

MASTER THESIS



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# The role of social auditors

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A categorization of the unknown

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# ABSTRACT

As demands on companies' accountability have increased, researchers have turned their attention towards the social auditing practice and studied its role in companies supply chains. This study highlights a theory gap, questioning existing praise and criticism correlated to the categorization of social auditors. By comparing two different social audit categories, namely the independent and internal auditors, this paper contribute with a broader understanding of the similarities and differences between the two audit types. This study addresses the research question; how does the independent and internal social audit type support companies' work with improving social standards in the supply chain? The theoretical framework includes aspects within the area of social auditing, buyer-supplier relationships and theories regarding the categorization of the two audit types. The study draws upon a qualitative approach investigating two cases with different social auditors, finding that both auditor types have their strengths and weaknesses, and therefore support companies in different ways. Referring to this tradeoff, this study concludes that the praise and criticism correlated to the two audit classifications of independent and internal auditor might not be completely valid, which calls for further research.

**Keywords:** Corporate Social Responsibility, Supply Chain Management, Independence, Multi-Stakeholder Initiative, Social Audits, Buyer-Supplier Relationship.

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## 1. SCANDALS AND RESPONSIBLE SUPPLY CHAINS

And it happens once again. Labour rights organizations are furious, showing their disappointment stating that companies are failing to take meaningful actions (NY Times, Webpage 2013). This time a building collapsed in Bangladesh resulting in the deadliest industrial disaster in the garment factory history, 1 127 people dead and many injured (CNN, Webpage 2013). The negative media attention is huge for several brands that failed to take responsibility for the accident, and in social media people are describing their anger and disappointments loudly (Twitter, Webpage 2013).

“Take action and demand justice for victims of Bangladesh building collapse” (Twitter, Webpage 2013)

“People should not be sacrificed for profit” (Twitter, Webpage 2013a).

The outrage over the collapse has led to companies being urged upon to sign a plan to help prevent fire and building collapses in Bangladesh. Many companies have signed the safety agreement accepting to perform safety inspections, publicly report the findings and help suppliers to finance the improvements (CNN, Webpage 2013). However, not everyone signed, the retail company Walmart decided not to sign the plan and supposedly intended to conduct its own inspections (Washington Post, Webpage 2013), which led to consumers questioning the company even more.

“Corporate greed: Even 1,127 dead in Bangladesh building collapse can't convince Walmart to join safety agreement.”(Twitter, Webpage 2013)

“Why can't Walmart do both - sign the treaty AND do inspections? WIN-WIN??” (Washington Post, Webpage 2013a)

Scandals like the one exemplified, are not an uncommon occurrence. Scandals entailing hazardous working conditions, poor wages, excessive working hours and child labour in factories supplying global brands have been portrayed numerous times in the media. The fact that scandals are constantly being raised testifies that companies are failing to control and improve the working conditions in their supply chains. In connection to these issues, several researchers argue that companies have broadened their responsibilities including not just financial, but also social and environmental responsibilities to a wider span of stakeholders and society, forming the notion of Corporate Social Responsibility (CSR) (e.g., Boyd et al., 2007; Grafström et al., 2008; Halme, 2010; Maon et al., 2010; Waddock & Graves, 1997). According to Locke et al. (2007), in response to increased concern for CSR from stakeholders, such as customers, NGOs and shareholders,

companies with global integrated supply chains have become more concerned about the social issues in the supply chains.

## 1.1 Control and social auditing

To cope with increasing stakeholder pressure and ensuring good labour standards, companies managing their greater responsibility by developing their own codes of conduct (Barrientos & Smith, 2007; Locke et al., 2007; Jenkins, 2001; O'Rourke, 2006; Mamic, 2005; Waddock & Graves, 1997). According to Mamic (2005), these codes of conduct express the companies' view on responsible businesses, labour practices and environmental issues. As a further step, Locke et al. (2007) explain that companies have implemented monitoring mechanisms aiming to reach compliance to their codes of conduct. Today the trend has become so significant that some claim that socially responsible supply chains are a new paradigm (Boyd et al., 2007). However, research show that issues relating to labour conditions and environmental impact in supply chains are often difficult for companies to have direct control over (Roberts, 2003). Nevertheless, several researchers confirm that control, through monitoring, is a common way for companies to cope with social standards, such as issues with working hours, wages and hazardous working conditions, in the supply chains (Gray, 2001; Pruett, 2005; Locke et al., 2007; Coyne, 2006; Owen et al., 2000). Pruett (2005) argues that social auditing is one of the most frequently used monitoring mechanisms. A social audit is described as a monitoring action used to determine and secure supplier compliance with a buying company's code of conduct (e.g., Mamic, 2005; Pruett, 2005; Barrientos & Smith, 2007). In social audits, evidence from interviews, documents and inspections are collected to check supplier compliance to the code of conduct.

### Different types of auditors

Pruett (2005) explains that a whole industry of commercial social auditors, self-assigned experts and non-profit organizations have jumped on the social audit bandwagon. As a result discussions regarding how buyers should audit their suppliers when implementing codes of conduct have gained interest. Questions like how often one should monitor (e.g., Locket et al., 2007), or how the monitoring should be performed (e.g., O'Rourke, 2003; Mamic, 2005; Pruett, 2005) have therefore gained a greater interest in theoretical discussions. Moreover, researchers have criticized the results of social audits, questioning if the auditors can be trusted to make accurate and honest assessment of suppliers' conditions (e.g., Pruett, 2005; Locke et al., 2007).

In line with this criticism, several researchers categorize the social auditors, claiming that different govern structure gives different levels of independence (Locke et al., 2007; Pruett, 2005). The internal auditor is employed by the company that wants to perform audits at the suppliers. This

auditor type has been criticized for not being objective and independent enough since conflicting self-interests are argued to be present when hired by the buyer. This critic highlights the risk that the internal auditor put the company's interests of cost optimization before the labour standards at the supplier (Locke et al., 2007). External and independent auditors refer to third party auditors, called upon by the buyer company to audit its suppliers. According to Locke et al. (2007) the external auditor relates to for-profit audit firms, which according to several researchers often have a business model that conflicts with delivering credible social auditing since they may want to please their clients and suppliers who pay for the services (e.g., O'Rourke, 2003; Pruett, 2005; Locke et al., 2007). With reference to the criticism of internal and external auditors, the so called independent auditor constructed as multi-stakeholder initiatives was set up (Locke et al., 2007; Pruett, 2005).

Related to these categories, a theoretical discussion regarding the optimal type of auditor has flourished (e.g., Locke et al., 2007; Rodriguez-Garavito; 2005; Pruett, 2005; Bendell, 2001). According to Pruett (2005) the independent auditor is preferred since the multi-stakeholder initiative brings together different stakeholders to address social issues and tries to develop a more comprehensive approach to code implementation. This is done through monitoring suppliers and verifications on companies to validate their initiatives taken in regards to bettering the working conditions of their suppliers (Pruett, 2005). Locke et al. (2007) explains that the so called independent auditor is argued to be more objective and independent. The internal auditor, on the other side of the spectrum, is highly criticized by researchers viewing the internal auditor as a function of company self-regulation with little credibility (Amaeshi et al., 2007; Rodriguez-Garavito; 2005; O'Rourke, 2006; Pruett, 2005; Utting, 2001). According to Bendell (2001), the assumption that independence should be important in the first case seems to come from theories constructed on the basis of the financial auditor's role. For instance, Lavin (2001) state that it is important that the financial auditor's estimation is based upon objective opinions, in addition he claims that the independence factor gives value and significance to the produced reports. Bendell (2001) argues that the emerging social audit profession is currently being developed as a neutral test of labour condition. It is stressed by several researchers who critically claim that the ideas developed in the setting of the financial auditor may not be valid for the social auditor since there are fundamental differences between the practices of a financial and a social auditor (Bendell, 2001; O'Dwyer, 2002).

### Existing knowledge gap

With conflicting theory as a background, little is known about the importance of independence in the actual practice of social audits. Further, with high stakeholder requirements and an increasing number of scandals the role of the social auditor calls for further research. Since the internal and independent audit categories presented by Locke et al. (2007) are criticized and praised in relation to the perceived independence relationship between the auditor and the company, and since they are at each end of this spectrum of supposed independence, this study explores these two audit types, hence in this study the role of external auditor is excluded. The effectiveness of social audits has been researched before (Locke et al., 2007), although little is known about how the different auditor types support companies in the work to secure compliance to code of conducts and increase working standards in the supply chains. Therefore, this study address the research question; ***how do the independent and internal social audit types support companies' work with improving social standards in the supply chain?***

We aim to deepen the knowledge about different social audit categories to explore how they support companies in their work with CSR related issues in the supply chains.



## 2. THEORETHICAL FRAMEWORK ON SOCIAL AUDITING

This section presents general ideas with regards to control, since monitoring in the form of auditing can be seen as an act of rational control, in line with Boyd et al. (2007). Further, theories which regards to the buyer-supplier relationship are explored. Then theories relating to the social audit process are described in order to investigate how researchers view the social audit practice. Lastly, we describe prior theories about the area of social and financial auditing to get an understanding of the categorization of the two types of social auditors.

### 2.1 Formal control, trust and collaboration

Boyd et al. (2007) explain that supply chains are vertically coordinated networks of firms that are associated with production and distribution to end customers. The author continue by stating that supply chains improve buying companies' competitive abilities by lowering total costs and provides access to resources and knowledge. Suppliers are seldom owned by the buyer companies, and from a manager perspective one cannot control what one does not own (Boyd et al., 2007). Nonetheless, Jenkins (2001) states that companies try to control many aspects of the production carried out by suppliers over large distances without exercising ownership. Jenkins (2001) and Cheung et al. (2009) argue that because of this, companies are required to take responsibility for suppliers' social conditions. Boyd et al. (2007) develop this observation further by stating that the concern of CSR related issues has driven buyers to increase supplier monitoring.

#### Control and monitoring

According to several researchers the main arguments of implementing social auditing in the supply chain is the perceived need of control (e.g., Boyd et al., 2007; Kok et al., 2001). Owen et al. (2000) argue that social audits as a concept have a strong emphasis on being a useful method when managing organizations. According to Barley and Kunda (1992) prior theories together with practitioners themselves have long had a focus on rational control. Monitoring is one type of rational control that has been highly recommended by researchers who believe that monitoring, as a control mechanism, is the most effective method to minimize the risk of opportunistic behavior (e.g., Jensen & Meckling, 1976; Williamson, 1981). Rational control theories are based on the belief that all employees are potential cheaters who will not follow the proper procedures unless they are monitored (Nilsson, 2005). Several researchers state that these ideas also get support in practice by a lot of companies, NGOs and other stakeholders who emphasize monitoring actions through social auditing in the supply chains (Locke et al., 2007; Pruett, 2005; Mamic, 2005).

## Buyer-supplier relationships

According to Barley and Kunda (1992), since the recent years of 1990s, there has been increased attention on theories of normative control. These normative theories recognize companies as collectives, held together by corporate culture and values of the people in the organizations. In line with this Boyd et al. (2007) state that an increasing number of researchers are questioning the idea of monitoring through social audits as a control mechanism, stating that monitoring can have a negative impact on the buyer-supplier relationship. Boyd et al. (2007) argue that high levels of monitoring can signal distrust which instead can lead to opportunistic behavior and noncompliance to established agreements. As an alternative to monitoring, trust is highlighted as a control mechanism (e.g., Langefield-Smith & Smith, 2003; Handfield & Bechtel, 2002). Langefield-Smith and Smith (2003) define trust as the belief that people are doing what they should be doing and state that trust can be a powerful control mechanism. Connected to the buyer-supplier relationship, Handfield and Bechtel (2002) suggest that if the buyers do not have a great deal of formal control over its suppliers, they should work to increase the level of trust since this can improve the supplier responsiveness towards the buyer. Pedersen and Andersen (2006) similarly state that trust is an effective safeguard even though they claim that trust alone cannot be the only control mechanism used to ensure supplier compliance.

Adam et al. (2005) and Cheung et al. (2009) found in their research that suppliers are interested in establishing partnerships with companies to improve their managing system leading to increased social standards. It is argued by several researchers that a greater emphasis on supplier engagement instead of a rational compliance model facilitates the creation of shared values and understanding in the supply chain, which simplifies implementation of code initiatives and increase labour standards (Mamic, 2005; Cheung et al., 2009; Boyd et al., 2007; Handfield & Bechtel, 2002). A close cooperation between buyer companies and suppliers is also recommended by ILO (2005) in order to improve implementation of codes of conduct. In support, Pedersen and Andersen (2006) argue that increased involvement of, and collaboration with, suppliers has positive impacts on both the buyer-supplier relationship and on the compliance since it builds trust and works as an effective safeguard. In support, Cheung et al. (2009) argue that a buyer-supplier relationship built on collaboration is to prefer, even though they highlight trust as the main drive instead of values and a common understanding.

As an alternative to monitoring, Boyd et al. (2007) suggest that CSR implementation should be characterized by procedural justice, which relates to mutual respect, shared goals, commitment and trust. Boyd et al. (2007) argue that procedural justice together with fairness between the two

parties of buyer and supplier results in a high degree of compliance. In this sense, they argue that the perception of fairness is created in a situation where an individual feel that they have greater control and a voice in the exchange. Moreover, Boyd et al. (2007) argue that having frequent communication, sharing information, being open and giving constant feedback enables a shared vision which may increase collaborative behavior in the supply chain. Thus, instead of rational monitoring systems the normative theories emphasize collaboration, openness, trust building, volunteer actions from suppliers and more partner based relationships in order to increase the level of compliance (Cheung et al., 2009; Boyd et al., 2007; Locke et al., 2007; Handfield & Bechtel, 2002; Adam et al., 2005).

To sum up, the theoretical framework shows that companies as well as practitioners favor the practice of monitoring and social auditing in order to fulfill the need of control. However, since companies often do not own their suppliers there is low formal control, therefore trust and collaboration are presented as alternative control mechanisms. In addition, several authors promote shared values, communication and fairness as effective ways to build buyer-supplier relationships which is argued to improve compliance in the supply chain.

## 2.2 The traditional social audit process

According to several researchers, the social audit process at the supplier factories has been criticized for not being thorough enough and thus failing to discover important factors that lead to improvements of working conditions (e.g., Pruett, 2005; Locke et al., 2007; Adam et al., 2005).

According to Mamic (2005) and Pruett (2005) the traditional audit process, contains three main parts: a physical inspection (factory “walk-through”), a documentation inspection, and interviews with workers. The physical walk-through is used to examine items like for instance; emergency exits, sanitary conditions in toilets and dining facilities, the use of protective equipment and safety guards on machinery. The documentation inspection is examining company records like pay-roll, health and safety documentation and employee records. The audit process of worker interviews main objective is to obtain direct feedback from workers about the conditions. Mamic (2005) research shows that these interviews are important complements to the other audit process parts, since they often provide critical feedback and raise issues that may have been overlooked by the auditors. Pruett (2005) argues that the traditional social audit process parts enables triangulation which he claims is crucial for the quality of the social audit. Further, he claims that triangulation gives the auditor the possibility to cross-check information, which increases the likelihood of finding deviations, thus reporting gives a more truthful picture of the supplier.

### **Criticism of the traditional social audit process**

According to Pruett (2005) one problem that the audit industry has is that it is closed and secretive, which prevents discussion about policies and practices that can lead to possible improvements to the methods used. Several researchers have criticized social audits and their effectiveness (e.g., Pruett, 2005; Locke et al., 2007; Adam et al., 2005; Barrentios & Smith, 2007). Adam et al. (2005) found that employees in companies' compliance departments are dissatisfied with the way social audits are carried out. One reason for this concerned the lack of perspective on data collected and consistent lack of data analysis. Pruett (2005) observed several limitations of the social audit practice, stating that social audits usually are too short, superficial and sloppy to actually identify certain types of code violations, such as discrimination. Moreover, Pruett (2005) explains that the legal minimum wage is one of the standards to audit against; even though it is commonly known that the minimum wage is too low for workers to meet their basic needs.

Several researchers argue that the traditional social audit process needs to be developed in order to ensure a higher quality of auditing (e.g., Mamic, 2005; Pruett, 2005; Locke et al., 2007; Adam et al., 2005; Barrentios & Smith, 2007). In relation, Pruett (2005) conclude that traditional social audits cannot produce change by them self, they only produce a checklist that needs to be remediated. This statement is supported by Adam et al. (2005) acknowledging that most audit practices focus on controlling and verifying separate factors and tend to leave out the analysis of the reasons behind the issues. This is in line with Pruett's (2005) findings that audits are often not followed-up on properly and improvements at the factory workplace often tend to be superficial.

### **Beyond the traditional social audit process**

Instead of the more traditional approach, several researchers suggest that a more overreaching social audit process should be adopted (e.g., Pruett, 2005; Mamic, 2005; Locke et al., 2007; Adam et al., 2005; Barrentios & Smith, 2007). In line with the researchers' statements, certain factors are stated to improve companies' social auditing practices, including; conducting unannounced visits, enhancing the worker interviews; implementation of complaints system, involving local stakeholders and effective follow-up processes.

### **Conducting unannounced visits**

According to Pruett (2005), fraud is a major problem in the area of social audits, falsified records such as payroll documents, time cards and double book-keeping, as well as coaching workers to convey false or incomplete information before interviews thus undermining the interview process is a common practice. Both Pruett (2005) and Mamic (2005) express that announced visits increases the risk that the supplier management have time to prepare a too positive picture of the

factory thus conveying false impressions of the working conditions. Pruett (2005) argues that unannounced visits give the auditors a chance to identify problems without supplier management trying to hide the issues beforehand.

However, Pruett (2005) acknowledges that there are different views on whether the audits should be announced or unannounced. Further, he argues that most auditors tell the factories in advance when they are coming so that the right managers will be available and relevant documents accessible. This is supported by Adam et al. (2005) who argues that unannounced visits often lead to incomplete information because of missing documentation. In addition both Pruett (2005) and Adam et al. (2005) highlight the risk of non-present factory management during unannounced audits. Another argument put forth by Pruett (2005) is the possibility that companies do not want to jeopardize the relationship with their suppliers who often view unannounced visits as impolite and inappropriate. Nevertheless, Pruett (2005) continues by stressing that a more advanced approach is to have the initial audit announced while the follow-up visit is unannounced.

### ***Enhancing worker interviews***

Adam et al. (2005) explain that workers can feel uncomfortable sharing information about the factory's working conditions. In regards, Pruett (2005) states that workers are often prepared beforehand. To ensure that the workers are more open during interviews, he argues that the interviews should be held outside of the workplace. Further, he claims that workers are often poorly informed about their rights in the first place, making them afraid of losing their jobs. Pruett (2005) argues that education about the rights of workers is an effective way to resolve these issues. According to Mamic (2005), the optimal audit result was obtained when the managers were not involved in the selection process and the workers were given absolute confidentiality when interviewed.

### ***Complaints mechanisms at the supplier factory***

Pruett (2005) argues that another step towards improving working conditions in the supply chain is to make sure that workers in the factories are able to leave complaints. According to Pruett (2005) it is common that workers are not offered the possibility to file complaints about the conditions at the factory. Even though some factories have implemented suggestion boxes, Pruett (2005) criticizes that these boxes are seen by supplier management as an easy way to score points in the social audit. Therefore, he encourages the implementation of a grievance or complaint system at both supplier and buyer level. According to Ascoly and Zeldenrust (2003) the implementation of a whistle-blower structure can function as a safeguard for workers'

interest. Moreover, they argue that the complaint mechanism could be used as a tool to facilitate and increase the level of participation from the factory workers.

### *Involvement of local stakeholders in the social audits*

Another criticism to the traditional social audit is posed by Pruett (2005) who argues that local stakeholders outside of the factory such as trade unions and labour NGOs are seldom consulted. With involvement of local stakeholders, Pruett (2005) claims that the social auditing is more effective since stakeholders like NGOs can help the auditor by providing a more accurate picture of local issues. Besides that, both Pruett (2005) O'Rourke (2006) claim that implementation of labour standards are most effective when NGOs are involved.

### *Effective follow-up processes*

As stated by Mamic (2005) the social audit process in itself rarely leads to changes in factories' working conditions, rather it is the action related to the follow up work that has the potential to improve compliance to the code of conduct. The use of corrective action plans (CAP) is a common complement to the code of conduct (Mamic, 2005; O'Rourke, 2006; Coyne, 2006; Pruett, 2005) The CAP, which consists of specific recommendations on what is needed to change, is often generally agreed upon by the supplier and the auditor after the social audit visit is done (Mamic, 2005; Pruett, 2005). According to Mamic (2005) the CAP can function as a support and consulting process rather than as a regulation procedure if it is developed by both parties and followed up properly. The stated benefits of such an approach are argued by Mamic (2005) to include both improved supplier compliance and better relations with the supplier.

According to several researchers, another action to consider in the audit process is to address and evaluate existing business or purchasing practices of the buying company (Pruett, 2005; Locke et al., 2007; Mamic, 2005; Welford & Frost, 2006). Barrentios and Smith (2007) state that a company's own buying systems with sometimes short lead times has an adverse effect on factories' labour standards. Locke et al. (2007) argue that evaluating companies own purchase systems can aid the supplier to be able to schedule their workload and as a result avoiding excessive overtime.

To sum up, the quality of the audit report is dependent on the auditor's ability to triangulate information gathered in the traditional audit process. Also, beyond traditional auditing, the auditor's ability to gather true insights of the social standards impacts the probability of a qualitative report. In this work interview structure, unannounced visits, compliant mechanisms, involvement of different stakeholders and effective follow-up actions are crucial.

### 2.3 Internal and independent auditors

The internal auditor type that is hired by the buying company has been criticized for not being objective enough and having self-interests to not report on the violations in the supply chain (Locke et al., 2007). According to Antle (1984) self-interest relates to the risk that auditors cooperate with company managers to primarily pursue the managers' interests. In response, multi-stakeholder initiatives have been set up, which according to Locke et al. (2007) are categorized as independent auditors. Jenkins (2001) argues that without an independent verification it becomes difficult to evaluate if a company are applying codes extensively or if it is only an expression of good intentions, since he argues that independence is required if an auditor is to provide valid and qualitative reports. In this way Pruett (2005) states that an independent auditor works to increase accountability toward the civil society.

Utting (2001) explains that the independent auditor involve different stakeholders like NGOs that encourage companies to participate in monitoring practices, promote social reporting, auditing and stakeholder dialogue. Moreover, Utting (2001) argues that the independent auditor type has attempted to address some of the weaknesses of codes of conduct and social auditing associated with corporate self-regulation by creating a more overreaching system. Rasche (2012) explains that the independent auditors often have a soft law approach and although it is voluntary for companies to join the initiatives, participants are expected to comply with the stated rules. It is stated that the independent auditor either certifies or employs its own auditors to minimize the dependency problem, strengthen transparency and accountability of auditors (Locke et al., 2007; Pruett, 2005).

However, both Utting (2001) and O'Rourke (2006) explain that the complexity of the area poses some difficulties for these initiatives. For instance, large companies often sources from thousands of suppliers and often move quickly between factories and that hides between several layers of ownership making systematic inspections difficult. In support, Rasche (2012) discusses that the initiatives need to be better at coordinating activities in order to be able to address problems in an organized way. O'Rourke (2006) criticize the independent monitoring by claiming that factory visits often are too infrequent to evaluate the normal day-to-day practice. Even though independent auditors are advocated by Pruett (2005), he argues that third-party auditors tend to lack the knowhow to address the important issue of good relations between the buyer and supplier. He claim that companies tend to spend less and less time in following up the work with social compliance at the suppliers, and instead over rely on third-party auditors, such as independent auditors. Pruett (2005) states that, if companies only rely on third party auditors to



carry out social audits and follow up work instead of using their own compliance staff, companies are failing to build the relationship needed that improves compliance. This critic about lack of ability to facilitate relationship and infrequent visits can be supported by Adam et al. (2005) findings that third party auditors find less non-compliance than companies own compliance staff.

### **The independence factor of the two auditor types**

The different categories of auditors, independent and internal, are argued to be divided depending on their perceived independence from the company (Locke et al., 2007). Coyne (2006) argues that social auditing arose from activities based on the traditional criteria of financial reporting. This gets support by Bendell (2001) who discusses the theoretical field's fondness of the independence factor to the auditor and claims that social auditors are often looked upon through theoretical perspectives grounded in the setting of financial auditing. According to Lavin (2001) financial auditors are called upon to attest statements made from companies and safeguard the interest of various external stakeholders, who are entitled to a fair and impartial report of the company. In relation to financial auditing, Lavin (2001) argues that the independence factor of the financial auditor gives value and significance to the financial statements.

Power (1997) state that: "There is a deeply held view that without independence, audit has no value" (cited in Page & Spira, 2005, p. 303). Even though the independence is viewed as a vital factor in auditing, it has been acknowledged by Bazerman et al. (2002) that total independence is impossible to achieve. When studying independence, Jenkins (2001) argues that even where there is a commitment in principle to independent monitoring, different stakeholders may differ over what they consider independent. According to Antle (1984), the key aspect for promoting independence is the risk of self-interest and moral hazards on the auditor's part. In this sense, he argues that independence decreases the risk of unmoral auditors giving an untruthful picture of companies' performance. In relation to the social auditor, the risk of unmoral behavior is connected to if the interest of profit-maximization of a buying company is prioritized, making social auditors overlook non-compliance in the supply chain (Locke et al., 2007). To act morally and thereby be able to produce accurate reports, Lavin (2001) state that it is important that the financial auditor's opinion is based upon objective and disinterested viewpoints, therefore relationship between the auditor and the target for the audit cannot be too close. This relates to Page and Spira's (2005, p. 311) definition of independence: "Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired".



Bendell (2001) argues that prior theory, which claims that objectivity is a crucial factor in the social audit practice, should be questioned. To develop this reasoning, Bendell (2001) explains that social audit has a different methodological approach than financial audits. According to Bendell (2001) and O'Dwyer (2000) the financial auditor primarily look at hard facts like numbers produced by accounting systems while social auditors investigate more non-financial and qualitative areas like social relations. Further Bendell (2001) states that the notion, that there would be objective evidence that can be interpreted by an objective auditor should be challenged. Bendell (2001) explains that objectivity is favored in the inspection industry since it is considered unprofessional to give advice. Concluding, he claims that the idea of neutral testing is illogical and undesirable in the social audit setting, stating that "workplace appraisals should be about change, not about more bureaucracy" (Bendell, 2001, p. 25).

Summarizing, the audit types in this study are categorized based on the belief of different levels of independence, which is argued to be crucial for valid statements and reports. Furthermore, researchers' criticize the notion of the objective auditor claiming that the fondness of independence, correlated to the independent social auditor, comes from theories regarding financial auditing, which is argued not to suit the social auditors setting.

### 3. METHOD

This study seeks to get a deeper understanding of a complex phenomenon by looking at how the two auditor types support companies' work to improve social standards in the supply chains. Patel and Davidson (2003) argue that a qualitative method is preferred when the goal is to understand a complex phenomenon since it then is important to pay close attention to organizational context and leave room for interpretations. Accordingly, this study draws upon a qualitative approach, investigating the categorization of social auditors by examine and comparing two cases with different auditor types. In regards, Eisenhardt and Graebner (2007) claim that a small number of cases provide the opportunity of describing a phenomenon in depth. However, in critic to our method, Eisenhardt and Graebner (2007) state that a multiple-case study provide a more robust, generalizable and testable theory.

#### 3.1 Sampling the cases

To answer our research question this study draws knowledge from two cases with different social audit structures; Filippa K, that operates within the textile industry and Axfood, active within the food industry. According to Eisenhardt and Graebner (2007) when the study is aiming to get a deeper understanding of a phenomenon and not to test it, theoretical sampling is appropriate, meaning that cases are selected because they highlight the area of interest.

#### The two cases - background information

Axfood and Filippa K belong to the same family-owned company, Axel Johnson AB Group (Axel Johnson Group Annual Report, 2011). Both Axfood and Filippa K are active within the retail market and have their main market in Sweden. Some obvious differences between the two companies are industries and size. Axfood operates within the food retail market with a market share of 20 percent in Sweden and had in 2011 a turnover of 6 365 million SEK. Retail business is conducted through the wholly owned Willys, Hemköp and PrisXtra chains with 246 stores and about 840 proprietor-run stores (Axfood Annual and Sustainability Report, 2011). Axfood is listed on Nasdaq OMX Stockholm AB's Large Cap list, with 50.1 percent of the shares Axel Johnson AB is the principal owner (Axfood Sustainability Report, 2012). In comparison, Filippa K is a medium sized company within the textile retail market with a turnover of 524 million SEK. Filippa K is a partly owned subsidiary of Novax (55 percent) an investment company, owned by Axel Johnson AB Group (Axel Johnson Group Annual Report, 2011). Retail business is conducted through 45 wholly owned stores and 740 resellers at seven markets (Filippa K Annual Report, 2011).

### Complex and global supply chains

Another difference is the number of suppliers used by the two companies, despite this both companies meets similar problems since both purchase through long, complex and global supply chains. Filippa K's suppliers are geographically spread within the two regions of Europe and Asia. When looking at Filippa K's purchases from 2012, 67 percent of the purchase volumes were from European suppliers and the remaining 33 percent were from suppliers in Asia. The suppliers of Axfood's private label products are geographically spread ranging from several continents, however, most of the suppliers are located in Europe (88 percent), representing 2 334 suppliers and Asia (10.6 percent) representing 281 suppliers (Axfood Sustainability Report, 2012). A similarity between the two companies is that both companies only perform social audits in, what they perceive as, countries with a higher risk of low social standards, such as China.

### Two different social audit types

Filippa K has been a member in the multi-stakeholder initiative, Fair Wear Foundation (FWF) since 2008, which is categorized by researchers as an independent auditor (e.g., Pruett, 2005; Locke et al., 2007). FWF states that they are a member-based, independent, non-profit organization with the mission to improve labor conditions for workers in sewing factories (FWF Document, 2013a). FWF is based in Amsterdam, Holland and is active in 15 production countries in the regions Asia, Europe and Africa (FWF Webpage, 2013b). Besides Filippa K, FWF have about 90 member companies (FWF Webpage, 2013b). As a member of FWF, Filippa K pays a percentage of the turnover each year and if Filippa K wants FWF to perform a social audit, this comes at an additional cost.

Axfood perform its social audits internally, through what Locke et al. (2007) categorize as an internal social auditor. According to the CSR Project Manager (hereafter CSR Manager) of Axfood the main reason for hiring an internal auditor was to lower costs and benefit from economy of scale. The internal auditor was hired to Axfood's Shanghai office in 2011. Even though Axfood use external auditors and FWF perform audits for Filippa K in other risk countries, this study focus on the internal auditor and independent auditors in China. Hence, as explained earlier this study focus its investigation by looking at the independent and internal auditor type, leaving the categorization of external auditor out.

Company	Main Owners	Country of origin	Industry	Size	Turnover (2011)	Auditing	Social Auditor
<b>Filippa K</b>	Axel Johnsson 55%	Sweden	Retail/ Textile	Medium sized	524 million SEK	Risk countries	Independent (MSI)
<b>Axfood</b>	Axel Johnsson 50,1%	Sweden	Retail/ Food	Large sized	6 365 million SEK	Risk countries	Internal

*Table 1 - Differences and similarities between Filippa K and Axfood*

### The codes of conduct of the two companies

In order to evaluate the basis for the two companies' social audits, the codes of conduct have been investigated. Since the study focuses on social audit categorization it is essential to choose a sample with similar codes of conduct as a basis for the social auditing, but with different auditing structures. Filippa K implemented their code of conduct in 2000 and Axfood in 2004. When comparing the two companies' codes of conduct and FWFs code of labour practice some similarities and differences are found (see Table 2.)

As a similarity, all the codes are based on the UN Declaration of human rights and the ILO conventions, also both companies expect that their suppliers and sub-suppliers comply with the stated codes. When it comes to wages, ILO aligns with local legislations and requires legal minimum wage. A difference is that Filippa K and FWF incorporate living wages<sup>1</sup> in their codes of conduct while Axfood require legal minimum wage. The main differences between the codes are found when looking on the paragraphs that go beyond the UN Declaration of human rights and the ILO conventions. Axfood's code of conduct has a greater emphasize on local legislation, animal welfare, local community and the suppliers' management systems. While Filippa K's code of conduct has a greater emphasize on education of workers and chemicals. However, initial interviews with the companies' revealed that the social audits focus mainly on the ILO conventions.

There are some differences in how the two companies enforce their codes of conduct towards the suppliers. In case of low compliance, Axfood states that the suppliers will be given time to develop, however several violations of their code of conduct will lead to termination of the relationship. In contrast, Filippa K encourage supplier development in case of low compliance

<sup>1</sup> A living wage means that: "wages earned for regular hours worked (i.e. no more than 48 hours) are sufficient for the worker and his/her dependents to feed, clothe and house themselves, overtime should not be needed to generate a subsistence wage" (Bendell, 2001, p. 10).

and state that action will be taken if there are several violations. However, it is not entirely clear what these actions are. In addition, both Filippa K and Axfood try to extend their codes of conduct downward in the supply chain requiring suppliers to have similar demands on subcontractors and sub-suppliers.

	Content of the Codes of Conduct	Filippa K	FWF	Axfood
ILO CONVENTIONS	No forced labour	X	X	X
	No discrimination	X	X	X
	No child labour	X	X	X
	Freedom of association and collective bargaining	X	X	X
	Legal minimum wage	Payment of living wage	Payment of living wage	Minimum wage
	Working hours	X	X	X
	Health and safety	X	X	X
	Safe employment	X	X	X
	Management system	Environmental system at supplier	Verify both company and supplier system	Supplier management system, Environmental system at supplier
	Environment	Follow environment legislation Follow chemical restriction list	-	Follow environment legislation
	Bribery and corruption	X	-	X
	Harsh or inhumane treatment	X	-	X
	Compliance issues	X	-	X
	Education of staff	X	-	-
	Legal requirements	-	-	X
	Use of resources and impact on local community	-	-	X
	Animal welfare	-	-	X

Table 2- A comparison of Codes of Conduct.

Summarizing, the companies have the same main owner, operates in Sweden and conduct social audits in what they perceive as risk countries. Further, both companies sell consumer goods and are active in the retail industry. Obvious differences can be seen in the industry, size and number of suppliers which can have implications on this study. Even though there are some obvious differences between the two companies the basis for the social audits, namely the companies' codes of conduct, are almost equal to each other since both are based on the ILO conventions.

### **Gaining access to the two companies**

Saunders et al. (2009) explain that one of the most difficult obstacles for researchers to overcome is getting access within the organization. As one of us did a five months internship at Filippa K, research access to this company was not a major problem for this study. Saunders et al. (2009) argue that having an insider perspective gives advantage of initial knowledge and understanding of the company. However, familiarity can also bring some disadvantages such as preconception and presumptions, thus the credibility and objectivity of the study might be threatened (Saunders et al., 2009). To reduce this threat, this study is not correlated with previous internship assignments and the research subject was identified without the company's involvement. Moreover, since one of us does not have an insider perspective it helped balancing the familiarity issues as well as keeping a more objective viewpoint.

In order to gain access existing contacts with the two companies was used. According to Saunders et al. (2009), when existing contacts have previous knowledge of the researchers it often leads to increased trust for researchers stated intentions, which facilitates information sharing. We believe that this has helped us since large parts of the data provided by the companies are considered sensitive and confidential. To further secure information sharing the two companies were given the opportunity to read through the research material before publishing, although no information has been changed.

### **3.2 Sampling of respondents**

This study draws on what Befring (2008) calls a subjective selection method, thus respondents have been selected from specific positions with importance for the study. In order to get an understanding of the two companies' social audit structures the interviews conducted focused on three different types of employees; purchasing employees, employees within the CSR departments and the social auditors associated to the two companies. In addition, we aimed to schedule an appointment with Axfood Environmental Manager, but it did not fall through. In total nine interviews were conducted, which we found sufficient since respondents in the end gave similar information.

Before scheduling the interviews we asked some introductory questions about the two companies' structure, to get an understanding of which roles we needed to target. Three different target groups were identified: (1) the purchasing employees who are the suppliers direct contact and customer. Since they "sit on the money" they are powerful players in the relationship towards the suppliers, (2) the CSR Management accountable for the structure of the social auditing process, and (3) the auditors who perform the social auditing.

	<b>Purchasing</b>	<b>CSR Management</b>	<b>Auditor</b>
<b>Filippa K</b>	3 interviews	CSR Manager	-
<b>FWF</b>	-	-	1 interview with auditor 1 interview with International Verification Coordinator
<b>Axfood</b>	1 interview	CSR Manager	1 interview

Table 3- Conducted interviews.

### **Purchasing department**

Interviews with purchasing personnel were held to get an understanding of their role in the social auditing process. We wanted to answer questions like: How do they work with follow-ups and are they accountable for the improvements?

The number of interviews differs between the two companies since we felt the need to conduct more interviews with the purchasing personnel at Filippa K than at Axfood since the purchase personnel at Filippa K had a greater responsibility in the social audit work, by being main responsible for the follow-up processes. In contrast, the CSR Manager and the internal social auditor of Axfood are mainly responsible for the follow-up process at their suppliers.

### **CSR Management**

Interviews were conducted with the CSR Managers at both Filippa K and Axfood, to get a holistic view of the motives that drove the companies to choose the current social audit structure. We wanted to learn more about the idea behind the structure. In Axfood's case, the CSR Manager is also directly involved in the ongoing audit work. Therefore, the interview also circulated around the CSR Managers responsibility and work within the audit process.

### **Social Auditor**

Two different respondents within FWF were interviewed, one social auditor who perform most of Filippa K's audits in China and one International Verification Coordinator who is Filippa K's main contact person. In the case of Axfood, the internal social auditor in China was interviewed. These interviews were conducted in order to get an understanding of how the auditors conduct

the audits, what other tasks they may have and what kind of relationship they have with the company and the suppliers.

### 3.3 Data collection

This study takes an abductive approach; the theoretical framework was developed throughout the study by going back and forth between data collection and relevant theory on the topic. In line with this, Felizer (2009) suggests that moving back and forth between the data sets and theory enables the researcher to interpret the data from several perspectives and to discover unexpected events. The data collected consisted of both interviews, external and internal documents, and connects to the three main angel's bury-supplier relationships, audit processes and independence, from the theoretical framework.

#### *Interviews*

The interviews were conducted during a two month period and all interviews with the companies were performed face-to-face. Further, they were recorded and transcribed to give the respondent full attention as well as making it possible for us to go back to the interview material to review and analyze it. Since the social auditors were located in China and the Netherlands the interviews were conducted via telephone and skype conversations along with email correspondence.

To get a flexible interview structure that allows exploration of different ideas and momentums of the discussion, semi-structured interviews were used. Alvesson and Deetz (2000) advice researchers to have high adaptability during interviews, the semi-structured interview gives flexibility to react when new ideas and reflections occurs. However, Saunders et al. (2009) describe that lack of standardization in semi-structured interviews can lead to interviewer or response bias, the use of open questions reduce this risk. Therefore, we tried to formulate interview questions openly around specific predetermined themes relevant to our theory. Overtime the themes and questions were shaped around specific organizational contexts relating to the research question and the two case companies. The questions dealt with; the role of social auditors, how the audit was performed, relationship between social auditor and the company and the companies follow up processes.

#### *Documents*

Both Axfood and FWF communicate externally; information from external documents used in the study can be found at the webpage's of the two companies. The documents used in Axfood case consists of the code of conduct, general information about the company and the company's strategies. The information from FWF's external documents regarded their practices, country



assessments and member company performance reports (Management System reports), strategy and general information about the organization.

The internal documents consisted of Filippa K's code of conduct, documents regarding suppliers, internal communication and supplier questionnaires. Also several audit reports, which are confidential, from both Filippa K and Axfood were examined. In Axfood's case eight audit reports and six corrective action plans were examined. The origin of the reports ranged from year 2007 to 2012 and there was a mix of reports both from the internal auditor in China and external audit reports from China and other countries. In Filippa K's case, nine audit reports and seven corrective action plans performed by FWF in China were examined, all ranging from year 2008 to 2013. The audit reports have been used together with interviews and other documents.

### Data analysis

The collection of data and the development of the analysis were conducted through an iterative process, which according to Eisenhardt (1989) means constantly comparing the theory against the data in order to achieve a high fit which is important to yield an empirically valid theory. Furthermore, in an iterative process researchers often move between steps of collecting data, to redefining the research question and then back again gathering evidence from cases. This approach suited this study well since it takes on a complex phenomenon that needed to be analyzed thoroughly over time. To answer our research question we looked at differences and similarities between the internal and independent auditor based on the main topics presented in our theoretical framework, namely the buyer-supplier relationship, the audit processes and the independence factor. First, we explore the different auditor types connected to the buyer-supplier relationship to see how and if the two categories supports a collaborative relationship structure. Thereafter, the audit processes were studied to determine the two auditor's ability to support the companies with accurate and high-quality report of the working conditions at the supplier. Lastly, the independence factor of the two auditors connected to the audit processes and structure are studied in order to examine the independence factor connected to the auditors' categorizations.

To get insight into the two different audit structures and audit types, detailed case study write-ups were performed for each case. Eisenhardt (1989) argues that within-case analysis where data is structured, described and sketched-up often gives clarity and helps to cope with gathered data. In line with Eisenhardt (1989) we mapped up the social auditing structure of the two companies and auditor types separately followed by a cross-case comparisons to reveal differences and similarities between the cases.

### **Delimitations of the study**

This study takes on a company perspective and limits the reasoning by looking at how the auditor types can support the companies, inevitable assuming that companies want to improve the social standards. However, this may not always be the case which many theories in the area of legitimacy and transparency highlight. Assuming that companies want to improve the standards in the supply chain, theories regarding transparency and legitimacy connected to the social audit area has been excluded in the study.

## 4. FILIPPA K AND AXFOOD - A DESCRIPTION OF DIFFERENT SOCIAL AUDIT PRACTICES

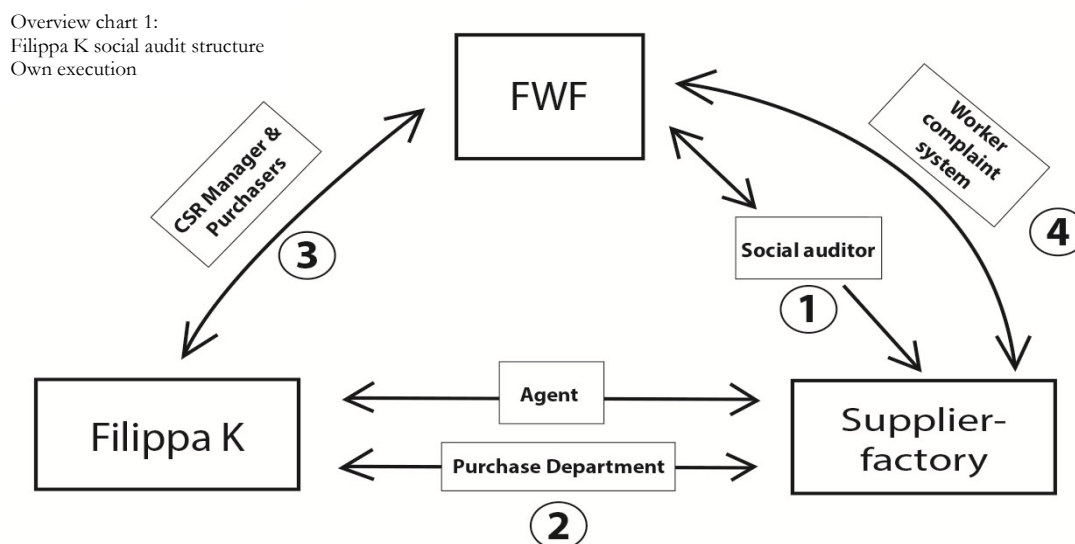
In this section, the structure of the two companies' social audits is illustrated to reveal the relationship pattern between the companies, auditors and suppliers. Then the social audit process of the two auditors is explained. Lastly, some issues that the social auditors meet during the audits are described.

### 4.1 The social audit structure of the two companies

In the following paragraphs the two companies' social structures are described. Since Filippa K have decided to work together with an independent auditor type while Axfood works with an internal auditor, the structures looks fairly different. Because of this difference we have decided to describe the two companies' social structure separate.

#### The audit structure at Filippa K

To get an overview of Filippa K's and Axfood's social audit structures two charts have been illustrated showing the relationship between the companies, their supplier factories and the social auditors' relating to the specific setting each company is in. Overview chart 1 shows the social audit structure of Filippa K.



#### (1): The social auditor's relationship to suppliers

The auditors who perform the social audits at Filippa K's supplier factories are hired locally by FWF. FWF requires Filippa K to audit sewing suppliers that together stands for 90 percent of the

company's purchasing volume in what is categorized as a risk country. According to purchase personnel at Filippa K, suppliers get chosen for social audits based on the purchase volume, if it is located in a risk country or if it is time to do a re-audit. In addition, if the supplier is considered important and if Filippa K is interested in a more long term relationship with the supplier a social audit is initiated.

The FWF auditor explains that Filippa K is responsible for initiating the audit, the auditor then confirms the schedule between the factory and Filippa K. After the audit is performed, the audit team sits down with the factory management, during an exit meeting, and goes through the audit findings and discusses what needs to be addressed. The aim of the meeting is to reach an agreement in regards to actions that needs to be taken and what timeframe is appropriate with the management. After the social audit report is written by the audit team and confirmed by FWF Verification Coordinator in Amsterdam, it is up to Filippa K to work with their suppliers on improvements regarding the labour standards based on the social audit report and the recommendations given in the corrective action plan. After three years, the FWF audit team comes back to the factory to make a new audit. Besides auditing, respondents at FWF and Filippa K explains that FWF recently started their own initiative to perform trainings at the suppliers to raise awareness among managers and workers about workplace standards and effective methods for communicating about problems in the workplace. Further contact between the auditor and the suppliers can go through the compliant system used by FWF (further discussed in nr 4).

To be able to require improvement of both the suppliers and Filippa K, FWF try to stay impartial and independent working for the factory workers' rights. In line with this, the audit reports show that FWF always ask the suppliers about their opinion regarding Filippa K's purchasing structure, to highlight what Filippa K can enhance to simplify improvements. According to the Verification Coordinator of FWF, it is important that there can be a shared responsibility between companies and their factories. In relation, respondents at Filippa K claim that FWF is a value driven organization that looks after the interests of the factory workers.

## **(2): The purchasing department's relationship with suppliers**

According to the respondents at Filippa K, the company wants to visit the supplier factories each year, both for purchasing reasons and to work with follow-ups. Further, the respondents claim that they try to be a part of the social audits as often as possible. Filippa K's CSR Manager argues that it is important for the purchase personnel to participate in a social audit. Otherwise, it is hard to get an understanding of the suppliers' situation just by reading a report. Also, FWFs auditor

explains that it is very effective to have a representative from Filippa K during the audits since it helps to convince the supplier managers that working conditions are of importance. Furthermore, he claims that the problem solving becomes more effective when a company representative is present. The FWFs social audit reports show that only two of the four respondents interviewed at Filippa K have accompanied a social audit so far. Besides audits, the FWF Verification Coordinator commends Filippa K's purchasers who work with training and educations at some of their suppliers. She states that supplier training is an effective way to increase awareness that can help dealing with more complex issues.

According to the social audit reports and interviews with Filippa K, the responsibility for the action plan and follow-up work with suppliers is sometimes projected on to trusted agents. In critic to this, FWF Verification Coordinator argues that the use of agents implies obstacles for the improvement work since agents' personal interest and education becomes crucial. Furthermore, the FWF Verification Coordinator argues that Filippa K needs to have more contact with the factories, since they now sometimes talk with the agent instead of the factory directly. Contradicting, Filippa K's CSR Manager explains that the agents are vital for the improvement work since they have local presence.

In the audit practice of Filippa K, the purchasers are responsible for the follow-ups of the action plans that are performed together with FWF and the suppliers. Since they became members in FWF "the collaboration with the supplier has not really changed that much, but we have gained better control" (Filippa K, Purchaser interview, 2013). The purchase employees explain that they often are not surprised if FWF finds problems with the working conditions, this is something that they claim to have a feeling about beforehand, because of strong relationships with their suppliers.

### **(3): The CSR Manager's and purchasing department's relationship to the auditor**

Before Filippa K became a member in FWF they felt that they needed further support to increase their knowledge about CSR issues. Filippa K felt that FWF was serious and put meaningful demands on the member companies. "And besides, they [FWF] have after all, focused on the textile industry which is also an advantage; that you know the industry that you monitor." (Filippa K, CSR Manager interview, 2013). One respondent state that Filippa K was very dissatisfied with FWF in the beginning, since a Dutch inexperienced audit team was sent to Filippa K's suppliers. However, the respondent further explains that since then, FWF has improved and now uses knowledgeable auditors in the audit team. Nevertheless, Filippa K have requested more support

in the Management System report (2009), as they felt that FWF could guide them more in their work with code related issues. Today, the respondents at Filippa K seem pleased with FWFs work and the support that they provide. Filippa K's CSR Manager expresses that the relationship with FWF has influenced Filippa K's work in a positive way, both because of training and because of the fact that FWF puts demands on Filippa K. The CSR Manager further explains that demands are helpful, especially in times of high workload. The FWF Verification Coordinator describes Filippa K as an open and collaborative member, and shows progress in their work with systematizing the compliance work.

According to Filippa K's purchasers, if they are not present during the factory audits, the communication with FWF is limited to audit scheduling. Besides social audits, FWF conduct a company performance check-up each year, testing if Filippa K is working with the issues in the supply chain in a structured way. During performance checks, FWF review Filippa K's documentation, interview staff, and look over the company systems. Recommendations and requirements for improvement are then provided, aimed to assist Filippa K in shaping their compliance plan for the coming year. FWFs findings from these brand performance checks are then published in a Management System Audit report on their webpage. FWF claim that they are able to give independent verification since their board consist of multiple stakeholders and the organization is not allowed to be funded by companies more than 50 percent. That, according to FWFs Verification Coordinator, makes them in control of their own opinion about the company's and their suppliers' performance.

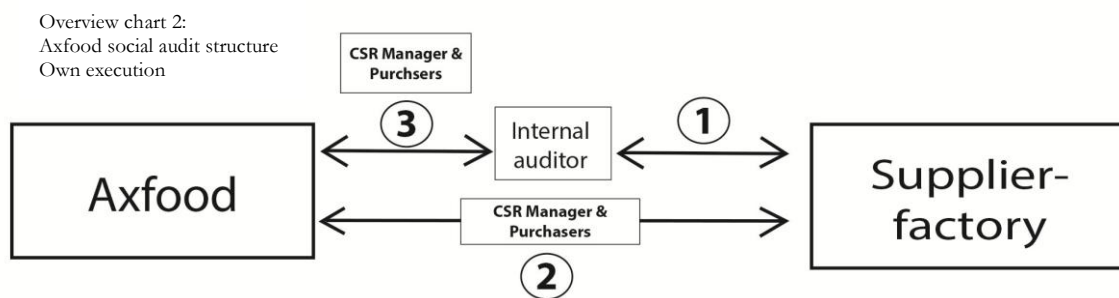
#### **(4): The compliant system between FWF and the suppliers**

In addition to the social audit and follow up work, FWF offers factory workers a local complaint hotline as an extension to the monitoring. The FWF auditor in China explains that after the audit they normally do not have any more contact with the factory. Workers are primarily encouraged to use the factory's internal grievance system, but if the factories are unable or unwilling to address the complaints, workers are free to contact the complaint hotline for help. In 2009, Filippa K received a complaint via FWFs complaint hotline from a worker at one of the Chinese suppliers. Filippa K's Management System Audit reports (2009, 2011), show that the complaint dealt with issues regarding false wage records. An action plan was set up, but the supplier was not willing to accept the improvement plan even though both Filippa K and the agent tried to discuss the issue with the supplier. According to the report from 2011, the issue was not yet solved despite a "constructive dialogue" with the factory management.

According to the CSR Manager, this inability to solve the worker complaint impacted the relationship between FWF and Filippa K, which can be seen in one of the Management System report (2009), where FWF explains that the communication between them and Filippa K had been unclear and that expectations from both sides needed to be clarified. Also, Filippa K comment the issue by suggesting that FWF should offer more training, support and advice to their members when complaints are not solved (Management System Audit Report, 2009, 2011).

### The audit structure at Axfood

The overview chart 2 of Axfood shows the audit structure between the company, its internal social auditor and the supplier factories in China.



#### (1): The internal auditor's relationship with the suppliers

The internal auditor conducts social audits at Axfood's suppliers in China. Besides performing the audits, the internal auditor together with her colleagues in Sweden decides which suppliers that are prioritized for an audit. The internal auditor explains that she together with her Swedish colleagues at Axfood has developed a classification system for identifying which factories to prioritize. Factories that are prioritized are for instance industries with hazardous production, factories with more than 300 workers and industries with media focus such as textile production. Axfood might change some of their suppliers' year by year, but the internal auditor explains that if the factories seem to be long-lived, have good prices and are active within a risky industry, then the factory will be prioritized for an audit. The internal auditor explains that she inspects around two or three factories each month. In 2012, out of the roughly 280 suppliers, 21 factories were audited in China (Axfood Annual Report, 2012).

Axfood's CSR Manager claims that the internal auditor is very self-propelled and states that she is "very autonomous and self-sustaining...and is able to make her own decision in her work". The internal auditor plans, schedules and performs all audits by herself. Before she schedules the audit with the factory Axfood's purchasers are informed. When the internal auditor has performed an audit, she initiates a discussion with the factory management about their non-compliance issues.

The internal auditor claims that she do not tell the factories what they should do instead she state that it is important that the factories themselves decide how to deal with the non-compliance issues. However, sometimes the internal auditor gives overall suggestions and advice to the factories. After this discussion the internal auditor writes an audit report, highlighting areas of improvements and non-compliance, after the CSR Managers approval it is sent to the suppliers. The management then has about two weeks to decide and plan improvements. Thereafter, the suppliers send the action plan back to the internal auditor who evaluates it and give feedback directly to the factories.

After an audit, the internal auditor is partly responsible for the follow-up work. The internal auditor may return to make a re-audit in about 6-12 months, depending on how much non-compliance issues found at the initial audit. The highest number of visits the internal auditor made at a single supplier factory is around four to five visits. In addition, the purchaser explains that if the internal auditor does not see any steps of improvements after several re-audits, she sometimes advice the purchasers to switch to another supplier instead of continuing with the audits. The internal auditor comments her strengths when working with suppliers improvements; “They know that I won’t give up, I am stubborn”.

The internal auditor explains that the relationship with the suppliers, that gets audited repeatedly, gets more intense as they get to know each other. However, she is also careful to point out that the conversations are always focused on business. Additionally, she explains that she gives suggestions to suppliers on what they can improve which she argues are often much appreciated. The internal auditor explains that suppliers are already quite cooperative from the beginning and stronger relationship does not matter that much. Moreover, Axfood’s purchasing practices are not checked with the suppliers by the internal auditor. In addition, in all information gathered, there is no sign suggesting that Axfood have a complaint system for factory workers in place or perform supplier trainings on labour rights.

## **(2): The purchase departments’ and CSR Manager’s relationship with the suppliers**

Besides approving and helping to schedule an audit, the purchasers are not usually involved during the factory audit. However, the CSR Manager gives support to the purchasers’ absence by claiming that she feels that the internal auditor is already acting as Axfood’s representative. After an audit is performed, the CSR Manager starts by ensuring that the information from the reports and action plans reaches the purchasers. Then the CSR Manager initiates the follow up procedure which mainly consists of getting the suppliers to correct the deviations. The CSR Manager states



that some of the purchasers communicates with their suppliers about the findings and use the information to put pressure on the suppliers to improve.

The purchaser at Axfood explains that she has the formal power in the relationship since she is the one “sitting on the money”. Further, she claims that it is important to invest in the personal relationship with the suppliers in China since the suppliers from this country often emphasize respect and honor towards the individual purchaser before the buying company. “By highlighting that I [the purchaser] look bad in front of my colleagues when you [the supplier] do not fix these issues, which you say you will fix, I make things happen. The supplier feels guilty since he cares about me”(Axfood, Purchaser interview, 2013). In addition to the Chinese representation office, Axfood occasionally uses agents to purchase from China. However, in contrast to Filippa K the agents used by Axfood do not have any responsibility for the follow-up work.

### **(3): The internal auditor's relationship with Axfood**

Even though the CSR Manager states that the internal auditor was hired mostly because of the reduced costs, she and the purchaser at Axfood claim that the internal auditor supports their work a lot. For instance, the CSR Manager compares her interaction with the internal auditor and external auditors used in other geographic locations outside China, and claim that the internal auditor gives better support after an audit since she feels freer to contact her with questions. Also the purchaser expresses that the internal auditor acts as a great support when evaluating and choosing suppliers. For instance, the purchaser explains that she sometimes sends audit reports from other factories, outside the auditors' responsibility, to get them evaluated by the internal auditor. The internal auditor states that it is very important for her to feel that Axfood supports her work, “if they do not care about the audit reports or the results, my role here is meaningless, useless”. In line with this, the internal auditor argues that she feel that her work is increasingly being supported by Axfood.

When it comes to the intensity of the relationship, the internal auditor at Axfood explains that most of the contact between her and the colleagues in Sweden goes via email on at least a weekly basis, and that she contacts the CSR Manager before and after each audit to raise support. Axfood's purchaser meets the internal auditor between two and three times every year and has daily contact with the representation office. Besides audits, Axfood has started to perform screenings when selecting new suppliers and they occasionally involve the internal auditor in these. The interview with the purchaser at Axfood revealed that in the following week she and the internal auditor were going to a new supplier to make such a screening in Asia.

To summarize, there are some difference in the social audit structure between Filippa K and Axfood. Axfood use an internal auditor, who has local presence and are viewed as a company representative. She works with follow-ups and takes great responsibility in the audit process. In contrast, Filippa K uses an independent auditor, who wants to stay independent and objective, does not perform follow-up visits, this responsibility is projected to the purchasers at Filippa K. Besides the audit visits the independent auditor uses a compliant system to get insights to the social issues at the factories.

## 4.2 The social auditor processes of the two companies

During the interviews with Filippa K and Axfood, respondents from both companies expressed that the main reasons to work with social auditing is to control the working conditions in their supply chains while also trying to ensure that the social standards improve. Both companies express that although they see improvements at some of the suppliers, the overall improvement at the factories is disappointing. Even if the improvements are dissatisfactory both companies express that social audits are an important part of the improvements and removing them would have great negative impact on the social standards.

When looking at the background of the two auditor types, the FWF social auditor explains that he has been within the social compliance industry for more than seven years while the internal auditor has been in the area for about two years. According to the social audit reports, FWF performs audits in teams of three auditors with different background and roles; one is responsible for Health and Safety, another for documentation and paper inspections and lastly worker interviews. When studying and discussing the specific audit processes with FWF and Axfood's internal auditor, many of the processes are similar. However, one difference between the two auditors is the time spent on an audit. Data from FWF audit reports show that, two days are usually scheduled with the factories, which is similar to the internal auditor which state that a factory audit for her takes about two days. However, since FWF uses audit teams with three auditors that split the time between them and audit different things, the independent auditor of this case spend much more man hours during an audit. Moreover the time for worker interviews isn't included in FWFs two day factory audit since these are performed offsite before the audit.

Before an audit is performed both auditors announce their visits by contacting and scheduling the audit visits with the suppliers. Both FWF and the internal auditor states that they find managers more forthcoming and open to collaborations and improvements if the audits are announced. Further, the FWF auditor explains that announced audit visits works best, "as we [FWF] are an international organization who regard transparency as very important, we have

nothing to hide, and we do not want to end up in a, for us, very embarrassing situation convincing suppliers to be transparent, while, we aren't, if we do audits on an unannounced basis.". Even though, Axfood do not work with unannounced visits today, the CSR Manager of Axfood claims that unannounced visits could be valuable and could be good to use when working with re-audits.

### **The traditional audit process steps**

The audit starts with an initial meeting with the supplier management where both the internal and FWF auditors have the possibility to explain why they are there, describe the audit process and explain the codes that lay as a foundation for the audit. The internal auditor spends about 20 minutes on this initial meeting and besides describing the purpose, asks basic questions about the factory regarding for example turnover and production capacity. FWFs audit reports show that the audit team also takes the opportunity to interview the managers more in depth.

After the initial meeting, both auditor types perform a factory inspection. During the walkthrough they inspect the factory grounds and dormitories looking for hazardous and unsafe working conditions, take photos, check if the codes of conduct are placed on the factory site for workers to view and ask questions to the workers in the production line. The internal auditor states that this inspection takes her about two to three hours for a small or medium sized factory. Similarly, According to FWF's Verification Coordinator, the FWF audit team takes about two hours inspecting the factory, depending on the size.

In addition to the factory inspection, a document review is performed by both auditors. The internal auditor states that she inspects ten samples from a selection of documents relating to employee files, contracts, wages and working hour records going back at least six months. Similarly, the reports from FWF show that they analyze the same types of documents, FWF claims to take about 20 samples. One difference between the two auditors is that the internal auditor also inspects documents and certifications related to environmental issues and emission approvals. However besides the steps described here, the FWF Verification Coordinator explain that they also require the suppliers to have a grieving system in place that can guide workers and management in resolving issues and conflicts related to labour practices.

Regarding the workers' interviews both auditors from FWF and Axfood interview around 5-10 percent of the workers at the factory and management representatives and choose workers at random although they pick workers from different working stations, male, female, old and young. At bigger factories both use group discussions instead of individual interviews to optimize the

time at the factory. Both companies claim that confidentiality is crucial if the workers are to give honest answers. The wish to achieve total confidentiality drives FWF to perform offsite interviews prior to audits, claiming that this solves some of the issues relating to announced visits (FWF Document, 2013a). In the case of the internal auditor, she interviews workers in a private room at the factory where management is not present. The internal auditor states that she randomly selects workers for the interviews by picking names in the employee files. Thereafter, she asks the managers to go get the workers that she has selected. Axfood's CSR Manager acknowledges that this is a risk concerning the confidentiality since management knows which workers that are incorporated into the interviews. However, the internal auditor claims that she sometimes picks out workers to interview during the factory walk-through. In addition to the more formal interviews with workers, the internal auditor and the FWF audit team takes the opportunity to talk to workers during the factory and dormitory walk-through.

During the exit meeting with supplier management both the internal auditor and FWF audit team goes through their findings and discuss what can be improved. One difference is that the FWF auditor talk and discusses with the management what actions that needs to be taken and what the time limit should be. While the internal auditor lets the factory discuss amongst them self first, regarding what actions they should take to improve and what time they might need to do it. As mentioned earlier, the internal auditor evaluates the management suggestions and gives feedback.

After the audit the reports together with the corrective action plans are written and approved by both the buyers and the suppliers. Similarly, the reports are used internally at both Filippa K and Axfood. When studying the reports it is clear that the reports of the independent auditor are more systematically structured, including management, workers interviews, NGO conversations, documentation and inspections. Thus, making it easy for the reader to compare information given and follow the line of thought. In comparison, the reports from the internal auditor give less information which opens up for more interpretations.

To summarize, when looking at the traditional audit steps of factory walk through, documentation inspection and worker interviews there are many similarities between the independent auditor and the internal auditor. However, when it comes to the time spent on the audit, the locations of the worker interviews and the engagement of the factory managers, there are some significant differences.

## **Overcoming difficulties and common problems**

In this paragraph, difficulties discussed in connection to the audit process are correlated to the two audit types since auditors ability to overcome this obstacles are correlated to the auditors ability to support the companies in their work with improving working conditions in the supply chain.

### ***Falsified documents***

Axfood's internal auditor argues that even though the factory has been audited before and has certificates, she will not rely on that. She explains that it is very easy to get a certification in China and states that this is one of the reasons why Axfood do not want to hire a third party auditor firm and instead want their own employed social auditor. Both the independent and the internal auditor have received falsified documents from suppliers at some point. The internal auditor explains that she has to be patient and explain to the factories why Axfood do not want to see fake documents. Further, the internal auditor states that "We [Axfood] want an open dialogue; we want our business to be established on openness and trust. We do not want to see a fake perfectness; we want to see the truth even if it isn't perfect yet. We understand that this is the fact in Chinese suppliers, but what we value most is the management attitude, if they have the attitude or consciousness to move forward".

One of the auditors in the FWF Chinese team is a former factory owner, which Filippa K's CSR Manager argues is important since she claims that this background makes the supplier management feel more confident in him. Filippa K's CSR Manager states that the suppliers can "paint any picture", so therefore it is important to build trust so that they dare to show the true picture. When looking at the audit reports from FWF it becomes clear that also they often finds falsified documents. In the reports it is clear that FWF analyses the data found by triangulating the information, this they argue gives them a good chance of finding falsified documents. However, when discussing with one of the respondents at Filippa K, it was revealed that one of the respondent's suppliers had told her about their falsified documents, claiming that the supplier had three different accountant books in 2007 that no third party auditor discovered.

### ***Involvement of unions and NGOs***

Both auditors state that they include trade unions or worker representatives during the audit. A more distinct difference between the two auditors is that the FWF audit team uses NGOs, trade unions, governments, employee organizations more extensively to aid in the audit process, while the internal auditor exclude these stakeholders. However, the internal auditor talks to trade union or workers representatives if present at the factories. The auditor of FWF states that they

investigate what local stakeholders have to say about the issues relating to specific regions in China. This is also clear in the audit reports, where comments from local stakeholders can be viewed relating to specific areas in the report. As an example FWF put demands on living wage, and uses different NGOs to benchmark against the workers' wages.

## 5. ANALYSING THE SOCIAL AUDIT STRUCTURE, PROCESS AND AUDIT TYPES

In this section the social audit structures are studied based on the three topics presented in the theoretical framework, namely the buyer-supplier relationship, the audit processes and the independence factor. First, the monitoring structures of the two companies are analyzed to get an understanding of how the audit structures can impact the buyer-supplier relationship. Second, the audit process at the factories is explored. Lastly, the independence factor and its impact on the auditors' ability to support companies' improvement is explored.

### 5.1 The buyer-supplier relationship of the two companies

Respondents at both companies state that, on one hand, social auditing is important for bettering the social standards in the supply chains, on the other hand, the same respondents express disappointment with the overall improvements that they see in the supply chain. This goes in line with the criticism presented by numerous researchers that the social audit in itself does not lead to increased supplier compliance (e.g., Mamic, 2005; Pruett, 2005; Locke et al., 2007; Adam et al., 2005). Instead, it is argued that the relationship between the buyer companies and its suppliers is vital to increase supplier compliance (e.g., Boyd et al., 2007; Pedersen & Andersen, 2006; Cheung et al., 2009; Mamic, 2005; Handfield & Bechtel, 2002). To achieve a better relationship between the company and its supplier, it is according to several researchers important to promote a collaborative approach through communication, follow-up processes, openness and trust (e.g., Mamic, 2005; Cheung et al., 2009; Pedersen & Andersen, 2006). In line with these arguments, our study shows that the internal auditor, used by Axfood, implies more direct communication links with the suppliers than the independent auditor, FWF. Thus, the internal auditor structure implies a better base for high supplier compliance. For instance, even though the formal pressure to improve comes from the CSR Manager and the purchasers at Axfood, the internal auditor communicates directly with the suppliers that are under development both through monitoring practices and the follow up work that the internal auditor engages in, which facilitate richer communication and support collaboration. However, even though FWF do not perform the follow-up work, FWF requires and verifies that Filippa K continuously works with follow-ups. In this manner, FWF encourage Filippa K to build relationships with the suppliers in order to increase the compliance.

Moreover, our study shows that both FWF and the internal auditor develop the corrective action plan in collaboration with the suppliers, which according to Mamic (2005) builds a foundation that can improve supplier performance and build better relations with the supplier. However,

there might be a difference in how the suppliers view the two kinds of auditors. The independent auditor, FWF acts more like a mediator between Filippa K and its suppliers by asking about the opinions of both parties. Since FWF develops the action plan on behalf of the supplier's client, Filippa K, the benefits of developing the action plan in collaboration with the supplier might get lost. This assumption can be verified by FWFs statements that the problem solving is more effective if a Filippa K representative is present. Based on this assumption, the internal auditor, who has constant local presence and functions as an internal communication link, facilitate increased collaboration and involvement between Axfood and its suppliers, which also implies that Axfood through the internal auditor can reap the benefits stated by Mamic (2005) by developing the action plan together with the supplier.

This indicates that the internal auditor can work as a relationship link which connects to Adam et al. (2005) critics, claiming that companies that rely on third party auditors, instead of own compliance staff, fail to build the relationship needed. The internal auditor is one additional link which can facilitate relationship building, better than the independent auditor, which according to Cheung et al. (2009) supports the company in improving social standards in the supply chain.

### **Independence creates a fair arbitration**

Even though the use of an independent auditor, like FWF, implies one less direct link between the buyer and its supplier our empirical data show that FWF also can facilitate a buyer-supplier relationship that increases the possibility for implementing improvements in the supply chain. FWF that wants to stay independent involves both the company and the supplier in the communication exchanged, giving both parties a voice. During the audit, FWF asks the supplier factories about their view on the buyer and its purchasing practices, in line with Boyd et al. (2007), this promotes fairness and justice between the buyer and supplier which increases the opportunity for building better relationships. By doing so, FWF opens up a discussion between the buyer and the supplier which facilitates fair collaboration and supplier engagement, which Cheung et al. (2009) claim is crucial for effective improvements in the supply chain. In relation, audit reports show that suppliers often are satisfied with Filippa K's collaborative approach when working with lead times which supports Pruett (2005) who argue that the issues are overcome by close cooperation.

In comparison, since the suppliers may view the internal auditor as a company representative it can be harder for this auditor to enable equal communications. Therefore, by trying to work impartiality, it becomes possible for the independent auditor to facilitate a two way communication based on fairness. In this way, FWF takes on the role of an arbitrator between



the buyer and supplier and allocate some part of the responsibility for the issues to Filippa K. This approach goes in line with Boyd et al. (2007), who argue that emphasizing equality and enable two way communications, promotes fairness and justice which increases the possibility for effective improvement work and high degree of compliance at the suppliers.

To summarize, our study suggests that the internal auditor has certain advantages when it comes to facilitating relationships compared to having a third party independent auditor. Two advantages are apparent. First, by having an internal auditor located near the supplier, a richer communication towards the suppliers is facilitated. Also, by using an internal auditor, instead of an independent auditor, an additional communication link between the buyer and supplier is established. These two advantages ease communication and collaboration, which promotes improvements and supplier compliance. However, the independent auditor can act as an arbitrator between the buyer and its supplier, mediating a more fair relationship which has positive impacts on the buyer-supplier relationship which increase and support improvements of social standards.

## **5.2 The social audit process of the two auditor types**

In order to get an understanding of the activities that the independent and internal auditors' implement in their social audits, the social audit processes are analyzed in this paragraph. This is related to the auditor's ability to support the work with improvement since the literature review suggest that the social audit process is vital in order to ensure a truthful picture of the suppliers working conditions, and since a qualitative audit report is believed to give more support to the company working with social standards.

Pruett (2005) claims that social audits are sometimes performed fast and sloppy by auditors that rushes through the traditional steps. In line with this critic, the time spent on an audit can be seen as an indicator of the audit quality. Both FWF and the internal auditor schedule about two days for an audit with the supplier factory. However, FWF use an audit team consisting of three auditors, splitting different parts of the audit between each other over the two day period. Also, FWF perform the worker interviews offsite before the audit, this time is not included into the two day factory visit. All in all, and in a comparison with the internal auditor, FWF spends more man-hours on a social audit. This does not mean that the internal auditor perform audits fast or sloppy. However, it indicates that information generated by the independent auditor may be more well-grounded and thoroughly investigated. In line with Pruett (2005) this data also suggest that the risk of rushed audits is lower with the independent auditor.

### **Going beyond the traditional social audit process**

In line with Mamic's (2005) statements of the traditional audit process, the audit process of the independent and internal auditors contains three main parts; physical inspection, a documentation inspection and interviews with workers. In this sense, the social audit processes of the independent and internal auditors are overall similar to each other. However, when comparing the two audit types (viewed in Table 4), there are some clear differences relating to whether the two auditor types go beyond the traditional audit process.

### ***Involvement of local stakeholders in the social audits***

Even though the internal auditor discuss with trade a union representative if present at the factory, which implies an additional perspective and an increased opportunity for triangulation no other local stakeholders are consulted. In comparison and in line with Pruett (2005) suggestion, the independent auditor has systematized its audit process by including consultation of additional local stakeholders, which Pruett (2005) argues improves the audit process since the stakeholders give the independent auditor additional perspectives that can be used for triangulating the information from the audits. Moreover, the findings from FWF are presented in the reports in a manner that makes it possible for the reader to triangulate and cross-check information when reading. In relation to this, Pruett (2005) claims that triangulation and cross-checking is vital for a clear and well-grounded report of the supplier, suggesting that the independent auditor that includes more perspectives has a better opportunity to give a more nuanced picture of the underlying issues concerning the supplier factory.

Moreover, Pruett (2005) strongly emphasize creation of partnerships with local organizations, claiming that it makes both auditing and implementations of labour standards more effective. The independent auditor of this study includes perspectives of local stakeholders in the auditing process in line with Pruett (2005). However, when it comes to implementation and follow-ups the responsibility are forwarded to the purchasers at Filippa K which does not have any contact with local stakeholders. FWF uses local stakeholders which according to Pruett (2005) gives high quality in the auditing, but does not use the established relationship to support implementation. Axfood's internal auditor does not have any or limited exchanges with local stakeholders, in addition no formal partnerships are established with local stakeholders to aid the progress.

### ***Worker interviews and unannounced visits***

FWF performs worker interviews in line with Mamic's (2005) and Pruett's (2005) recommendations, which should produce optimal result, since the interviews are performed offsite and before the factory audit to secure total confidentiality for the workers. In this way,

FWF offer the workers a more neutral place that might give them more reassurance to share information. In addition, FWF claims that the selection of workers is done without any involvement of the management. Similarly, the internal auditor promise the interviewed workers confidentiality by explaining that the information given to managers will not be connected to the individual workers. However, this confidentiality is limited since the managers are commonly involved during the selection process of workers and since the interviews are performed in the factory. With this in mind, the approach used by the internal auditor is not preferable since worker confidentiality can be questioned. All in all and in line with Mamic (2005) and Pruett (2005), the information gathered from the worker interviews can be expected to be more truthful and less influenced by the management in the case of the independent auditor, which increases the possibility for better reports and statements of the workers situation thus increasing the support of finding non-compliance. In addition, our study shows that FWF recently introduced supplier training and education which Pruett (2005) argues is an important step to enhance workers understanding of labour rights at the factories, which is argued to result in openness towards the independent auditors.

In relation to the subject of worker interviews, several researchers states that announced visits can have an undermining effect on the worker interviews, since the workers are often prepared beforehand (Mamic, 2005; Pruett, 2005). The importance of unannounced visits is highlighted by Pruett (2005), however, none of the independent or internal auditor performs unannounced visits as shown in Table 4, which could be criticized through Pruett (2005) arguments.

On the other hand, the independent auditor which states that announced visits functions best since a social audit require preparations for the supplier, this goes in line with Adam et al. (2005) and Mamic (2005) arguments that unannounced visits often lead to incomplete information. In addition and in line with Pruett (2005) statements that companies and organizations do not want to jeopardize the relationship with the suppliers who can view unannounced visits as impolite and inappropriate, FWF states that unannounced visits signals low trust. In line with these arguments, Pruett (2005) recognizes that unannounced audits can have negative consequences. However, he still believes that unannounced audit visits is crucial in order to get a truthful picture of the social standards at the suppliers, hence he suggests that follow-up visits should at least be unannounced. This can be related to Axfood, who has the same reasoning when discussing unannounced visits. However, even though Axfood seem to agree with Pruett's (2005) suggestion, unannounced re-audits has not been carried out so far.

### *Complaints mechanisms at the supplier factory*

FWF has implemented a complaint system, which Pruett (2005) and Ascoly and Zeldenrust (2003) argue is an important part to increase insight and ensure that workers are able to raise concern about working conditions in the supplier factories. Even though this complaint system is integrated into FWFs audit practices, it has not always been clear how these complaints should be handled, which goes in line with the criticism of Rasche (2012) that independent auditors needs to be better at coordinating activities in order to address problems in an organized way.

### *Effective follow-up processes*

According to Mamic (2005) corrective action plans is an important part of effective follow-up processes, this is addressed earlier in the analysis (see paragraph 5.1). As mentioned by Pruett (2005) another important step beyond traditional auditing is to address existing business or purchasing practices, as discussed previously FWF does not only audit the supplier factories compliance system, they also check and put responsibility on Filippa K's purchase and order system. This aspect is especially important relating to working hours, since some of the exceeding working hours can be explained by short order time (Pruett, 2005). In Axfood's case, the company's purchasing practices is not checked with the suppliers by the internal auditor.

Beyond the traditional social audit process	Independent auditor (FWF)	Internal auditor (Axfood)
Interviews with workers outside the workplace	X	-
Involve local stakeholders in the audit practice	X	Trade union representatives at the factory
Create partnerships with local stakeholders	-	-
Implement complaints mechanisms	X	-
Offer education and training	X	-
Address existing business or purchasing practices	X	-

Table 4: Beyond traditional auditing

As discussed in the literature review, Pruett (2005) argues that the traditional social audit process cannot produce change by itself; instead he highlights certain areas that need to be addressed in order to get the social audit to go beyond the traditional approach and function optimally. As just described, the independent auditor in this case requires and facilitate some of the areas which Pruett (2005) argues is important in order to better the working conditions in the supply chain. A review is presented in Table 4, this review is based on areas where the two auditors go beyond the traditional audit process. Based on this comparison it is clear that FWFs audit practices includes more additional factors to the traditional approach in comparison to Axfood's internal

auditor, as a result it is argued that this extended approach can give better support to companies aiming to better the working conditions in its supply chain. In this comparison we have focused on the auditors' role and activities, however both companies may work with for instance local stakeholders in other ways.

### 5.3 Independent and objective auditors

Locke et al. (2007) discuss different types of social auditors and claims that the independent type is preferred, since this auditor type is believed to be more objective and independent. In the light of the arguments that the independent auditor is the most effective this paragraph explores how important the independence factor is when supporting companies in their work with improving the working conditions in the supply chain.

As discussed in the theoretical framework, in relation to social audits, it is argued that independence is crucial for an effective social auditing (e.g., Locke et al., 2007). FWF, used by Filippa K, claim to be independent because of factors such as a board consisting of multiple stakeholders and the limit of how much income the organization gets from member companies. Thus, according to FWF, performing company checkups and supplier audits is not problematic since they are considered independent from the companies and its suppliers. In this sense, the independence factor, for FWF, can be argued to give value and significance to the organizations verifications and reports about the social standards in companies supply chain, much in line with the statements about the financial auditor put by Lavin (2001). At the same time and in line with Rasche (2012), the independent auditor FWF, has a soft law approach meaning that even though Filippa K has voluntarily become a member of FWF, it is expected that the company comply with the stated rules. In relation, Filippa K's CSR Manager expresses that she values the demands put by FWF which shows that FWF has the ability to put pressure on Filippa K to uphold its stated commitments. In comparison, one can argue that the internal auditor may not have the same opportunity to act as a pressure to its own organization as the independent does, since the internal auditor does not enforce a soft law approach or verify the own company's systems.

In line with Utting (2001) and O'Rourke (2006) our empirical data shows that the independent auditor compared to the internal auditor perform audits less frequently at the supplier factories. As a result, Filippa K has to take greater responsibility for the work with effective follow ups. In comparison to Axfood with the internal auditor, the purchase personnel does not have to take the same responsibility since much of the follow up work is dedicated to the auditor.

Furthermore, the fact that FWF transfer responsibility of the follow up work to Filippa K is positive in the line with Pruett (2005) who suggests that companies should not over rely on third party auditors. However, Filippa K has requested more support from FWF on how to deal with certain issues. In line with this, the communication between FWF, the company and the supplier factories is crucial if the transfer is to be successful. In the case of Filippa K, when the report is handed over by FWF and the responsibility is transferred to the company, the formal reason for communication is thereafter lowered. In line with Lavin (2001) another reason for less communication may lie in the desire from FWF to remain independent from the company. Even though there could be other factors that lead to less frequent contact between FWF and Filippa K, the desire to be independent can be related to Lavin's (2001) arguments that auditors opinions need to be based upon objective and disinterested viewpoints and therefore the relationship between the auditor and its client cannot be too close. In this sense, the independence factor can help FWF to verify that companies actually do what they say they do, this goes in line with Lavin (2001) who states that the financial auditors are called upon to attest companies' statements and provide a safeguard of stakeholders' interests. However, as previously discussed, our study shows that independence and impartial relationships, to both buyers and suppliers do not have to be crucial factors when the aim is to improve working conditions in the supply chain.

The independence issue can be seen from two perspectives. First, the dependence towards the buyer company, second the dependence towards the supplier. Connecting to the internal and independent auditor of this study, Jenkins (2001) argues that the function of the independent auditor is important since it otherwise would be difficult to evaluate if a company really is working to implement their code of conducts in practice or if it is only a façade.

In relation, Antle (1984) argues that one key aspect for promoting independence is the risk of moral hazards on the auditor's part. Some of these statements works as a base for the criticism of the internal auditor, hired by Axfood, and therefore would be too close to the company to give independent and objective statements about the issues in the supply chain. However, in the case of the social auditor, the dependency relationship is a bit different from financial auditors because of two main reasons. Since the internal auditor in this study is not asked to audit its own company (or a client company), but instead their suppliers that are not directly connected to Axfood, the dependency relationship is different than for the typical financial auditor whose job is to either audit a client company or their own company. However, since FWF also investigate and verify Filippa K's purchasing practices the auditor does to some extent audit their own client, which may call for some independence and objectivity. In line with Antle (1984) and Locke et al.

(2007), who discusses the higher risk of moral hazards connected to auditors, the internal auditor of this study showed awareness of pricing when choosing suppliers for audits. Moreover, there is a risk that the internal auditor of Axfood can identify with the suppliers before the buyers. Although, the data given in this paper gives some insights suggesting that Axfood's internal auditor view herself as a company representative.

Furthermore, Jenkins (2001) concern about auditors reliability are based on the notion that the reports produced from the auditor are to become publicly used by stakeholders to evaluate the company's practices, which is the case of the reports produces by a financial auditor. In this sense FWF functions as a verifier, compared to Axfood's internal auditor, since it publishes company performance reports of Filippa K each year. Even though, the independent social auditor has a role to play regarding confirming Filippa K's accountability to the suppliers, our study show that the social audit reports, based on the factory visit, both from FWF and the internal auditor are confidential and the main objective for these reports produced is to be used internally at the two companies. The reports serve as a base for compliance and follow-up work with the suppliers and not to report externally. This makes the independence issue of a social auditor not as questionable as for a financial auditor whose role are more pronounced on verifying company performance to external stakeholders as argued by Lavin (2001) and Antle (1984).

## 6. CONCLUSIONS

In this section conclusions are drawn from the analysis by comparing two different auditor categories, namely the independent and internal auditors. This study seeks to answer the research question; *how do the independent and internal social audit types support companies' work with improving social standards in the supply chain?*

### Different audit structures give different support

When comparing the social audit structure connected to the two auditor types both differences and similarities are shown. In favor of the internal auditor; they represent both an extra communication link between the company and the supplier and incorporates a possibility for local presence since the internal auditor can be seen as a company representative. In this way, rich communication and collaboration between the buyer and supplier is supported, which is argued to be crucial for the work with improvements of social standards in the supply chains.

The independent auditors try to be impartial and do not want to represent any part of the exchange between the buyer and the supplier. Therefore, the category of independent auditors implies one less communication link between the buyer and the supplier, compared to the internal audit structure. However, by trying to be independent, the so called independent auditors function as arbitrators between the buyer and the supplier which increases the probability of two way communication and fairness in the relationship between the two parties. In this way the independent auditor supports the buyer company by building a basis for fairness in the relationship between the company and its suppliers even if the independent auditors do not take on the role as a communicator.

### The independent auditor performs more qualitative audits

This study has highlighted similarities and differences between the independent and internal auditors audit processes. In a comparison between the two auditors, the independent auditors spends more time, involves more perspectives, consults with NGOs more and structure the interviews in a way that increase the possibility of true confidentiality. This audit process gives the independent auditors a better foundation for thorough triangulation and increases the possibility for more accurate insights, thus provides a better base for qualitative reports, which add to the opportunity to support the buyer company.

### Independence: a tradeoff to relationship

The data provided in this study brings some support to the argument that the so called independent auditor functions more independently and objectively compared to the internal



auditor, which is to some extent beneficial since the independent auditors also verify the buying companies' practices. However, objectivity and independence comes at a price, of less communication links between the company and the suppliers. Further, our findings show that the so called independent auditor performs audits in a way that gives more insight for the auditor and the company, highlighting that the support given comes from performing good audits prior to being independent.

The independence factor has an impact on the relationship structure given that the auditor does not function as a company representative. Since the independent auditor do not function as a relationship link between the buyer and the supplier, other relational channels between the buyer and the supplier become crucial for the work with improvements, making the relationship between the individual purchaser and the supplier essential. However, when working with independent auditors the buyer and the supplier receive an arbitrator who can facilitate two way communication and fairness in the buyer-supplier relationship. Therefore, it is a tradeoff between independence and relationship building, compelling buyer companies to choose between two structures with different strengths and weaknesses.

### **Independence is not essential for the improvement work**

As seen in this study the social auditor missions is not primarily to produce objective reports but rather to push the progress towards bettering the working conditions at the factories. The independency factor of the social auditor has been argued to be crucial for the compliance work. However, since the social auditors audit the suppliers of the buyer company the dependency factor becomes somewhat different for the social auditor compared to the financial. In addition, since reports of the social auditors are confidential and mainly for internal use the independence factor becomes less crucial than for auditors that report externally. Our findings suggest that in this case, compared to the internal auditor, the independent auditor goes beyond the traditional social audit process and thus has greater possibility to support companies improving working conditions in the supply chains. However, our findings also show that the internal auditor may act as a stronger base for relationship building between the buyer and the supplier, which in turn supports increasing compliance. Hence, our study concludes that the praise and criticism that is correlated to the two classifications of independent and internal auditor might not be totally valid. Hence, the findings of this study suggest that prior theories on financial auditing that lie as a base for the ideas connected to the social auditor needs to be separated from the social auditor role.

## 7 DISCUSSION AND FURTHER RESEARCH

By comparing two different audit categories this study contributes with an understanding of how the audit types similarities and differences support companies' in their work with CSR related issues. In this section, the study's findings and contributions are discussed through the development of alternative explanations and limitations. Also, further research based on the study's findings and limitations is presented.

By looking at how different auditor types can support companies in their work to improve social standards in the supply chains, this study takes on a company perspective. Concluded, this study suggests that both the internal and the independent auditor type can support this work, even though different types of support are given, depending on the auditors desire to be independent. This study showed that audit structures have its strengths and weaknesses, by pointing towards the tradeoff between independence and relationship building. In regards, this study contributes by questioning the notion that independence is essential for the quality in the audit work by highlighting a knowledge gap concerning the independence factor in relation to social auditors. In this sense, there is a great need for further research in order to explore the social auditors' true role.

Contrasting to our findings, both researchers and practitioners seem to be fond of independence. Now we ask, what makes the expression of independence so attractive?

In this paper, little attention has been given to the framework relating to legitimacy and transparency since the study is based on the assumption that companies work with social audits in order to improve social standards in the supply chain. This viewpoint is a deliberate limitation of this study. Since the audit reports of both companies are only used internally the connection to legitimacy are not direct or obvious. However, both companies communicate externally that they perform social audits in their supply chain, which can be viewed as a legitimizing action. Based on this argument, it is questionable if companies perform social audits in order to improve social standards or if they are performing audits just because it is legitimizing. The answer to this question can also be dual since the social audit both can be performed to increase company legitimacy and to secure good labour standards. By looking at the study from the perspective of legitimacy, it would be interesting to develop the findings of this study by exploring different auditor's impact on company legitimacy. Connected to transparency, it would be interesting to further explore how it impacts the auditors' ability to support improvements. Also, to further develop the findings in this paper it would be valuable to take a holistic perspective by adding transparency and asking how the different auditor types can work to facilitate improvements,

whether the company wants to improve or not. One can question if companies really want to improve the working conditions in the first place, or if they even want the support provided by the auditors. However, this perspective has not been explored in this study since we have looked at the support that the different auditors can give assuming that companies wants to improve.

Further, this study have concluded that the internal auditor have a greater possibility for building rich supplier relationships. However, this is not tested since the supplier perspective is not included in the study. To further strengthen our findings, it would be interesting to study the audit categories abilities to build relationships based on two way communication, fairness and collaboration. This study showed that the independent auditor type can function to a greater extent as an arbitrator, which provides fairness in the buyer-supplier relationship. However, to explore the true fairness of the arbitrator a supplier perspective is needed.

This study criticizes the praises and critics of the different auditor categories, questioning the validity of these categories. However in this study, one of the three categories has been excluded, namely the external auditor. Since the external auditor is argued to have more similarities to the co called independent auditor it would be interesting to further examine our criticism and study possible differences and similarities between these two categories.

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