The Role of Internal Auditing in Sustainable Development and Corporate Social Reporting

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Award Topic:

Social responsibility reporting by publicly traded companies has become an expected part of doing business on a global scale. The IIA's Standard 2130 on Governance states that internal auditing "should contribute to the organization’s governance process by evaluating and improving the process through which:

1) Values and goals are established and communicated

2) The accomplishment of goals is monitored

3) Accountability is ensured

4) Values are preserved.

What is the role of internal auditing in sustainable development and corporate social reporting?
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Introduction
Social responsibility reporting at the corporate level is fast becoming a critical element of reporting for public companies at the global level. Social responsibility reporting, also referred to as corporate responsibility (CR) reporting, includes non-financial information made available to the public in either a separate report or in addition to the firm’s annual report. In 2005, Japan led the world in the amount of submitted corporate responsibility reporting.

In a publicly traded company, performance is evaluated by internal as well as external stakeholders. In most cases, assessment is based on information created and distributed by corporate management. Information that is publicly reported is a direct reflection of corporate governance within the firm. Financial and non-financial information reveal either positive or negative results of the firm's direction and leadership decisions. Corporate governance and leadership must take responsibility for results distributed in public performance reporting, devise improvement plans, and execute those plans in order to improve results before the next reporting period.

Internal Auditing Function
The objective of the internal auditing function has always been to improve any process within the organization that will result in improved revenue and reduced risk. Internal auditing projects are assigned internally and prioritized by the level of risk associated with each identified area. Areas of interest are determined by leadership with recommendations from all departmental areas within the company including finance, accounting, operations, and sales and marketing. Risk and audit opportunities are often cyclic and arise within the same department or procedure repeatedly over time, often for varying reasons. Internal auditors must therefore keep track of past audit procedures and results in order to refer to them in future audit opportunities or validation requests.

Internal Auditing and Corporate Governance
IIA standards on governance outline four methods an internal auditor should influence corporate authority. As an internal auditor evaluates a specific department or process of the company, he or she should seek to improve that process as it relates to corporate governance in the areas discussed below. Figure 1 outlines these four methods, their relationship to each other, and how they work together to influence a company’s governing practices.
Establish and Convey

Corporate responsibility reporting at this time is varied and has not yet been standardized at the global level. Previous submittals of social corporate responsibility reporting have mainly been for environmental and industrial industries. As more and more businesses participate in social responsibility reporting, additional formatting and included material has lead to a wide variety of reporting styles and content.

Regardless of the content or format, any company that intends to create and publicize this type of material must first evaluate and determine the values and goals that are to be discussed and reflected in that report. These values must be clearly discussed in the report with information on how the company is supporting and maintaining those values in daily operations. Goals must also be outlined and may often include financial, operational, or philanthropic targets.

Internal auditors have the responsibility of understanding the stated values and goals of the company fully and intelligently relating those values and goals to every audit opportunity that is executed. In addition, an auditor may encounter a situation where the values and goals of the company have actually introduced risk in an area or procedure. In that case, the internal auditor has an obligation to raise this risk to management.
Monitor
As performance targets and goals are established and distributed among the company and the public, execution plans outlining the methods for achieving the stated goals must also be created. The role of internal auditing with respect to corporate governance and their performance goals is to observe and examine the implementation of related execution plans as well as the outcomes of those plans.

Although a stated goal may be accomplished within the targeted time frame of leadership, there may be issues within the implementation such as budgeting issues, employee attrition, or operational inefficiencies. Internal auditors must participate in observing implementation procedures in order to identify any new or existing risk.

Validate
Corporate management and leadership must be held accountable for all actions within the corporation. The image of the firm is directly dependent on ethical and moral actions of executive leaders in today's business world. Even as cultures and business practices vary, all leaders of business expect and respect firms with disciplined and accountable governing officers.

Internal auditors must evaluate goals to ensure that reported results, distributed by corporate management, are truly accurate as stated and communicated internally as well as externally in either an annual report or separate corporate responsibility report.

Uphold Standards
External stakeholders, leading competitor companies, as well as compliance officers expect that the standards of companies will be maintained, but seek every opportunity to identify situations where standards have been violated. To avoid situations where corporate problems are isolated externally, internal auditors must identify and communicate their findings to management first.

By completing the three actions described above (establish and convey, monitor, validate) the internal auditor can significantly contribute to upholding the standards of the company. Risk reduction within the corporation as a result of internal audit findings will help management become more effective at preserving and maintaining stated corporate values.

Sustainable Development
The Global Reporting Initiative (GRI) has established reporting standards that are outlined in the Sustainability Reporting Guidelines. Hundreds of companies adhere to GRI standards in reporting. The GRI is currently working to include detailed industry specific information with respect to responsibility reporting.

Compliance
For a global company to grow or develop major initiatives must be meticulously designed and executed. Initiatives for sustainable development, those that keep the
company running, include activities that influence or directly involve compliance requirements.

At this time, required compliance documentation at the corporate responsibility level mainly relates to and includes environmental information and may also include manufacturing or operations information. Regardless of the content, future projections indicate that with more and more global corporations participating in voluntary social corporate responsibility reporting more compliance requirements may arise in each industry sector. Corporations must be prepared to respond to a potential introduction of this type of reporting in order to sustain normal business operations.

**Accountability in Leadership**

Amidst recent scandals, corporate leadership has a very public obligation to maintain accountability in the company. Social corporate responsibility reporting is a means for management and leadership to communicate and acknowledge the accomplishments and shortcomings of the company to employees internally and all external stakeholders.

Continual distribution of financial as well as non-financial information by leadership creates trust and confidence with the company among all stakeholders and facilitates sustainable development within the corporation.

**Corporate Responsibility**

As stated above, leadership must strive to maintain and show that they are accountable within their company. In addition, the corporation as a whole must also communicate their responsibility to their consumers and the world (if a global organization) in order to build as well as maintain consumer confidence. Consumer confidence is crucial to sustaining development as they directly influence revenue for the company.

**Overall Morale: Internal**

Corporate responsibility reporting is often read and examined closely by internal stakeholders such as employees. Information distributed in all reporting material must represent accurate information as understood by employees and must acknowledge the appropriate employees or departments where appropriate. Increases in morale will positively affect performance, resulting in continued development and sustained growth.

**Investor Confidence**

As in the case of employee morale, investors also seek accurate information in responsibility reporting from corporations from which they base financial investment decisions. Stated corporate information will either positively or negatively impact existing or potential investment confidence for a company. Corporations must ensure accuracy of distributed information, taking care to truthfully describe increases and decreases in performance in the appropriate manner.
Case Analysis: Nike

Existing companies are utilizing opportunities to publicly post corporate responsibility reporting as a means of gaining first mover advantage in the area of compliance as well as a show of good faith to investors, consumers, and the general public. At this point, social corporate responsibility reporting is not mandatory and only standardized at a high level (by GRI).

Nike, a leading footwear manufacturer, has taken an aggressive role in its efforts in corporate responsibility reporting, as exemplified in their extensive internet based site: www.nikebiz.com. The site outlines Nike’s approach to corporate responsibility reporting as well as details on how and why Nike has taken steps to improve reporting to the general public.

Nike’s online collection of information on the topic of corporate responsibility reporting is impressive and embodies several key points that are of value to any global corporation involved in corporate responsibility reporting. Key points described by Nike that are relevant to any global organization are:

- A specific Corporate Responsibility mission statement
- Relating Corporate Responsibility to the company’s Strategic Direction
- Product and Manufacturing information
- Brief description and posting of Fiscal Year Corporate Responsibility report (FYCR)
- Discussion of Corporate Governance
- Acknowledgment of Stakeholders

The Report

An examination of Nike’s Fiscal Year 2004 (FY04) corporate responsibility report reveals a well-planned and organized reporting effort by the company. The report is organized into two sections: Part I and Part II. An outline of each reporting section is given below.

Part I

- Statements from Leadership
- Acknowledgment of the company's impact at a global level
- Belief that Corporate Reporting is good for the business
- Description of the scope of the report
- Report Review Committee Statement

Part II

- Company Profile
- Governance
- Management and Strategy
- Workers in Contract Factories
- Employees and Diversity
- Environment
Community
Public Policy
Challenges and Opportunities
GRI and Global Impact Index
SRI (Social Responsibility Index)

As indicated by the bullets above, Part I of Nike's report embodies general overviews of corporate reporting as well as statements from various leaders in management and administration. Part II of the report contains actual corporate details on topics that Nike feels are important enough to describe in detail. As described in Part I of the report, Part II of the report contains chapters or sections of topics that consumers and compliance offices, mainly governmental offices, have either questioned in the past or will in the near future.

An example of how Nike is using corporate reporting as a means to respond to public global criticism is with regard to factory workers globally. Nike utilizes manufacturing facilities and workers all over the world in different countries. Many concerns have been raised about worker and factory conditions in countries with little to no regulations on worker safety and adequate worker compensation. Nike recognizes the global concern for factory worker conditions and uses corporate reporting as well as a separate set of reporting which they refer to as social reporting to report on global conditions of workers in contract factories. It is in these reports that Nike reports on conditions and performance of the past year as well as the direction of the workers and the factories for the next fiscal year.

Keeping up with Change
Nike has clearly recognized the need for corporate reporting as well as social reporting. The company has clearly planned out and mapped specific topics as they relate to the company’s performance as they relate to what consumers and lawmakers have shown interest and concern in. Nike has taken a direct approach to reporting by dedicating extensive internet resources to distribute what they refer to as the Fiscal Year Corporate Report since they distributed the first report for Fiscal Year 2001 (FY01).

Nike openly admits that corporate reporting is new and they encourage feedback regarding corporate reporting in order to improve their processes and reporting in the future. A posted survey on corporate reporting is available on the responsibility internet site in addition to information relevant to students researching corporate reporting.

Summary
A summary of the case analysis of Nike’s efforts on corporate reporting is outlined in the bullets below:

- Posted description of corporate reporting and its history at Nike is good. The original corporate report from 2001 as well as 2002 and 2003 are also available for review on the website.
Nike acknowledges reasons for participating in corporate reporting: the corporate self-analysis is good for business. Nike uses corporate reporting to respond to concerns from the public, consumers, and lawmakers. Nike also uses corporate reporting as a benchmarking tool for year-to-year performance and change. Nike successfully recognizes and admits that corporate reporting is not yet standardized and they welcome feedback for improvement.

**Case Analysis: IBM**

IBM, a business services and products giant, also distributes corporate reporting material specific to their business. IBM states that they have been taking part in environmental corporate reporting since 1990, and have expanded that corporate reporting practice to include a wider array of topics within the last two years. As in the Nike case, IBM has dedicated internet pages specific to their views and mission for corporate reporting.

IBM's focus on corporate reporting is evident through the resources on their website and is organized and described at a very high level by the following key points:

- Company View on Corporate Responsibility Reporting
- Industry contributions to Corporate Responsibility Reporting
- IBM's emphasis on Corporate Responsibility: Corporate Governance, Management, Relationships, Accountability and Sustainability, Supply Chain
- IBM's Workforce and Diversity
- Global and Community Information including Governments and Public Policy

**The Report**

The IBM corporate report for 2004-2005 is posted in one large report that emphasizes IBM's commitment to innovation and values. An outline of the report is given below.

- IBM's devotion to innovation
- Statement of IBM's values
- Corporate Profile: Business Model
- Corporate Governance
- Management System
- Supply Chain
- Accountability and Sustainability
- *Global Workforce*
- *Our World: Business at the Global Level*
- *Environmental Protection*
- *Security*
- Government and Public Policy

*Italicized points are discussed extensively within the report.*
Summary
IBM's attempt at corporate responsibility reporting effectively outlines topics that relate to the company's overall business. As this is IBM's third year of social corporate responsibility reporting, it is evident that the report lacks distributed detail among all topics. In order for the report to be as effective as possible, all topics must be addressed in as much detail as possible. Simply adding topics with one page commentary does not add much value to this report.

Social Corporate Responsibility Reporting in the Future
Future trending indicates that more and more companies globally will create and maintain social corporate responsibility reporting.

Standardization: Industry Specific
The GRI is aware of the need to standardize corporate responsibility reporting among industry sectors and regions. As corporate responsibility and social reporting expands, companies are individually defining discussion topics that they feel are relevant to consumers and the public. Although the information is useful, unless more standards and reporting requirements are announced, the information cannot be appreciated at the global level. Information and announcements made in corporate reporting may not be relevant or necessary. Developing standards and guidelines for creating corporate responsibility documentation and reports will help companies perform an effective and thorough self-evaluation of performance over time.

Benchmarking and Performance Comparison
There is a strong desire among publicly traded companies to use this type of reporting for benchmarking non-financial information among different companies globally. Companies that have participated in internal corporate responsibility and social reporting for more than two years can use historical reports for benchmarking against their prior year's performance, but that is the extent of it. Real competitive comparisons on the global level in areas such as philanthropy, worker compensation and satisfaction, diversity, and public policy are not yet possible. Once directives are outlined for each non-financial area for reporting, companies can compare actual performance in these areas.

Governance Driver
Corporate governance and authority in a publicly traded company is influenced by internal and external factors. At this point in time, corporate responsibility reporting is a means for leadership within a company to communicate social progress and action taken over a stated amount of time. In addition, corporate responsibility reporting is perceived by governing members as a critical aspect of business strategy and direction.

Surprisingly, the popularity of corporate social responsibility reporting is not isolated by region in the business arena. Modern businesses in developed countries other than the US are increasingly stressing the importance of responsibility reporting at a variety of levels. Successful companies that offer corporate responsibility reporting to consumers
and investors are motivated by improving confidence in products and business practices resulting in superior business performance. Corporate social reporting is therefore becoming a competitive factor among global companies that affects reputation among leaders in the business world as well as consumers in the industry specific target market.
References

IBM.  www.ibm.com/ibm/responsibility/.
