

AUDIT OF CORPORATE SOCIAL RESPONSIBILITY PROGRAMS: A FRAMEWORK **PAPER FROM CURALEA**

Social responsibility is a major concern for management from a reputation risk perspective. Typically, reputation risk is associated with fraudulent reporting, regulatory actions against a company, or misconduct of individual officers (for example, personal tax fraud). However the scope of social responsibility has been expanding continuously to include several aspects that are perceived by the public to be the social impact of business actions.

Communities understand the impact of corporate influences in the local dynamics of their marketplace (i.e. “big box” retailers displacing local businesses or offshore sourcing of labor.) Consumer advocacy groups and international human rights organizations help consumers to stay informed of possible corporate transgressions that may or may not be unfounded.

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

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

To help protect an organization against these risks the internal audit brief should ideally include a review of social responsibility. Although this is an intangible area of analysis, such analysis can raise awareness of risks that may not be illuminated otherwise.

Developing a CSR Program

Typically many organizations begin with performing research on social or environmental issues facing an organization’s industry and competition. This leads to the development of policies for social responsibility programs and establishing social and ethical initiatives. Management participation at the highest levels is key to increasing the impact and effectiveness of the review.

There are significant challenges to creating a social responsibility program. Any program to address social issues should be supported by management and seen as an opportunity to ensure the organization creates a balance between public duty and profitability. Many organizations employ public relations professionals and call on crisis relations firms when situations arise. Proactively addressing social responsibility risks will help limit possible fallout and even create marketplace goodwill.

Programs should be designed to be consistent with management's philosophy and corporate goals. As an example, BP or British Petroleum advertises its desire to search for alternative energy sources and its concern over protecting the environment. The BP logo is a green flower. BP's social responsibilities and corporate goals are aligned to drive value to shareholders.

CSR: General Concerns for Audit Coverage

CSR programs can operate at different levels according to the policy adopted by the organization. At the basic level, organizations have some level of community awareness, public service, or charitable contributions as part of good corporate citizenship. Examples include scholarships for students, adoption of parks or highways, sponsorship of charity events, and gifts to the arts. **Such initiatives are also subject to internal controls and should be considered for periodic review of their accounting and oversight processes.**

At a more sophisticated level, CSR activities cover a variety of additional issues including:

- Protection of Human Rights – denial or prevention of legal or social rights of workers. Examples include fair wages for factory workers with reasonable work conditions, including restrictions on child labor.
- Destruction of Natural Habitat or Resources – depletion of natural habitats, wildlife, and land surfaces. Examples include strip mining, protection of endangered species, deforestation and pollution.
- Free Market Development – the mega corporations that significantly impact developing market economies are under fire regarding fair trade policies. Less developed countries and their marketplace communities should have opportunities for healthy economic growth that do not exacerbate wealth disparities or exploit people. Examples include exploitation of poor country labor or agricultural markets.

At the highest level, the CSR strategy is closely integrated with the business objectives, creating a 'virtuous circle' for all the stakeholders. This is a highly sustainable model as the success of the business is integrated with the CSR initiatives and there is high commitment from the business at all levels. good examples are the Cisco Networking Academy, that trains high school to be network administrators and the E-Chaupal initiative of ITC in India (*Reference: The Competitive Advantage of Corporate Philanthropy by Michael E Porter and Mark R Kramer, Harvard Business Review on Corporate Responsibility*).

The more sophisticated CSR initiatives would benefit by periodic independent internal reviews of the effectiveness of program implementation and integrity of the reporting of performance against targets. These would enable the Board to take corrective actions where relevant.

CSR Audits: Special Considerations

The auditor should develop a general understanding of the social responsibility issues that affect their organization and industry. The challenge of developing a socially responsible organization is creating the balance between profitability and other public goods. Management must reconcile these sometimes contrary needs. On one hand, management is responsible to shareholders and investors to deliver a financial return. Conversely, management is responsible to the society that invests the modern corporation with control over its resources and employees.

The risks of not paying adequate attention to social responsibilities is clear – reputation damage, lawsuits, and government scrutiny. Internal audit should focus on these risks and assist management to identify appropriate actions.

Government regulatory agencies have established various rules and regulations on industry to enforce some types of responsibility (i.e. tobacco, OSHA). Stiff penalties for not complying can adversely impact financial performance and can be relatively arbitrary. Federal Sentencing Guidelines are used to determine penalties based upon legitimacy of related compliance programs. Also, consumer action or public welfare groups may see corporations as a way to accomplish objectives regarding societal problems. The environmental Superfund is a good example of corporations paying a share of society' financial burden.

Developing a CSR Audit Program

A CSR audit program can cover all or any of the following risks:

- Effectiveness of the operating framework for CSR implementation
- Effectiveness of implementation of specific, large CSR projects
- Adequacy of internal control and review mechanisms
- Reliability of measures of performance
- Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc

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

- Donating Funds & Resources – management should ensure that donations are carefully reviewed and based upon sound judgment. Although this is a very common type of community involvement the timing, amount of funds, and type of gifts should be considered. Some companies allow personnel to volunteer in the community on paid time.
- Project Implementation – companies often embark on large CSR projects that are aimed at delivering high Brand or business impact. These projects may typically run over a long time horizon and involve significant investment of time and resources, both monetary and people. Setting of clear objectives, adequate resourcing, effective monitoring and independent review of project performance are critical to success.

- Communications – establish effective plans to communicate to employees and the public to describe the organizations actions and the related impact to the community. Assess public relations and the adequacy of the PR function in addressing social issues.
- Social Responsibility Analysis – organizations can allocate dedicated resources to identify, evaluate, and research social responsibility issues. Establishing liaisons with community groups and working with those responsible for public welfare or the environment will help the organization understand and address appropriate issues.
- Managerial Policies & Decision Support – all organizational levels and objectives should incorporate social responsibility plans. These intentions may be included in policy and procedures, statements to the public, marketing campaigns, and made transparent to the public (where appropriate). Management decisions should incorporate social responsibility considerations especially those that directly impact the community. For example, operations or plants that create noise, traffic, or pollution, or that impinge on any part of the community should include a social responsibility component.
- Research & Development – organizations can conduct research into alternative methods or approaches to operations or products that reduce or remove undesirable impacts or by-products. For example, manufacturing companies can support recycling programs for printer ink cartridges and other products to ensure proper disposal or reuse.
- Government Program Participation – companies collaborate with government agencies to provide research on issues often along with their industry competitors. Organizations that better understand the problems at issue and the governments responsibilities can help ensure they are part of the solution rather than part of the problem. Companies can also ensure related legislation and regulatory mandates are sound, effective, and incorporate common interests.

Reputation risks associated with lack of adequate social responsibility programs, instances of potential ethics violations, and other ‘red-flag’ occurrences should be considered during annual audit planning. For organizations developing ERM programs, the area of CSR should be incorporated.

The Internal Audit function is well positioned to help identify the issues that the organization may not be addressing adequately.

Annexure

Social Responsibility Review: Work Program

Project Team (list members):

Audit Timing	Date	Comments
Planning		
Fieldwork		
Report Issuance (Local)		
Report Issuance (Worldwide)		

Work program:

Time	Project Work Step	Initial	Index
	Objectives		
	1. Through the use of inquiry and gathering evidence, gain an understanding of the Company's risk identification, response plans, and internal control techniques surrounding the corporation's social responsibility program.		
	2. Perform testing and analysis on sample of social responsibility programs to determine compliance with related management policies and intent.		
	3. Identify control weaknesses and make recommendations for improvement to social responsibility program components, or individual program operations.		
	Planning		
	1. Planning meeting – Audit Team		
	(a) Conduct a planning meeting to discuss scope, approach and timing. (b) Determine timeframe of period to be examined. (c) Consider the areas to be included such as: Communications, donation programs, social responsibility expenditures, compliance with regulations, etc. (d) Determine the appropriate auditee contact(s).		

	<p>2. Obtain sufficient understanding of the audit area:</p> <p>(a) Determine if an internal audit of this area has been done previously. Utilize any previous work products for training and development of the current plan.</p> <p>(b) Obtain and review the policy and procedures for social responsibility programs, including available roles and responsibilities.</p> <p>(c) Use self-assessment material, if appropriate, to have the auditee or program managers evaluate their own control environment prior to the audit.</p> <p>(d) Develop a risk profile for the Social Responsibility area.</p>		
	<p>3. Work with the auditee as to the scope, approach and timing of the audit and detailed document request.</p>		
	<p>4. Review any known best practices for the social responsibility area, and incorporate them into the audit work and audit report, if appropriate.</p> <p>Note: consider follow up issues in this area as the status of these may be included in this review scope.</p>		
	<p>Fieldwork</p>		
	<p>1. Conduct an entrance meeting re-establishing the scope and timing of the review. Include the ethics officer, Human Resources Director, CSR Head and Marketing Director to understand specific issues facing the organization. Establish a schedule for status meetings and open-communication protocol.</p> <ul style="list-style-type: none"> ▪ Determine scope of social responsibility areas to be included & consider components based upon donation amounts, nominal resource values, and centralization of operational procedures. ▪ Arrange verification procedures for remote locations as required; some program components may be part of extensive network of business locations or specific to certain areas based upon issue(s) under review. 		

	<p>2. Based upon interviews discussing several significant social programs related to the entity over recent quarters, determine if programs were developed to address such issues.</p> <ul style="list-style-type: none"> ▪ Determine the reason for not participating if no action was taken. ▪ Based upon interviews with the CSR Head, Ethics Officer and other Director level personnel, including input from management, select several programs to evaluate. 		
	<p>3. Obtain the following:</p> <ul style="list-style-type: none"> ▪ Organizational chart for social responsibility function(s) ▪ Policies and procedures for social responsibility programs and management involvement efforts. ▪ Policies and procedures for approved charities, partner organizations, etc. ▪ Signature authorization list – checks and invoice approval ▪ Program management procedures <p>Note: Consider requesting, reviewing, and discussing material prior to meeting with auditee management and fieldwork.</p>		
	<p>4. Gain an understanding of procedures for social responsibility program expenditure processing: requisition requests, approval limits listing, vendor approvals/changes, vendor invoices, expense reimbursements, petty cash and imprest accounts.</p> <ul style="list-style-type: none"> ▪ Evaluate the adherence to spending limits policies and procedures ▪ Consider walk-through of purchase requisition through payable processing to determine reasonableness of processing personnel’s knowledge of procedures, limits, and audit trails accordingly 		

	<p>5. Observe and document (via flowcharts) the social responsibility management processes. Consider the following points as a guide:</p> <ul style="list-style-type: none"> ▪ How are social responsibility issues identified and incorporated into the organization? Review current applications/systems used, including spreadsheets, data files, and automated controls ▪ Determine how management oversight is incorporated into the process ▪ Determine what controls (manual & system) are in place to avoid unauthorized purchases, spending limit work-around, and ▪ Determine if internal controls are in place throughout the process ▪ Determine of proper segregation of duties exists ▪ Determine if invoices are properly authorized and approved on a timely basis and are matched with proper P.O. 		
	<p>6. Meet with managers responsible (full or part-time) for the selected social responsibility programs. Determine:</p> <ul style="list-style-type: none"> ▪ Current budgets ▪ Planned activities and program objectives ▪ Communication and reporting ▪ Other promotions and programs ▪ Document the approval obtained ▪ Analyze the adequacy of the approval in comparison with Company Policy & Procedures ▪ For blanket PO's, document the adequacy of approval <p>Note any exception including those with inadequate audit trails, management overrides, and exception processing</p>		

	<p>7. For selected social or large philanthropic projects, perform a review of expenditures. Determine if all expenditures are related to the stated program.</p> <p>Sample (10) invoices paid related to the program and walk-through the process to determine the following:</p> <ul style="list-style-type: none"> ▪ Payment properly authorized per internal policy (verify signature) and compare to spending authority limits. ▪ Proper backup attached to voucher; acquisition costs recorded with taxes and freight; note date consistent with invoice paid date ▪ Appropriate number of signatures present on checks over certain limits or according to donation/gift project approvals ▪ Ensure related tax treatments are appropriately applied and supported 		
	<p>8. Meet with the third-party charitable organization receiving the funds, resources, or actions to determine the impact. Evaluate the impact of the company’s social efforts with recipients, local news organization, and the charitable community (trade publications).</p> <ul style="list-style-type: none"> • How do these individuals feel about the gifts? • What impression is evident in those interviewed based upon the program merits? 		
	<p>9. Evaluate the compliance with related laws and regulations</p> <ul style="list-style-type: none"> ▪ Does the social responsibility program incorporate all required elements of considering operational impacts of compliance ▪ Adequate level of awareness and training to ensure compliance with related program 		
	<p>10. Examine the progress of each social responsibility program compared to beginning stated objectives.</p> <ul style="list-style-type: none"> ▪ Did objectives or goals change? Why? ▪ Which programs increased/decreased in size, commitment, or level of participation? ▪ Note all exceptions 		

	<p>11. Evaluate the communication programs concerning social responsibility programs.</p> <p><u>Internal:</u></p> <ul style="list-style-type: none"> ▪ Determine adequacy of understanding of specific social responsibility programs within the organization ▪ How familiar are management personnel with the various programs, issues, and goals ▪ How often are employees trained (new hire, management, board of directors/audit committee)? ▪ Are social responsibility considerations incorporated into the corporate code of conduct? <p><u>External:</u></p> <ul style="list-style-type: none"> ▪ Determine the adequacy of external-internal crisis communication plans. Interview Marketing and Public Relations directors to determine preparations for responding to social responsibility issues. ▪ Are community social responsibility complaint processes established to ensure proper handling? Is there an escalation process for receiving the complaint, communicating media response coordination plans to location personnel, and forming a strategy for a timely response approved by management. ▪ Evaluate the effectiveness of product warrantee and service complaint reporting. Do package or service contracts include toll free numbers for customer responses? ▪ Understand the organization’s customer feedback and response for product or services issues. How are social responsibility complaints retained, handled, and reported? 		
	<p>12. Consider the level of senior management support for social responsibility programs.</p> <ul style="list-style-type: none"> ▪ Does senior management lend support to legitimize an organizational program and then refrain from action? 		
	<p>Reporting</p>		
	<p>1. Reporting – Draft</p> <p>(a) Prepare preliminary draft of the audit report using the standard format. Ensure appropriate auditee reviews draft and that any action items have been discussed with auditee.</p>		

	<p>2. Reporting – Issuing draft</p> <ul style="list-style-type: none">(a) Issue preliminary report to management. At this point management/auditee should agree on the timing for implementing any action items identified and agreed to in the report. Responsibility for implementation should also be assigned.(b) Validate the accuracy of all audit report content.(c) Update permanent file with new details about the process, people, and controls for future use.		
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