues, and that your approach to governance is made transparent.

# Introduction

**Performance management:** Performance management consists of the systems and processes you use to turn your CSR vision into action in day-to-day operations. It is in this area that much of the hard work of CSR happens.

**Public disclosure:** Public disclosure refers to how your company tells the outside world about its material issues and how it is dealing with them.

**Assurance:** An independent check – or assurance – of your CSR report and other aspects of your CSR programme can be a vital step in securing the trust of your stakeholders. It can give them confidence that your activities have been subject to proper scrutiny. Meaningful assurance is not just about seeking verification of the claims you are making and the data you are reporting, but also confirmation that you are tackling and reporting on the material issues in the most effective way.

All six elements are interdependent. For example, through stakeholder engagement, the company better understands its material impacts on society, the economy and the environment. This understanding can be built into governance to ensure the company addresses stakeholder issues in its core decision-making rather than as an isolated sideline. Similarly, performance management systems are designed to ensure the effective management of the material issues, and the effectiveness of these systems is then disclosed publicly, which in turn secures greater stakeholder trust.

If you are serious about making CSR a reality, then you need to be aiming for high performance in all six areas of the cycle.

## 1.4 Today's CSR challenges

**General CSR issues for stakeholders:** Although your company will be dealing with its own unique combination of CSR challenges, it is likely you will have to grapple with a number of issues common to many organisations. These are set out in Table 1.1 against each of the main stakeholder groups<sup>6</sup>. Use the table as an introduction to the main CSR challenges facing big business.

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6 Draws significantly from Crane, A & Matten, D (2004), "Business Ethics: A European Perspective"

# Introduction

**Table 1.1 General CSR issues for stakeholders**

<b>Stakeholders</b>	<b>Potential issue</b>	<b>Key concerns and considerations</b>
Shareholders	Governance	<ul style="list-style-type: none"> <li>Executive accountability and control of performance</li> <li>Executive remuneration</li> </ul>
	Socially responsible investment	<ul style="list-style-type: none"> <li>Investment decisions based on potential CSR issues over the long term</li> </ul>
Employees	Working conditions	<ul style="list-style-type: none"> <li>Health, safety and environmental regulations</li> <li>Managing varying local standards in international operations</li> <li>Contract labour and wider supply chain issues</li> </ul>
	Fair wages	<ul style="list-style-type: none"> <li>Minimum wage</li> <li>Equal pay</li> <li>Managing varying norms in different countries</li> </ul>
	Diversity	<ul style="list-style-type: none"> <li>Equality of opportunity</li> <li>Discrimination on the basis of race, gender, age, religion, disability, sexual orientation and nationality</li> </ul>
Consumers	Product responsibility	<ul style="list-style-type: none"> <li>Product safety</li> <li>Labelling</li> </ul>
	Marketing	<ul style="list-style-type: none"> <li>Misleading or deceptive marketing practices</li> </ul>
	Pricing	<ul style="list-style-type: none"> <li>Anti-competitive behaviour and/or malfunctioning markets leading to unfair pricing</li> <li>Affordable access where users have an irrevocable need, eg for housing, food and medicine</li> </ul>
	Vulnerable consumers	<ul style="list-style-type: none"> <li>Duty of care to vulnerable consumers, especially in relation to products perceived as harmful such as alcohol and cigarettes</li> </ul>

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Stakeholders	Potential issue	Key concerns and considerations
Suppliers	Sourcing	<ul style="list-style-type: none"> <li>Responsible sourcing taking account of issues such as labour standards and environmental management in the supply chain</li> </ul>
	Fair contracts	<ul style="list-style-type: none"> <li>Transparency of contract</li> <li>Abuse of market power</li> <li>Payment terms</li> </ul>
Civil society	Environmental and Social NGOs	<ul style="list-style-type: none"> <li>Climate change</li> <li>Access to clean water</li> <li>Pollution</li> </ul>
	Emerging economies	<ul style="list-style-type: none"> <li>Management of bribery and corruption</li> <li>Variations in local standards</li> </ul>
	Contribution to local economy	<ul style="list-style-type: none"> <li>Revenue sharing, particularly linked to exploitation of natural resources</li> </ul>
	Taxes and subsidies	<ul style="list-style-type: none"> <li>Responsible practice in tax planning</li> <li>Transparency of payments</li> </ul>
	Human rights	<ul style="list-style-type: none"> <li>Child labour</li> <li>Forced labour</li> <li>Proactive protection of human rights in areas of high risk</li> </ul>
	Relationships with local communities	<ul style="list-style-type: none"> <li>Resettlement issues</li> <li>Management of nuisance</li> </ul>
	HIV/AIDS	<ul style="list-style-type: none"> <li>Help to access affordable healthcare</li> <li>Discrimination</li> </ul>
Governments and regulators	Lobbying and party financing	<ul style="list-style-type: none"> <li>Transparency on payments and lobbying priorities</li> </ul>

**Industry-specific CSR issues:** Although Table 1.1 offers a summary of the main types of issues any business might be expected to address, it is not meant to be universally applicable or exhaustive. The priority issues your company should address will include some of these, but there will always be issues specific to your sector and your company's unique circumstances.

Table 1.2 provides examples of more specific CSR issues in two example sectors: automotive and financial services. These examples, which again are not exhaustive, demonstrate the breadth of issues that can be covered in a CSR programme.

# Introduction

Properly identifying, managing and responding to your company's priority social, environmental and ethical issues is what CSR is all about. That process is explained in detail in the chapters that follow.

**Table 1.2 Example issues for the automotive and financial services sectors**

Industry	Potential issue	Key concerns and considerations
Automotive	Impact on communities	<ul style="list-style-type: none"> <li>Automakers and car manufacturers are frequently the largest and longest-standing employers in a community. As such, they have to pay particular attention to the needs of employees and local communities when considering job losses, plant closures and relocation as they seek greater productivity.</li> </ul>
	Health and safety	<ul style="list-style-type: none"> <li>In any large-scale manufacturing business, employee health and safety is a vital consideration.</li> </ul>
	Human rights in the supply chain	<ul style="list-style-type: none"> <li>Car companies have large and complex supply chains, often extending across the world. One of their main challenges is to influence their suppliers to treat their employees fairly.</li> </ul>
	Environment	<ul style="list-style-type: none"> <li>With climate change at the forefront of the international agenda, automotive companies are expected to reduce the carbon dioxide emissions and petrol/diesel usage of the automobiles they produce. In addition, society is increasingly looking to them to develop alternative fuel systems, green technology, hybrids and other alternatives to fossil fuels.</li> <li>Automotive companies must also consider the environmental impacts of their production. They are being pressured to reduce their use of energy and water.</li> <li>Finally, they are starting to have to face issues related to end-of-product-lifecycle issues. Possible solutions include introducing recyclable components and reducing the use of chemicals and materials that have a significant negative impact beyond the life of the automobile.</li> </ul>

# Introduction

Industry	Potential issue	Key concerns and considerations
Financial services	Regulation	<ul style="list-style-type: none"> <li>Financial services companies face CSR issues arising not only from their own business practices, but also because of the potential influence of the capital they supply. As a result, companies are becoming increasingly heavily regulated internationally.</li> </ul>
	Mis-selling	<ul style="list-style-type: none"> <li>There have been numerous mis-selling scandals relating to the financial services industry. Consumers are now highly sensitive to any possible instances of mis-selling.</li> </ul>
	Responsible lending	<ul style="list-style-type: none"> <li>Financial institutions are expected to lend responsibly to help consumers avoid accumulating unmanageable debts.</li> </ul>
	Access to financial services	<ul style="list-style-type: none"> <li>Extending access to services, especially basic banking facilities, among poorer consumers and communities is seen by some as a fundamental duty of financial institutions.</li> </ul>
	Project financing	<ul style="list-style-type: none"> <li>When providing funds for major commercial projects, project financiers have to consider a wide range of complex social and environmental issues, particularly with respect to projects in the emerging markets. These are addressed by initiatives like the Equator Principles and the United Nations Environment Programme Finance Initiative.</li> </ul>
	Fair pricing	<ul style="list-style-type: none"> <li>Fair pricing and making sure that they are not charging more than people can afford is a key CSR issue for financial institutions. This is especially true of insurers who could end up setting premiums that are prohibitively high for perceived 'high-risk' consumers, notably those in developing economies.</li> </ul>
	Micro-finance	<ul style="list-style-type: none"> <li>Banks are often expected to provide small loans to poorer people who would not qualify for traditional banking credit. This is often the only way they can establish a business and lift themselves out of poverty.</li> </ul>
	Money laundering	<ul style="list-style-type: none"> <li>The internationalisation of financial services, and concerns about organised crime and the funding of terrorism, mean that financial institutions must be vigilant against money laundering.</li> </ul>
	Cultural/religious issues	<ul style="list-style-type: none"> <li>Financial services organisations, especially banks, must observe different cultural/religious attitudes to money and banking. For example, Islam does not permit the earning of interest.</li> </ul>

# Introduction

## 1.5 Case study – AZ Mining – making CSR a reality

Throughout this guide, we follow the progress of Jane, senior manager responsible for health, safety and the environment, as she develops and implements a corporate responsibility programme for a hypothetical company, AZ Mining. We use this imaginary case study to illustrate the challenges you may face in your own organisation, and to show how you can use the techniques described in this guide to solve them.

AZ Mining is a purely hypothetical company, and any similarities with actual companies are accidental and unintentional.

As background, AZ Mining is involved in the extraction and processing of gold deposits. The company has a turnover of approximately \$100 million a year and employs around 4,000 people. The company is headquartered in the United States, but has mining operations in Canada and China.

Jane has been tracking the development of CSR over the last year through conferences and informal discussions with counterparts in Australia and Europe. She has noted several potential benefits being realised in other companies, and has received initial support from the chief executive to move the CSR agenda forward in AZ Mining. It is particularly important to AZ Mining to be able to focus its programme on areas that will generate the greatest value and to avoid committing resources to work that does not fit with the principles of the company.

Jane's task, therefore, is to create from scratch a CSR programme that will provide value to AZ Mining, secure buy-in from the Board and shareholders, and roll out the programme to 4,000 employees in three countries.

To find out more about how she does this, refer to the sub sections at the end of each of the chapters that follow.

***Jane's story continues on page 23***

# Strategy

An effective CSR strategy gives a company a framework for managing all of its CSR challenges, and is the starting point for an effective CSR programme. More than this, it seeks to put responsible practices at the heart of corporate decision-making by ensuring that core business strategy reflects the organisation's CSR objectives.

Integrating CSR issues into core strategy helps the organisation manage a wide range of current and future risks, and enables it to spot and exploit opportunities that might otherwise remain hidden – for example, to develop new products and services or gain access to new markets.

## 2.1 Background and definitions

Any attempt to improve CSR performance needs to be based on a sound strategy that specifies your objectives and sets out how you will achieve them. Without a strategy, it will be impossible for your organisation to do anything more than tread water in its performance.

To be truly effective, your CSR strategy needs to be aligned to and integrated with the organisation's core business strategy. It should encompass all your organisation's material non-financial impacts, and should seek to ensure your organisation is contributing to long-term sustainable development.

There are lots of different definitions of the term strategy, especially when applied to CSR. Some see it as an overarching statement of intent; others as a code of ethics. This guide takes a practical view, and sees strategy as the path towards achieving a particular vision. Not only does it encompass the organisation's high-level goals, but also a pragmatic plan for achieving them.

## 2.2 Opportunities, benefits, risks and downsides

A good CSR strategy puts responsible practices at the heart of your business. An effective CSR strategy can be characterised in the following way:

- critical to ensuring that your investment in CSR delivers the results you want;
- visible demonstration to stakeholders that the organisation is committed

to CSR and ethical practice, which enhances stakeholder support and corporate reputation;

- provides the framework for decisions on what the company will and will not do;
- employees have a reference point to guide their day-to-day behaviour in support of the organisation's CSR goals; and
- integrating CSR issues into core business strategy will help the organisation manage risks and spot and exploit opportunities that might otherwise remain hidden – for example, to develop new products and services or gain access to new markets.

The main risks inherent in developing a CSR strategy stem from over- or under-commitment to the task.

Committing too much time to honing the strategy without development of the associated management systems can become an academic exercise. Many companies invest time and resources in the development of business principles, but fail to address the change management challenges of getting the organisation to integrate these principles into daily practice. So a CSR strategy must be underpinned by management systems – formal or informal – that define procedures, set performance targets and establish ways of collecting data and measuring performance – for more on this, see section five, Performance Management.

Under-commitment to strategy development usually results in the organisation having two distinct strategies – one core commercial strategy for profitability, and another for CSR. The danger of this approach is that you end up with conflicting priorities that pull the organisation in different directions and are counter-productive. It is vital that your CSR strategy is aligned with, and ideally integrated into, the core business strategy.

## 2.3 Your next steps

For those who are starting out on the development of a CSR strategy:

- identify the material impacts of the organisation on society and the environment;
- identify and agree strategic CSR goals, eg build reputation as an ethical business, reduce carbon dioxide emissions to capitalise on carbon trading schemes;
- ensure CSR goals are in line with the overall business strategy;
- report publicly on the CSR strategy; and

# Strategy

- evaluate the applicability of international frameworks and standards to the CSR strategy.

For advanced practitioners who have already considered and possibly developed a CSR strategy:

- move from being a company that makes a profit and behaves responsibly to being a company that makes a profit because it behaves responsibly – this is accomplished by fully integrating non-financial issues into core business strategy and identifying opportunities to create value as a result;
- continuously review and seek to expand the range of non-financial issues covered by the CSR strategy;
- document your process for assessing materiality and show how stakeholder feedback is integrated into this; and
- integrate a broader range of stakeholder concerns into strategy formulation.

The two key elements in an effective CSR strategy are shown in Figure 2.1.

**Figure 2.1 The elements of effective CSR strategy**



## 2.4 Determining material issues

Establishing your organisation’s ‘material’ issues – the non-financial impacts that are of greatest importance to the company and its stakeholders – underpins all aspects of CSR. Knowledge of what is material is the starting point of strategy formulation. It provides the basis for an effective approach to governance, performance management, reporting and assurance.

The process for determining material issues is described in this section because it is so fundamental to strategy development. But a thorough determination of material issues depends to a large extent on dialogue with your stakeholders. So this description of how to determine material issues should be read in conjunction with section three, Stakeholder Engagement.

**Setting materiality criteria:** The key steps in identifying material issues are shown in Figure 2.2. The process of identifying and prioritising your non-financial impacts starts with the development of criteria to establish those non-financial issues that are most important – or material – for your company.

**Figure 2.2 Key steps in identifying material issues**



When setting your criteria, you should consider your own organisation's priorities, and also what matters to your stakeholders and society. Useful criteria for doing this are suggested by AccountAbility (the Institute for Social and Ethical Accountability)<sup>7</sup>.

When assessing the significance of internal issues, AccountAbility suggests you should consider:

- direct financial implications – the social and environmental issues that are associated with direct costs to the business;
- reputational risks and opportunities;
- potential effects on operational performance; and
- strategic opportunities to boost competitive position – for example, tapping into demand from ethically minded consumers.

Meanwhile, key factors to take into account when assessing the significance of issues relating to stakeholders and to society include:

- the extent of media coverage;
- the number of complaints;
- survey results; and
- the number of unprompted mentions by stakeholders.

**Research issues internally and through peer review:** Begin drawing up a comprehensive list of issues that could be material so you can evaluate them

<sup>7</sup> AccountAbility (2006), The Materiality Report - aligning strategy, performance and reporting

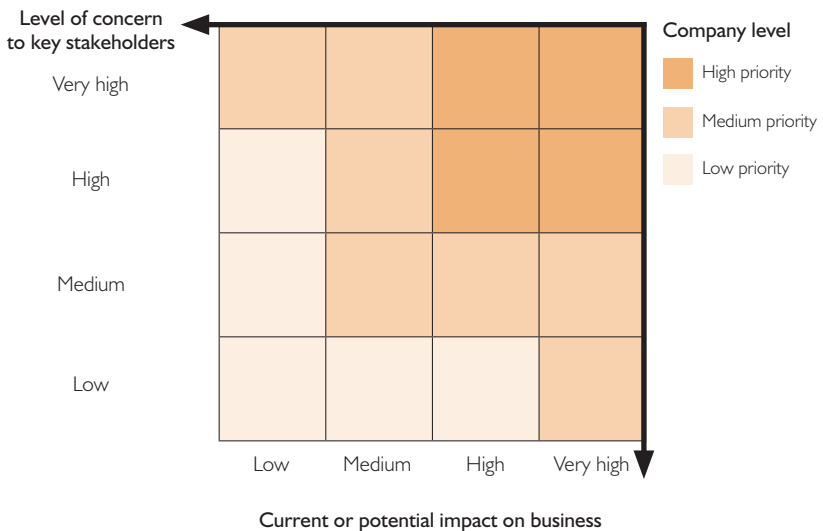
against your criteria. Your initial sources for this list should be research – either informal or more formal (eg through a survey) – of the issues that matter most to employees, and a review of the issues that your peers say are important (eg through their reporting and other public disclosure).

**Establish stakeholder views:** Once you know what the organisation and its peers regard as material, you need to establish the issues external stakeholders think are important. You do this most effectively through systematic stakeholder engagement, as described in section three, Stakeholder Engagement.

However, in the early days and when you are first working on your CSR strategy, you might need to work with information you already have rather than launching a comprehensive stakeholder engagement programme. It might be sufficient to develop a list of issues you presume, from experience, are most important to your priority stakeholders. Customers are a good source for possible material issues if you already have established customer feedback methods.

**Use materiality criteria to determine material issues:** Now evaluate your list of possible issues against your materiality criteria. You will probably find it helpful to map issues onto a matrix that enables you to rate each issue on its concern to stakeholders and its potential impact on the business (see Figure 2.3). This will help you determine and prioritise the material issues.

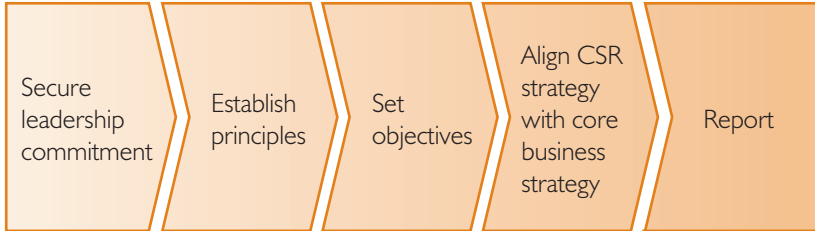
**Figure 2.3 The materiality matrix**



## 2.5 Aligning core strategy with non-financial goals

The key steps in aligning strategy with non-financial goals are shown in Figure 2.4.

**Figure 2.4 Key steps in aligning strategy with non-financial goals**



**Secure leadership commitment:** When you set out to include non-financial issues in your organisation’s core strategy, the first step is to secure commitment from your company’s leaders. Their commitment will ensure CSR can be at the heart of the way your company does business.

Of course, winning over top management is a challenge for anyone trying to make change happen in organisations. There is no easy solution. Good change management practice would suggest you get as close as you can to your organisation’s leaders to build an understanding of their priorities. And then you need to present a clear and compelling business case, with hard numbers showing likely returns. Focus not just on the long term – offer some quick-win opportunities, too. These can often capture the interest of those who are impatient for progress, as many senior leaders are. And of course you should make it as obvious as possible how the results you want to achieve through CSR will support the core goals of the business.

**Establish principles:** A building block in strategy development is to establish CSR principles that reflect your company’s values and commitments.

At this stage, it may be best to formulate principles that are fairly general, eg “We aim to treat all of our stakeholders in an ethical manner”. They need to be broad enough to encompass unforeseen circumstances as you should not change your stated principles very often. Also, principles that are too specific can be misconstrued as moral or ethical judgements. For example, a principle such as “We aim to improve the lives of all of our stakeholders through infrastructure development” could be construed by some as destructive to traditional ways of life.

When developing your CSR principles, you should undertake a process of value exploration inside the organisation. Here, support from external consultants can be useful. Many leading companies create cross-functional teams of senior managers to lead the process of developing their principles.

Many core values will be independent of your company's specific product and sector – eg honesty, integrity, teamwork and creativity. You will also uncover values specific to your organisation, sector or location – eg connectivity (for telecommunications) or mobility (transport and auto sectors).

Once you know your company's core values, you can devise a statement of principles based on integrating them into your operations. Strong CSR principles have been formulated by Vodafone (see below), BP and Stora Enso (for more information, see the CSR sections of their corporate websites).

## **Box 2.1 Vodafone CR principles**

Our vision for 2010 is to be one of the most trusted companies in the markets where we operate. In 2005, we developed a five-year CR strategy to help us realise this vision. It sets clear priorities to:

- maintain high ethical standards;
- understand and respond to our stakeholders' priorities;
- ensure our operating standards are consistent across the Group;
- deliver on our promises in three key areas: responsibility to our customers; reuse and recycling of mobile phones; and energy and climate change; and
- capture the potential of mobile telephony to bring socio-economic value through access to communications.

Source: see footnote 8

**Set objectives:** Objectives should be set for all material issues. For example, a utility company might decide that greenhouse gas emissions are a priority issue. An objective could range from something as simple as “We want to reduce emissions” through to a more ambitious “We want to be carbon neutral”. It is not imperative here to develop specific and measurable targets (covered in section five, Performance Management) – this stage is about making more general commitments.

**Align CSR strategy with core business strategy:** Any attempt to embed responsible practices in your organisation must be aligned with your company's core business strategy. Some CSR issues will directly align with the core strategy,

8 'Managing CR' pages of the corporate responsibility section of Vodafone website [www.vodafone.com](http://www.vodafone.com)

and should be prioritised accordingly. For example, a mobile telecommunications company may have as a core commercial aim the penetration of new markets. One of its material CSR issues might be the digital divide – customers excluded due to lack of access to technology. A project that enables poor people in rural areas of sub-Saharan Africa to get access to banking services via mobile telephony aligns with both CSR and core business objectives, and therefore it is a top priority. Of course, there may be some elements of your CSR strategy that do not directly support the core business strategy. This does not mean these should be abandoned, but they would not be assigned quite as high a priority.

**Report:** Transparency is a key element of corporate responsibility. You should put into the public domain your principles, strategy and objectives. Material issues should also be expressed in the public domain, as well as the process you used to determine and prioritise them, and your responses. The primary channel to do this is your annual CSR or sustainability report – an effective process for reporting is described in section seven, Public Disclosure.

## 2.6 Good practice and beyond

**Develop a continuous improvement cycle:** Review your strategy regularly. Ideally, you should take on Board feedback from international standards reviews, internal and external benchmarking, and from stakeholder engagement (see also below).

**Gather stakeholder feedback on specific aspects of your strategy:** Integrate stakeholder views on specific aspects of your strategy, for example the process you use for determining materiality, your list of material issues, your responses to those issues, and your strategy statement itself.

**Align with voluntary frameworks or standards:** While your company's CSR strategy will be unique, you may wish to look to the various international standards and frameworks for guidance and ideas when developing or reviewing the principles that underpin the strategy. For example, when Shell set about revising its business principles in 1997, the company turned to the UN Universal Declaration on Human Rights for guidance on how to address human rights issues across its global operations.

The major frameworks and standards address a broad spectrum of CSR issues including the environment, human rights and business ethics. Some are cross-sector and others are sector-specific. If you are unclear on which ones might be applicable, you could use peer-group comparison and stakeholder engagement to point you towards those you should be considering.

The key frameworks that apply across all sectors are described below.

- **The United Nations Universal Declaration of Human Rights:** The United Nations adopted the Universal Declaration of Human Rights in 1948. The Declaration has since served as the starting point for many emerging international human rights standards as well as standards adopted by both private and public sector entities with trans-national operations.
- **International Labour Organisation's Declaration on Fundamental Principles and Rights at Work:** This declaration identified fundamental international labour standards covering issues such as freedom of association, collective bargaining, discrimination, forced labour and child labour.
- **The Global Sullivan Principles of Social Responsibility:** Created in 1997, the Global Sullivan principles consist of eight single-sentence value statements that address a range of human rights issues.
- **The OECD Guidelines for Multinational Enterprises:** The subject of a major review in 2000, the guidelines aim to encourage responsible business practices, strengthen relationships between governments and multinational businesses, and enhance the contribution of businesses to sustainable development.
- **UN Global Compact:** The Global Compact is not a prescriptive set of standards, but rather a values-based platform with core principles that cover human rights, labour, the environment and corruption.
- **Equator Principles:** The Equator Principles set out environmental and social guidelines for ethical project finance. Banks and other signatories have pledged not to finance projects that fail to meet the guidelines contained in the principles.
- **United Nations Environment Programme Finance Initiative (UNEP FI):** This is a global partnership between the United Nations Environment Programme and the private financial sector. It brings together more than 160 financial institutions and a range of partner organisations to develop and promote linkages between the environment, sustainability and financial performance.

The standards vary not only in content, but in level of detail too. Several are rather basic in their articulation of issue coverage – the Global Sullivan Principles of Social Responsibility consist of overarching and aspirational statements while

the OECD Guidelines for Multinational Enterprises provide significantly more direct and detailed guidance on specific topics such as combating bribery or the proper handling of labour disputes.

Signing up to an international framework or standard can add rigour to your CSR programme as it will ensure you are covering many of the important issues in a way that is generally regarded as effective. It also indicates to your stakeholders – internal and external – that you are taking a progressive stance. Finally, if you sign up to a framework or standard, you are often given preferential access to valuable resources in the form of guidance notes, data sources, best practice research and contacts for companies undertaking similar efforts.

## 2.7 Case study – Veolia Environnement<sup>9</sup>

Sustainability is embedded in the core business strategy of global environmental services giant Veolia Environnement. In a recent sustainability report, Veolia claims that:

“Environmental solutions are our business, which means we can never be content to treat sustainable development merely as a question of image, reputation or behaviour. Environmental and social responsibility, together with integration within the local community, are part of our daily work. Our responsible approach is illustrated in all our technical and business actions, and it is central to our value creation strategy for the decades to come.”

It goes on to explain how it factors society’s expectations into its strategic decision-making:

“Sustainable development is more than a philosophy. It has prompted growing awareness of such issues as global warming, public health and access to essential services in the developing world. This in turn is fuelling new aspirations, driving societal change, and giving rise to the enactment of national, European and international standards, as well as to public policies that have a direct impact on the conditions in which we operate. That explains why our commitment to sustainable development is not incompatible with our business performance; in fact, it is actually driving changes in our activities, practices and business proposals. This is what allows us to continue to create value in an evolving world.”

The company clearly recognises its major social, environmental and broader

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9 Veolia Environnement Sustainability report – [www.sustainable-development.veolia.com/en/](http://www.sustainable-development.veolia.com/en/)

economic impacts and makes efforts to address them. It has signed up to the UN Global Compact, as the 10<sup>th</sup> principle of its sustainable development charter. This charter makes clear its commitments to future generations and includes protection of the environment, natural resources and biodiversity, participation in the social development of local communities and innovation to improve its ability to respond to environmental challenges.

Veolia recognises the importance of staying alert to emerging non-financial issues that may be of significant strategic importance to the company. It has established an independent non-profit think-tank, Institut Veolia Environnement, and a Foresight Committee to help it anticipate social, environmental and wider economic developments. Studies carried out by the committee and the institute are used by senior management in strategic decisions. Through this approach, Veolia seeks to introduce a forward-thinking perspective into operational decisions and to promote dialogue with stakeholders.

## 2.8 Case study – AZ Mining – strategy

Jane believes that AZ Mining's CSR strategy should paint a picture of how the organisation will move from where it is now to where it wants to be over the next five years. But she realises she does not know where AZ Mining should be in five years with regard to CSR. She decides that, before she starts to formulate a CSR strategy, she needs to know the significant CSR issues and opportunities. Based on this list of 'material issues', she will be able to craft a vision.

As a starting point, she sets out basic criteria for determining what issues are important (her materiality criteria). She decides that the most important criteria are:

- direct financial implications;
- reputational risks and opportunities;
- potential effect on operational performance; and
- strategic opportunities to boost competitive position.

She starts in her own field of expertise: health, safety and environment. By looking at her own position, she produces the following three broad issues:

- 1 complying with local, regional and national regulations for health, safety and environment;

- 2 engaging with government and local communities during exploration, opening, operation and closure of mines; and
- 3 creating a culture of 'safety first' in all operations.

Jane then circulates her materiality criteria and list of three issues to a number of senior managers at headquarters and selected managing directors at each of the operations. She groups the responses into an additional four broad issues:

- 4 providing infrastructure and health services to employees, families and communities at operations in remote locations;
- 5 enforcing labour standards in line with AZ Mining policy, particularly around employee well-being and child labour;
- 6 reducing direct energy usage to cut greenhouse gas emissions resulting from AZ Mining operations; and
- 7 resettlement issues around new deposits and locating tailings ponds.

In addition, several managers suggest that the environmental policy should be strengthened to go beyond compliance, particularly in places where regulations are less stringent. Others suggest that Jane's second material issue be expanded to include government, local communities and local interest groups.

Rather than spending additional resources to expand her list through benchmarking and stakeholder feedback, Jane decides she needs to prioritise these issues, frame a strategy to address them, and then present this to the Board.

She prioritises the issues based on the importance of the issue to internal stakeholders (shareholders, management, employees) and external stakeholders (local communities, government regulators, local interest groups, media). Based on this prioritisation, she decides that all of the issues except greenhouse gas emissions are 'material' and therefore need to be addressed by the CSR strategy.

AZ Mining's core business strategy is highly responsive to shareholder demands for growth (via development of existing mineral rights in developing economies) and profitability (through reduction of liabilities), and Jane decides that, in order to achieve buy-in across the company, the CSR strategy has to be inherently tied to business value. The CSR strategy also has to promote the corporate principles of effort, honesty and integrity.

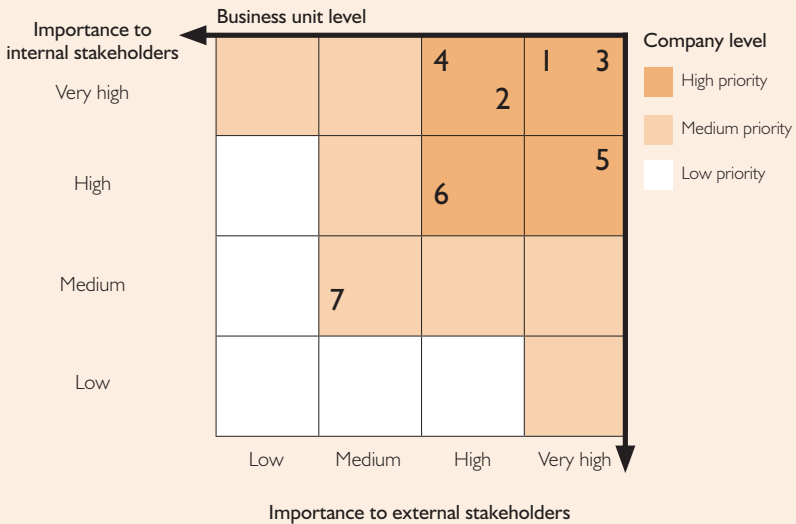
# Strategy

As a result, she produces and presents an initial CSR strategy to the Board based on two objectives:

- reduce liabilities and risks associated with environmental and social performance of the company through proactive engagement with local communities and other external stakeholders; and
- ensure responsible operations by implementing and enforcing corporate policies on health and safety, labour conditions, and environmental protection that go beyond local and national regulation where appropriate.

The Board reviews the CSR strategy and responds with a green light for Jane to proceed with the formulation of the policies mentioned in the second objective and a management and engagement system to identify, record and report on significant CSR risks in AZ Mining's operations.

**Figure 2.5 Materiality matrix for AZ Mining**



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Note: The numbers in the grids refer to the seven material issues listed in the text

**Jane's story continues on page 40**



# Stakeholder Engagement

Stakeholder engagement is the foundation of effective corporate social responsibility. Of course, your organisation interacts with its customers, employees, suppliers and investors every day. But few companies carry out systematic stakeholder engagement. Through carefully planned engagement, you learn about the perceptions and expectations of your stakeholders, and can use this insight to manage and report your key social and environmental issues. Stakeholder engagement is therefore vital to risk management and the protection of corporate reputation. But that's only part of the story. A systematic stakeholder engagement programme also gives you new access to the expertise and ideas of your stakeholders so you can build these into your core business strategy and decision-making, and gain competitive advantage as a result.

## 3.1 Background and definitions

Stakeholders are the people and organisations that affect and/or could be affected by your organisation's activities, products and services, and associated performance. And stakeholder engagement is about reaching out to these groups so you can better understand society's expectations and then respond effectively. Stakeholder engagement is also a means for society to hold to account those who make decisions that affect people's lives.

The basic premise of stakeholder engagement is that, by better capturing the interactions between a company and its stakeholders and by including stakeholders in company processes, your business will be better run and better prepared for the future.

Without even realising it, most companies are already involved in some forms of stakeholder engagement. They ask their customers what they think via market research, and communicate with their shareholders through annual reports and at investor briefings. They engage with their employees through surveys, work councils or trade unions. The challenge – and it is one of the most difficult in CSR management – is to bring together existing activities and other, less traditional ways of gathering stakeholders' input and ideas in a comprehensive engagement strategy. Companies who take this progressive approach do not see it just as an optional means to touch base with a variety of interest groups, but rather as a critical part of their business strategy.

# Stakeholder Engagement

For an in-depth discussion of the principles and current thought around stakeholder engagement, you could review the AA1000 standard on stakeholder engagement (AA1000SE) published by AccountAbility<sup>10</sup>.

## 3.2 Opportunities, benefits, risks and downsides

Stakeholder engagement helps you anticipate the future and respond accordingly. If you understand society's social, environmental, community and ethical concerns, you are better equipped to manage risks and deal with difficult issues and conflicts on the horizon. You are also able to respond to potential opportunities through your development of products and services and entry into new markets. If you are effective in your stakeholder engagement, you will open up new ways to improve your organisation's performance and reputation.

Less obviously, but no less importantly, engaging with stakeholders allows you to challenge traditional views held within your organisation as it can provide an alternative to the 'expert' view that often holds sway.

Of course, the devil is in the detail, and success rests in large part on the skills of the people representing the company and engaging in dialogue. Setting and managing stakeholders' expectations is also vital: the longer-term benefits can only be derived if the company shows it has reflected carefully on the dialogue and responded authentically.

The opportunities and benefits of stakeholder engagement are listed below:

- **Avoidance and resolution of conflicts and difficult issues:** By engaging stakeholders directly, companies are better able to avoid conflicts and to resolve them when they arise.
- **Protection against boycotts and other disruptive action:** Companies engaging stakeholders may be better prepared to address the concerns of customers – or activist shareholders or non-governmental organisations – who would otherwise take negative action, alone or in groups, on social issues.
- **Licence to operate:** Effective engagement can help maintain the organisation's 'licence to operate' – both the formal licences they need from governments and regulators, and the informal licence they need from local communities, the media and so on.
- **New commercial opportunities:** Direct engagement of customers and other interest groups can help companies to spot opportunities to develop new products and services, and enter new markets.

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<sup>10</sup> [www.accountability21.net](http://www.accountability21.net)

# Stakeholder Engagement

- **Market access:** Stakeholder engagement can make entry and success in emerging markets easier by helping the organisation forge relationships with important stakeholders such as governments, regulators, key customers and business partners, and local communities. This is particularly the case in overseas markets when the challenges of different cultures, languages and laws need to be overcome.
- **Innovation:** The inclusion of perspectives and expertise from a wide range of stakeholders can provide the basis for learning and innovation in policies, processes and products, and services.
- **Cost savings:** By enhancing communication and building trust between parties, stakeholder engagements can lead to a variety of cost-saving benefits.
- **Better corporate communication:** Because stakeholder engagements often include direct, face-to-face discussions with a variety of outsiders, they can help sharpen the ability of personnel to communicate – and listen – on behalf of the company, and help the organisation as a whole better hone its messages to customers, community members, activist groups, regulators, employees, the media and others.

When you begin systematic stakeholder engagement, it can be like opening Pandora's Box, as you have to deal with the unexpected issues that have come to the fore. Effective engagement also requires access to people with the necessary skills – communicative and otherwise – and the ability to influence decision-making. Finally, you have to realise that, once your stakeholders have been asked for their views, they will rightly expect a response. However, none of this should be used as an excuse not to engage with your stakeholders. The benefits clearly outweigh the downsides.

## 3.3 Your next steps

For those who are starting out on stakeholder engagement:

- evaluate the stakeholder engagement the organisation is already doing;
- make sense of what is already known from current engagement activities;
- improve communications on stakeholder issues across the business;
- integrate the outputs of engagement with the company's decision-making and goal-setting;
- build basic dialogue skills; and
- make a plan to develop your stakeholder engagement.

If you have an engagement process in place that includes methods for stakeholder identification and issue identification and response, you are already

# Stakeholder Engagement

an advanced practitioner. You should move forward by improving your methods and integrating stakeholder engagement in wider business processes.

The three key elements of stakeholder engagement are shown in Figure 3.1 and described and discussed in the following three sub-sections.

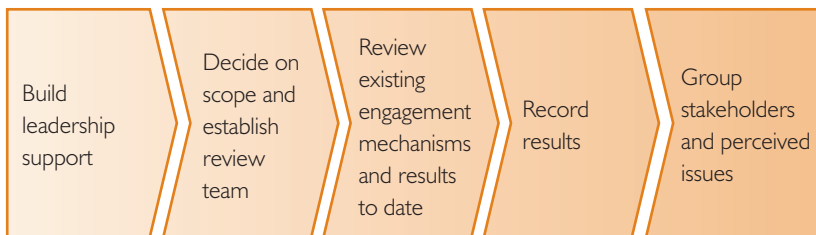
**Figure 3.1 The elements of effective stakeholder engagement**



## 3.4 Stakeholder identification

Figure 3.2 shows the key steps in stakeholder identification.

**Figure 3.2 Key steps in stakeholder identification**



**Build leadership support:** For stakeholder engagement to make a meaningful contribution, you need the backing of the company's leaders. They need to support what you are trying to do, explaining to others in the organisation what is proposed and why. This is particularly important if your organisation has a formal or hierarchical structure, or if there is only a limited exchange of information across divisional or functional boundaries.

# Stakeholder Engagement

**Decide on scope and establish review team:** You need to decide which unit of organisation is to be included in your stakeholder engagement programme. For a smaller organisation, this may be the whole business. For larger, more complex organisations, your initial focus might be on a particular site, country, region or function.

You should then establish a small team to carry out the review. This team needs to be granted the authority to access all relevant information. To ensure support and cooperation, the team should report to a manager at the most senior level.

**Review existing engagement mechanisms and results to date:** In all likelihood, many parts of your organisation will already be in dialogue with stakeholders, even if they do not necessarily recognise it formally as stakeholder engagement. So the next step is to get a full picture of where the business is already interacting with its stakeholders by carrying out a review. For larger organisations, extensive research may be needed.

The review would normally be based on interviews or discussions with a cross-section of managers who either own existing stakeholder relationships or know how they are managed. The interviews should identify who is involved in each relationship and, for each stakeholder group, who leads on that relationship. The interviews will also be a useful mechanism for building internal understanding and support for the CSR programme.

In a larger organisation, it is important to understand whether there are any similar stakeholder engagement projects happening elsewhere in the organisation and make contact with these groups in order to pool information and resources.

You may benefit from the support of consultants in this part of the process.

In a review of existing mechanisms, capture existing processes for informal and formal dialogue with:

- employees (eg appraisals, work councils, trade unions, employee surveys);
- investors (eg briefings for analysts, annual reports);
- suppliers (eg supplier relations and quality control processes);
- customers (eg satisfaction surveys, focus groups, complaints-handling processes);
- governments and regulators (eg health, safety and environment management

# Stakeholder Engagement

systems, public affairs and lobbying processes); and

- local communities (eg community investment projects, complaints registers).

During interviews with stakeholders, information should be gathered regarding:

- the general frequency and usual form of contact (meeting, workshop, telephone call etc) and the date of the last contact;
- the nature of stakeholders' economic relationship with the company (if any) and their perceived ability to affect the company's performance or reputation;
- the interviewee's opinion on that stakeholder's current attitude towards the company, the nature of the relationship and any views the stakeholder has expressed on the main social, environmental, community and ethical issues facing the company;
- the nature and form of any records (eg meeting notes, survey data);
- new issues that have arisen recently; and
- any steps the company has already made in response to representations made by the stakeholder.

It is important that all the existing relationships are researched, understood and captured. Be aware that existing records may be held in individual departments and that it is not uncommon for information flow to be weak across organisational boundaries. For example, customer research data may be based on surveys that are conducted and held by the marketing department, whereas supplier relations information may be held by the procurement team. Therefore, information arising from existing stakeholder interactions will vary in format and will not be stored in a central place as records will generally have been designed to meet other objectives. So the available data should be assessed to identify what will be most useful, and the review should record the types of output and where they are stored.

Where there are confidentiality issues, you may be able to request a summary of data – for example avoiding individual records. These issues need to be debated and agreed by managers with the authority to make decisions and arrive at solutions.

**Record results:** The results of the interviews should be compiled into a suitable format. This could be a simple spreadsheet or a sophisticated database depending on the complexity of the information.

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**Group stakeholders and perceived issues:** There are a variety of standards for grouping stakeholders and their perceived issues. As a starting point, it is useful to arrange stakeholders in three groups: economic stakeholders (where there is a direct financial relationship), influencers (NGOs, regulators etc), and community stakeholders.

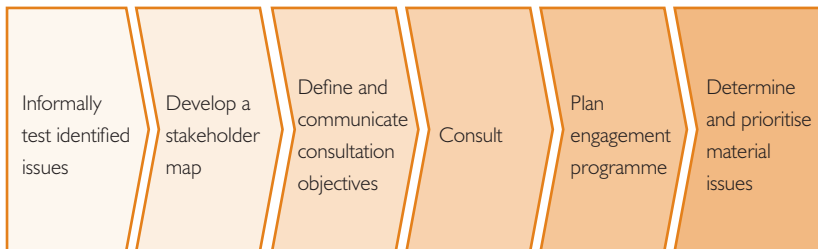
You should also collate and sort what you already know, or have gleaned in the review, about each group's priority social, environmental, economic and ethical issues. Take care to do this thoroughly, organising issues into categories and avoiding unnecessary complexity. You may wish to seek external advice, as the way you marshal the information now will be the backbone for much of your future engagement work.

At this point, you should also start thinking about the stakeholder groups the company might not currently engage with as the range of stakeholders you engage with should be as broad as possible. Think beyond the traditional business stakeholders and include all those groups that have opinions on the company's social, environmental, community and ethical impacts. Consider pressure groups and other NGOs, trade associations, community groups, local authorities, regulators, regional development agencies, and government offices and departments.

## 3.5 Stakeholder consultation and identification of material issues

Figure 3.3 shows the key steps in stakeholder consultation and identification of material issues.

**Figure 3.3 Key steps in stakeholder consultation and identification of material issues**



**Informally test identified issues:** Your initial review of existing stakeholder engagement mechanisms and categorisation of possible issues will have provided

# Stakeholder Engagement

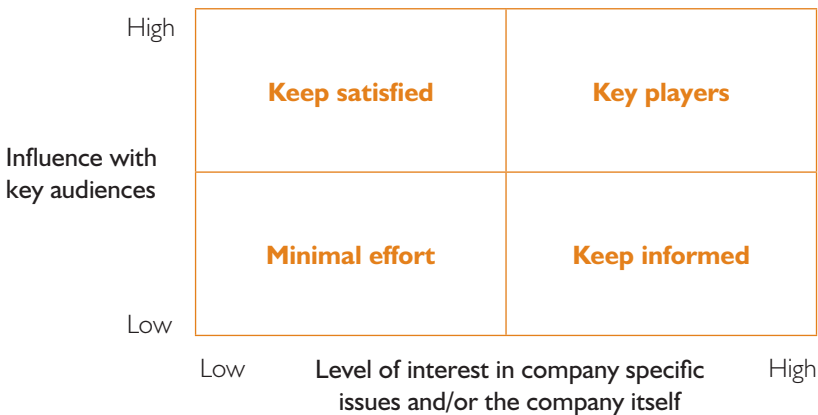
an insight into stakeholders' concerns. However, the views you have collated so far need testing. The only way to do this is to make contact with stakeholders and ask them directly.

Your first step could be to make an informal approach to less dissenting voices. This will allow you to find out how close your estimation of stakeholder views is to reality, and will prepare the ground for a new, formal engagement programme.

**Develop a stakeholder map:** You will need to prioritise stakeholder groups so you can focus your efforts, particularly if you have only limited management and other resources you can devote to stakeholder engagement. It is probably sensible to start with a modest number of target stakeholder groups rather than trying to be comprehensive, as long as you don't exclude obviously significant voices.

You should record the basis for deciding who will be included and excluded (although of course you can be more inclusive later). This can be done by dividing your economic stakeholders, influencers and community stakeholders into further sub-groups according to their influence with key audiences and their level of interest in your company's issues – see example in Figure 3.4.

**Figure 3.4 Example of a stakeholder map**



**Define and communicate consultation objectives:** You should define the objectives of the planned consultation of stakeholders. These may vary from time to time. Some consultations will be explicitly aimed at planning and

# Stakeholder Engagement

implementing the company's overall CSR programme and the objective will be to identify and respond to the most important issues. Others may be more specific, for example to understand the local community's views on the development of a new production site or to help you plan a CSR report and identify indicators for reporting.

The next step is to initiate dialogue with the key stakeholders you have identified by explaining the objectives of the work and what will happen as a result of this (and future) interactions. This initial contact will help build trust among target stakeholder groups, which will make it easier for them to raise concerns and give opinions.

**Consult:** In your first proper consultation exercise, your aims should be to verify your initial understanding of issues and stakeholders' views and to uncover new and emerging issues. You might find it useful to give stakeholders a set of questions and possible responses based on the issues you already know about.

Mechanisms for engaging with stakeholders vary and can include:

- participation in professional societies and advisory boards;
- customer relationship management systems;
- employee surveys;
- analyst/investor presentations and meetings;
- one-on-one meetings;
- roundtables and conferences;
- consultations on policy developments;
- supplier audits and site visits;
- stakeholder panels and workshops;
- web portals, telephone enquiry reporting lines; and
- feedback forms and surveys.

**Plan engagement programme:** While the first full stakeholder consultation is taking place, you should plan your ongoing engagement programme. For each stakeholder group, you need to establish the mechanisms you will use, the frequency of contact, and the process you will follow to make the planned engagements happen. You also need to design a process for determining the company's response to stakeholder dialogue.

Of course, where you need to understand stakeholders' views on specific issues, you can set up one-off engagements to do this.

**Determine and prioritise material issues:** In general, stakeholder

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engagement will generate a long list of issues raised by stakeholders. With so many different issues relevant to different groups, it can be difficult to see which deserve most management attention. Therefore it is important to decide which are the material issues. The basis for this should be the materiality criteria that you have developed as described in section two.

Of course, the process of stakeholder consultation and identification of material issues is never finished. Periodically, you should review your analysis. Have other stakeholder groups emerged that the company should engage with? Are information sources still providing robust data? Are there other sources you should use? Are engagement mechanisms working? Can issues that were material some time ago still be considered material?

## 3.6 Responding to material issues

Figure 3.5 shows the key steps in responding to material issues.

**Figure 3.5 Key steps in responding to material issues**



**Allocate responsibilities for the responses:** For trust to be maintained in an engagement programme, you will be expected to show how you have responded to the things you have heard. That starts with gaining support from top management; they are most likely to be able to ensure appropriate action across organisational boundaries, which is necessary when you want to integrate results from stakeholder engagement into strategy development or performance management. So you should look to allocate the responsibility for responding to the outputs of stakeholder engagement at the highest possible management level.

**Develop responses:** It is through your response to stakeholder concerns that you can discover new ways to create long-term business value and get ahead of the competition.

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You can respond to issues in many different ways. Of course, what you do will depend on the issue in question. However, in general, try to integrate your response into wider business planning in order to avoid CSR simply becoming an optional add-on to core activities. This can be done by considering how the outputs can be integrated in objective and target setting, performance management or incentivisation – as described in section five, Performance Management.

You may also want to consider asking stakeholders how they would expect the company to respond. Here, external consultants' advice might be of value in helping you think outside the box and develop innovative ideas for responding to stakeholder concerns – an example is given in Box 3.1.

### **Box 3.1 Responding to material issues: an example**

A food company may realise, through stakeholder dialogue, that it has done too little to respond to claims that its products are contributing to childhood obesity. It might demonstrate its response through:

- a public commitment to spending more on scientific research and publishing the results;
- setting an objective to work with suppliers to reduce the percentage of fat and sugar in the products they provide to the company;
- deciding to eliminate certain ingredients within five years, and announcing that decision;
- participating in an industry initiative to develop a standard approach to labelling which will help consumers make more informed choices; and
- developing a responsible marketing initiative that revises the company's conduct with respect to advertising that reaches children.

**Create a communication strategy:** A communication strategy will enable you to put across appropriate messages internally and externally about the issues the company is dealing with and how.

Internally, this will help your colleagues understand what you are trying to achieve in response to stakeholder concerns so that they are more likely to play their part. And effective external communication will help raise awareness among stakeholders that the issues that have been raised are being dealt with. Note that, if you fail to tell stakeholders about the response, they will probably deem the consultation worthless and you will find it difficult to persuade them to come to the table again.

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## 3.7 Good practice and beyond

Update the stakeholder map: You should update your stakeholder map on a regular basis as issues and stakeholder groups change. It is important that you have a process for identifying new stakeholder groups.

You might consider involving stakeholders themselves in updating the stakeholder map. They can probably help you identify new stakeholder groups you have not previously considered relevant. For example, a company in regular dialogue with Greenpeace might, through these discussions, find out about another single-issue environmental NGO interested in its operations.

**Involve stakeholders in developing criteria for identifying material issues:** You should ultimately try to involve stakeholders in the design and implementation of criteria for determining the relevance and significance of material issues. This can help provide a longer-term view of what might be material. This is something that is not provided by many companies' traditional risk management processes, which tend to focus on direct impacts on the business in the short to medium term, with criteria that do not allow for issues that may arise over the longer term as a consequence of the company's current behaviour. For example, a company's contribution towards climate change could indirectly result in long-term impacts – such as disruption to transportation and logistics networks – that the company does not include on its current risk register.

**Recognise different levels of power:** Stakeholders are many and varied, and it is impossible to state categorically that all views have been considered. Engagement processes enable companies to understand only a sample of stakeholder expectations and concerns. So you need to recognise the relative 'power' of stakeholder groups in the stakeholder map, and make a conscious effort to engage with those who have less power.

Power can be understood in terms of influence, but also in terms of ability to communicate views. So you should focus on seeking out the views and concerns of stakeholders who do not (or cannot) have a 'voice', ie a practical means of expressing their opinions to the company – for example, individual community members, small special interest groups, and future generations. A process to enable anonymous input of less powerful stakeholders can be a useful tool. Also, look to engage with organisations that speak on behalf of less powerful stakeholders.

**Extend stakeholder engagement through sector initiatives:** An effective way of extending your engagement programme to more stakeholder groups

# Stakeholder Engagement

is to participate in international sector initiatives. This can make engagement with a large number of stakeholders easier and more effective. For example, the International Council on Mining and Metals has used the Mining, Minerals and Sustainable Development project to establish a network of stakeholders to determine material issues for the sector, and has developed guidance to the industry on responding to this feedback.

**Embed locally:** For multinational companies, developing mechanisms to ensure local stakeholder concerns and priorities gain suitable recognition at the corporate level is a major challenge. One approach is to introduce a company-wide reporting procedure for operating companies, business units or sites to provide the corporate centre with regular information on dialogue with stakeholders at the local level. To make this work, you need a process for determining when an issue identified in one or more locations becomes material at the corporate level.

**Improve communication:** During the early stages in the development of an effective stakeholder engagement programme, your approach to internal and external communication will probably have been quite basic. However, the more sophisticated your stakeholder engagement becomes, the more sophisticated your communication strategy needs to be as it becomes crucial to keep internal and external parties informed.

Internally, you could consider integrating non-financial indicators into business performance reviews. That way, whenever you communicate to employees, senior managers or other parties how the company is currently doing, you would include the results of stakeholder engagement and the responses the company is making. You could also consider establishing an internal network of CSR managers and informal opinion formers. This can help in the communication of stakeholder issues across regional and functional boundaries.

Externally, you should ensure your non-financial reports set out clearly your stakeholder engagement programme – how you identify stakeholders, your engagement methods, your processes for determining material issues and responses, and what actions you have taken as a result. You should also seek to incorporate these messages in the company's main annual reports. This will help embed CSR at the heart of the business as it will come to be seen as integral to core activity.

## 3.8 Case study – Vodafone

Vodafone takes an approach to CSR that is heavily dependent on stakeholder

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engagement. Indeed, its process for prioritising its material issues is based in large part on the level of concern and interest among stakeholders.

Vodafone has invested time and resources in identifying its main stakeholder groups and the issues that affect them. Stakeholders are identified as those who are impacted significantly by the company and/or who can have an impact on the company.

It also has in place clearly defined and systematic engagement methods that are integrated into the management structure so that material stakeholder issues reach the decision-making points for development of strategy and systems. For example, it uses focus groups and interviews to understand consumers' attitudes to its key CSR issues.

Engagement takes place at both group and local operating company levels. Engagement at both levels provides a more informed understanding of the issues of concern to all stakeholders.

In its CSR report, Vodafone discloses who its stakeholders are and what their material issues are. Crucially, it provides a summary of its response on each of the significant issues, for example through the SIM Project which was developed to analyse the socio-economic impacts of mobile phones and is guided by an external advisory panel.

The report also publishes stakeholder feedback on the company's CSR strategy and communications.

## 3.9 Case study – AZ Mining – stakeholder engagement

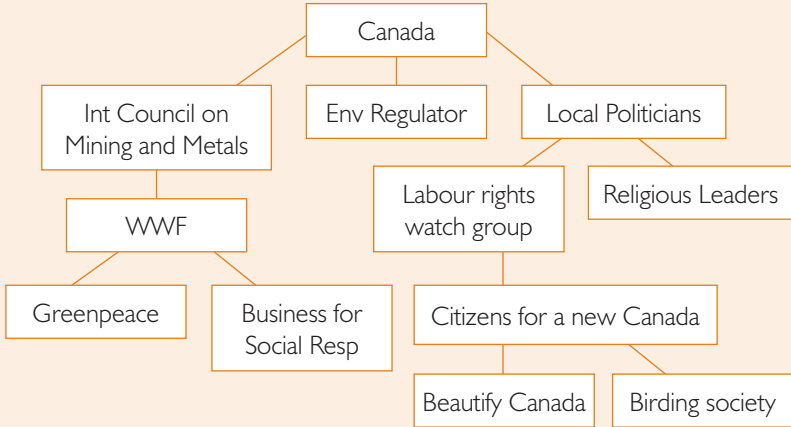
The AZ Mining CSR strategy has received the backing of the Board, and now Jane takes on the challenge of developing a systematic stakeholder engagement programme. The strategy included the objective: "Reduce liabilities and risks associated with environmental and social performance of the company through proactive engagement with local communities and other external stakeholders." Based on this objective, Jane decides that part of the management approach must be an effective stakeholder engagement process at both the global and local level.

She begins by developing a scheme to identify significant stakeholders at headquarters and each of the operations. To do this, she employs a cascade

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approach where she relies on each stakeholder group to identify additional stakeholders – see Figure 3.6.

**Figure 3.6 Connections between stakeholders in the Canada region of AZ Mining**



Before approaching each region, she tests the model at one of the operations in Canada and asks the MD to appoint a small team of people to conduct interviews with specific stakeholder groups already engaged as part of normal business operation. The team compiles a list of questions over three broad categories:

- Who should AZ Mining engage with?
- What are the material issues your group is interested in discussing with AZ Mining?
- What is the most effective way for us to engage with you?

Following the pilot, she decides the approach is valid and moves to expand it at the global level as well as at each of the AZ Mining operations. She begins with the senior management of AZ Mining and the MDs at each operation. Each of these managers compiles a list of significant stakeholders, and is then tasked with assigning a team to interview the first tier of stakeholders.

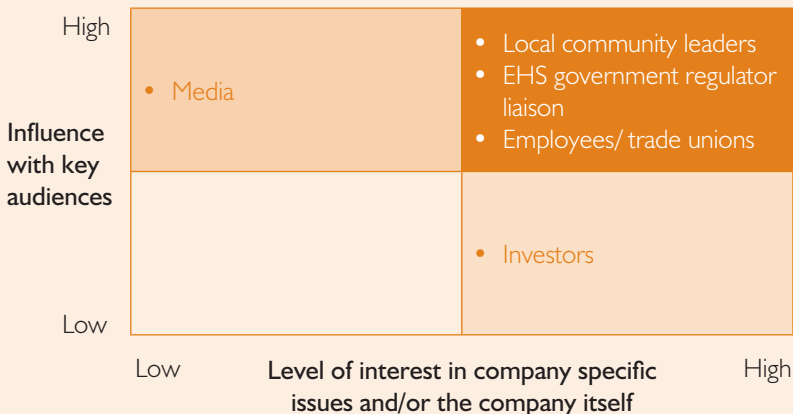
Although the responses to these questions vary a great deal in terms of topics, ideas and utility, the exercise results in a large list of stakeholder groups, suggested material issues and response mechanisms.

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The results of the survey indicate that the strategic priorities outlined in the AZ Mining CSR strategy are fairly comprehensive in the eyes of most stakeholder groups, although many think that greenhouse gas emissions should be added to the list of material issues for the company (particularly stakeholders at the global level). Additionally, it appears that AZ Mining operations have fairly good engagement with local regulators and some interesting partnerships with local charities, but the engagement with local community representatives is frequently informal or non-existent. In one case, it appears that this lack of communication has led to small outbreaks of violence during a protest over living conditions around the mine.

As the list of stakeholder groups grows, it becomes apparent that stakeholder engagement should be focused at the regional and global levels, rather than having separate programmes for each operation. Therefore, Jane distributes the stakeholder-mapping diagram (see Figure 3.4) to the regions (Canada and China) to fill in using the information gathered from the regions. She also populates a map for the global-level stakeholders. The map for Canada is shown in Figure 3.7.

**Figure 3.7 The Canada region stakeholder map**



Jane and the CSR leaders from each region realise that the more influence stakeholders have on key audiences (the higher on the y-axis in Figure 3.7), the more AZ Mining needs to know what those groups are thinking, particularly to get an insight into emerging issues. That means engagement mechanisms focused around listening. On the other hand, for those stakeholders who are

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more interested in AZ Mining's issues (higher on the x-axis), the engagement mechanisms need to focus on informing. For 'key players' (those in the upper right quadrant), the engagement mechanisms have to emphasise dialogue.

For stakeholders such as the media, each region is asked to create a media tracking function and to add media relations into the job responsibilities of the communication team with specific responsibilities to determine key issues raised by the media.

To communicate with investors, the decision is reached to produce a corporate responsibility report within the next 18 months.

For the 'key players', the AZ Mining regions and global operations follow the advice of the stakeholder groups themselves to develop the dialogue mechanism. For example, regular meetings with community leaders are scheduled along with informal 'visit the mine' days.

Jane and her colleagues also realise that the response to stakeholders from AZ Mining is likely to be critical to the success of the programme. Therefore, initially, they decide to set tight controls on who in the organisation is authorised to respond to stakeholders outside of 'normal job-function communication'. This is set strictly in line with the command and control function of the company by giving overall responsibility for responding to stakeholders to the MDs at each operation. However, the team also recognises that, to make dialogue with key stakeholders more effective, over time they need to empower 'champions' in the company to be stakeholder liaisons and de-centralise the response.

***Jane's story continues on page 55***



# Governance

These days, stakeholders demand that governance frameworks apply to corporate social responsibility as well as the company's financial interests. Board directors must be accountable for the company's social and environmental impacts and its long-term sustainability. They have to balance financial goals with ethics, and that demands that they understand and properly consider CSR issues when running the company and formulating corporate policy.

### 4.1 Background and definitions

In response to stakeholder pressure and in the wake of corporate scandals, the duties of boards of directors have broadened over the last few years to include corporate social responsibility. Corporate governance, which generally used to apply only to the high-level direction and control of the company's financial interests, now also applies to CSR.

The Organisation for Economic Co-operation and Development (OECD) says: "Corporate governance is the system by which business organisations are directed and controlled. The corporate governance structure specifies the rights and responsibilities among different participants in the corporation, such as the Board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."<sup>11</sup>

In the management of CSR, governance involves defining responsibilities for non-financial aspects of performance. It also includes drawing up the policies that will guide the behaviour of all employees on CSR issues, and clear mechanisms for keeping the Board apprised of issues and performance on CSR issues.

Stakeholders' specific demands with respect to governance of CSR include:

- transparency on the Board's capacity to understand CSR risks and opportunities;
- the link between CSR performance and remuneration;
- actions with respect to CSR impacts and issues;

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11 Organisation for Economic Cooperation and Development (OECD) (1999)

- policies aligned with accepted international standards; and
- transparency in the chief executive's relationship with the Board of directors and senior management on CSR issues.

**Codes, standards and laws:** In response to a succession of corporate transgressions, failures and crises, a raft of non-legislative codes have been produced to deal with corporate governance issues. The most important codes for the UK are outlined below<sup>12</sup>. Although none of these were written exclusively to address non-financial risks, they have been significant in broadening and clarifying directors' duties. They cover CSR issues in so far as they are relevant to the bottom line – in other words, if they are significant to the management of companies' financial performance.

- **Cadbury report (1992):** The report of the Committee on the Financial Aspects of Corporate Governance, chaired by Sir Adrian Cadbury, recommended the First Code of Best Practice and compliance statements for all listed companies, raising standards of corporate governance and confidence in financial reporting and auditing.
- **Greenbury Report (1995):** This report, by a study group chaired by Sir Richard Greenbury, promoted greater boardroom pay transparency and detailed disclosure on executive pay for listed companies.
- **Hampel Report (1998):** This report contains the Combined Code based on recommendations of the Cadbury and Greenbury committees.
- **Turnbull Report (1999):** The Turnbull Report provided guidance for directors to help companies implement the provisions of the Combined Code with regard to internal control. It made directors responsible for risk management and the assessment of the effectiveness of the related internal control. It was revised in 2005. A more structured approach to tracking and managing corporate risk has caused many companies to upgrade their processes for understanding how social, environmental and ethical risks and opportunities have the potential to impact on the bottom line.
- **The Combined Code (2003):** This code, produced by the Financial Reporting Council, replaced the Combined Code issued by the Hampel Committee. It derives from a review of the role and effectiveness of non-executive directors by Derek Higgs and a review of audit committees by a group led by Sir Robert Smith. It was amended in 2006.

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12 Institute of Directors (2007), [www.iod.com](http://www.iod.com)

- **Companies Act 2006:** This Act consolidates company legislation, updates and clarifies the law in various areas, particularly in relation to directors' duties, which now include a requirement to be aware of the company's social and environmental impacts no matter the size of the company. It also simplifies the administrative burden on smaller private companies. Although requirements for an Operating and Financial Review were withdrawn at the last minute, the Act nevertheless introduced the requirement for publicly traded companies to write a forward-looking business review, which should include information on environmental matters, employees and social issues to the extent necessary for shareholders to understand the likely future performance of the business.

Essentially, the UK system follows a 'comply-or-explain' principle; companies that do not comply with the codes have the right to explain why they choose not to do so.

In contrast, prescriptive legislation has been introduced in many other countries. For many UK companies, the governance standards introduced in the United States are particularly relevant as all companies listed in the US have to comply with them. They are outlined below.

- **Sarbanes-Oxley:** The Sarbanes-Oxley Act 2002 outlines requirements related to business policies and procedures of financial auditing and reporting, record retention, personal legal accountability for chief executives and chief financial officers, as well as the make-up and practices of company Boards of directors. Although focused on financial issues, this legislation has also had a major impact on internal controls for non-financial issues.
- **New York Stock Exchange Corporate Governance Standards:** Among other things, these listing standards require listed companies to:
  - a) have a majority of independent directors (a tighter definition of 'independent director' is included in the standards) and conduct executive sessions of non-management directors;
  - b) establish nomination and compensation committees with the requisite charters;
  - c) increase the authority and responsibility of the audit committee, adopt an audit committee charter, and establish an internal audit function;
  - d) adopt governance guidelines and a code of conduct and ethics; and

- e) provide chief executive certification of compliance with listing standards.

## 4.2 Opportunities, benefits, risks and downsides

Building oversight and responsibility for CSR-related issues into a company's corporate governance apparatus helps embed responsible practices across the organisation. It is fundamental to effective CSR management. Good governance of CSR issues:

- demonstrates transparency and social accountability and enhances corporate reputation with all stakeholders;
- helps keep corporate and individual employee behaviour in line with company policy and ethics;
- reduces risk;
- streamlines management of emerging CSR challenges as they can be addressed rapidly and decisively at the top level;
- helps gain the trust of investors and therefore improves access to capital markets; and
- encourages employees to think more deeply about non-financial issues and in the process uncover opportunities they might not otherwise have seen – for example, opportunities to innovate or tap new markets.

An over-emphasis on policy and governance structure development can complicate the actual implementation of CSR/sustainability initiatives as it can focus too much of your attention on 'how' instead of 'what' you are trying to achieve through CSR.

It can also be tempting to put in place a governance structure that is too complicated and does not work in practice. If in doubt, keep it simple.

## 4.3 Your next steps

For those who are starting out on the development of good governance processes:

- establish a governance structure with explicit lines of responsibility for non-financial performance;
- raise responsibility for non-financial performance to the level of the Board of directors;
- understand your company's core values to develop policies rooted in these values; and

# Governance

- communicate policies to roll them out into the organisation.

For advanced practitioners who have already considered and possibly developed good governance processes:

- help Board members acquire training or qualifications in non-financial aspects of the business;
- establish a direct feedback channel from stakeholders to the Board;
- create a continuous improvement cycle for policy development that integrates stakeholder feedback; and
- expand the scope of policies to cover a wider range of issues.

The three key elements of effective governance of CSR issues are shown in Figure 4.1 and described and discussed in the following two sub-sections.

**Figure 4.1 The elements of effective governance of CSR issues**



## 4.4 Including CSR in Board activity

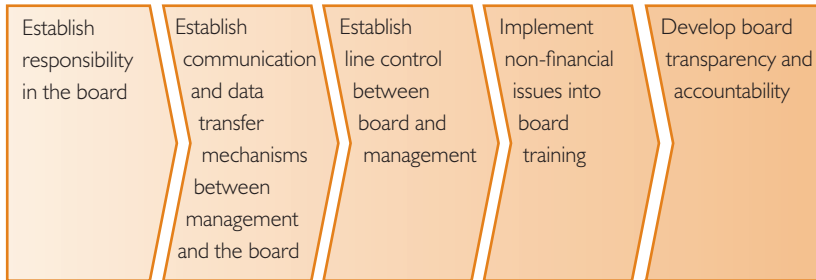
**Establish responsibility in the Board:** Figure 4.2 shows this and other key steps in the inclusion of CSR in Board activity. Responsibility for non-financial aspects of performance should reside at the same level as financial responsibility so that CSR issues can be incorporated into wider business strategy and decision-making.

Larger companies could establish a Board committee tasked with identifying and addressing social or environmental issues. Meeting as a committee can help facilitate meaningful conversation around specific issues that might otherwise be minimised during full Board gatherings.

Another option is to broaden the scope of more traditional standing committees to include responsibility for CSR. For example, while audit

committees have long had oversight of a range of compliance-based ethics issues, some are now looking at ethics and other core CSR issues more broadly and more proactively. If you choose to address CSR issues through a designated committee, you should still ensure that committee members report to the main Board so that all directors are aware and informed about the CSR issues facing the company.

**Figure 4.2 Key steps in the inclusion of CSR in Board activity**



You could also choose to address CSR issues at the full board level, or appoint directors to the board based on the unique expertise and experience they bring on specific CSR issues. They would serve as advisors to others on the Board.

Smaller companies wanting to demonstrate that they are responsible should simply make sure that CSR issues receive quality ‘air time’ at the most senior level, and that the outcomes of these discussions are recorded formally and acted upon.

**Establish communication and data transfer mechanisms between management and the Board:** For the Board to be effective at taking responsibility for non-financial performance, it must receive appropriate information from management. So you need to give responsibility to a person, department or committee within management for proactively raising CSR issues with the Board. You also need to set up mechanisms to prepare information for the Board. You could do that by compiling a regular report, producing a database of relevant performance data, or by convening regular meetings of a CSR committee. You should communicate the key outputs to the Board in a succinct format and at regular intervals.

**Establish line control between Board and management:** You should ensure that, when decisions are made by the Board, they are passed back effectively to management for action. This requires a clear line of responsibility

between the Board and management teams. Ideally, CSR should be added to the existing responsibilities managed through the line – for example, the Board would delegate CSR management to regional or functional managers alongside the other duties expected of them rather than being managed exclusively by a separate CSR team. For more information on assigning line management responsibilities for CSR issues, see section five, Performance Management.

**Implement non-financial issues into Board training:** Board members may be unfamiliar with CSR in general and the subtleties of some of the specific CSR issues your company faces. So you need to look for ways to make sure all Board members – whether or not they sit on any CSR committee – receive training in non-financial issues. Start by getting CSR included in the general induction new Board members receive. And then develop a programme of regular training on non-financial issues to help Board members familiarise themselves with all aspects of CSR, particularly those most relevant to your company. You may also seek a commitment from the company to make non-financial training compulsory for Board members.

This is an area in which you may want to consider seeking support from a third-party with experience in designing and delivering training in CSR issues for senior people.

**Develop Board transparency and accountability:** Transparency is a basic principle of good governance. In terms of your specific CSR governance arrangements, you should aim to make public the CSR responsibilities of Board members, and any particular CSR-related training and qualifications they might have. You can do this most easily through the company website and financial or CSR report. Describing the ongoing actions of the Board is not quite so straightforward. You might be able to provide an update on the topics covered in the most recent Board meeting(s) or provide a more general discussion of the remit of Board meetings. Ideally, the description of Board actions should be written so as to show how the Board is responding to stakeholder requirements and concerns.

You should also consider linking remuneration of the Board to the achievement of non-financial objectives (as well as the more conventional financial ones).

## 4.5 Developing effective policies to guide behaviour

Good governance is not just about making sure CSR is integrated into Board activities. You also need to develop effective policies to guide the behaviour of

employees. Figure 4.3 shows the key steps to developing effective policies to guide behaviour.

**Figure 4.3 Key steps in the development of effective policies to guide behaviour**



**Identify key issues for policy development:** When drawing up policy, you will not be able to deal with all CSR issues at once. So identify the areas that need most attention and formulate policies for these. Be guided by the priorities that have emerged from stakeholder feedback, benchmarking and risk registers.

If you have a significant manufacturing base, health and safety might be the most pressing issue that needs addressing through a policy. On the other hand, if you operate in countries where bribery and corruption is an issue, this needs to be dealt with urgently.

**Define good practice goals:** You need to be clear what the policy will accomplish. Do this by establishing good practice goals. Goals should not be specific and measurable targets, but rather general objectives – for example, increased awareness of health and safety risks during production.

**Define coverage:** Deciding on the coverage of policies is essential. Will they apply group-wide, in specific regions or just at corporate headquarters? Will they be applied only to specific activities – such as production or procurement – or more broadly? Will they be applied outside the company to suppliers and contractors?

Your decisions about coverage will depend on the capacity of the organisation to successfully implement the policy. For example, it may be feasible to set policy on greenhouse gas emissions that is specific about performance management at production plants because they have readily available data. But it may be more difficult to exercise similar controls for your transportation and distribution even though these activities might have a more significant impact on overall emissions. These issues need careful thought when developing your policy – balancing the desired outcome against feasibility of action and the resources needed for implementation.

**Develop roll-out plan:** It is not enough just to develop a new policy. You also need to be clear about how it will be rolled out so it is understood and acted on by all employees. Possible mechanisms include communication through line management, spreading policy through policy ‘champions’ and publicising it through proven internal communication channels such as team briefings, newsletters or the intranet. In addition, you should work with colleagues in human resources to integrate the new policy into existing training (eg in health and safety or procurement). As you develop more policies, it may be worth establishing training to raise awareness of CSR-related policies and improve compliance with them. Ideally, this should be made compulsory. Ultimately, you should consider reflecting your policies in employee rewards as a way of motivating staff to comply (for more on this issue, see Section five, Performance Management).

**Develop control mechanisms:** You need control mechanisms to tell you how well a new policy is being implemented – whether employees are aware of it, understand it and, most importantly, are adhering to it. Control mechanisms could include employee survey questions, feedback from employees’ performance reviews, or reports from line management. The most effective approach is to use existing tracking mechanisms. Find out how other aspects of employee performance are tracked and reported, and seek to include monitoring of your policy with these. Also, your internal audit department can be a useful ally – if possible, integrate CSR control mechanisms into their ongoing auditing work.

## 4.6 Good practice and beyond

**Establish a way for stakeholders to provide input to the Board:** As section three on Stakeholder Engagement outlined, your CSR programme should be informed by your response to stakeholder expectations and the issues that are important to them. Once you have the governance basics in place, you should aim, therefore, to establish a means for stakeholders to exchange views with, and provide feedback to, the Board. Some companies find that an effective way to do this is to develop an advisory panel made up of representatives of key stakeholder groups. Through different channels, they can advise the Board directly on how they expect your company to deal with the issues that matter to them. Support from an external consultancy can be helpful if you are looking to establish an advisory panel.

**Align policies with international frameworks and standards:** Although every company will need its own policies, you should consider aligning them with international frameworks and standards (see Section two, Strategy, page 21). Reviewing these standards can raise issues you might not previously have

thought of as relevant for your company but which, in the light of an international standard, you might realise you need to tackle through the development of policy. Making reference in your policies to international standards will improve the credibility and reputation of your CSR governance.

**Keep policies under review:** Policies should not be static. The issues facing your company are constantly changing, and new challenges – unknown only a few years previously – crop up frequently. As an advanced practitioner, you need to make sure your policies are responsive to changing risks and priorities. You should use your stakeholder engagement programme to keep your policies under review: Are they still appropriate? Do stakeholders deem that the company is adhering to them? You should also monitor the policies of peer-group companies and others to ascertain if you need to learn from what they are doing. Based on these findings you should seek to adapt your policies regularly.

**Expand the coverage of policies:** When first drawing up CSR policies, you should have focused first on the social, environmental and ethical issues that matter most to your company. Over time, you should develop new policies to embrace emerging issues, and also expand the scope of your policies so that they cover more of your company's interactions with society and the environment – for example, through joint ventures and supplier relationships.

## 4.7 Case study – ScottishPower

At international energy company ScottishPower, the chief executive has overall executive responsibility for corporate responsibility. The company's performance on each of its impacts is monitored by an executive team member who serves as an 'impact leader'. These executive impact leaders make regular progress reports to the executive team.

The chief executive and other members of the executive team bring CR matters to the attention of the plc Board as required.

Below the executive team sits a Corporate Responsibility Steering Committee (CRSC), which updates the executive team on corporate responsibility strategy, management and reporting. The CRSC is made up of senior managers, with each business and each impact represented. It meets four or five times a year and provides the link between the executive team and business operations. The CRSC is responsible for driving the corporate responsibility agenda at operational level and for ensuring clarity about the role of corporate responsibility among managers across ScottishPower.

On environmental management, the cross-company Environmental Co-ordination Committee, which reports to the executive team, is the key vehicle for environmental governance and policy development. It also monitors compliance and performance issues. It is chaired by the Group Energy and Environment Director.

Environmental issues are incorporated into the company's risk and control management framework. Material environmental issues are central to core strategy development, and are formally included in ScottishPower's business planning process.

Environmental performance is measured through targets and associated KPIs, and is reported to external stakeholders on an annual basis.

The ScottishPower Environment Forum provides a balanced stakeholder perspective and constructive feedback on environmental policies and proposals. Membership of the forum includes most senior executives and external experts in energy and environmental issues. The forum meets at least twice a year to discuss topical and emerging energy and environmental issues.

## 4.8 Case study – AZ Mining – governance

For AZ Mining's CSR programme to be effective, Jane knows she needs to engage the company's leaders. To track and control the CSR agenda from the Board level, three Board directors are assigned responsibility for performance in different areas of CSR; these are:

- environment, health and safety;
- community and stakeholder engagement; and
- employees and labour relations.

Each of these Board members is tasked to obtain quarterly updates of progress through the appropriate senior manager for EHS, communications and HR.

In addition, Jane is appointed as chair of a newly formed CSR steering committee. This committee, which is to meet semi-annually, is given the remit of drafting CSR strategy, policy and management tasks for the six months ahead, as well as reviewing performance and compiling non-financial risk and opportunity registers.

The committee is to be composed of the three senior managers directly responsible for aspects of CSR, as well as key managers from the global headquarters and regional operations. Jane is responsible for presenting the conclusions of the committee to the Board, including the submission of draft strategy and policy statements for approval.

The Board considers that the quarterly monitoring and semi-annual updates will be sufficient to increase their knowledge of the non-financial risks facing the company and therefore votes not to adopt a formal training mechanism. However, they agree to revisit the possibility of Board training in a year. They do agree to publish further details of the Board composition on the AZ Mining website including the remuneration, biographies and assessment of independence for each Board member.

At the first CSR steering committee meeting, the draft strategy originally produced by Jane and approved by the Board is approved without modification. In addition, a draft policy is agreed based on the initial results from the stakeholder surveys completed by Jane and the CSR teams in both regions. Because the committee has information from across the company, the policy is drafted to be applicable to all of AZ Mining's operations. The policy is constructed to match each of the key impact areas determined during the stakeholder engagement.

#### **Box 4.1 AZ Mining CSR policy**

- Treat the health and safety of our employees as our first priority.
- Comply with all local, regional and national regulations for health, safety, labour standards and environmental protection and refer to international guidelines in the absence of these regulations.
- Engage with our key stakeholders such as government and local communities during the exploration, initiation, operation and closure of mines.
- Follow international standards of responsible behaviour when planning for resettlement, or developing the infrastructure to improve health, education and well-being of the communities in which we work.

The goals of the policy are to assure AZ Mining's external stakeholders of its intentions to be a responsible company and community partner and to achieve buy-in from AZ Mining's employees so they can more effectively serve as ambassadors for the company in their daily interactions. The policy is also

designed to provide public relations material to be used with governments, socially responsible investors, and awards and ratings schemes in the CSR community.

Because these goals are all focused on effective communication, the roll-out of the policy (pending Board approval) is tasked to the senior managers of communication and HR to ensure that the policy is communicated to the targeted audiences. These two senior managers are also assigned the task of implementing feedback mechanisms to enable the steering committee to assess whether the policy is reaching the target audiences, whether it is being understood and whether opinions of AZ Mining are changing as a result.

***Jane's story continues on page 70***



# Performance Management

Performance management is the bread and butter of CSR management. It's about making CSR a reality by getting your company to change – at management level and below, across business units and regions, and in daily business-as-usual operations. For this reason, it demands a lot of your time and effort. But without it, your CSR aspirations will go unrealised. You need to have a robust approach to performance management so that your organisation can walk the talk.

## 5.1 Background and definitions

Performance management drives an effective CSR programme. Where strategy provides direction, performance management provides the engine to deliver on CSR commitments. Without effective performance management, new initiatives will be ineffective and eventually fail altogether.

Effective performance management requires clear lines of management responsibility for non-financial performance, appropriate incentives and support for staff, and solid management systems. These elements are covered in detail later in this section.

There are several key concepts you'll need to think about when you're looking at how to manage CSR performance. They are set out below.

- **Management responsibility:** For performance to be managed effectively, you need to decide and make clear, for each key non-financial issue, who is responsible for performance.
- **Performance evaluation:** If you can't measure it, you can't manage it, as the saying goes. You need metrics for measuring performance so you can take corrective action where it's needed and identify good practice to adopt elsewhere. But what gets measured? Measure the wrong things, perhaps just because they are easy to measure, and you will fail to lift performance where it matters. Use too many measures, and you won't be able to see the wood for the trees.
- **Targets:** Once you have a handle on how to measure performance, and you have a perspective on baseline performance, you can set targets for

improvement. Targets should be realistic, but challenging. Target-setting should not be carried out just by those at the centre, but should also involve those with responsibility for delivering improvements. Targets are only useful if they are supported by clear and realistic action and resource plans.

- **Remuneration:** Performance-related pay can play an important part in performance management because it can motivate individual employees to act in a way that helps achieve your wider targets. It is also a useful way of showing just how committed the organisation is to a particular aim or position.
- **External standards:** There are various standards for managing non-financial issues, but as yet there is no certifiable international management standard covering all the aspects of CSR management. ISO 26000, currently under development, will provide guidance on managing CSR, but will not be a certifiable management standard.

Two of the best-known standards that address specific aspects of CSR are ISO 14001 and OHSAS 18001.

ISO 14001<sup>13</sup>, first published in 1996, specifies the requirements of an environmental management system. It applies to the environmental issues over which the organisation has control. ISO 14001 is the cornerstone standard of the ISO 14000 series. Currently, it is the only ISO 14000 standard against which you can be certified by an external certification body.

OHSAS 18001 was created to try to resolve the confusion brought about by the proliferation of certifiable occupational health and safety (OH&S) standards. OHSAS 18001 specifies the requirements of an OH&S management system to enable an organisation to control its OH&S risks and improve its performance.

## 5.2 Opportunities, benefits, risks and downsides

Effective performance management is essential to your organisation making significant improvements in its overall CSR performance. It can also help you integrate environmental and social considerations into day-to-day operations. Effective performance measurement will provide:

- greater awareness among employees of company social and environmental

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- priorities and greater likelihood they will act and take decisions that support the achievement of your CSR objectives;
- increased efficiency through clear lines of responsibility and management;
  - a greater likelihood that you will achieve your stated goals; and
  - the possibility of an enhanced image with the public, regulators, lenders and investors.

A common trap is to assign responsibility for non-financial aspects of performance to managers without sufficient authority, or to group issues together into a portfolio that cannot easily be managed by one person. Great care is needed in ensuring the right responsibilities are given to the right people.

Good performance management is founded on access to sound data. It's possible to get carried away committing resources to setting up data-collection systems and then collecting data before you know how you're going to use the information you get and how valuable it will turn out to be in your efforts to improve your performance. When it comes to data collection, it's better to start small, and build from there. Once you know your initial data is of value, then you can start expanding the range of data you seek to collect.

## 5.3 Your next steps

For those who are starting out on the development of performance management measures:

- establish an effective management structure and assign responsibility at and beyond senior management;
- benchmark competitor key performance indicators;
- develop measurement mechanisms;
- set targets; and
- support and motivate employees to help achieve CSR objectives by providing training and introducing incentives.

For advanced practitioners who have already considered and possibly developed effective performance measures:

- develop processes that build non-financial considerations into innovation, research and development;
- review your targets for non-financial performance on a regular basis and consider how you might raise the bar year on year;
- consult stakeholders more widely on key elements of your approach to performance management;

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- make your data collection more accurate and comprehensive over time; and
- use benchmarking to compare your CSR performance with companies outside your sector, including those acknowledged as leaders.

The key elements of effective performance of CSR issues are shown in Figure 5.1.

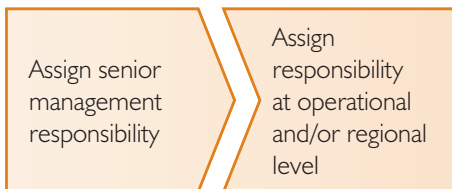
**Figure 5.1** The elements of effective performance management of CSR issues



## 5.4 Establishing management responsibilities

The key steps in establishing management responsibilities are shown in Figure 5.2.

**Figure 5.2** Key steps in establishing management responsibilities



**Assign senior management responsibility:** At the outset, it makes sense to assign responsibility for your main CSR issues within the existing management structure. For example, issues related to employee well-being almost certainly fit the remit of the human resources director. Similarly, there may already be other senior managers whose current remit would cover environmental management

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and employee health and safety issues. But not all issues will sit so easily within the current structure, and it makes sense to carry out a proper audit of the responsibilities of senior managers before deciding where responsibility for individual CSR issues should sit.

In some companies, there may also be a case for creating a new role of CSR director or equivalent. This might be appropriate if:

- the existing structure narrows the perspective of most managers such that they are unable to take responsibility for a complete CSR issue;
- the issues themselves require a manager with a remit that cuts across traditional functional boundaries;
- the issues are sufficiently large (both in terms of the time they take to manage and/or their significance to the business) to warrant a new role being created; or if
- there is a requirement for someone who can communicate the organisation's CSR performance externally and internally.

Apart from the obvious cost implications, the downside of creating a completely new position is that CSR can then be seen by other senior managers as someone else's job. For that reason, you should be clear that the job of the CSR director is to be responsible for the management of CSR issues. Ultimate accountability for CSR performance should rest within the Board of directors in order to ensure that CSR is integrated into your company's governance (for more information, see Section four, Governance).

Be aware that CSR issues can frequently cut across functional boundaries. Their successful management often depends on several departments cooperating, and a CSR initiative can be undermined if, for example, procurement or marketing act in ways that run contrary to it. The most successful companies set up a steering group or similar cross-organisational body for dialogue and decision making.

**Assign responsibility at operational and/or regional level:** Effective management of non-financial issues over the long term requires a sound management structure. To drive performance across your company's operations and regions, you need a management structure similar to that of any other corporate function. This involves cascading responsibility for CSR issues beyond senior management to various regional or site managers.

These responsibilities might be added to managers' existing duties or, depending on the nature of your operations and the issues you are dealing

with, it might be appropriate to allocate responsibility to a regional or site CSR manager.

## 5.5 Developing and motivating staff

The key steps in developing and motivating staff are shown in Figure 5.3.

**Figure 5.3 Key steps in developing and motivating staff**



**Train staff in non-financial issues:** Training your staff in non-financial issues can equip them with the knowledge and skills to take action and make decisions that support your organisation's CSR goals. Ideally, training should extend beyond classic business risk issues such as compliance with environmental or health and safety laws.

Although some non-financial training can be quite general (such as training on a corporate ethical policy), most should be audience-specific. For example, senior managers may need to know about how to include non-financial issues in the corporate risk register, whereas how to develop management systems for non-financial issues would be more relevant to regional or functional management. Similarly, communication professionals may need training on how to carry out stakeholder dialogue, while engineering teams may need training on how to reduce the company's carbon footprint.

By providing training on CSR issues, you are emphasising to employees their importance and the extent of your organisation's commitment to them. Over time, this can help raise overall awareness of the breadth of CSR issues and shift ingrained attitudes among staff so that they take account of these issues in their daily work.

**Reflect non-financial issues in performance incentives:** You can invite, encourage, guide and cajole employees to play their part in the achievement of your CSR goals, but for many this will not be enough – they need it to be made personal.

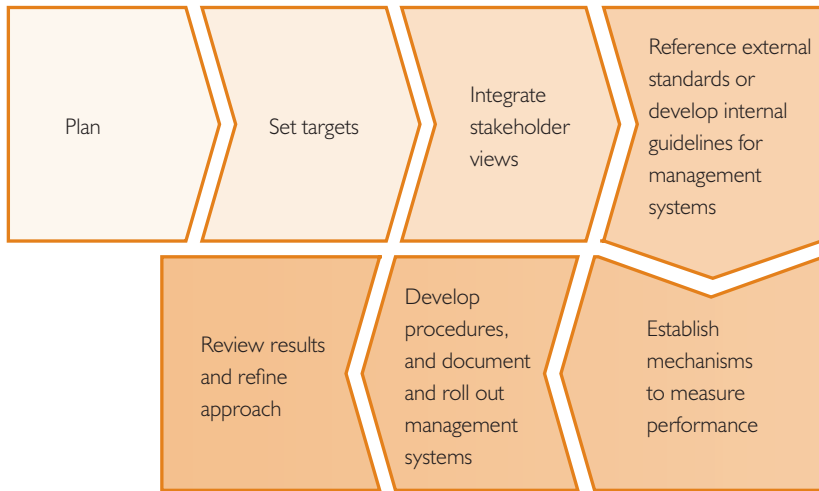
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You could reflect non-financial issues in performance incentives by linking employee rewards to certain measures of corporate performance on CSR issues (eg customer satisfaction surveys or performance in socially responsible investment indices). Of course, for this to be effective the employee would need to have a reasonable degree of influence over company performance in these areas, and this may only be the case for those in management positions. It is also more common to use individual and perhaps more subjective measures, which would be assessed by an employee's line manager in their performance evaluation, such as 'compliance with company ethical code' or 'level of community engagement'.

## 5.6 Implementing management systems

The key steps in implementing management systems are shown in Figure 5.4.

**Figure 5.4 Key steps in implementing management systems**



A management system is made up of the steps you need to take to achieve a particular objective. Most management systems follow the classic 'Plan-do-check-act' cycle. A similar approach should be taken to managing your CSR issues. However, the extent to which you need a formal system will depend on your circumstances.

**Plan:** The planning phase requires clarity about what you need to achieve. We have already addressed the most important elements – setting policies, assigning responsibility and providing training.

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**Set targets:** Ultimately, you should aim to set objectives and targets for each of the material issues you have identified. Although targets should be realistic, they should also be challenging: they need to serve as a driver to address significant risks and opportunities. For the most important non-financial issues, 'stretch targets' can play a part. Stretch targets seem extremely ambitious goals at the time, but can provide encouragement to managers to think outside the box and look for innovative and even radical ways to improve performance to a greater extent than they previously thought possible.

For those in the early stages of implementing CSR programmes, targets for non-financial performance can be a mix of measurable, time-specific targets on some issues and more general commitments on other issues. However, in order to drive up performance over time, you should make your targets more time-specific and measurable each year.

**Integrate stakeholder views:** Stakeholders have views not only on the issues you are managing, but also the way you are addressing them. You should look to gather stakeholder views on your performance management of non-financial issues – for example, your allocation of management responsibility or the targets you set. This consultation can provide new ideas for the management of complex issues as well as securing the support of stakeholders for your approach to performance management.

**Reference external standards or develop internal guidelines for management systems:** External international standards – such as ISO 14001 and OHSAS 18001, which describe 'best practice' management systems – can be instrumental in performance management. You may choose to follow them closely when designing your management system as doing so means you can be confident you are covering most of the important aspects of performance. Applying for certification to a standard means your management system will be subject to external auditing, which in itself can provide valuable feedback and advice.

However, when external standards are not available for a particular issue, you may need to develop internal standards. These are definitions of what your organisation expects of itself – its staff, and even contractors and suppliers – in managing an issue.

This probably won't be easy. For environmental management, legislation varies considerably from country to country. Developing standards for social and economic development performance is even more complex. Perceptions of what is good for society in the US are very different to what is good in Thailand.

The drivers for economic development in the UK are very different from those in Nigeria.

If your objective is legal compliance, one solution is to establish a set of minimum standards that apply across all operations, but to allow for local variance in performance standards according to the requirements of local legislation. A similar approach can be taken to developing standards for any non-financial objective, enabling adaptation to local circumstances.

**Establish mechanisms to measure performance:** Mechanisms to measure performance could range from data collection systems for greenhouse gas emissions or accident frequency to customer and employee surveys. Your company's current internal audit procedures for evaluating risk may be a good starting point when you're looking for ways to measure performance on non-financial aspects.

It can be tempting to get bogged down creating complex systems for collecting and analysing data. Instead, your initial efforts should be on establishing processes for getting the most important data, even at its most basic, into the right hands. Once you have proven processes in place, you can look to collect and analyse more data, and broaden your coverage of issues.

The Global Reporting Initiative<sup>14</sup> (GRI) is a widely recognised, multi-stakeholder-led process that has resulted in guidelines for sustainability reporting. The guidance includes protocols for measuring a wide range of indicators and some of these may be useful to your organisation in defining performance measures.

**Develop procedures, and document and roll out management systems:** In order to make your systems work in practice, you should think carefully about the things your employees should do on a day-to-day basis to adhere to your policies and drive performance. This may mean writing some new procedures, or amending existing ones. This work is often called 'operational control'.

To document your management systems, you should record all your relevant policies and procedures, the criteria you have used to establish mechanisms to measure performance, your methods for integrating stakeholder views, the standards your systems must adhere to, and your criteria for setting targets, as well as the targets themselves. It helps if all these factors are brought together in a single document.

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14 [www.globalreporting.org](http://www.globalreporting.org)

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When you document your management systems, ensure each documented system covers all the relevant issues. For example, an environmental management system could include everything from emissions to biodiversity.

Relevant issues should be grouped together in a management system document according to the way you have assigned responsibility for them. For example, if you have assigned responsibility for employee well-being to the HR director, the management system document should integrate well-being and all other issues assigned to that director.

Documented management systems should be communicated to business units, regions or operations, so you can secure their understanding and support. You do this just as you would communicate and get buy-in to any other significant new initiative.

**Review results and refine approach:** Review your management systems regularly. If they are not working as well as planned, you will need to improve them. Evaluate trends in relevant data. Is performance different in certain departments or regions? Why might that be? Gather information on compliance with relevant procedures – perhaps involving internal audit in this work. Does this shed light on why things are, or are not, working?

Make sure all these factors get discussed at an appropriate management forum which should ask not only: ‘Are we doing things right?’, but also: ‘Are we doing the right things?’ Be prepared to go back to basics if necessary by amending your policy or revising your targets.

## 5.7 Good practice and beyond

**Integrate non-financial issues into innovation processes:** One of the greatest opportunities opened up by a well-developed CSR programme is in innovation. Evaluating products and operations to improve their environmental and social performance can have long-term benefit to the company and society.

Aim to build social and environmental issues into your process for innovation, such that anyone involved in developing new processes, products and services is prompted to consider non-financial issues. In this way, your organisation may be able to spot and exploit opportunities to seize first-to-market advantage.

**Be more ambitious in target-setting and in systems coverage:** You can drive performance by setting progressively more ambitious targets and by expanding the coverage of your management systems to cover a wider range of

the issues that are important to the company and its stakeholders and more of your operations.

**Be more proactive in seeking and acting on stakeholder views:** As you develop your management systems, establish a process for ongoing consultation with stakeholders on your approach to performance management. The process needs to enable you to keep stakeholders informed about your management systems and to gather, distil and act on their feedback.

**Introduce more robust data collection and consolidation processes:** As your CSR programme develops, the need for accurate and comprehensive data will become greater. To ensure accuracy, you will need to develop quality assurance and control systems as well as internal and external audit procedures. To expand the scope of your data, you will need to encompass more of your operations and impacts. To use greenhouse gas emissions as an example, you could initially limit the scope to direct production (eg boilers) and then expand it to purchased energy and emissions from transportation and distribution and then to employee commuting and end-of-life disposal of products. Being clear about the scope of your data systems becomes very important in determining the most appropriate metric. Over time, the tendency is generally toward an expansion of scope. However, you need to keep control of metrics and only collect data that is relevant to driving performance.

## 5.8 Case study – General Motors

General Motors has a strong process-oriented approach to managing its CSR performance. It has a Public Policy Centre (PPC) that identifies, coordinates and manages key issues that affect its business in the areas of corporate responsibility and sustainability, government relations, energy and environment, economics, diversity, philanthropy and community relations. A global coordination team directs the PPC and comprises members from GM's four operating business regions and the respective regional strategy boards.

The activities of the PPC are reported annually in the company's CSR report and through the GMability website. The management approaches adopted for specific environmental, social and community issues are discussed in the respective sections of its report. General Motors drives CSR performance through training for all employees, including senior managers. It also has clear CSR policies and certified environmental and health and safety management systems and supplier management systems. Each of its management systems is supported by specific targets linked to the goals of the company.

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The principles underlying these management systems, as well as GM's code of ethics, are based in part on various international standards, including the Global Sullivan Principles of Social Responsibility.<sup>15</sup> The net effect of this structure and management system set is that the processes are in place to drive non-financial performance.

The evidence for the success of GM's performance management for non-financial issues can be seen in the ability of the organisation to integrate non-financial aspects into product innovation. Examples include responsible vehicle use, vehicle design, vehicle quality, vehicle safety and vehicle recycling. Of particular note is GM's system of gathering and integrating employee views on the vehicle lifecycle. Its 'Design for the Environment' approach encourages innovation in environmental management across the lifecycle of the vehicle.

## 5.9 Case study – AZ Mining – performance management

After AZ Mining has established its global CSR governance structure, mainly through its new CSR steering committee, Jane turns her attention to the regions to integrate CSR at operational level.

**Assigning operational responsibility:** She asks the managing director in each operation to assign responsibility for CSR to one of the on-site managers. This manager is to be responsible for collecting CSR performance data and working with Jane's global team to roll out the new CSR policy and associated initiatives. It is agreed that each of the managers will take part in monthly conference calls and an annual meeting to discuss challenges and share best practices.

**Training:** At the first conference call of regional managers, a training programme is drawn up. The training is to be developed and implemented in line with the existing environmental, health and safety training which all staff undergo. Modules are added to cover labour standards, human rights, community engagement and resettlement.

Jane contracts with a consulting firm to develop the training modules. She also asks the consultancy to train one person from each region and someone from her global team in a 'train the trainer' approach. These in-house trainers deliver the training to the on-site operational CSR managers.

**Performance management mechanisms:** Jane opts to allow the operations the flexibility to manage CSR in the way that makes most sense

15 [www.thesullivanfoundation.org/gsp](http://www.thesullivanfoundation.org/gsp)

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in their region. So, instead of mandating company-wide responses, she gives each region the list of material issues covered by the CSR strategy and asks them to determine the most pressing needs and the appropriate mechanism for improving performance based on their own perceptions and any existing stakeholder feedback. An example response from a Canadian operation is set out in Table 5.1.

**Table 5.1 Responses to material issues from one of AZ Mining’s Canadian operations**

Material issue	Response
Complying with local, regional and national regulations for health, safety and environment	Improve reporting of EHS incidents within the operation by implementing a new EHS Prevention Plan with cards for each employee on which to record incidents, good practice or near misses
Engaging with government and local communities during exploration, opening, operation and closure of mines	Create a list of topics for community engagement and determine the current level of engagement around them through interviews of appropriate managers
Creating a culture of 'safety first' in all operations	Improve work practices for explosives storage and handling
Providing infrastructure and health services to employees, families and communities at operations in remote locations	Construct permanent housing for long-term contract employees
Enforcing labour standards in line with AZ Mining policy, particularly around employee well-being and child labour	Conduct survey of employees on well-being issues

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Material issue	Response
Resettlement issues around new deposits and locating tailings ponds	Not currently applicable, although there is room for the operation to review plans for future expansion of the tailings pile with regard to broader CSR risks

**Set targets:** Jane agrees with the CSR steering committee that targets should be set at both global and operational levels.

Based on the responses she gets from the operations, she realises that there is a strong need for better information-gathering to provide a picture of the current status of the organisation. Therefore, she sets group targets that commit AZ Mining to:

- compile a formal stakeholder map for each operation;
- implement group-wide policies on labour standards and community engagement;
- develop a formal risk management process that integrates CSR issues; and
- develop and implement an audit procedure for resettlement plans across all operations.

She then asks each of the operations to set targets for each of the six key material issues for AZ Mining that are in support of the wider global targets described above. She also asks operations to take the lead on developing management systems at the operational level to achieve those targets.

**Performance incentives:** After discussions with the CSR steering committee, Jane recommends to the Board that CSR issues should be included in the performance evaluations and remuneration packages of the managing directors of each operation and the members of the CSR steering committee. She advises against a similar package for all employees until the metrics for the CSR programme are more fully developed. At present, Jane believes the metrics do not provide a fair indication of the performance of employees not explicitly involved in managing the CSR programme.

***Jane's story continues on page 81***

# Public Disclosure

Being transparent about your material CSR issues and reporting your performance is your route to securing many of the potential benefits of being a responsible corporate citizen. It can help you win the trust of your stakeholders and set your organisation apart as an accountable business.

For most companies, the primary channel for disclosure is the annual CSR or sustainability report. It allows you to tell the world about your priorities and successes, and also to be candid about your shortcomings and plans to improve.

## 6.1 Background and definitions

Companies are facing increasing demands from customers, investors, and a wide range of other stakeholders for transparency on their social and environmental performance. Public disclosure enables you to meet these demands. It is also a key part of your dialogue with stakeholders – see also section three, Stakeholder Engagement.

The most obvious application of public disclosure is the annual CSR or sustainability report. In recent years, there has been a rapid rise in the number of companies issuing these reports, even though it remains a largely voluntary activity<sup>16</sup>, including in the UK. In 2005, 52 per cent of the Fortune Global 250 companies produced CSR or sustainability reports in addition to their statutory annual financial report. This is a trend that is likely to continue over the next few years, and it is expected that around 90 per cent of the big companies will be reporting on CSR by the end of the decade.

Of course, quantity should not be confused with quality. The standard of many reports being produced remains worryingly low, and really good reports are rare indeed. As reporting grows more widespread, companies face increasing challenges to improve the comparability of what they report. However, a one-size-fits-all approach does not work for non-financial reporting. It is up to you

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16 In many countries, environmental performance reporting is compulsory for large companies. And some governments have also begun to demand more public disclosure of companies' CSR performance. In the UK, one of the provisions of the Companies Act 2006 introduced the requirement for companies to write a forward-looking business review, which should include information on environmental matters, employees and social issues to the extent necessary for shareholders to understand the likely future performance of the business.

to determine the approach you want to take depending on your organisation's own needs.

This is an evolving field. There are many companies yet to produce a report while others have published environmental reports for many years and are now moving further down the road toward integrated financial and non-financial reporting.

## 6.2 Standards

Two clear standards have emerged to guide corporate reporters and promote comparability: sustainability reporting guidelines from the independent Global Reporting Initiative (GRI)<sup>17</sup>, and the AA1000 series of standards for social accounting, reporting and auditing published by international think-tank AccountAbility (the Institute for Social and Ethical Accountability)<sup>18</sup>.

The GRI is a network of representatives from business, environmental and human rights groups, and other civil society organisations. Its sustainability reporting guidelines provide a widely accepted and popular voluntary framework for businesses to achieve best practice in sustainability reporting. The guidelines provide clear direction on report content through a series of indicators of what should be reported. The GRI also offers sector-specific supplements, technical protocols on issues such as measurement of water use, and resource documents on issues such as HIV/AIDS.

To indicate that a report is GRI-based, reporters should declare the level to which they have applied the GRI reporting framework via its Application Level system<sup>19</sup>. There are three levels in the system: A (for advanced reporters), B (intermediates) and C (beginners). The reporting criteria are more demanding as you progress up the levels. It is possible to add a plus symbol (+) to the main letter if you have utilised external assurance for the report.

Only a few companies are yet equipped to report against all the indicators in the GRI guidelines. Most instead prefer to use the guidelines as a resource to point them towards areas they should consider reporting.

The AA1000 framework provides a systematic stakeholder-based approach to organisational accountability and performance improvement through social and ethical accounting, auditing and reporting. Within AA1000, the AA1000

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17 [www.globalreporting.org](http://www.globalreporting.org)

18 [www.accountability21.net](http://www.accountability21.net)

19 Information correct at time of writing

Assurance Standard (AA1000AS) is the first assurance standard for social and sustainability reporting. It provides a framework for ensuring that reports provide information that is material, complete, and responsive to stakeholder concerns and interests (see section seven, Assurance). The AA1000 series also includes a standard for stakeholder engagement. This is known as AA1000SE.

The GRI guidelines and AA1000 are broadly complementary. AA1000 defines a rigorous process of stakeholder engagement, while the GRI guidelines provide globally applicable guidelines for reporting that emphasise stakeholder engagement. Together, the GRI guidelines and AA1000 provide good reference points to help you manage, measure and communicate your overall CSR or sustainability performance.

## 6.3 Opportunities, benefits, risks and downsides

There is a compelling case for being transparent about your non-financial performance. Transparency offers:

- enhanced reputation with all stakeholders, with resulting benefits to brand, shareholder confidence, consumer loyalty and overall ‘licence to operate’;
- access to long-term capital and favourable financing – reporting helps attract ‘patient’ shareholders with long-term horizons and may help to justify lower risk premiums from financiers and insurers – this is because analysts and socially responsible investors are increasingly considering companies’ disclosure on CSR issues when making investment decisions;
- improved management systems because reporting can trigger development of management systems to better handle the impacts being reported;
- greater employee awareness and understanding of CSR issues, strategy and performance; and
- the basis for dialogue with stakeholders – for example, many leading reporters integrate stakeholder feedback into their reports.

Reporting isn’t cheap. It takes significant human and financial resources to produce a credible CSR or sustainability report. Also, if you want to report new areas of activity, it is likely to take time to create the right data-gathering systems. As a result, some companies tend to report on issues they are familiar with. The call for increased transparency in reporting creates two key dilemmas:

- how open can you be?
- how do you handle the fact that stakeholders have different information requirements and have a different level of influence on the organisation?

# Public Disclosure

## 6.4 Your next steps

For those who are starting to consider issues concerned with public disclosure:

- ensure top-level commitment to increasing organisational transparency;
- allocate reporting responsibility;
- be clear on why, how and what is being reported;
- collect relevant data;
- construct and write a report that is useful to all readers; and
- continually improve reporting.

For advanced practitioners who have already considered and possibly developed public disclosure processes:

- incorporate external feedback into report development;
- develop an integrated report; and
- obtain independent assurance.

The key elements of effective public disclosure of CSR performance are shown in Figure 6.1.

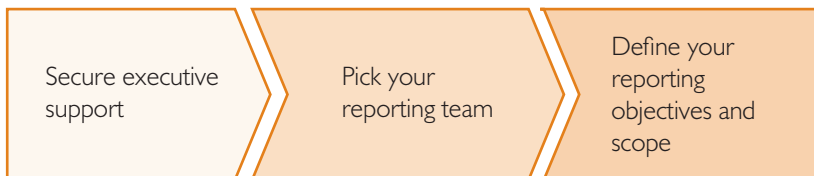
**Figure 6.1 Elements of effective public disclosure of CSR performance**



## 6.5 Report planning

The key steps in establishing report planning are shown in Figure 6.2.

**Figure 6.2 Key steps in report planning**



## Public Disclosure

**Secure executive support:** As with any other CSR activity, reporting requires support and commitment at Board and senior management level. At its most basic, senior-level sponsorship will help you secure the funds you need to do a proper job of reporting. It will also help you obtain the cooperation of colleagues that is required if you are to gather and make public data on your organisation's non-financial performance.

**Pick your reporting team:** Because comprehensive CSR reporting will draw information from many areas and functions, it may be helpful to assemble a cross-functional reporting team to agree your approach to reporting. Some companies also engage outside consultants and writers as part of their team.

**Define your reporting objectives and scope:** Defining the objectives of your report will enable you to clearly describe your approach to reporting to your internal and external stakeholders and secure their support. At this point in the process, you should be asking yourself the questions outlined below.

- **Who is your intended audience?** Keep in mind that you may not be able to meet the needs of all stakeholder groups in a single report. Especially at the beginning, you have to make choices – choosing the audience brings clarity and focus to a report.
- **What is the scope of your report?** If you are fairly new to reporting, stakeholders will give you some leeway – they will not expect you to provide comprehensive coverage of all your impacts across all your operations and activities right away. In year one, you might focus just on your main operations, looking to extend the scope from years two or three onwards. Or you might initially limit the report to the operations under your company's direct control rather than what is happening in the supply chain. Whatever scope you choose, you should be transparent about this – and your reasoning – in the report.
- **What standards or guidelines will inform your reporting?** You should consider using the GRI sustainability reporting guidelines and its sector supplements for different industries. Also, many sectors have produced their own reporting guidelines – eg Project Forge for the banking industry, and the International Petroleum Industry Environmental Conservation Association guidelines for oil and gas. You may also wish to consider how the AA1000 framework could guide your approach.
- **What are the limitations of your approach?** With all CSR and sustainability issues, there are uncertainties, and no-one expects you to have

all the answers. It is seen as positive by your stakeholders if you acknowledge where you will need to do more to understand, tackle and report issues, and if you describe how the organisation is learning as it goes.

- **How will the report be published?** You need to decide if you want to produce a stand-alone document or integrate the disclosure on your social and environmental performance into the annual report. In addition you could consider adjusting reports according to the needs of different audiences. Some organisations produce shorter versions for customers, shareholders and staff. Others exploit new technologies such as podcasting, and a few have begun to explore the potential for fully interactive web reporting in which users get a different version of the report depending on whether they're investors, customers, employees, journalists, activists and so on.

### 6.6 Report writing and publication

When planning what to include in your report, the key point is to make the report relevant; in other words, it needs to cover all your material issues. Aspects of your CSR performance to consider covering in your report are:

- your policies and targets on material social and environmental matters, and the extent of their application; eg across operations and into the supply chain or subsidiaries;
- the organisation's and employees' performance in adhering to policies and how you are planning to improve performance in the future;
- the results of any external benchmarking of your performance, for example in the Dow Jones Sustainability Index, the FTSE4Good Index or the Accountability Rating;
- your organisation's shortcomings and negative impacts so that you provide a balanced and frank account of performance; and
- new issues that have emerged in the reporting period and that have or may have an impact on financial performance – such as fines your company had to pay or any other liabilities related to non-financial issues.

It makes sense to benchmark what other companies in your sector are reporting on, and also to look at the reports produced by other companies you admire.

You also need to decide what data you will include. This will be closely linked to the performance management systems you have in place (see section five, Performance Management). If you are in the early stages of reporting,

stakeholders may be willing to accept an issues-based report illustrated with case studies rather than one that provides comprehensive data. However, you would need to be open about where you have insufficient data, and what you plan to do about this.

The best reporters show how their sustainability strategy links to their core business strategy and decision-making (see section two, Strategy). You should highlight how non-financial performance is central to the running of the company (see section four, Governance) and is embedded in processes, standards and incentives.

Taking all of these factors into account and designing an appropriate solution can be challenging. Many companies, particularly first-time reporters, find that they benefit from external advice.

## 6.7 Continuous improvement

Most stakeholders view CSR reporting as an exercise in continuous improvement. They are likely to be willing to accept a fairly basic first report, as long as you try to improve over time. Whatever base you are starting from, be sure to tell stakeholders about your plans to improve.

Also, your reports should include commentary on the progress your organisation has made against its prior commitments. And it is good practice to reflect on any organisational learning derived from the publication of previous reports.

## 6.8 Good practice and beyond

**Incorporate external feedback:** Link your reporting to your stakeholder engagement programme (see section three, Stakeholder Engagement). By seeking the perspective of stakeholders on your report, you will be able to identify ways you can meet their information requirements more effectively. Being open about stakeholder expectations and concerns in the published report, even where these are critical of company strategy or performance, is a key test of transparency.

**Include non-financial performance in the annual report:** Best practice in non-financial reporting is to publish a fully integrated annual report that covers the organisation's financial and non-financial performance. You can bring material social and environmental related risks and opportunities to the attention of all stakeholders including investors by outlining them in the main annual report. To achieve this, you will first need to have integrated CSR issues

into the company's core strategy (see section two, Strategy) and probably also assigned Board-level accountability for CSR (see section four, Governance).

**Get independent assurance of your report:** Any reporting company will benefit from investment in assurance, although first-time reporters may feel cautious about committing to publishing external assurance before they have experience of the reporting process. Independent assurance of your report can be instrumental in winning the trust of stakeholders. It can help give them confidence that what you say – and what you do not say – about your CSR performance has been subject to proper scrutiny. Effective assurance has many other potential benefits, which are discussed in detail in section seven, Assurance.

### 6.9 Case study – Électricité de France <sup>20</sup>

Électricité de France (EDF), the main electricity generation and distribution company in France and one of the world's largest producers of electricity, discloses performance against all of its key non-financial policies – particularly its code of ethics, supplier policy, and CSR Agreement. Between them, these policies cover a wide spectrum of performance in environmental, social and broader economic aspects. It also reports performance on the 10 UN Global Compact principles in the form of a table with specific references to actions, policies and systems that EDF is using.

Throughout its report, EDF makes extensive reference to the GRI guidelines, including in its index of metrics. It has, for now, elected not to report 'in accordance with' the guidelines. It also refers to Agenda 21, a plan of action adopted at the Earth Summit in Rio de Janeiro in 1992 to promote sustainable development.

EDF uses a variety of reporting mechanisms – financial, governance and sustainability – to meet particular stakeholder needs. The company has also developed a website that gives financial and non-financial data and outlines its governance arrangements, management systems and policies.

Stakeholder opinion is given space in EDF's reporting. The organisation includes in its report an explanation of the stakeholders it considers important. It also uses advisory panels to seek out stakeholder feedback on its material issues and its reporting approach, and uses this to inform developments in its reporting. In doing so, the company is helping to establish long-term relationships with its stakeholders.

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20 [www.edf.com/30199i/Homefr/Sustainabledevelopment.html](http://www.edf.com/30199i/Homefr/Sustainabledevelopment.html)

Finally, EDF integrates sustainability reporting into its annual report in the form of a discussion of material issues and how these relate to long-term financial performance, and provision of performance metrics.

### 6.10 Case study – AZ Mining – public disclosure

AZ Mining's year of hard work to understand and start measuring its CSR impacts begins to pay off and a picture of overall CSR performance begins to form. The CSR steering committee feels it could reasonably communicate to the outside world AZ Mining's CSR priorities, how the company is performing against them, and where it needs to do more.

In addition, feedback from key stakeholders and from departments such as Human Resources and Marketing indicates that the company CSR programme should be communicated through a public report. In response to a recommendation from the CSR steering committee, the Board approves a budget for developing a report over the coming year.

The CSR committee decides the report will be published in hard copy and through the company website, and using a similar design to that for AZ Mining's annual financial report.

Jane appoints a reporting team headed by the CSR committee representative from the Communication department, Mark. And Mark sets about collecting data from the CSR managers at each operation over a two-year cycle.

In order to respond to stakeholder needs, Mark decides the report will have three sections. The first section, global CSR, will cover aspects of strategy, global policy, stakeholder engagement, group targets and initiatives, and a statement from the chief executive discussing the significance of CSR to the company. The two sections that follow will cover each of the two regions' specific material issues, management systems and performance.

Because the first report only has two years of performance data, very little effort is placed on identifying data trends and responses.

Having created the basic structure for the report, Mark seeks input on text for specific performance areas (such as environment, health and safety and human resources) from issue owners. He uses this input to write the report, and then commissions a report designer to put the report (both the

## Public Disclosure

printed and online versions) in the same format as AZ Mining's annual financial report.

Before publication, Mark places a feedback form on both the hard copy and website versions of the report to find out whether it is seen as responsive to stakeholder expectations. However, he finds that the company receives almost no unsolicited responses. Therefore, he convenes a forum for a number of stakeholders so he can gather feedback on the report. As a result, he identifies three priorities for the following reporting cycle. These are to:

- obtain independent assurance of the content of the report;
- include performance data on greenhouse gas emissions; and
- establish benchmarks for performance and report on AZ Mining's position or performance in these benchmarks.

These points of feedback are discussed by the CSR steering committee and used to guide the reporting process for the following year.

***Jane's story continues on page 96***

# Assurance

Accounting failures, corruption scandals, environmental disasters and supply chain malpractice have all taken a heavy toll on public faith in big business. In response, companies are looking for ways to restore the trust of their stakeholders. Gaining independent assurance of your CSR report and other aspects of your CSR programme can be a vital step in that process. It can give your stakeholders confidence that your activities have been subject to proper scrutiny.

A small but fast-growing number of companies are now seeking third-party opinion on their reporting. However, the assurance statements that appear in their reports still tend to be limited to verification of data. Few companies have yet been bold enough to seek broader comment on whether, and how well, their report addresses the issues that really matter to stakeholders. Meaningful assurance is about checking not only that the information in your report is right, but also that the right information is in your report. Only then will assurance instil the trust companies crave.

## 7.1 Background and definitions

Assurance is a way of securing the trust of stakeholders in your organisation. One of the best technical definitions of assurance is that it is: “the process leading to the provision of an opinion or conclusion to a specified audience regarding the extent to which an organisation is living up to its values and the quality of the mechanisms and competencies in place to ensure that it is”.<sup>21</sup>

In a CSR context, assurance is usually applied to an organisation’s public CSR or sustainability report. However, it can also be applied to other CSR activities including management methods, data collection systems and stakeholder engagement processes.

Where the focus of assurance is a CSR report, there is more to the job than simply ticking boxes. Verification of claims made and the accuracy of data can play a significant role, but it is only one component. The function of independent report assurance should be to check not only that the information in the report is right, but also that the right information is in the report. It should be a process that assures your stakeholders that you understand and are managing the issues that really matter to them. To do this, assurers must check that the report presents

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21 Institute of Business Ethics, ‘Living up to our values – Developing ethical assurance’

a balanced and complete account of the company's performance and its response on stakeholders' main concerns – for more information on understanding stakeholder concerns, see section three, Stakeholder Engagement.

If assurance is carried out with a view to issuing a public statement about the activity being assured, it is generally accepted that, to be credible, it needs to be carried out by an independent third party. There is also a place for internal assurance though. This can be carried out by your own staff, although they would usually need to work in a separate part of the organisation to those responsible for the report, data or process being assured. For instance, many large companies have internal audit departments that exercise internal control over financial systems and data or significant business risks. Internal assurance can also generate useful evidence for use by external assurance providers in forming their opinion.

Uptake of independent report assurance continues to increase. According to the 2006 Accountability Rating<sup>22</sup>, published in Fortune Magazine in October 2006, 25 out of 64 Fortune Global 100 companies rated used some form of assurance, with nine of the top 10 companies publishing independent assurance statements within their reports. And according to a survey by KPMG of the Fortune Global 250, 30 per cent of those that produced a report used assurance.

## 7.2 Opportunities, benefits, risks and downsides

Assurance helps build people's understanding of, and confidence in, your organisation. It can improve public perception of your company and its activities. It also offers you the chance to learn from the findings of a third-party review so that you can improve your systems and processes and make progress towards your objectives. Assurance offers:

- greater public confidence in the organisation's non-financial reporting and wider CSR programme leading to an enhanced corporate reputation;
- improved management of risks and opportunities;
- early visibility of future CSR and sustainability challenges for the business;
- improved compliance with legal and regulatory requirements;
- access to recommendations for improving the CSR programme; and
- increased confidence of senior management in the company's CSR programme.

When you carry out or commission assurance of some aspect of your CSR

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22 [www.accountabilityrating.com](http://www.accountabilityrating.com)

## Section 7

programme, there is a chance that the assurance work will uncover significant shortcomings. This could, initially at least, diminish internal and external confidence in the activities being examined. However, this will be more than offset by the credibility you gain with stakeholders and the opportunities it will create to make genuine improvements. After all, it is far better to know about issues so you can address them rather than being unaware of them until they cause significant problems for the business.

In addition, assurance processes are sometimes poorly understood, even by experienced managers. If the scope of assurance is not well defined and management expectations are not set in advance, you could end up wasting some of the management resources you invest in assurance, feeling a loss of control or, worse still, not achieving your objectives.

### 7.3 Your next steps

For those who are starting to consider using assurance:

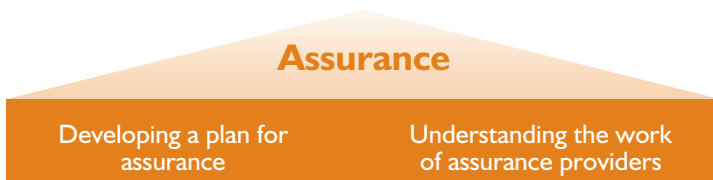
- understand where assurance can add greatest value;
- identify existing sources of internal assurance;
- identify potential quality issues in performance data;
- identify potential problems with management systems and processes;
- find ways to consider stakeholders' issues in the assurance process; and
- develop a plan for introducing assurance.

For advanced practitioners who have some familiarity with assurance:

- use assurance as an essential tool in honing your CSR programme;
- involve stakeholders (internal and external) in the assurance process; and
- extend the scope of assurance beyond traditional boundaries to better define and manage risks outside your direct control – eg in the supply chain.

The two key elements of effective assurance of CSR performance are shown in Figure 7.1.

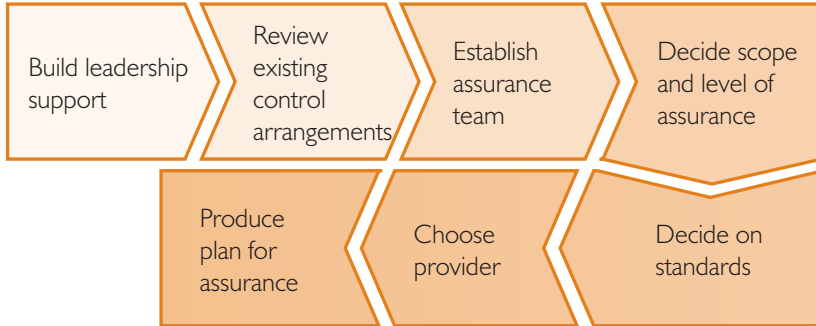
**Figure 7.1 The elements of effective assurance**



## 7.4 Developing a plan for assurance

The key steps in developing a plan for assurance are shown in Figure 7.2.

**Figure 7.2 Key steps in the development of a plan for assurance**



**Build leadership support:** To make assurance effective, you need the backing of the company's leaders. You need them to support what you are trying to do, explain to their colleagues what is proposed and why, and be willing to take on Board learning and recommendations. Leadership support is especially helpful because a good assurance exercise may challenge the status quo in the organisation. You should secure the involvement of leaders from the outset in the planning process so they can 'own' the outputs.

**Review existing control arrangements:** Even though you might not have a formal assurance process for non-financial data or processes, it is likely that existing internal control mechanisms, for example those driven by your internal audit department, will cover certain aspects of non-financial performance. Especially in larger organisations, you need to ascertain which areas of the business could provide you with information about existing assurance mechanisms.

**Establish assurance team:** You should form a small team to set the objectives of the assurance process and be involved in decisions as it unfolds. This is where you can bring in people from other parts of the organisation, particularly from the finance or internal audit areas where there may be managers with assurance expertise.

**Decide scope and level of assurance:** You need to select the parts of the organisation to be covered. Will all business units be included? What about joint venture companies? Will the focus be solely your own operations, or will it

extend to embrace your supply chain or outsourced services? Your decisions will often be linked to the extent of your external disclosure, such as the activities covered by your CSR report.

You also need to decide what aspects of your CSR programme to subject to assurance. For example, you could look to assure:

- the identification and prioritisation of CSR issues, including the quality of stakeholder engagement programmes;
- the quality of the management systems employed to control CSR risks and opportunities – eg environment, health and safety or HR;
- data collection systems for CSR performance information;
- the consolidation of CSR performance data from dispersed sources – eg from sites or business units; or
- the quality of the source data itself.

With the scope of the assurance exercise mapped out, you need to agree the level of assurance you want to achieve. The financial accounting industry has developed its own jargon to describe levels of assurance. In ‘reasonable assurance’, the work done by the assurers is deemed sufficiently thorough as to reduce the risk of a material misstatement to an acceptably low level. In these circumstances, the assessor will provide a positive statement eg “The information is correct”. In ‘limited assurance’, the assessor investigates claims less thoroughly (although the risk of misstatement is still low). In these circumstances, negative language tends to be used eg “Nothing came to our attention to suggest...”. Your decision on the level of assurance you want to achieve will have a major impact on the costs of an assignment.

**Decide on standards:** You may want to use an external assurance standard as the basis for the assurance work. This can give added credibility to the assurance.

Currently, there are only two widely recognised professional standards for carrying out assurance: the International Standard on Assurance Engagements (ISAE 3000)<sup>23</sup> provided by the International Audit and Assurance Standards Board, which is part of the International Federation of Accountants; and the AA1000 Assurance Standard (AA1000AS)<sup>24</sup>, provided by AccountAbility – the Institute for Social and Ethical Accountability.

The ISAE 3000 is essentially a quality system for ensuring assurers approach

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23 [www.ifac.org](http://www.ifac.org)

24 [www.accountability21.net](http://www.accountability21.net)

non-financial assurance in a consistent way and produce similar outputs. It is often used by traditional accountants involved in non-financial assurance as many of the principles are similar to those used in financial accounting. It has not, however, been specifically designed for assurance of CSR information.

The AA1000AS is now used by many leading reporters and assurance practitioners. It sets out the principles of a robust and credible assurance process in a CSR context, the essential elements of an assurance statement, and the independence and competence required of an assurance provider. It defines three key principles assurers should use in their work: materiality, completeness and responsiveness. It therefore emphasises the inclusion of stakeholder priorities in the assurance process. Further information on AA1000AS principles is shown in Box 7.1.

Research by AccountAbility<sup>25</sup> has established that assurance based on the combined use of AA1000AS and ISAE3000 is likely to deliver enhanced results. Therefore it might ultimately be useful to combine both standards when seeking assurance. NovoNordisk ([www.novonordisk.com](http://www.novonordisk.com)) is a company that uses a combination of AA1000 and ISAE 3000 in its assurance statement.

## Box 7.1 AA1000AS principles

On **materiality**, the assurance provider looks for evidence that your company has identified the CSR issues that are important to your stakeholders. These might relate to legal compliance, the company's policy positions, and the issues considered material by the company's peers and competitors.

On **completeness**, the provider looks at the extent to which your stakeholders have been provided with relevant information on material issues so they can form meaningful opinions on the company's performance in these areas. The assessor will also want to be satisfied that you have good systems in place to sense new and emerging stakeholder expectations and concerns, and report against them.

On **responsiveness**, the assurance provider evaluates how well your company has responded to stakeholder concerns. This doesn't require that the company agrees with, or complies with, everything external stakeholders say. But you must be able to show how you have responded in a consistent and considered way, for example through the development of relevant goals, objectives and targets.

25 AccountAbility (2005), "Assurance Standards Briefing: AA1000 Assurance Standard & ISAE 3000"

**Choose provider:** In general, when choosing an external assurance provider, it is essential that the provider has previous assurance experience and knowledge of the industry. The provider must also be able to demonstrate that competent personnel will be undertaking the work. Depending on the nature of your business, you may also need to check the provider's international capabilities.

An additional consideration, following the financial auditing scandals of previous years, should be to avoid conflicts of interest. Some companies do not want their assurance provider to be actively involved in providing them with other services. Other companies perceive an advantage where its provider is also involved in development of its CSR practices – they believe this helps build mutual understanding. There is no single right answer; you must decide on a case-by-case basis whether any other involvement by your assurance provider will build or diminish trust externally. But one thing is for certain: in your public assurance statement, you should be transparent about any links your provider has with your organisation.

There are several different possible assurance providers. Traditional financial accountants have historically offered the kind of global reach that multinationals feel they need in order to get good coverage of their operations. However, they are often inherently limited in what they are allowed to comment on due to constraints put on them by the structures within which they operate. Therefore they might not be able to comment or make recommendations on the very issues that users of the assurance outputs are actually interested in.

CSR assurance specialists, typically smaller outfits than the large accountancy firms, tend to have deep subject matter expertise in the key CSR issues for your organisation. Where this experience is backed by professional audit experience, they can be very effective assurers. In general, they will provide public comments in their assurance statements that are richer and more meaningful for you and other users of the assurance outputs.

Stakeholder panels are starting to be used more often in assurance to provide a direct stakeholder perspective on the organisation and the activities being assured. However, panel members are usually only able to interview staff in the organisation at a senior level and are unlikely to closely investigate claims and data, as would happen in an assurance carried out by those with professional expertise. This limits their ability to evaluate the level of implementation and consistency of the CSR programme.

Some organisations ask a CSR expert to give his or her views of the organisation, and then publish these, usually in the external CSR or sustainability

report. This ‘testimonial’ approach does not really qualify as assurance. It is not a proper substitute for evidence-based analysis, and should only be used as a supplement to assurance.

Hybrid approaches are starting to be used more commonly, where an assurance provider undertakes a systematic evaluation and their findings are discussed with the expert or stakeholder panel. This can provide a comprehensive assurance solution.

**Produce plan for assurance:** A clear assurance plan will provide a working guide to the assurance exercise for your team and for your external provider. The plan should record the objectives of the assurance, the scope and level of assurance sought, and the assurance standard to be used. It should also set out in detail the steps that will be followed in the assurance project, including how stakeholder issues will be considered, and who will need to be involved from your organisation and when. You may wish to seek the input of your assurance provider before finalising the plan.

You should also think about producing and making public your plans for developing the scope of the assurance you use over time. This should include an explanation of why some things are being examined in detail now, and why others are being left for the future. This can help to win the trust of external stakeholders.

## 7.5 Understanding the work of assurance providers

This section will help you understand the work of assurance providers. For the sake of simplicity, it assumes that you are applying assurance to a CSR report, but the principles apply equally to other assurance applications.

For providers adhering to the AA1000AS framework, the activities detailed below will contribute towards the provider’s opinion on materiality and responsiveness. They will provide the basis for assessing whether your company has identified the CSR issues that are important to your stakeholders, and the effectiveness of your response to their concerns. Sources of evidence could include the outputs of the company’s own risk and issues management processes, the results of engagement with stakeholders and internal performance reporting measures.

The key steps in the assurance of an organisation’s CSR report are shown in Figure 7.3.

**Figure 7.3 Key steps in the assurance of the company's CSR report**



**Identify priority topics and relevant data:** Based on your assurance plan, the assurance provider will identify the priority topics and relevant data for the assurance process. This determination of priority could be based on stakeholders' priority issues, your views on the areas of greatest risk or opportunity, or feedback from previous assurance work on areas of concern. The provider will discuss these topics and data with you, in particular to understand any areas of omission, or where their views on priorities differ to your own.

For every assignment, the topics that will be the focus of the assurance will be different. The relevant data can be both quantitative (eg underlying source data on emissions and waste) and qualitative (eg quality of identification and prioritisation of CSR issues and robustness of management systems).

**Understand management arrangements and data collection processes:** The provider will build a picture of how your company manages the issues under review and collects relevant data. The provider will gather information and documentation on the arrangements for managing these issues including objectives, targets and policies. The following questions will probably be asked:

- Is there a defined system for gathering and checking data – eg a data protocol that provides definitions and compilation methodologies (either developed internally, or drawn from a recognised external source such as a trade body or the Global Reporting Initiative<sup>26</sup>)? Do the protocols specify units and a

compilation methodology?

- Is there a process for local data validation either internally or by third parties?
- How is data recorded and transmitted internally – eg is there manual transcription that could lead to errors or is there an IT-based system such as Credit 360<sup>27</sup>?

The assessor will review the management systems your company has in place and ask whether, for example, they are independently certified. The assessor will also gather information on the application of these systems and review the results of management systems audits and external certification audits, if these have been undertaken.

In addition, the assurance provider will look for evidence of these systems being embedded across your organisation, and investigate if your company carries out systematic analysis of compliance with these systems. Crucially, the provider will look for evidence that your CSR management systems and data collection systems align with the interests and expectations of stakeholders.

**Senior-level interviews:** It is common for the assurance provider to request direct dialogue with a cross-section of senior staff responsible for activities relevant to CSR. Typically, interviews between the provider and senior staff might address issues such as:

- governance arrangements, for example Board responsibilities regarding non-financial performance and transparency of the Board's qualifications, remuneration and actions;
- mechanisms for sensing and responding to new CSR issues, through stakeholder engagement for example;
- significant CSR incidents, risks and opportunities; and
- goal-setting processes and mechanisms for achieving desired levels of performance.

**Check data consolidation:** The assurance provider will check how data has been consolidated from sources throughout the company. The following questions will probably be asked:

- Is data compiled at a business unit or function level and then transmitted to a central point for consolidation, or does it pass directly from the source to the centre?

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27 Credit 360 is a proprietary tool designed for the efficient collection of sustainability and CSR data – [www.credit360.com](http://www.credit360.com)

- What steps are in place for checking data integrity as it is transmitted? Is there a process for spotting and fixing errors?
- Is there a formal sign-off process independent of those generating and processing the data?
- Is there a policy on data materiality that allows for a given level of detected error at site level and above? Is it linked to an accepted impact level of error at group level?

**Undertake sample checks:** Up to now the work undertaken by the assurance provider has been at a fairly high level. If necessary to achieve the level of assurance you are seeking, the assessor may also want to undertake sample checks, usually via visits to operating units and sites, to investigate whether the systems in place are working.

The extent of sample checking is a key aspect of assurance planning and will be affected by your budgetary considerations. It is common to keep the number of site visits fairly small. But even a limited programme of visits can provide invaluable learning about the quality of CSR management systems and data. If significant issues arise through the audit work, then it would be usual to expect the sample size to be extended. In general you should allow the assurance provider the freedom to select sites to visit. Some possible sources of information are shown in Box 7.2. During sample checks, the assessor will be looking at:

- compliance with systems;
- adherence to and understanding of data protocols;
- the quality and outputs of local checking and validation; and
- source data, including its completeness, the time periods used for data collection and the calibration of instruments.

### **Box 7.2 Possible sources of information and evidence that can contribute to assurance**

- Results of audits of corporate responsibility risk (such as EHS risks).
- Internal control mechanisms including sign-off processes and management reviews.
- General reviews of stakeholder expectations and concerns, and information gathered on specific stakeholder issues and the company's response.
- Information on regulatory compliance and performance, eg the Sarbanes-Oxley Act or emissions trading schemes.
- Internal and external benchmarks of performance and management arrangements.

**Review report text:** At a suitable stage in the development of your report, the assurance provider will review the text to identify significant claims and data relevant to the assurance scope. This is typically developed into a 'register' which can be used to record information about evidence gathered and whether claims have been accepted or not.

**Develop an assurance opinion:** The assurance provider will review all the collected evidence to arrive at its assurance opinion, which will refer directly to the original objectives of the assurance engagement. For an AA1000 AS-based approach, the provider will be looking for evidence that your organisation is meeting certain standards for materiality, completeness and responsiveness.

For assurance statements published together with CSR and sustainability reports, formal standards exist – see Box 7.3.

As well as producing an assurance opinion for public consumption, it is common for a third-party assessor to also provide an assurance statement for management. This would include detailed recommendations for how you can improve your processes and reporting.

### **Box 7.3 Components of a typical assurance statement**

- Assurance provider's name/s and qualifications.
- Statement of independence that the assurance provider does not have any relationship with the company or with its stakeholders that may compromise its ability to make impartial and objective judgements about the report and the company's management systems. In particular the assessor should not have been involved in designing the accountability systems or in writing the report.
- Statement that the directors are responsible for the content of the report.
- Statement that the assurance provider's primary responsibility is to consider the interests of stakeholders and not those of the company's managers.
- Short description of the reporting and assurance standards the assurance provider has used.
- Scope of the assurance work and the methods used to assess the company's report and management systems.
- Statement of the assurance provider's opinion on whether the report meets the audit criteria and whether it provides a reliable, complete and balanced view of the company's impacts on its stakeholders.

## Box 7.3 Components of a typical assurance statement (cont)

- In some cases, additional commentary and recommendations setting out the assurance provider's views on the future development of performance management and reporting systems and stakeholder engagement processes, as well as an opinion on whether the company has behaved consistently with its stated values.
- The assurance provider's signature and the date the assurance statement was written.

## 7.6 Good practice and beyond

Professional assurance providers can reasonably be expected to be expert in audit techniques and the subject matter being subjected to assurance, but they can never fully act on behalf of stakeholders in forming their opinion. Emerging practice calls for better integration of stakeholder opinion in assurance or, ideally, the direct involvement of stakeholders in the process.

**Include evidence of stakeholder views:** When an assurance provider examines the issue of responsiveness to stakeholders, it will look for robust evidence of stakeholders' views. Your company might have outputs from its own stakeholder engagement, which the provider can review. Alternatively, assurance providers use proxies such as media research, although this can never be truly representative of stakeholder opinion.

**Involve stakeholders directly in assurance:** Ultimately, your company should try to develop stakeholder-inclusive assurance. A small group of leading companies is currently trying to do this. You may be able to learn from what they are doing.

One example is Royal Dutch/Shell. The company's decision to move away from traditional assurance and use a stakeholder panel in its 2005 sustainability report attracted a lot of attention. The company justified its move on the basis of an historic lack of challenge on the scope and completeness of the report from its previous assurance provider. Shell's approach seems a healthy development, but its approach could be given added credibility if the outputs of the stakeholder panel were clearly integrated with a thorough review by a professional sustainability assurance provider. In this way, the panel could draw upon the provider's systematic, evidence-based analysis in reaching its conclusions.

## 7.7 Case study – Kesko<sup>28</sup>

Leading Finnish retail organisation Kesko is one of the pace-setters in CSR report assurance.

For its 2006 corporate responsibility report, it used a specialist assurance provider who carried out its assurance activity with reference to the AA1000 Assurance Standard. As a result, the provider assessed the report against the principles of materiality, completeness and responsiveness.

The assurance process involved extensive interviews with senior managers responsible for issues covered in the report, as well as staff leading the processes for collecting relevant performance data. The assurance provider also carried out a systematic check of the accuracy of data and claims in the report.

The final assurance statement was clear and frank, and was not constrained by the conservative language often used by the traditional accountancy firms in their statements on the grounds of presumed liability. Instead, it provided a meaningful assessment of the quality and range of the report and gave constructive recommendations for improvement in Kesko's CSR programme.

As part of the assurance engagement, the assurance provider participated in processes to develop Kesko's approach to determining its material issues for management and reporting, and also in further embedding CSR in its purchasing processes. It also carried out benchmarking of Kesko's accountability using the Accountability Rating<sup>29</sup> methodology. In its assurance statement, the provider made clear it had been involved in this work as part of its contract.

## 7.8 Case study – AZ Mining – Assurance

In response to AZ Mining's first CSR report, stakeholders called for future reports to be subjected to independent assurance. So in the second cycle of reporting, Jane persuades the CSR steering committee to commit to obtaining assurance of the next report.

AZ Mining is particularly keen that assurance be responsive to the stakeholders who expressed an interest in assurance. These stakeholders tended to either be CSR professionals or investors. Both groups were

28 The Kesko corporate responsibility report – available in the 'Responsibility' section of the Kesko website – [www.kesko.fi](http://www.kesko.fi)

29 [www.accountabilityrating.com](http://www.accountabilityrating.com)

interested in assurance processes against a recognised standard. Therefore, AZ Mining seeks an assurance provider who can conduct the assurance against the AA1000 Assurance Standard.

Jane commissions the assurance provider early in the reporting cycle so that significant findings from the assurance team can be used to inform the writing of the report. In this way, the assurance process becomes interactive and the findings from the assurance are not a surprise when the report is finalised.

After discussing the report with the assurance provider, Jane agrees to the provider conducting a small number of interviews at site level to spot check the data and validate the data collection systems and materiality processes. This approach limits the cost of the assurance work, but allows the provider to give a definite opinion on the accuracy and completeness of the report.

In addition, the assurance provider interviews senior managers to understand management processes, company strategy and priorities, and future plans for the CSR programme.

Although AZ Mining wants the assurance statement to give positive statements about its CSR programme, it recognises that a transparent and constructively critical assurance statement will help win the trust of stakeholders.

So when the report is published, the assurance statement included within it gives not just the assurance provider's appraisal of the report's accuracy and completeness, but also broad recommendations to address perceived areas for improvement.

To help AZ Mining make progress on these issues, Jane also asks the assurance provider to give detailed recommendations and guidance for its next reporting cycle. These are reviewed at the CSR steering committee meeting.

By now, Jane has helped AZ Mining establish a solid CSR programme. The company has gone from being a relative novice in managing its impacts to one that is starting to put responsible practices at the heart of its business. This is a significant achievement, and one that is enabling AZ Mining to realise many of the benefits of being a responsible corporate citizen. It is also an impressive accomplishment for Jane's CV.

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