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CONTENTS

CORPORATE SOCIAL RESPONSIBILITY AUDIT: TEORETICAL ASPECTS

Artem Koldovskyi*

Abstract

This paper puts a conceptual framework to outline research for corporate social responsibility (CSR) audit based on the analysis of current CRS literature and audit models as implementation of CSR. It is intended to make clear the phenomena about the relationship between audit, implementation of business ethics principles and corporate governance. However, most studies do not take into account modify CSR audit. This paper reports part of a research we carried out on the theoretical interpretation of the corporate social responsibility audit. This paper examines the corporate social responsibility audit as a composition of four categories - management system audits, on-site audits, verbal probability expressions (VPE) audits and technology audits. The paper concludes suggests to systematize multiple audits so that they can be conduct in three types of audits - environmental management audits covering in-house companies, environmental technology audits of products, and environmental audits of sites, including non-manufacturing sites and non-consolidated subsidiaries.

Keywords: Audit, Corporate Social Responsibility, Corporate Governance, Stakeholders, Social Audit

JEL Classification: G34, G32, M49

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1 Introduction

The nature of the financial markets implicates, first of all, the profit maximization and distribution of financial resources. Financial market decisions are accepted on the basis of information analysis (including financial statements and audit reports). The main cause of the crisis in terms of the information model of the economy is undermining the credibility of the information. This problem deals with two concerns in achieving greater accountability in social reports - the lack of completeness of reporting, and the lack of credibility of reports. That's true, that social audit plays an important role in improving the completeness and credibility of reporting. So, it is very important problem to determine the nature and specificity of social reports, which will satisfy all involved stakeholders.

Within the globalized economy, corporations are consolidating their commitment to respecting human rights, social and environmental accountability, ethical control and promoting sustainable development through their services, processes, products and relationships.

Government, business and society should work together more closely to improve human accountability. Corporations can achieve both maximization of profits and social responsiveness. CSR in a global economy entails aligning a company's activities with the social, economic and environmental expectations of its «stakeholders». [2]

Corporate social responsibility, corporate governance and auditing are interactively connected and cooperate with each other. In order to ensure sustained growth and development and to fulfill CSR, the corporation must create and operate corporate governance. In order to achieve corporate governance effectively audit plays an important role in corporate governance and then the implementation of CSR. According Johnson (2001), a role of auditing is very important for executives to explain fulfilling their fiduciary responsibilities to stakeholders. [4]

By playing a key role in social control, auditing corrects people's mistakes including fraud, errors and illegal acts, leading them in the right direction. It also reinforces and expands the relationship between corporations and stakeholders who have far less knowledge and capability than corporations. Auditing is not only a medium to ensure a good relationship between corporations and society in a true sense but also a social infrastructure to build up public trust as a social capital.

Auditing contributes to the sound development of corporations and society. By building up public trust, auditing is essential to corporations and society. Auditing is a publicly accepted social system and is a social structure. [3]

This paper examines the social accounting and AS is the communication of social and environmental effects of a company's economic actions to particular interest groups within society and to society at large. It emphasizes the notion of corporate accountability.

Crothers defines social accounting as «an approach to reporting a firm's activities which stresses the need for the identification of socially relevant behavior, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques».

This paper is based on the current reporting guidelines and standards serve as frameworks for social accounting, auditing and reporting (Appendix A).

The objective of this research is to depict the general state of CSR audit. In this paper the following research questions will be answered:

- What is the theoretical foundation underling the emergence and development of CSR audit?

- How conceptual highly sustainable framework integrated with the CSR initiatives can create the effective business?

The paper is structured as follows. Section 2 - review of literature. Section 3 - theory and hypothesis. Section 4 - research framework of the study. Section 5 – practical outcomes and Section 6 concludes.

2 Review of literature

Academic papers relating CSR and CSR audit have been widely reviewed for the background study. The trend observed in the process of literature review is that corporate social responsibility has gained much attention in the academia. A lot of work has been done on the research of CSR, especially from the theoretical perspective. In contrast there is the obvious lack of study done on CSR audit from both theoretical and practical perspectives. Hence the literature review was majorly used to learn the background of and theoretical foundation for CSR and CSR audit.

Audit is carried out by public accountant (auditor) in the form of gathering and evaluating audit evidence. In gathering audit evidence, an auditor refers to the audit model (AM) (Elder and Allen, 2003). Allen et al. (2006) have especially noted the existence of various studies with regard to AM accuracy in the last two decades, which provide different conclusions.

Velte and Stiglbauer (2012) focused on AM concentration of listed firms which is characterized by an oligopoly of "Big Four" audit firms. Hence a state of the art analysis of the status quo of concentration measurement has been conducted on the audit market from an international perspective. Thereby risks and causes of concentration development have been assessed along with the current regulatory proposals of the European Commission (EC). After a discussion of conventional measurement methods of audit market concentration, our paper gives a review of previous empirical results of audit market concentration for EU and non EU-member states. Results show that EC reforms cannot clearly be related to increase audit quality but increasing transaction costs. [22]

Kostyuk and Mozghovyi (2012) gave an international overview of corporate social responsibility in banks. The analysis based on the assumption that the basic models of CSR do not exist in pure form and depend on the historical peculiarities of different countries, as well as the financial condition of individual banks and banking systems as a whole. Their study identified the distinctive features of the social responsibility of banking business in different countries, and also formulated the conclusion that the American model of CSR is the most widespread in the world because of simplicity of its implementation in the short term. [5]

Some studies support the strength of AM such as Dusenbury et al. (2000) who specify that AM does not disregard material misstatements. Houston et al. (1999) find evidence that AM is suitable in explaining auditor behavior, given sure errors in financial statements. However, this model does not apply to fraud. Libby et al. (1985) emphasize that AM is consistent with auditor decisions.

In contrast, other studies show that AM has some weaknesses. The weaknesses for instance, can be seen in the form of inherent risk and control risk that can become obscure (for example, Haskins and Dirsmith, 1995, Messier and Austen, 2000), also AM is not in line with the quality of audit evidence (Dusenbury et al., 2000). also AM is not commensurate with the wrong unaccepted risk (example, Kinney, 1989, Sennetti, 1990, Boritz and Zhang, 1999). Finally, AM is inconsistent with actual auditor consideration (Daniel, 1988, Strawser 1990).

Out of those studies Bedard and Johnstone (2004) and Cohen and Hanno (2000) provide evidence that the auditor evaluates a situation in relation to aggressive management and inadequate corporate governance, and there is a relationship with such evaluation with planning and pricing made by the auditor.

Findings by Cohen and Hanno (2000) are consistent with public companies obligation in compliance with corporate governance and ethics code to senior management (SOX 2002 in Elder et al., 2008, SK Meneg. BUMM No. 17/2002 in Tjager et al., 2003). Considering that the stipulaton of SOX 2002 and SK Meneg. BUMN No 17/2002 is relatively new, it is necessary to conduct research to obtain empirical evidence related to corporate governance risk and to implementation of events business ethics principle related to audit risk. Perception approach is used due to risk components determined by the auditor based on professional judgment, i.e. consideration or evaluation which is conducted by a person raving adequate skills and education (Elder et al., 2008, Louwers et al. 2007).

To our point of view there is the obvious lack of study done on development and specifics of the CSR audit. We believe it is necessary to consider this issue on the theoretical side, which will lead to a logical continuation of the study in a empirical way (testing our theoretical developments on specific objects).

3 Theory and hypothesis

3.1. The stakeholder theory

The stakeholder theory stems from a memorandum in Stanford University and later was conceptualized by Freeman (Freeman 1994). The term of stakeholder was defined as any individual and entity that could be affected by the activity, strategy, policy, operation or target of a corporate. In return, those individuals and entities also could affect the corporate activities, strategies, policies, operations and targets. This theory is generated in the context of increasing conflicts among different corporate stakeholders. Since its emergence, it has been widely accepted, and especially favored by the management levels in corporate. [6]

Donaldson and Preston present three aspects of stakeholder theory including descriptive (to describe the corporate features and practices, and identify who and what are stakeholders), instrumental (to identify and solve the problem between stakeholder management and the accomplishment of corporate targets) and normative (to understand and identify the new function of corporation besides persuing profits) (Donaldson and Preston 1995; Van der Lan 2009). [7]

In summary, the functions of stakeholder theory are reflected from the following perspectives:

1) stakeholders are the receivers of corporate social impacts, and the fundamental goal of CSR is to meet the wider scope of stakeholders (Jamali and Mirshak 2006; Waddock et al. 2002); 2) stakeholders' expectation determines the expectation of CSR performance from corporate; 3) by evaluating the gap between CSR achievement and expectations, stakeholders could be the assessors of CSR performance; 4) stakeholders take actions according to their interest, expectation, tolerance and assessment result.

The stakeholder theory provides the study of CSR a theoretical framework, within which the issue of CSR is scoped within the relationship between corporate itself and stakeholders.

Meanwhile stakeholder theory also provides a theoretical support to the study of CSR audit.

Some essential problems such as audit scope, audit object and quantification of CSR audit are to some extent solved in this context. The stakeholder theory assists to transform the abstract CSR issue to the concrete stakeholder issue, define the concrete auditing object and build a road from the abstract CSR audit theory to practices. Hence the stakeholder theory has been considered in academia as a precondition to study CSR audit (Wang 2010).

3.2 Corporate governance and audit risk

Several empirical evidences show that weak corporate governance is related to fraudulent financial reporting (Dechow et at. 1996. Agrawal et al. 1999. Karpoff and Lott, 1993; Farber. 2005) Decpow et al. (1996) reports on compares conducted fraud tend to nave board of director (BoD) dominated by insider, only few of them have audit committees. They do not reveal significant effect to fraud by using the Big Six. [10]

Agrawal et al. (1999) investigate the relationship among fraud finding, rotation of director and senior manager however the intended relationship fails to occur Agrawal et al. (199) continue on investigating 103 companies that conducted fraud, in which four companies provide evidence of conducting fraudulent financial report. Karpoff and Lott (1993) extend the evidence of fraud that on average the abnormal return in two or three days period when fraud is found, significantly more negative in fraudulent financial reporting rather than in any other fraud.

Other studies have also provided evidences on the contribution of board of directors and audit committee to corporate governance (Beasley and Petroni, 2001. DeZroort and Salterio 2001) Beasley and Petroni (2001) for instance, investigate the role of outside board of directors in the selection of external auditor for property-liability insurance companies. [18]

They further report that insurance company which employs good reputation auditor specializing m insurance industry is likely to increase in line with the percentage of outside board member However they do not provide significant relationship between the composition of board of directors and unspecialized insurance auditor with both good reputation and bad reputation which suggests that specialization is important.

3.3 Corporate social responsibility audit

CRS audit aims at identifying environmental, social or governance risks faced by the organization and evaluating managerial performance in respect of those. CSR is a broad term however, for the purpose of addressing the scope of a CSR Audit, CSR is about managing and taking into consideration organization's operational, processes and behavioral impact on society and stakeholders from a broad perspective. [15] Contrary to common belief CSR is more than basic legal compliance and is highly connected with and affects organization's bottom line.

In order to ascertain an organizations effective CSR policy, practices and culture, the notion of auditing CSR in organizations is becoming key. However, this requires a substantial shit in the audit profession to include beyond the traditional lines of finance and information technology to wider operational practices that respond to client and professional pressures brought about by a growth in the practice of risk management.

Audits and the process of auditing as we commonly know it is focused on the organizations achievement of:

- Its stated and communicated objective;

- Its compliance with rules, regulations and legislation;

- The reliability of its records and information accessible to the public or communicated to the public;

- The safeguard of its assets. [22]

This does not address CSR or CSR related risks. The risks of not paying adequate attention to CSR are clear – reputation damage, lawsuits, and government scrutiny. Internal audit should focus on these risks and assist management to identify appropriate actions. This called for a different approach to audit and in particular an audit that takes into consideration health, safety, environmental, reputational and business probity not to mention CSR governance. The CSR audit, is a tool for decision making and for strategic management.

There are several CSR criteria against which a CSR Audit can take place, just like a financial audit, demonstrated on:

- Global Compact;

- Global Reporting Initiative;

- Good Business Framework. [13]

These standards although vary in style and depth cover the basics of CSR and enable organizations to be audited against them. However, for the purpose of being generic, we will address organizations different approaches to CSR and how a CSR audit can facilitate a better understanding of an organization's:

- CSR goals and objectives;

- CSR practices, policies and culture;

- Approach to CSR related issues with respect to its internal decision making process. [20]

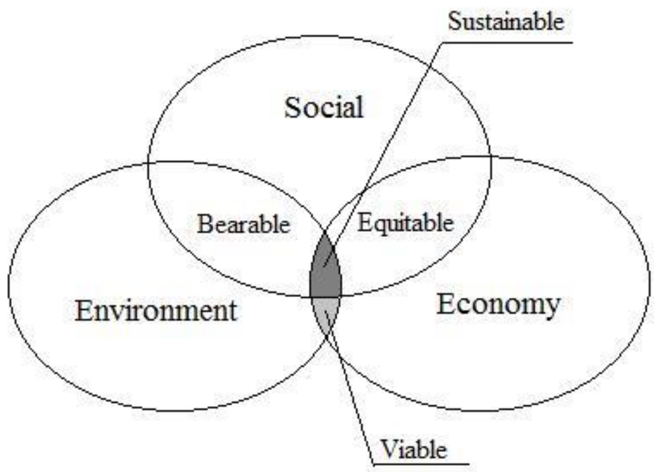
Traditionally organizations prime focus is to do business. With the increased hype of CSR, organizations started to undertake certain CSR related activities whereby they undertake responsible activities independent of their business operations, their impact on society and how they affect society or can be affected by society at large. [19]

This evolved into a more integrated approach of CSR in organizations whereby organizations started to do what they do but doing it in a more responsible manner i.e. embedding societal considerations in their decision making process etc. A higher evolution finally led organizations to doing responsible things in a responsible manner a closer definition to what we now call today "sustainability".

The most widely quoted definition of Sustainability and sustainable development, is that of the Brundtland Commission of the United Nations on March 20, 1987: «Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs». [12]

The triple bottom line emphasizes the value of mutually considering the areas of economic, social and environment in the decision making process to create added value as follows (Figure 1):

Figure 1. The triple bottom line of sustainable



It's no longer simply a matter of doing good things to society, or operating ones organization in a responsible manner but a further step of integrating CSR with the organization's objectives, creating a «virtuous circle» for all the stakeholders.

We propose a highly sustainable research framework as the effective business is integrated with the CSR initiatives and there is high commitment from the business at all levels (Figure 2).

Figure 2. Highly sustainable research framework as the effective of the business

	Traditional Methods	Responsible Method
CSRActivities	2 level Doing Responsible Things	4 level Doing Responsible Things Responsibly
TraditionalActivities	1 level Doing Business	3 level Doing Things Responsibly

So, let's turn our attention to Developing a CSR Audit Program. An internal audit that is intended to cover CSR should start by creating an understanding of the social responsibility issues that affect the organization and its industry. Following that, the audit should review how management reconciles these sometimes-contrary needs.

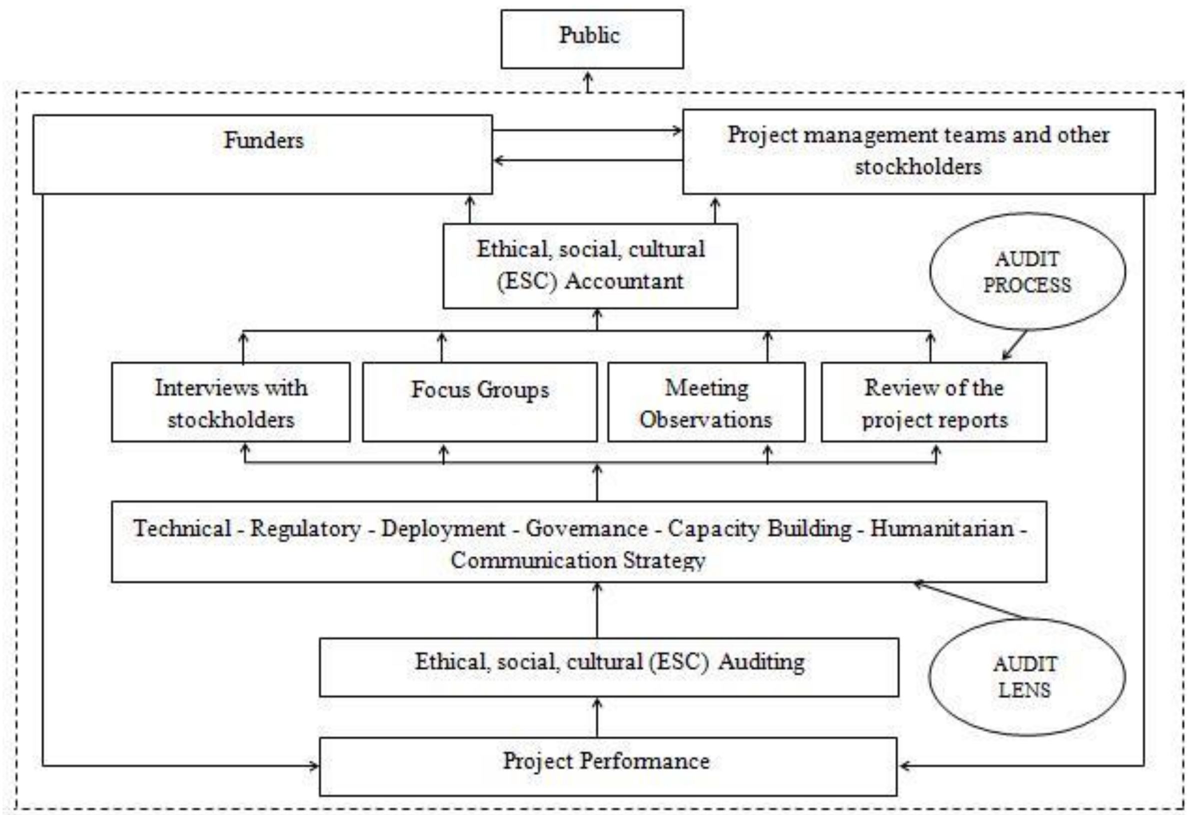
A CSR audit program can cover all or any of the following risks:

- 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.

4 Research framework of the study

Based on the various studies discussed previously, the following research framework is developed as the basis of this study and illustrated in Figure 3.

Figure 3. Framework of the study

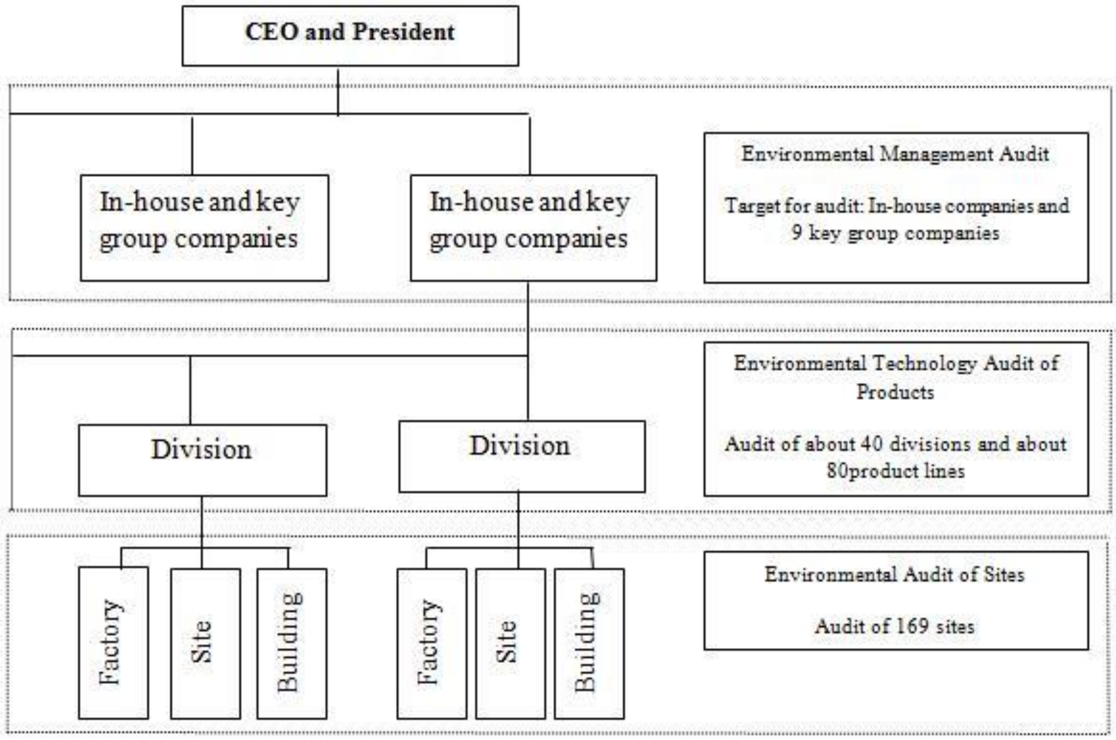


To develop a social audit research framework, we created a framework that took into account the goals of the A project, which generally covers all aspects of a typical initiative managed by a public private partnership. The goals of the A project are divided into seven major components and include: technical, regulatory, deployment, capacity building, charitable purpose, project management and governance, and communication.

The critical component of the audit process is the engagement of stakeholders and focus groups. The observation of meetings and project reports is crucial; it is mainly from these engagements that views and issues of key stakeholders become palpable. All four audit processes are performed through a lens network, which have been designed to account for all aspects and phases of the project. After the first cycle, depending on the ESC issues that were raised, a series of indicators are developed to track the incorporation of these changes in subsequent years.

We refer to these seven components as audit lenses, and they are shown in Figure 4.

Figure 4. Group's environmental audit



In the research framework, these lenses shape the four processes through which ESC issues are made explicit.

These processes include: 1) Interview with stakeholders; 2) Focus Groups; 3) Review of project reports and; 4) Meeting Observations. According to our research framework, once the social audit is completed and key concerns from stakeholders are shared with the project team managers, the project managers provide a management response. Both the report and the management response are shared with stakeholders to foster transparency and accountability.

Some of the ESC issues that arose mainly revolved around intellectual property rights, seed cost concerns, seed control, and communication.

5 Practical outcomes

The research framework of the CSR audit was composed of four categories:

- Management system audits (environmental activity promotion systems, etc.),

- On-site audits (levels of compliance with rules regarding environmental facilities, etc.),

- VPE audits (levels of achievement of goals set in voluntary plans),

- Technology audits (product environment management system, environmental performance, etc.).

These multiple audits have been systematized so that they could be conducted in three types of audits:

(1) environmental management audits covering in-house companies and nine key group companies: (2) environmental technology audits of products covering about 40 divisions, and (3) environmental audits of sites covering 106 business and production sites, including non-manufacturing sites and non-consolidated subsidiaries. In-house companies and group companies conduct self-audits (self-inspections) within their companies based on the same standards in order to check business and production sites with relatively low levels of environmental impact that are not covered by site environment audits. Audit items for these three audits are reviewed annually to improve evaluation level.

Figure 5. Audit results. Environmental management audit

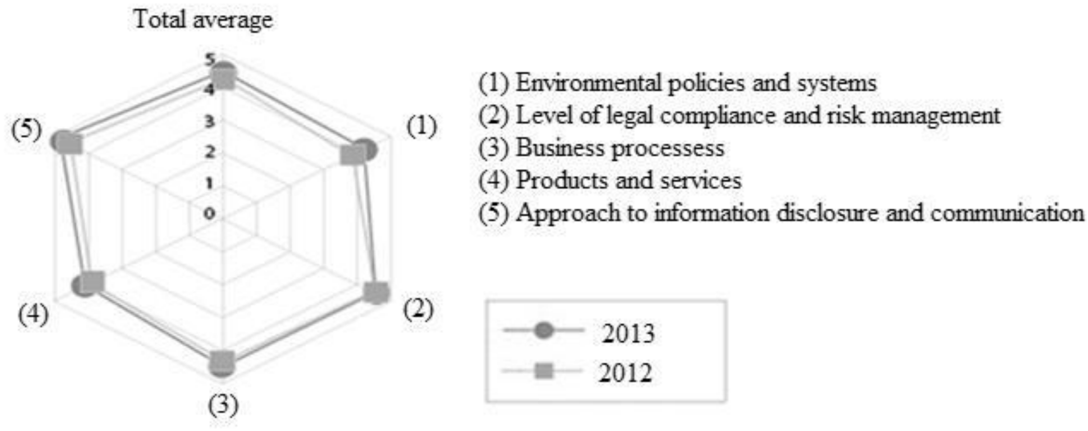
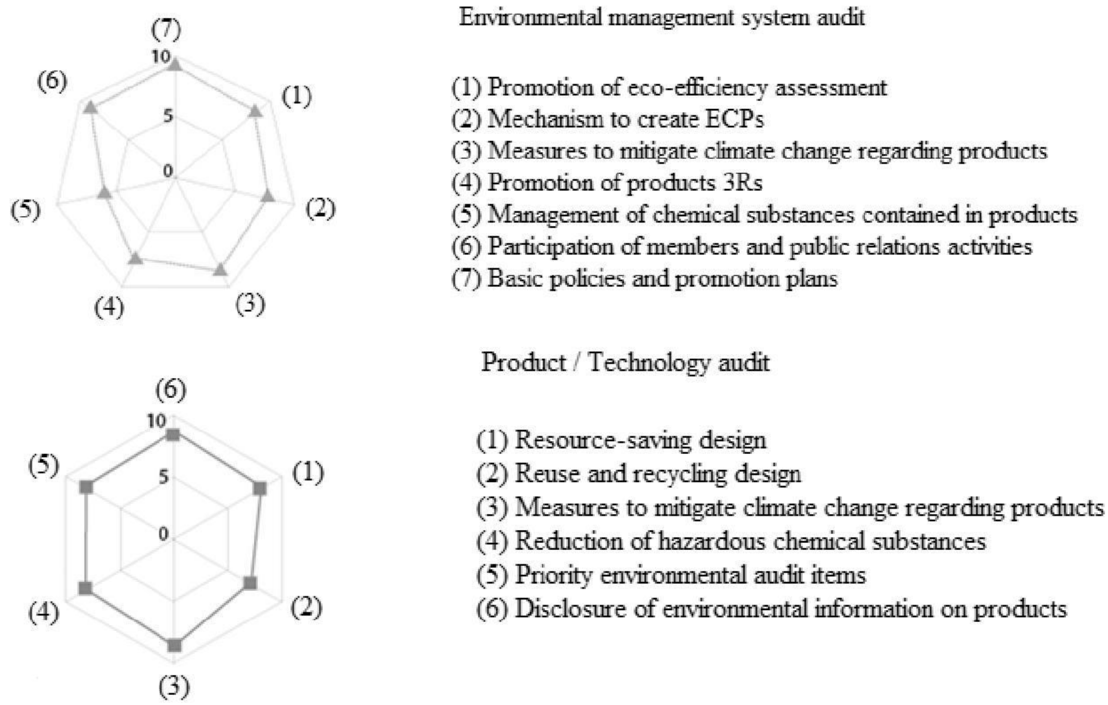


Figure 6. Environmental technology audit of products



This research framework may serve as a practical guide to help companies be more conscious of their social and moral responsibilities. However, critics claim that it is selective and substitutes a company's perspective for that of the community. Another criticism is about the absence of a standard auditing procedure.

A CSR audit program can be an aid to recruitment and retention, particularly within the competitive graduate student market. Potential recruits often consider a firm's CSR policy. CSR audit can also help improve the perception of a company among its staff, particularly when staff can become involved through payroll giving, fundraising activities or community volunteering. CSR audit has been credited with encouraging customer orientation among customer-facing employees.

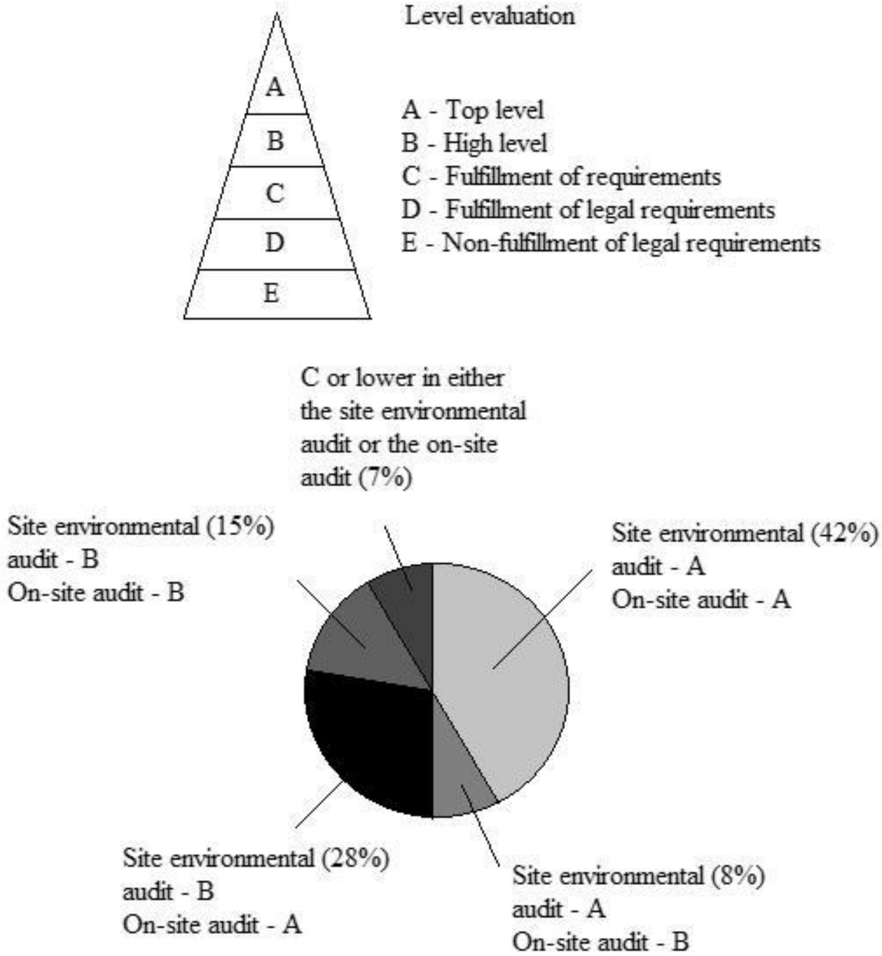
Managing risk is an important executive responsibility. Reputations that take decades to build up can be ruined in hours through corruption scandals or environmental accidents. These draw unwanted attention from regulators, courts, governments and media. CSR audit can limit these risks.

CSR audit can help build customer loyalty based on distinctive ethical values.

Corporations are keen to avoid interference in their business through taxation and/or regulations. A CSR audit program can persuade governments and the public that a company takes health and safety, diversity and the environment seriously, reducing the likelihood that company practices will be closely monitored.

This research framework with all this potential business benefits must be confirmed and requires empirical testing, which will be examined in further studies.

Figure 7. Environmental audit of sites



7 Conclusions

It is necessary for us to reconsider a CSR auditing based on the questions, - "What is the theoretical foundation underling the emergence and development of CSR audit?" and "How conceptual highly sustainable framework integrated with the CSR initiatives can create the effective business?"

This paper puts a conceptual framework to outline research for corporate social responsibility (CSR) audit based on the analysis of current CRS literature and audit models as implementation of CSR.

In this paper analyzed the Stakeholder Theory, Corporate governance and audit risk Theory and Corporate Social Responsibility Audit Theory.

This paper reports the findings of a study into subject of CSR, including a literature review. This research is novel in the sense that it addresses the complex issue of CSR auditing with a scientific approach using Stakeholder Theory, Corporate governance and audit risk Theory and Corporate Social Responsibility Audit Theory. The literature review revealed no studies of a similar nature.

The following items were highlighted by the research as crucial points to be considered in developing a CSR auditing system: - The inclusion of all significant stakeholder groups in the auditing process;

- Diversity in individual perceptions of CSR;
- The problem of negative screening;
- The shortcomings of the 'tick-box' approach to auditing CSR;
- The requirement that the measurement of CSR should be both quantitative and qualitative in nature;
- The six key elements to the achievement of successful CSR are perceived as:

1. Good stakeholder management;
2. Good corporate leadership;
3. Greater priority for CSR at board level;
4. Integration of CSR into corporate policy;
5. Regulation at the national and international level;

6. Active involvement of, and good coordination between, government business, NGOs and civil society.

A concept for a proposed CSR auditing system has then been developed in this

Research, which incorporates the key issues identified in the literature review. The concept derived from the project findings is intended to be a product that can be applied in practice as the basis for developing a CSR auditing system.

This paper reports a highly sustainable research framework as the effective business is integrated with the CSR initiatives and there is high commitment from the business at all levels.

This research framework may serve as a practical guide to help companies be more conscious of their social and moral responsibilities. This research framework with all this potential business benefits must be confirmed and requires empirical testing, which will be examined in further studies.

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Appendix A

Table A.1. Current reporting guidelines and standards serve as frameworks for social accounting, auditing and reporting

№	Guidelines and standards
1.	Account Ability's AA1000 standard, based on John Elkington's triple bottom line (3BL) reporting;
2.	The Prince's Accounting for Sustainability Project's Connected Reporting Framework [34];
3.	The Fair Labor Association conducts audits based on its Workplace Code of Conduct and posts audit results on the FLA website;
4.	The Fair Wear Foundation verifies labour conditions in companies' supply chains, using interdisciplinary auditing teams;
5.	Global Reporting Initiative's Sustainability Reporting Guidelines;
6.	Good Corporation's standard [4] developed in association with the Institute of Business Ethics;
7.	Economy for the Common Good's Common Good Balance Sheet [3];
8.	Synergy Cod ethic 26000 [5] Social Responsibility and Sustainability Commitment Management System (SRSCMS) Requirements — Ethical Business Best Practices of Organizations - the necessary management system elements to obtain a certifiable ethical commitment management system. The standard scheme has been built around ISO 26000 and UNCTAD Guidance on Good Practices in Corporate Governance. The standard is applicable by any type of organization;
9.	Earthcheck Certification / Standard;
10.	Social Accountability International's SA8000 standard;
11.	Standard Ethics Aei guidelines;
12.	The ISO 14000 environmental management standard.