

1. Introduction

These guidelines are written to help your company manage sustainability issues in your supply chain.

It is IFU's policy that project companies must strive to promote their sustainability policies and standards towards their suppliers. Your company should ensure that suppliers providing products or services to your company manage their operations and relations in a way that minimizes any adverse impacts on sustainable development as stated in the 10 principles of the UN Global Compact. It goes without saying that your company must also meet the sustainability expectations you have for your suppliers.

These guidelines can help your company to prepare a supplier code of conduct with sustainability requirements, prioritising the suppliers and deciding on levels of monitoring and cooperation with the suppliers. We believe that real change only happens when the suppliers themselves see the value of sustainability efforts. The aim is therefore to go "beyond monitoring" and establish supplier relations based on cooperation.

Assisting suppliers in improving social and environmental conditions will generate value by protecting your company against production disruptions and bad publicity. Moreover, it could help reduce costs and ensure product quality. Close collaboration with suppliers is often also a prerequisite for your company to develop more sustainable products and gain new market opportunities.

Our recommendations are based on the CSR Compass and also take into account the approach of the UN Guiding Principles. Helpful tools are provided by CSR Compass on the website www.csrcompass.com, which was developed by the Danish Ministry of Business and Growth, the Confederation of Danish Industry and the Nordic Council of Ministers.

2. Supplier code of conduct

Your company should prepare a supplier code of conduct specifying sustainability standards for your suppliers and what is expected of them. The code of conduct is your company's response to and recognition of your responsibility in your supply chain.

The code of conduct lists sustainability requirements and how these should be met, controlled and evaluated. The aim is to ensure that the supplier understands, accepts and commits to complying with the code of conduct, so that it becomes an integral part of all business agreements.

The code of conduct should clearly state that your company does not accept non-compliances in its suppliers' operations, and that such non-compliances can affect the business relationship.

The code of conduct should also include a requirement that the supplier informs its chain of supply of the stipulations in the code of conduct.

Management requirements

We recommend that the code of conduct includes the following requirements for how suppliers should manage sustainability issues:

- **Sustainability policy:** Suppliers should adopt a sustainability policy that reflects the sustainability issues that are most important for the supplier and the ambition level for their sustainability efforts. The policy should be approved by management and provide guidance for implementation.

- **Sustainability procedures:** Suppliers should establish procedures for making and subsequently implementing sustainability-related decisions in order to achieve their sustainability objectives. The procedures should match the supplier's size and sector and the environmental, economic, political, cultural and social context in which it operates. The procedures should ensure that the suppliers:
 - Continually identify and assess all adverse impacts related to significant sustainability issues.
 - Take action to prevent and mitigate adverse impacts and ensure continuous improvements.
 - Account for how they address their adverse impacts by communicating progress and results to the project company and, to the extent possible, externally.
 - Handle grievances from other businesses, individuals or communities, who are adversely impacted or have identified adverse impacts.
 - Provide for, or cooperate in, the remediation of identified adverse impacts that the supplier has caused or contributed to.

Specific performance requirements

You may want to add specific performance requirements to your code of conduct. You could include requirements that are important to meet demands from your customers, product quality standards or specific environmental standards, or requirements reflecting specific social and environmental challenges in your business sector. The requirements could also relate to zero-tolerance issues such as violations in child labour laws and anti-corruption laws that would affect the business relationship immediately.

You can use the CSR Compass (www.csrcompass.com) to draft your performance requirements on specific topics. The topics in the compass cover issues relating to human rights, labour standards, anti-corruption and environmental conditions. Here are some examples:

- The supplier must not manufacture, trade and/or use chemicals and hazardous substances subject to regional or international bans or phase-outs.
- The supplier should measure and document the emissions of greenhouse gasses and energy use and have an action plan for meeting reduction targets.
- The supplier shall provide its employees with the protective equipment and training necessary to perform their tasks safely.
- The supplier shall refrain from hiring young workers (below 18 years of age) to perform any type of work, which is likely to jeopardise their health, safety or morals.
- The suppliers' contracts with agents, intermediaries and consultants must include a section on anti-corruption.

3. Prioritising suppliers

Your responsibility for adverse impacts in your supply chain cannot – in principle – be limited to a specific number of suppliers or a specific tier in the supply chain. But in practice, you should focus your attention and resources on the suppliers where you have leverage or influence.

We believe that you have a special influence in relation to first tier suppliers, where you have a direct contractual relationship. We suggest that you focus your attention on first tier suppliers and prioritise which suppliers to engage with based on commercial relevance for your company, e.g. spending and dependency.

However, if the supplier is a trading company, you should consider how to impose requirements and/or influence through the first tier to the second. Suppliers in other tiers

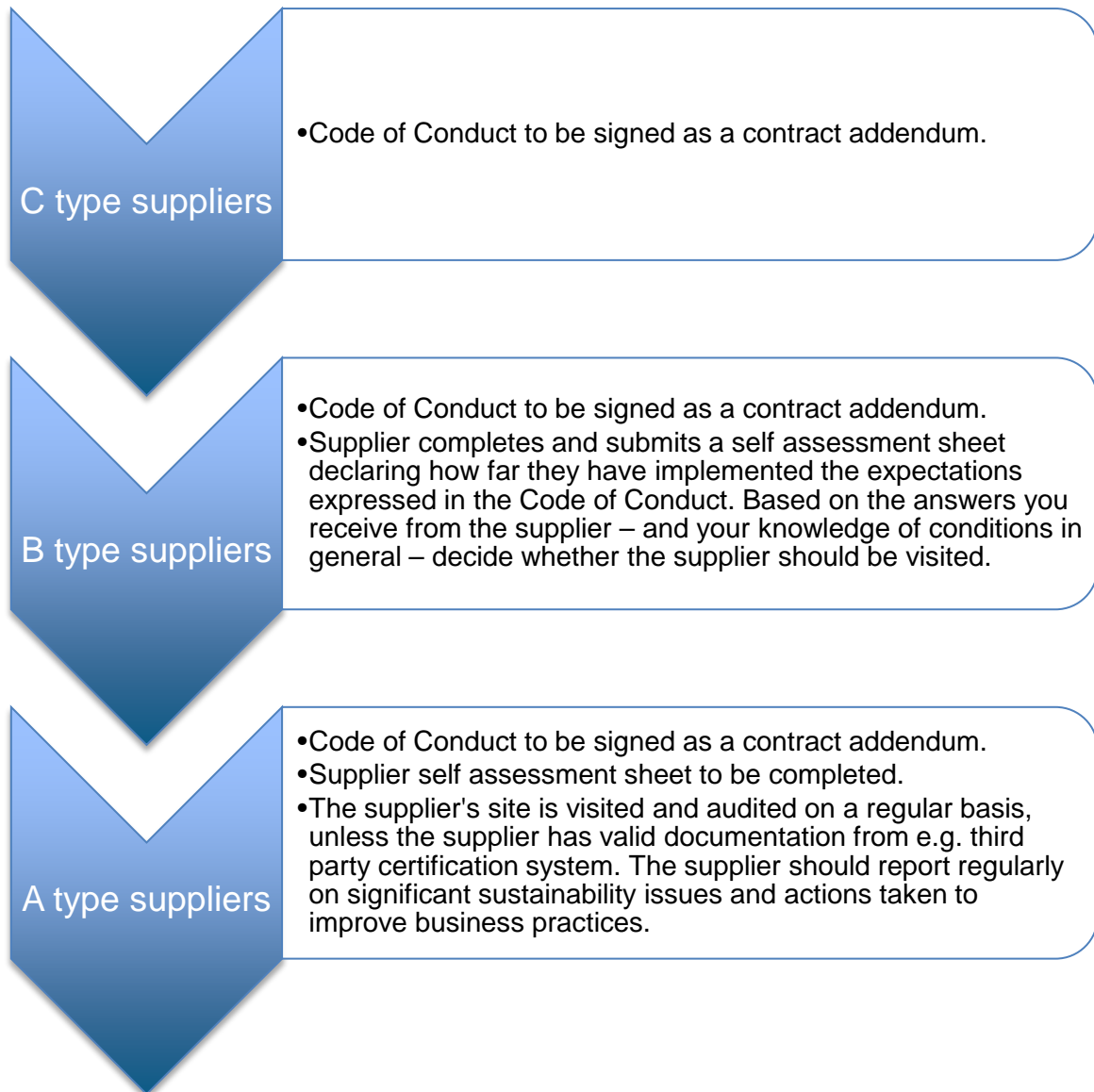
should also be included if they have high commercial relevance, e.g. produce a raw material which is closely linked to your product.

The suppliers can be divided into three groups based on commercial relevance:

- A. Strategic suppliers: Suppliers with whom you have strategic partnerships, including joint investments and the suppliers' use of your logo. The supplier may receive more than 50% of his annual revenue from your company. Due to the close relationship, many stakeholders cannot distinguish between you and the supplier.
- B. Suppliers with long-term contracts: These are selected suppliers, typically with contracts of more than 12 months. The contract might cover product optimisation. In some cases suppliers may be bigger and more powerful than your company, which reduces your leverage.
- C. Specific suppliers on few and occasional purchases: Suppliers where you make a few purchases primarily based on price. There is no relation between the company and the supplier, and the possibility of influencing the supplier is limited.

4. Sustainability measures towards suppliers

You may take different measures to assess and monitor the suppliers, depending on the type of supplier. We recommend that you differentiate between the following types of suppliers:



Self assessment

A self assessment sheet is a questionnaire that evaluates how well the supplier lives up to your code of conduct. If you use the CSR Compass to generate requirements for your code of conduct, the tool will automatic generate a self assessment checklist that contains the same topics as the ones included in your code of conduct. This list should be supplemented with questions regarding management requirements described above.

When you receive the self assessment sheet from a supplier, you should evaluate the answers in light of country and sector risks, and contact the supplier to discuss any lack of implementation of management procedures and/or potentially non-addressed risks.

The greatest risk of adverse impacts or violations of fundamental rights exists when the supplier belongs to a sector that:

- Employs large numbers of low-paid workers.
- Employs migrant and/or seasonal workers.
- Uses hazardous chemicals or materials.
- Uses scarce natural resources.
- Produces primary resources.

- Involves long working hours and tight deadlines.
- Involves a lot of repetitive work.

It is important to create a positive dialogue with suppliers regarding the self assessment and the subsequent follow-up process so that they view the self assessment process as part of a long-term cooperation.

Supplier visits

We recommend that you incorporate your assessment of sustainability conditions into your routine visits at the supplier, signalling to the supplier that you do not view sustainability activities as a separate business activity. If your visit reveals conditions that seriously violate, for instance, fundamental human rights, you can carry out a follow-up audit with the sole aim of assessing sustainability conditions.

As a practical example of how to control human rights violations, it is important to be observant and for instance ask to see the backyard and the basement while visiting and reviewing a supplier. Unannounced visits may be a good idea, if the supplier seems doubtful. This, however, may cause a loss of confidence and trust.

You can also choose to let external sustainability specialists perform third party audits on behalf of your company. Third party audits can be more costly, but can also have more credibility than audits performed by your own employees.

Handling non-compliances

If a supplier's self assessment or a visit to the supplier's premises reveals non-compliances with the requirements in your code of conduct, and the supplier is willing to change the relevant conditions, it will probably be sufficient to ask the supplier to prepare an action plan. The action plan should describe the improvement measures to be implemented, as well as deadlines for implementation.

It is important not to break off cooperation with a supplier, even when the improvement process does not go as planned. There might be economic, political or cultural barriers that have prevented the supplier from implementing good sustainability practices. Terminating the business partnership is not likely to ensure core human rights and labour rights or reduce environmental impacts. The main thing is to maintain open dialogue with the supplier, and to ensure that the supplier is willing to implement the improvement measures. The aim of responsible supply chain management is to bring about a process of positive change, gradually improving sustainability conditions at the supplier's.

Cooperation about improvements

Not all suppliers have the necessary knowledge and resources to improve social and environmental conditions by themselves. You can strengthen the improvement process by offering to help them prepare an action plan and by encouraging them to suggest how your company can best contribute to the implementation of the requirements in the code of conduct.

Sharing sustainability knowledge can be a part of your ongoing dialogue with your suppliers, but you can also organise training activities. If you have the necessary knowledge yourselves, you can train your suppliers, or you can ally yourselves with others in your sector or other companies active in the same local area. Similarly, if you have several suppliers in the same area you can arrange joint training.

Terminating the cooperation

In cases where the supplier has critical sustainability issues, and your company does not believe the supplier has the commitment or ability to address the issues, the consequence

might be that the cooperation will have to be terminated.

We recommend that you only terminate the contract with the supplier if it can be proved that the supplier is:

- Deliberately and knowingly violating the code of conduct.
- Unwilling to engage either by refusing to respond or by denying access.
- Not inclined or able to improve performance even after being helped.