Fédération des
Experts Comptables
Européens

FEE Discussion Paper

Assurance for a

Sustainable Supply Chain

June 2005

The Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe. FEE's membership consists of 44 professional institutes of accountants from 32 countries. FEE member bodies are present in all 25 member states of the European Union and three member countries of EFTA. FEE member bodies represent more than 500,000 accountants in Europe. Roughly 45% of these accountants work in public practice, providing a wide range of services to clients. The other 55% work in various capacities in industry, commerce, government and education.

FEE has published a range of papers in the field of sustainability and assurance. Details of these are provided in Section 6 *Further information*. In addition, members of FEE working parties contribute their time and expertise to the International Federation of Accountants, the Global Reporting Initiative and AccountAbility.

Comments on this paper are welcome and may be submitted to the FEE Secretariat (Corinne.Soubies@fee.be).

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1. INTRODUCTION

1. The businesses that, directly or indirectly, provide the goods or services used by a company form its supply chain. A sustainable supply chain is one in which environmental, social and economic policies are implemented in keeping with the goal of sustainability, i.e. to meet the needs of the present generation without compromising the ability of future generations to meet their own needs. In pursuit of corporate sustainability, a company seeks to impose its policies on its supply chain, often by using a supplier code of conduct.

2. Assurance[1] is a process designed to enhance confidence in a reported evaluation or measurement, such as an assertion that a company has a supply chain whose members comply with its code of conduct.

3. The sustainable supply chain is increasing in importance in the management of business risks and opportunities and hence in the governance of many companies. Retailers are aware of the reputational risks associated with the products they sell and other companies in the public eye may feel the need to respond to the growth in socially responsible investing. Suppliers to governments, which respond to voter concerns, and to stakeholders with a sustainability agenda, experience pressures to adopt sustainability policies and practices, and to extend those to their own supply chain.

4. This paper is aimed primarily at professional auditors and audit firms ('assurance providers'), and those who commission or rely on their assurance work in business or the public sector. It provides background on the wider aspects of sustainable supply chains and provides guidance on aspects where independent assurance and related services may be particularly valuable. It does not, however, deal with assurance on general sustainability reports such as those prepared under the GRI Guidelines[2].

5. Subsequent sections of this paper examine the concept of the sustainable supply chain, the role of the supplier code of conduct and the need for and use of assurance. Further information is provided in Section 6.

[1] "Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
[2] See Section 6 *Further information*, for information on FEE publications relating to assurance on sustainability reports, such as the FEE Discussion Paper: "Providing Assurance on Sustainability Reports".

2. THE IMPORTANCE OF THE SUSTAINABLE SUPPLY CHAIN

'We see sustainability as our way of doing business, involving all levels of our own organization as well as including our suppliers.'
Gerard Kleisterlee, President and CEO, 2004 Annual Report of Royal Philips Electronics

6. Supply chain management that aims to mitigate risk in relation to sustainability, for example through enforcing a supplier code of conduct, focuses on factors that are particularly relevant to suppliers. In many instances, labour issues will be prominent but other social issues and environmental matters will be important and economic factors cannot be ignored.

7. Supply chain sustainability risks may arise in relation to:

   - Use of materials (scarcity, danger to workers, extraction damage, pollution through waste, etc.);
   - Production and transport technology (energy inefficiency, greenhouse gas emissions, safety issues, etc.);
   - Labour conditions (slavery, low wages, child workers, etc.);
   - Local impacts (employer dominance, erosion of competition, use of local sub-suppliers).

8. Many sustainability factors also affect profit directly. For example, energy efficiency often gives rise to energy cost savings; recycling can reduce the costs of raw material purchases; better health and safety practices and increased social responsibility can both reduce insurance costs and avoid the costs of litigation.

9. Good corporate governance, socially responsible management and above-average returns on investment are often linked. Companies that feature in the increasing number of socially responsible or sustainability indexes are likely to outperform the market. Such businesses are able to recruit better staff, who are attracted by the knowledge that they will be working for a company that shares some of their own personal values.

10. Some companies have used their position on sustainability issues as a marketing tool in its own right. For example, New Zealand now exports seafood to the EU and North America to replace fish from the North Atlantic that are in short supply. Consumers will pay a premium to buy fish certified by the Marine Stewardship Council as being managed in accordance with its principles and criteria.

11. In managing sustainability risk and opportunity it is, however, necessary for companies to look beyond their own boundaries. Customers and external commentators expect a company's values to be present in the products it sells. The rationale for this is that by selling a product, a company endorses it to its customers. Thus it cannot on the one hand claim good sustainability credentials and on the other hand be associated with products that do not embody these. This means that its supply chain must form part of a company's sustainability management strategy.

12. In their own procurement processes, retailers, wholesalers, manufacturers, and even extractive industries such as mining, are all aware of the vital importance of their suppliers. Historically, buyers were influenced in their choice of supplier only by the latter's ability to supply products of the right quality, at a fair price and with reliable and timely delivery. In general, the relationship was one in which the supplier maintained freedom of choice in relation to the products it sold. In some instances, major customers were able to influence the design and delivery of products but, generally, buyers have not been in a position to dictate to suppliers.

13. In more recent times, many industries have experienced a change in the balance of power between suppliers and customers. The public, as customers of supermarket groups, has demanded that the products offered for sale are socially responsible, for example, that meat should come from livestock whose well-being has not been endangered by factory-farming methods. Major clothing retailers have been under pressure to ensure that the brands they stock are not manufactured in areas where workers are exploited.

14. The concentration of market power in the hands of large retail groups has meant that they are in a position to pass on the pressure from their customers to their own suppliers. Suppliers that do not meet the buying criteria of such retailers find themselves severely disadvantaged.

15. Pressures experienced at all stages of the supply chain are wide-ranging and at times fundamental to the continued existence of some entities. A company involved in primary production that pays little attention to its effects on local communities, a manufacturer that flouts health and safety regulations, a retailer whose staff are paid minimum wages and expected to work unsocial hours, are all at risk of alienating customers.

16. It could be argued that market forces ensure that suppliers adopt sustainability policies because of the compelling business case for them to do so. However, there are no universally-agreed criteria against which to measure this. A supplier may find that one retailer is satisfied with its arrangements but another, which takes a different view, is not. What has happened in practice is that companies that can influence suppliers sufficiently to achieve change have drawn up their own criteria and sought to have them accepted by these suppliers. Companies that are not able to exercise such influence must look towards governments to enforce laws and standards to promote sustainable practices.

17. The ability of a company to design and implement a set of appropriate criteria, referred to elsewhere in this paper as a supplier code of conduct, becomes a key factor in that company's success. Although implementation of an appropriate supplier code of conduct is important, its continuing use is even more important. One incident at one supplier can cause a disproportionate amount of adverse publicity and damage to a company's business. It is perhaps worse for a company to implement a code of conduct and not monitor its use than it is to have no code of conduct at all.

18. Stakeholders of companies are becoming more sophisticated in their appreciation of the differences between codes of conduct, and of the extent to which companies are investing time and effort in developing codes that are capable of achieving a contribution to sustainability. To be useful, codes must be set out in sufficient detail to allow clear interpretation, and companies must be able to measure the extent to which suppliers are complying. Because of the rigorous approach inherent in the process of independent assurance, stakeholders derive considerable benefit from it, in terms of both the inherent value of the report itself and the knowledge that the company has succeeded in implementing a code that meets the assurer's standards.

3. SUSTAINABLE SUPPLY CHAIN MANAGEMENT

19. The supply chain is all the business entities that, directly or indirectly, provide the goods or services used in the production of a company's goods or services[3].

20. Supply chains differ between industries: aerospace and motor manufacturers have few customers but many suppliers; retailers have many customers but relatively few suppliers; a balance of suppliers and customers exists in many manufacturing industries. Elements of the supply chain differ in 'length', that is proximity to the company: power may come from one utility company but a bought-in component may have passed through many stages after the mining, production or recycling of its raw materials.

21. The supply chain will be managed in the context of a company's approach to its products and customers, and be influenced by its own manufacturing processes and logistics. Irrespective of sustainability considerations, a company will normally aim to ensure that it has timely access to the goods and services it needs, at an appropriate cost and quality. This might involve no more than careful selection of suppliers but could, in contrast, extend to long-term joint working, facilitated by common IT systems.

22. The practical boundaries of a supply chain are not precise and a company decides with which suppliers and sub-suppliers it will engage to achieve its business objectives. In making this decision, management considers practicality and cost, as well as the relevance of elements of the supply chain to the company's objectives.

23. A company that has embedded sustainability in its own operations and reports externally on its sustainability performance will, automatically, extend sustainability policies towards its supply chain. Where an overall commitment does not act as a motive, there may nevertheless be a need to respond to important individual environmental, economic, or social risks: for example, a retail clothing company may concentrate on labour conditions in its suppliers' factories.

24. In some industries, law closely controls product quality. For example, food regulations may ban the use of certain substances and a company will have to ensure that suppliers of ingredients do not include prohibited materials. Although supply chain management could address legal compliance on its own, it is frequently a driver of wider sustainability management considerations.

25. In addition to the need to comply with law and regulation, there can also be significant influence from widely-adopted codes of good practice and industry-wide agreements. Section 6.3 'External standards and information' provides an introduction to the many codes and standards of behaviour that may be applied to a supply chain. These vary in subject matter, level of detail, the authority of the issuing body, the degree of acceptance of the code or standard, and the degree to which assurance plays a part.

26. When deciding how to develop sustainable supply management, a company is influenced by the views of its customers and other stakeholders. Consumer attitudes may focus on 'single issues', such as the absence of animal products from vegetarian foods, 'dolphin friendly' tuna fishing, and timber from sustainable forests, but may also be more broadly-based. Where a company is itself a supplier to other companies that have sustainable supply chain management policies, it may be heavily influenced by them.

[3] This definition draws on that in Social Accountability 8000 (for further information see Section 6.3 *External standards and information*).

27. Public sector entities, whether in central or local government, or other bodies of a governmental nature, frequently require suppliers to comply with specific procurement requirements. For example, a supplier will have to demonstrate that it does not discriminate against any class of employee in order to be allowed to tender for certain government business. Governmental bodies vary in the extent to which monitoring of suppliers is entered into and in the use that is made of independent assurance. Such bodies may not report externally on their supply chain management but, nevertheless, government bodies frequently act as drivers of change and sources of best practice.

28. A diversified company may analyse sustainability risk and decide to limit its sustainable supply chain management to one or more of its product groups or locations. For example, a furniture retailer may concentrate on sustainable sources of wood, as that is given high priority by its stakeholders, but pay less attention to environmental issues in relation to products that are made mainly of metal or plastic.

29. As well as putting pressure on a company to implement sustainable supply chain management, the existence of external codes of conduct may provide a convenient mechanism for that company, in turn, to manage its own supply chain. Where external standards either do not exist or do not cover all aspects that a company wishes to manage, it may be necessary for the company to set out its own standards for suppliers. A set of such standards is frequently referred to as a ‘supplier code of conduct’.

4. SUPPLIER CODE OF CONDUCT

30. A code of conduct is, essentially, a statement by a company of the principles underlying the conduct of its business. Ordinarily, it will be designed to ensure compliance with relevant laws and regulations but may be more stringent than those in some jurisdictions. A code may be intended for use only within a company or for application by its suppliers as well, with or without modification. In some instances, a supplier code of conduct may exist without there being a direct counterpart within the company.

31. This paper concentrates on supplier codes of conduct that include sustainability considerations. The border between general business matters and sustainability matters is not precise nor is the relationship always simple. For example, where recycled materials are more expensive, there may be tensions between product cost and environmental impact. Nevertheless, once management has resolved such tensions, the application of a code of conduct may be considered as a whole.

32. The degree of application of a supplier code of conduct will vary in accordance with either the intentions of company management or the constraints on its use. A company will apply its best endeavours to ensuring that suppliers follow its code. Some companies may even go so far as to state that they will not do business with suppliers that do not comply with their code of conduct. This is not feasible unless there is a wide choice of suppliers or significant influence can be exerted on them. If a company is not a major customer of a supplier, such influence is not likely. Influence over suppliers may also be problematic in respect of utilities, or raw materials purchased on commodity exchanges, from state-owned suppliers or under international conventions.

33. A code of conduct may be considered to pass through three stages: development, implementation and use. Feedback from each stage, and changes in external factors, such as stakeholder expectations, will drive alterations in the code over time. Management decisions will be informed by information obtained in monitoring the use of the code.

34. The development of a code of conduct is an important aspect of supply chain management. Once a company has determined what its stakeholders want, it may consider their needs together with available precedents and external standards to determine what, in theory, its code of conduct should include. Further consideration of both the cost and benefit of its implementation and the feasibility of its use by suppliers will determine its practical content. Increasingly, codes of conduct are developed in sufficient detail to allow compliance to be measured and assurance to be obtained.

35. If a code of conduct is developed in full consultation with suppliers it is likely that its implementation will be more successful than if this had not been the case. Companies should anticipate that there will be differences in the way that their suppliers adopt a code of conduct. Companies may have to engage in training and in different degrees of monitoring of suppliers, as well as taking decisions about who their suppliers should be, in order to achieve the overall objectives of implementation. Where the company anticipates that assurance will form part of its continuing use of a code of conduct, the implementation stage should cover assurance issues in exactly the same way as other primary implementation matters.

36. A company may carry out procedures, such as monitoring press reports or reports from NGOs, to identify significant instances where its code has been breached, but these are not sufficient on their own. Active monitoring of take-up and compliance is important if a company is to derive the maximum benefit from its supplier code of conduct. The form and extent of monitoring will be determined by its feasibility and cost in relation to the uses to which it is put. The need for monitoring may vary between suppliers, depending on such factors as their relative importance

and an assessment of the risk of non-compliance. For example, when deciding its monitoring strategy, a company may take account of the fact that a supplier's environmental management system has been independently certified to be in accordance with ISO 14001. The effectiveness of monitoring is often the most important consideration in its use.

37. Active monitoring may be done by requiring suppliers to certify that they have complied with the code of conduct (this may be backed up by completion of detailed checklists). This may be an appropriate approach for some lower-risk circumstances or in conjunction with other forms of monitoring. More direct monitoring typically involves visits to the jurisdictions and specific locations where suppliers operate. This may be done by company staff involved in supplier selection or implementation of the supplier code but they may not possess the right skills for continuing involvement in monitoring. Such work may be done by a company's internal audit function (the internal audit function may, of course, be outsourced) or it may involve using work by third parties such as assurance providers. The latter commonly involves commissioning independent assurance but other approaches are possible, such as an engagement to undertake 'agreed-upon-procedures' (see Section 5.7 *Other services* below).

5. ASSURANCE

5.1 Introduction

This section:

- Sets out the value of assurance, in particular independent assurance;
- Identifies the characteristics of assurance providers;
- Promotes an understanding of assurance through a discussion of assurance standards and the assurance engagement in practice;
- Considers the case of suppliers that provide their own third-party assurance;
- Explains the relationship between assurance and certification.

5.2 The value of assurance

38. Independent assurance is a powerful tool for use in the monitoring of suppliers. There are two principal reasons why independent assurance is valuable. The first is that those firms providing independent assurance are experts in the discipline concerned and a company may rely on the fact that the work is carried out by personnel who are highly skilled, in both the practice of assurance and the technical aspects of social or environmental matters. Secondly, because an independent third party undertakes the work, its results may be presented to stakeholders as being independent, adding credibility to a company's own reporting. Independent assurance commissioned by the company provides a degree of confidence, therefore, in the implementation and operation of its supplier code of conduct. Where a company chooses to report externally on implementation of and compliance with its code of conduct, independent assurance is vitally important to give credibility to the reports.

39. Where supply chain matters are disclosed in a report with the financial statements or in a general-purpose sustainability report, assurance work for those purposes may overlap, to a degree, with specific assurance work on the supply chain. In such instances, sustainable supply chain assurance is, therefore, both necessary and can be cost effective.

40. Increasingly, independent auditors of financial statements consider aspects of the supply chain when understanding a company and its environment, and assessing the risks of material misstatement. Sustainable supply chain assurance may be of use, therefore, in connection with the audit of the company's financial statements.

5.3 Assurance providers

41. The high level of expertise involved in financial statement audit also applies to the work of auditors and audit firms in other forms of assurance. Where the activities of the supplier involve significant technical issues, for example in monitoring the emissions of a chemicals plant, the assurance provider will ensure that sufficient expertise is maintained by multidisciplinary teams to satisfy the requirements of the engagement.

42. Where the supply chain is of a significant size, perhaps involving many suppliers in several countries, the assurance provider will necessarily have to provide sufficient appropriately skilled staff, as well as accommodating what may be tight reporting deadlines.

43. Accountancy firms are generally required by professional standards to maintain independence when carrying out assurance work so as to be able to report without any apparent lack of objectivity. This does not preclude the use of the company's independent financial statement auditors for such work, although the nature and significance of the work will necessarily be considered before acceptance to ensure that independence is maintained.

5.4 Understanding assurance

44. Assurance is a process designed to enhance confidence in a reported evaluation or measurement, such as an assertion that a company has a supply chain whose members comply with its code of conduct. Accountancy firms apply a definition of assurance from the International Framework for Assurance Engagements (the Framework) issued by the International Federation of Accountants:

> *'Assurance engagement' means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.*

45. In the definition, the 'responsible party' is the preparer of the subject matter and their exclusion from the 'intended users' is to remove from the scope of the Framework and standards established under it engagements where, for example a company asks for work to be carried out on an internally-generated matter. Such work may be of an assurance nature, but would not be subject to external standards.

46. The rigorous definition of assurance and the standardisation of the assurance process is unique to accountancy firms. Other providers of 'assurance' may describe their work as 'audit' or 'verification' but such work may be more than 'agreed-upon-procedures' (see Section 5.7 *Other services*) from which users may draw no direct assurance.

47. The Framework explains that there are two types of assurance engagement, a 'reasonable assurance engagement' and a 'limited assurance engagement' and explains the difference between these two in terms of their objectives:

> *'the objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion. The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.'*

48. To understand this, it is of course necessary to understand what is meant by 'assurance engagement risk'. This is the risk that the firm will express the wrong conclusion when the subject matter is, in fact, materially misstated.

49. Of the two types of engagement, 'reasonable assurance' engagements are familiar to users of financial statements as this is the form of engagement that equates to a statutory audit. A 'limited assurance' engagement is identical except that the nature and extent of evidence-gathering procedures are less than in a reasonable assurance engagement. To signal this, the assurer's report is worded in a negative fashion, for example, '*... nothing has come to our attention that causes us to believe that X is not ...*'.

50. It follows that the cost to a company of commissioning a limited assurance engagement will be less than a reasonable assurance engagement. It is for management to decide whether the difference in cost is significant, given that a reasonable assurance engagement will result in a different form of report and remove limitations from the nature and extent of evidence-gathering procedures.

51. The Framework specifies that professional accountants are permitted to perform only these two types of assurance engagement. This theoretically limits a company's ability to commission assurance that is either intermediate between ‘reasonable’ and ‘limited’ or less than ‘limited’. In practice, however, a limited assurance engagement can cover a wide range of circumstances. Perhaps more importantly, professional accountants are prevented by the Framework from providing absolute assurance. This means that it is impossible to obtain a report from an assurer stating categorically that X is true.

52. A further important consideration is that professional accountants are not permitted to accept an assurance engagement unless it meets all the prerequisites laid down in the Framework. In practice, the one that is most relevant to assurance on supplier codes of conduct is the need for there to be suitable criteria against which to report. This means that the supplier code of conduct must be in a suitable form for the assurer to assess a supplier’s compliance with it. In particular, it must be clear and not subject to significantly different interpretations. Its subject matter must be capable of reasonably consistent evaluation or measurement. This is particularly important when it is applied in jurisdictions where translation is necessary or where laws and customs differ from those experienced directly by the company. Because of this, it may be particularly helpful for a company to develop its supplier code of conduct in consultation with the assurer.

53. Assurance engagement risk is assessed by reference to the likelihood of material misstatement. A misstatement in the subject matter of an assurance engagement is material if it could influence the decisions of users of that subject matter.

54. A company may commission an assurance engagement on all suppliers, leaving it to the assurance provider to decide what work needs to be done to be able to conclude, using an overall materiality assessment, on the degree of compliance with the company's code of conduct. Alternatively, the company may be concerned only with certain suppliers and materiality will be judged in relation to those suppliers. This may entail considerably more work than if the scope of the assignment were determined by consideration of overall materiality and risk.

55. In practice, the assurance providers and company carry out initial planning together so that, having mutually agreed an assessment of risk at the supplier level, the direction, focus and overall numbers of site visits, and the locations to be visited, can be agreed.

Assurance standards

56. Professional accountants are required to use the basic principles and essential procedures set out in International Standard on Assurance Engagements 3000 *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* (ISAE 3000) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). In addition, as required by that standard, assurance providers are required to comply with applicable parts of the IFAC Code of Ethics for Professional Accountants (the most significant section of which relates to independence) and to implement quality control procedures.

57. Quality control procedures are required at two levels. The International Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements* requires that the assurance provider establishes a system of quality control to provide reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that the assurance report, as issued by the firm, is appropriate. For individual assurance engagements, the assurance provider is further required to implement specific quality control procedures in relation to ethical requirements, acceptance and continuance of client relationships, assignment to engagement teams, engagement performance and monitoring.

58. Under ISAE 3000, the assurance providers may accept (or continue where applicable) an assurance engagement only if they possess the necessary professional competencies, the subject matter is appropriate, and there are no anticipated circumstances that would compromise the requirements of applicable standards.

59. The assurance providers are required to plan the engagement so that it will be performed effectively and with an attitude of professional scepticism. As part of planning, the assurance providers are required to obtain sufficient understanding of the subject matter, in the context of the engagement, to identify and assess the risks of material misstatement to enable them to design and perform appropriate evidence-gathering procedures. In considering materiality, the assurance providers must consider both quantitative and qualitative aspects. The assurance providers aim to reduce assurance engagement risk (that material misstatement will remain undetected) to an acceptably low level. Under ISAE 3000, what constitutes assurance engagement risk in a reasonable assurance engagement will differ from that in a limited assurance engagement.

60. Where it is necessary to use an expert, the assurance providers must nevertheless determine that the expert's work is adequate and that sufficient appropriate evidence has been obtained. The assurance providers are required to have sufficient involvement with the work done by the expert to enable them to accept responsibility for the expert's conclusion.

61. The assurance providers are required to base their conclusion upon sufficient appropriate evidence. Sufficiency is a measure of the quantity of evidence, whereas appropriateness refers to the qualities of relevance and reliability.

62. The assurance providers are required to obtain representations from the party responsible for the subject matter of the engagement. Where an engagement involves many parties, the assurance providers will consider the extent to which representations are implicit in evidence examined (for example, compliance returns from suppliers) when determining the need for further representations.

63. If, as is normal, there is a delay between the completion of work 'in the field ' and the issuance of an assurance report, the assurance providers must remain alert for events in that period that may affect the information being assessed or the assurance report itself.

64. ISAE 3000 requires the assurance provider to conclude whether sufficient appropriate evidence has been obtained and to issue a clear written report including the following specified basic elements (these may be expanded upon):

- Title;
- Addressee;
- Identification and description of the matter reported upon;
- Identification of the criteria;

- Description of any significant inherent limitations;
- A statement restricting the use of the assurance report to certain intended cases where that is relevant (for example, one reporting on a code of conduct that is not available other than for certain stated purposes);
- A statement identifying the responsible party or parties and describing their responsibilities and the responsibilities of the assurance providers;
- A statement that the engagement was performed in accordance with the applicable standard;
- A summary of the work performed;
- The assurance providers' conclusion accompanied, where appropriate, by information for the intended users on the context in which the conclusion is to be read. The conclusion should be expressed in either a positive or negative form depending on the nature of the engagement (reasonable assurance or limited assurance engagement) and where the conclusion is not unqualified, a clear description of all the reasons.

The report will be dated and show the name of the assurance providers and their address (which may be abbreviated to, for example, the name of a city).

The assurance engagement

65. Although it is not really a linear process, the following simplified series of steps is suggested as an analysis of the assurance engagement from the assurance providers' viewpoint:

- Consider the acceptability of the engagement;
- Agree the scope and terms of the engagement formally with the company;
- Plan, i.e. gather information, assess the risk of material misstatement, design appropriate assurance procedures;
- Where planning indicates that reliance may be placed on management systems, test the operation of systems (if tests are cost effective);
- Perform substantive procedures, i.e. analytical procedures and tests of detail;
- Issue the assurance report and any associated reports to the company.

Acceptability

66. When considering whether to accept an assurance engagement, the assurance providers will be concerned with such matters as whether:

- They have the necessary multidisciplinary skills to undertake the assignment;
- There are sufficient resources and personnel at appropriate locations to carry out the assurance work within a realistic timetable;
- There are any threats to independence that, after applying available safeguards, are so significant as to prevent acceptance of the engagement;
- The subject matter is appropriate for the intended level of assurance, and whether there are suitable criteria;
- The scope of the assurance engagement is not subject to unacceptable restrictions, for example on access to suppliers premises and records;
- The company is of sufficient reputation and standing, and its motive to have an assurance engagement performed has a valid reason so that the assurance providers can allow their name to be associated with it;
- Other risks arising from the engagement are acceptable to the assurance providers;
- The fees for the engagement are sufficient.

67. Much of the information gathered for these purposes will also be used during the engagement itself to assist in assessing the risk of material error and in the design of appropriate procedures.

68. For the successful provision of assurance, intended users must feel confident that the assurance providers have the necessary standing and integrity, as well as the specific expertise, for example in complex environmental matters, to carry out an engagement.

69. Accountants providing assurance are required by their professional ethics to be objective in their assessment of the evidence. To promote confidence in their objectivity they are also required to be independent. This means both independent in mind (which is not capable of proof) and, in order to demonstrate independence of mind, sufficiently independent in appearance. The assurance providers will therefore consider any significant threat to their independence and either put in place appropriate safeguards to preserve that independence or, if this is not possible, refuse to undertake the engagement. Further guidance is available in the Code of Ethics for Professional Accountants published by the International Federation of Accountants (IFAC).

70. When agreeing the scope of the assurance engagement with the company, the assurance providers are particularly concerned to ensure that the scope is appropriate and that there are suitable criteria for meaningful reporting. It would be normal for a company to request assurance on a subset of its suppliers, or locations or products, but assurers must satisfy themselves there is no question that oversight is being limited for any reasons other than cost and practicality. The assurance providers will, however, be alert for restrictions that could be intended to distort the appearance of their report when that report is made available to others. For example, the assurance providers could be asked to report externally on aspects of the supply chain in one continent but not another; and this might not be acceptable to the assurance provider if the reason for excluding that continent was because it was known that there were problems there that management did not wish to have exposed.

71. The need for suitable criteria is paramount. The assurance provider will require criteria that are specifically developed to be suitable for the intended users' purposes. For example, a code of conduct will have to be sufficiently detailed to be capable of consistent application and to allow performance to be measured against it without ambiguity.

Planning

72. Planning involves gathering information and assessing the risk of material misstatement, in order to design appropriate assurance procedures. The concepts of risk and materiality are important. They interact because if relatively insignificant matters were to be considered material there would be an increased risk of material error.

73. In practice, the assurance providers and company carry out initial planning together so that, having mutually agreed an assessment of risk at the supplier level, the direction, focus and overall numbers of site visits, and the locations to be visited, can be agreed.

Assurance work strategy

74. Throughout the engagement, the assurance providers need a sufficient understanding of the company and its supply chain and their environments, including the applicable legal and regulatory framework. This is particularly important where there are significant geographical or other differences between the suppliers and the company.

75. In planning the assignment, the assurance providers obtain knowledge of the design of relevant aspects of systems, and evaluate their existence, appropriateness and effectiveness as a basis for deciding the nature and extent of the other work to be performed. This includes the techniques used in measurement, analysis, calculation or estimation of environmental and other significant impacts. The assurance provider considers whether the use of these techniques is acceptable and assesses the quality control over their use.

76. The assurance providers have to obtain sufficient appropriate evidence to be able to draw reasonable conclusions on which to base their opinion. Such evidence is obtained from an appropriate mix of tests of control designed to confirm assessments of systems and substantive procedures (which also provide indirect evidence of the effectiveness of control).

77. For example, an assurance provider may visit several suppliers and, in connection with work on labour standards, consider the adequacy of their payroll and human resources systems. Where it is not appropriate to place reliance on such systems, the assurance provider will perform substantive testing on matters such as minimum ages for employees or hours worked. In some cases, a supplier code of conduct will stipulate that certain systems have to be maintained to a particular degree of effectiveness. They will, therefore, themselves constitute the subject matter of the assurance engagement. Even where this is not the case, testing of management systems and controls can be of considerable importance, because these systems influence the conduct of operations on a continuous basis.

78. If the assurance provider becomes aware of material weaknesses in the design or operation of management system or controls, the provider should draw these to the attention of an appropriate level of management as soon as practicable. The company commissioning the assurance engagement may benefit considerably, in the longer term, from the active sharing of such information by the assurance provider with supplier management.

Substantive procedures

79. Substantive tests are those performed to obtain direct evidence of material misstatement. Assurance providers categorise such procedures as either ‘analytical procedures’ or ‘tests of detail’. Analytical procedures involve analysing disclosures and other data to see if they 'make sense'. The assurance provider may use analytical procedures at the planning stages to identify any obvious potential misstatements so that these may be investigated further. Analytical procedures do not alone provide sufficient evidence as a basis for a final conclusion on critical areas. Test of detail are often carried out on a sample basis; they may involve substantiating individual items and checking that calculations and summaries have been done accurately. Assurance providers ordinarily make use of computer techniques where the nature of the test allows that.

Reporting

80. Assurance providers report their conclusions in a form that includes the specified basic elements set out in subsection Assurance standards of Section 5.4 Understanding assurance.

    In addition, management may receive information and advice arising as a by-product of the assurance engagement.

5.5 If supplier provides own third-party assurance

81. Independent assurance work may also be commissioned by the supplier. There may also be scope for liaison with other companies with similar supply chain management issues.

82. Companies in industries where supplier chain monitoring is common, such as clothing manufacture, may experience monitoring from several customers; an exception would be where a company has only one major customer. Whether the monitoring involves the completion of questionnaires or extends to site visits by independent assurers, the need to satisfy the requirements of several separate customers can be a drain on resources. The company concerned may wish to engage independent assurers to provide a report that may be made available to all those wishing to monitor its activities. Alternatively suppliers may be visited by one assurer reporting to several companies.

83. Where a supplier offers a report by a third-party assurance provider, the company and the primary assurance providers will have to determine the extent to which reliance may be placed on that work. Accountancy firms will draw on their background as providers of audit services, where there are established standards for reliance on the work of other auditors. The primary assurers will consider the independence and professional competence of the other assurer and obtain sufficient appropriate evidence that the latter’s work is adequate for the primary assurers’ purposes, in the context of the specific assignment.

5.6 Assurance in relation to certification

84. There is potential for confusion between assurance and certification. Certification, for example under ISO 14001, is an independent assessment of the extent to which a company's management systems meet specific criteria. The certification may indicate the extent to which a company is paying attention to accuracy in its processing, yet say nothing about the outcomes of those processes or the company’s commitment to sustainability.

85. One form of certification does, however, demand further consideration in relation to independent assurance. SA 8000 is an important labour standard and it is necessary to consider, in detail, the interface between SA 8000 certification and assurance for the social elements of a sustainable supply chain.

86. SA8000 is a standard that covers all widely accepted international labour rights. It is in use by businesses and governments around the world and is broadly recognised by trade unions and non-governmental organisations (NGOs) as one of the strongest workplace standards. Certification to SA8000 performance standards promotes management systems that upgrade working conditions.

SA8000 is a powerful tool for creating environments in which both management and workers benefit[4].

87. Companies carrying out sustainable supply chain management may participate in the SA8000 Corporate Involvement Programme. Companies may become involved with SA8000 at two levels; the higher level not only involves assistance with implementing the standard throughout a supply chain but also allows public reporting of a company's SA8000 involvement.

88. Suppliers may seek to have individual facilities certified to SA8000 through audits by an accredited certification body. There are currently certified facilities in 30 countries across 22 industries. For a stated period of time, the certificate gives appropriate evidence of compliance with the underlying labour standards. If a company has included these standards in its supplier code of conduct, the need for independent assurance may be reduced if some suppliers have SA8000 certification.

89. OHSA 18001 is an Occupational Health and Safety Management (OHS), management system specification, Like SA8000, it contains performance requirements. Originally created from the British Standard for Occupational Health and Safety Management Systems BS 8800:1996, it was designed to enable companies to control their OHS risks and demonstrate their commitment to provide a safe working environment, protect their employees, and improve their performance.

5.7 Other services

90. Accountancy firms that provide assurance in relation to supply chain monitoring may be well placed to offer other services to their clients, so long as their independence is not compromised. Such services may be broadly categorised as consultancy, agreed-upon-procedures and certification.

91. The accountancy firm must be careful to ensure that such work does not jeopardise independence in cases where an assurance report is also provided. The financial statement auditor is required by professional ethics to maintain a high degree of independence from the audit client. The fact that a professional accountant or firm acts as both a financial statement auditor and a provider of assurance on supply chain management is not, of itself, necessarily an insurmountable threat to independence provided they follow an appropriate professional code of ethics.

92. An accountancy firm may provide consultancy services in relation to risk analysis and to developing a code of conduct and reporting systems, and to assisting in implementation. After a code is implemented, consultants may analyse related systems and information to assess efficiency and, through benchmarking against best practice, suggest improvements. Direct monitoring may be outsourced through an arrangement whereby the consultancy firm in effect manages the process for the company but is not considered to be independent.

93. Where a company wishes to use the services of an independent accountancy firm, this may be done through what is termed ‘agreed-upon-procedures’. The firm is instructed by the company to carry out specific procedures and report the results, for example a series of visits to, say, 100 supplier locations, which may yield factual evidence of the extent to which each location has implemented certain aspects of the supplier code of conduct. In this case, accountants do not express an opinion on the overall findings.

[4] From http://www.cepaa.org/AboutSAI/AboutSAI.htm

94. Certification of management systems may be carried out against standards, such as those published by the International Organization for Standardization. Although certification may be taken into account by a company when assessing risk at its suppliers' plants, certification against standards provides evidence that specified requirements have been met, but doesn't provide assurance on defined criteria, that go beyond what is required in standards. For company specific codes of conduct, there can be no standard, therefore independent assurance may be recommended.

95. Where an accountancy firm, or one of its associates, is an accredited certification body it will be able to do the work necessary to issue a formal certificate. Where this is not the case, an accountancy firm may, nevertheless, offer a pre-certification assessment to assist the client in gaining certification from an appropriate body in due course.

6. FURTHER INFORMATION

6.1 FEE Publications

FEE publications may be downloaded, free of charge, from: http://www.fee.be/publications/main.htm

96. The following publications are the most recent in the area of sustainability. The FEE Discussion Paper: Providing Assurance on Sustainability Reports (2002) contains an introduction to the subject of sustainability and an extensive guide to obtaining further information.

- FEE Alert: Emissions Trading (2005);
- FEE Call for Action: Assurance for Sustainability (2004);
- Benefits of Sustainability Assurance (2003);
- FACT SHEET: Greenhouse Gasses and the Accountancy Profession (2002);
- FEE Discussion Paper: Providing Assurance on Sustainability Reports (2002);
- FEE Update on Sustainability Issues (2001);
- Analysis of Responses to FEE Discussion Paper Providing Assurance on Environmental Reports (2000);
- FEE Paper: Towards a Generally Accepted Framework for Environmental Reporting (2000).

6.2 Information for business

97. This paper does not attempt to cover the wider aspects of supply chain management and its place in relation to other management concepts such as the lifecycle value optimisation, the balanced scorecard, and so on. The following are sources for business-oriented information relevant to sustainability aspects of the supply chain.

    World Bank Study, 'Strengthening Implementation of Corporate Social Responsibility in Global Supply Chains'
    http://siteresources.worldbank.org/INTPSD/Resources/CSR/Strengthening_Implementatio.pdf

    OECD, 'Managing Working Conditions in the Supply Chain: A Fact-finding Study of Corporate Practices' June 2002
    http://www.oecd.org/dataoecd/44/22/2489753.pdf

6.3 External standards and information

98. External standards and benchmarks may influence a company's sustainable supply chain management and its supplier code of conduct. The influences range from inter-governmental codes (e.g. OECD 'Guidelines for multinational enterprises') through sector-specific codes adopted in a particular industry (e.g. toys) to model codes developed by NGOs or other organisations.

99. IFAC (International Federation of Accountants) has issued an International Framework for Assurance Engagements and a general "umbrella" Standard for Assurance Engagements Other Than Audits or Reviews of Historical Financial Information (ISAE 3000 Revised). The latter provides basic principles and essential procedures that – to some extent - could be used for assurance engagements on sustainability reports. It may be read online at: http://www.ifac.org/IAASB/

A printable copy may be downloaded from:
http://www.ifac.org/Members/Source_Files/Auditing_Related_Services/2005_A060.pdf

100. A key resource is the European Commission's *ABC of CSR Instruments*. It provides simple, background information on the main CSR instruments used in consumption, investment and management (including codes of conduct) and links to other sources of information. It may be read online at: http://europa.eu.int/comm/employment_social/soc-dial/csr/abc.htm

A printable copy may be downloaded from:
http://europa.eu.int/comm/employment_social/soc-dial/csr/csr_abc.pdf

101. ILOLEX is a trilingual database (English, French & Spanish) containing International Labor Organisation Conventions and Recommendations, ratification information, comments of the Committee of Experts and the Committee on Freedom of Association, representations, complaints, interpretations, General Surveys, and numerous related documents: http://www.ilo.org/ilolex/english/index.htm

102. One of the links in the *ABC of CSR Instruments* is to a website that itself collects links to the full text of various codes of conduct, and their provisions, sponsors and effects on business practices: http://www.codesofconduct.org/

103. The following direct links provide further information on matters mentioned in the body of this document.

Global Reporting Initiative (GRI) Sustainability Reporting Guidelines:
http://www.globalreporting.org/

International Organization for Standardization – ISO 14001 and similar standards:
http://www.iso.org/iso/en/ISOOnline.frontpage

Risk assessment sources

104. The risk that members of a supply chain will not comply with a supplier code of conduct is influenced by the extent to which international labour standards have been implemented by the government of the jurisdiction in which they operate. The ILOLEX database (see above) includes information on ratification.

105. The US Department of Labor was instrumental in setting up the Committee on Monitoring International Labor Standards (CMILS) in 2001. The results of its work include an online database on country-level progress toward observance of the international labour standards. Sources of information and compliance indicators for over 200 countries may be accessed at: http://www.dol.gov/ilab/webmils/