

The Corporate Responsibility Report

Volume II, Winter 2005



Welcome Message from PwC Global Sustainability Leader: Sunny Misser



PricewaterhouseCoopers is pleased to present the ongoing series of our newsletter—*The Corporate Responsibility Report*. In this issue, we cover a range of topics within the sustainability universe—the successes and future challenges of the United Nations Global Compact; corporate responsibility in the Oil and Gas sector; the complexities of managing risks in a global supply chain; the structure of climate change transactions and much more.

I would like to thank all our clients and global practitioners who have contributed to this issue. Through our Newsletters, we aim to share information which is relevant and insightful while facilitating an exchange of knowledge within the global network.

We value your thoughts about our publication and encourage you to submit feedback through the Rate Our Newsletter section of this issue.

We look forward to continuing to share our thinking and experiences with you.

Regards,

Sunny Misser
Global Sustainability Leader

Industry Focus

Oil and Gas: The Challenges of Global Stewardship

Global energy demand is growing at an unprecedented rate and energy companies are positioning themselves to respond. Many experts believe the world will require about 40% more energy in 2020 than today. In meeting demand over this period, it is expected that at least 60% will continue to come from oil and gas. As a result, the energy industry is expected to invest heavily over the next few years to find, produce and deliver oil and gas to growing economies.

The global energy industry already has an extensive and highly significant social, environmental and economic footprint: through increasing demand for its products; its role as a generator of wealth, employer of people and provider of government tax revenues; and, through its impact on the environment and, local communities. As the industry continues to grow and confronts alternative strategic options, it faces conflicting pressures from a wide range of stakeholders: local communities; governments; nongovernmental organizations (NGOs); investors; and employees.

The challenges of satisfying these competing stakeholder concerns have become more complex in recent times. The depletion of older oil and gas fields in North America and Europe, concerns about security of supply and the desire of many countries to reduce their dependence on imported oil and gas are driving energy companies into new geographic areas (which are often more politically, culturally and technically challenging) and forcing them to confront a whole new set of stakeholder issues. Moreover, this geographic expansion is increasingly being accomplished through mergers, acquisitions and joint ventures

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prompting new challenges in corporate governance and the management of financial and non—financial risks.

In addition to these sector-specific challenges, the global energy industry is facing pressure similar as other industries for greater accountability and transparency to stakeholders, increasing regulation and concerns about corporate governance.

Bob Ridge, Vice President of Health, Safety and Environment at ConocoPhillips (“CP”) and Igor Zaikan, Head of Environment, Health and Safety at OAO LUKOIL (“LUKOIL”) both recently spoke with PwC about their company’s approach to Corporate Responsibility and the major challenges facing their companies. Ridge cites providing an affordable energy supply to the world economy, producing cleaner and safer sources of energy, and engaging transparently with the communities in which it operates as a few of the greatest challenges facing CP today. Look in this edition to find out more about sustainability at ConocoPhillips. Igor Zaikan explains that LUKOIL pays much attention to its stakeholder relations as it is a key element of the company’s business strategy. Read on to find out more about LUKOIL’s sustainability objectives.

“Creative and innovative solutions are absolutely imperative as we go forward. We cannot continue with ‘business as usual’” Ridge

“Sustainable business development is critically important for the viability of companies in the Russian energy sector” Zaikan

The Governance Challenge

The energy sector, not unlike any major industrial sector, is heavily regulated from a financial, operational, compliance and market perspective. In this instance, “regulated” includes not only codified external laws and statutes for which strict compliance is required, but also voluntary standards, and societal pressures and expectations that influence corporate behavior. These requirements can exist at a local, regional and national level adding to their complexity. An effective response to these collective pressures is essential to achieve both compliance and to maintain a “license to operate” from local, national and international communities.

There are many overlapping perspectives on what constitutes good governance. Each stakeholder group tends to emphasize aspects of governance to ensure that the interests of their group are being served. The “narrow” shareholder value definition of corporate governance addresses matters intended to ensure that shareholder value increases over time, for example issues relating to board structure, director selection, director compensation and shareholder matters such as voting rights or selection of independent auditors. However, increasingly, these concerns are being supplemented by social, environmental, economic and ethical issues such as bribery, corruption, political donations, tax and royalty payments to host governments and the extent of investment in local communities. The increasing pressure on energy companies to be more transparent about their performance in these areas is evident: in 2004 thirteen major US public pension fund leaders collectively managing nearly \$800 billion, called on the US Securities & Exchange Commission (SEC) to eliminate any doubt that publicly traded companies should be disclosing the financial risks of global warming in their securities filings.

In meeting these demands, the energy sector has become a globalized market in which governance and compliance continue to drive the risk characterizations of energy operations upstream, midstream and downstream. Sarbanes-Oxley, International Financial Reporting Standards (IFRS) and other regulatory mechanisms have obliged all companies to enhance the diligence with which they govern their global operations and widen the scope of their reporting to include non-financial aspects of the business. The energy sector is no exception.

The Challenge of Consolidation and Emerging Markets

Energy resources are largely dispersed around the globe. This geographic dislocation of resources to market has triggered many companies to seek business opportunities in parts of the world where resources are more abundant. Emerging markets like India, Russia and China are key targets and many Western companies have established operations in these areas of the world. In a recent energy trends report released by ExxonMobil, 80% of the energy demand growth from 2000 to 2020 will stem from the developing world, where 85% of the world’s population will live in 20 years.



Reputation Due Diligence Case Study

PwC was engaged by a global energy company to perform a highly confidential assessment of an integrated oil company with operations in Russia and Eastern Europe. The assignment included an assessment of the environmental, health and safety (EHS) performance of the company in relation to international standards, client company policies and regional peer group performance. Working alongside the client, the PwC team visited company headquarters and a range of production, transport and refining sites. We fielded a truly international and multi-disciplinary team with representatives from the US, UK, Eastern Europe and Russia, whose experience included EHS, oil industry, transaction, and relevant regional experience. At the end of the assignment, the team provided the Client with a balanced picture of the company’s EHS compliance performance, risks and liabilities. The team was able to identify areas of good practice and areas where further investment and / or changes in behavior would be required to manage current and future risks and liabilities.

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In recent times, mergers, acquisitions, strategic alliances and joint ventures have become vehicles by which companies have brought resources to market. While this appears to suit emerging markets, significant business risk issues have been raised in the process. The trend has driven the need for companies to develop a greater understanding of the broad scope of financial and non-financial risks, and effective governance associated with inorganic growth in widely dispersed territories and business arrangements.

One key tool that energy companies are using for managing both financial and non-financial risk through the life cycle of a merger, acquisition or joint venture is the due diligence process. Traditional financial due diligence is now being supplemented by consideration of a broader range of non-financial risks including reputational factors such as integrity, bribery and corruption, environment, health and safety, carbon management and supply chain integrity, as well as broader political and country risks.

The Economic Challenge

The economic dimension of the sustainability challenge for energy companies is gaining increasing attention. The sector has an immense global footprint and potential to contribute both positively and negatively to global sustainable development. One recent initiative has focused on the industry's role as a generator of wealth and a provider of government tax revenues.

The Extractive Industries Transparency Initiative (EITI) is a UK Government Initiative which aims to ensure that the revenues from oil, gas and mining industries contribute to sustainable development and poverty reduction by increasing transparency over payments made by companies and revenues received by governments. The rationale behind the initiative is that lack of accountability and transparency in these revenues can exacerbate poor governance and lead to corruption, conflict and poverty. Companies supporting the initiative include AngloAmerican plc., Areva, BG Group, BHP Billiton, BP, ChevronTexaco, ConocoPhillips, De Beers, ExxonMobil, Newmont, NNPC, Repsol YPF, RioTinto, Shell, SOCAR, Sonangol, Statoil and Total, as well as a group of over 40 institutional investment companies.

The EITI defines a number of different benefit streams provided to governments

in its draft reporting framework, including production entitlement taxes on profits, license fees and royalties paid in cash.

The Reporting Challenge

There is increasing pressure from all sections of society for a more holistic approach to reporting on the social, environmental and economic impacts of energy companies, operations and how they are addressing them. Insight provided in a PwC study shows that investors see tangible gains for companies widening the scope of their reporting. Gains such as reduced share price volatility or more long-term investment are just a few. The latter benefit is an indication of the investor's confidence in the longevity, or sustainability, of the business. Addressing climate change, creating dialogue with stakeholders or protecting corporate reputation, are risk issues that can be managed through a robust and comprehensive corporate communication strategy.

[Click here](#) to find information on Value Reporting, a PwC UK group specializing in corporate reporting strategy www.valuereporting.com.

Conclusions

Societal expectations regarding the way in which energy companies should conduct their business are becoming increasingly challenging. As a society we want abundant, cheap and clean energy extracted with minimum environmental disruption while affording the maximum benefits to local communities, national governments and shareholders. We want energy companies to be both sensitive to local, cultural and societal concerns and to respect international standards of performance. We expect energy companies to comply with a complex web of local, national and international laws and regulations, and even to go beyond the standards that these prescribe. We expect them to be innovative and creative in the way they address the technical and environmental challenges they face. Above all, we want this done in a manner as transparent as possible and we expect them to publicly report in a timely, accurate and accessible fashion on every aspect of their financial and non-financial performance around the world.

It seems a daunting challenge and yet there is a growing body of experience and examples of best practice on which companies can draw. There are myriad tools and techniques that can be used to



Geoff Lane, Partner, United Kingdom



John Fillo, Director, United States

Total tax

The amount of tax paid by multinational corporations is coming under increasing scrutiny and public debate. But there is little information in the public domain about precisely what taxes and how much tax companies pay. PwC UK has recently published a discussion paper entitled "What is the contribution of large companies in taxes? The company's total tax contribution." According to a PwC survey of the Heads of Tax of large companies, 99% of the respondents felt that there was not sufficient understanding among investors, employees and stakeholders about the company's economic contribution in taxes. The discussion paper contains guidance on how to calculate, report and communicate the company's economic contribution in taxes.

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manage these issues. We have illustrated just a few in this article and more are referenced in the remainder of this newsletter.

For more information, please contact Geoff Lane in the United Kingdom at +44 (0) 207 213 4378 or John Fillo in the United States at +1 412 355 6181

Client Interview

A Conversation with Bob Ridge, Vice President, Health, Safety and Environment— ConocoPhillips

Delivering Energy Responsibly to the World

ConocoPhillips is an international integrated energy company. It is the third largest integrated energy company in the United States based on market capitalization and oil and gas proved reserves and production, and is the largest refiner in the United States. The company is known for technological expertise in many areas, including deepwater exploration and production, natural gas liquefaction and transportation, and the production of low-sulfur gasoline. Headquartered in Houston, Texas, ConocoPhillips operates in more than 40 countries, with approximately 35,800 employees and has assets of \$86 billion.

Bob Ridge is Vice President, Health, Safety, and Environment at ConocoPhillips. Prior to the recent merger that created ConocoPhillips, he served in a similar role for Phillips Petroleum Company and in earlier years was general manager of refining assets for a unit of that company. Like more than a few petroleum industry leaders, Bob never had doubts about where he belonged. He obtained an undergraduate degree in chemical and petroleum refining engineering at the Colorado School of Mines and has participated in the industry since that time.

PwC: Why has corporate social responsibility become a strategic imperative for ConocoPhillips?

Mr. Ridge: We have a fundamental intent to thrive as an enterprise well into the future and to contribute to a better world wherever we operate. And this is a matter of choices carefully considered

and carefully implemented. How will we grow? How will we meet the needs of the communities where we operate? How will we relate to stakeholders? Those questions and others lead us directly to a sustainability model based on social, environmental, and financial responsibility. There is a strategic correlation between ensuring that we are an enterprise with a long future and sustainable development principles.

PwC: Has corporate social responsibility rapidly become a mandate in your industry, or has it been a more gradual phenomenon?

Mr. Ridge: If I put that question in the context of CP and the heritage companies joined by the merger, my view is that both prior companies and all the other ones that make up our company today, were already serious about corporate social responsibility and sustainability. But they were not necessarily proceeding in a holistic manner—there were pockets of excellence where sustainability was fully embedded, but in other parts of the companies it wasn't fully mature. As we grew and started to understand the direct ties, and started looking at holistic corporate type model, it was a gradual maturing rather than a rapid overnight type of thing. Now, we are gradually exploring and implementing a holistic model across the entire Company.

PwC: How did you yourself become interested in corporate social responsibility issues?

Mr. Ridge: Earlier in my career I managed refineries and learned how important it is not only to be a safe and financially successful operator, but also a contributor to the community. A refinery needs to be viewed as a desirable member of the community, and that can only be achieved through dialogue with stakeholders, through real listening to their views and needs. That model was natural to me and to those I worked with at the time, but when I started thinking about the model we had evolved and also learning more about sustainability, at the end of the day it struck me as a matter of common sense.

In a nutshell, here is my point of view—thirty years from now, when my peers and I are long gone, I hope that our successors sitting around a conference table will say of us, “The decisions made by those folks back in 2005 were good decisions for us today—they were solidly focused on sustainable development.”

Now that excites me. I want to be



Bob Ridge, Vice President Health, Safety and Environment - ConocoPhillips

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involved in something that can make a positive difference well into the future.

PwC: What are the three top challenges facing ConocoPhillips today?

Mr. Ridge: We're going to be challenged, as in the past, to provide an affordable energy supply to the world's economy. We'll be challenged to produce ever-cleaner sources of energy, be it low- or zero-sulfur gasoline and diesel fuel, readily available natural gas sources, or other clean fuels. And we'll continue to be challenged to understand the communities we operate in and to be transparent both in our operations and in our dialogue with these communities.

PwC: How have these challenges affected your current corporate responsibility program?

Mr. Ridge: We face them today. We are making large investments in our refineries to produce clean fuels. We are working on issues in the areas of transportation, fuel storage, heating, and power generation. We have become proactive in setting up advisory panels at our refinery locations to create forums for stakeholders.

PwC: How do these public forums actually work?

Mr. Ridge: I'll use the example of forums here in the United States. At our major facilities across the country we have what we refer to as either community advisory councils or community advisory panels. These panels meet on a regular basis throughout the year with our facility managers to go into issues of shared interest to the community and the company. The membership of advisory panels is typically composed of community leaders from government, the schools, and other key constituencies. The meetings are structured so that all participants can gain a clear understanding of common concerns, aspirations, and often enough simply information that needs to be shared.

PwC: What types of issues come up in forums?

Mr. Ridge: Issues can range from investment opportunities that might bring tax dollars to the community to an upset condition that may have occurred at a facility and our action plan to prevent that type of event in the future. We may seek the panel's input on programs we have in mind to benefit the school system. The topics can be extremely varied.

PwC: Looking to the larger context again, would you say that the processes and objectives of ConocoPhillips' corporate

social responsibility initiatives align with the strategic objectives of the business?

Mr. Ridge: Alignment was recognized as imperative when we worked on our Sustainable Development position statement right after the merger. We did not want to create a sustainable development initiative that would be viewed or administered as a stand-alone process, as if it were somehow unrelated to what the Company is all about. ConocoPhillips' approach to sustainable development is entirely supportive of our Company's purpose, which is to deliver energy responsibly to the world, and it is aligned with the core values of the Company. Sustainable development is not contrary to this Company's values. It is fully integrated into how we think and the decisions we make. It is the way we do business.

PwC: What is ConocoPhillips doing about climate change issues?

Mr. Ridge: That was another of the early positions taken by the Company. We issued a position statement, which I'll be happy to summarize for you. Our position on climate change is that we do acknowledge that human activity, including the burning of fossil fuels, contributes to the generation of greenhouse gases. We also acknowledge that there is still uncertainty about the timing of the impact of greenhouse gases on climate change and global warming. Even with that uncertainty, we have committed to taking action to address greenhouse gas emissions and to develop greenhouse gas targets for our operations.

This position on climate change is consistent with our position on sustainable development, which involves not only social and environmental responsibility but also financial viability.

PwC: A lot of people worry about the petroleum industry. The resource is finite and there is a need at some point in the future for new fuels and types of engine.

Mr. Ridge: I think that renewable fuels will have a role to play in the future. It's also my view that carbon-based fuels—the diesels, the gasolines, natural gas—are going to be by far the more significant player well into the future. If you look at projections on energy use, oil consumption is projected to rise more in the next 30 years than it did in the last 30 years. It takes a long time to develop a hydrogen infrastructure or wind infrastructure. From our perspective, we are doing research in advance fuels, including renewables, while



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acknowledging that the hydrocarbon fuel business is the major player for some decades to come. For that reason, we are working out ways to produce cleaner, carbon based fuels.

PwC: CP is a very large organization, with vast systems in its refineries and distribution network. Every stage involves technology. What need is there for creative initiatives and is there the opportunity for real innovation?

Mr. Ridge: Creative and innovative solutions are absolutely imperative as we go forward. We cannot continue “business as usual.” We have to make some fundamental shifts in how we do business. One of our core values is innovation. And it states that we as a company anticipate change, and that we strive to respond to change with creative and innovative solutions.

PwC: Would you be able to give us an example of innovation?

Mr. Ridge: Some of the technology we’ve developed in low-sulfur fuels is remarkable. Our S Zorb™ Sulfur Removal Technology is amazing as a method for producing low-sulfur gasoline. Its development was a very real innovation and goes a long way toward helping the industry produce low-sulfur fuels.

The innovative work we’re doing on the liquefaction of natural gas enables us to transport large volumes of natural gas all over the world. Coal gasification—converting coal into methane and hydrogen—is another technology we’re continuing to develop. These are all very creative initiatives and very much a part of a new way of doing business in the future.

PwC: What are the implications of the liquefaction technology?

Mr. Ridge: There are huge quantities of gas available around the world, but historically much of it has been stranded because there have been no pipelines to transport it to market. It’s difficult to move excess gas in the Middle East, in a gaseous form, to markets at a great distance from that region—the oceangoing vessels to transport it would have to be absolutely huge. So the technology of refrigerating, compressing, and actually liquefying this gas enables us to take what historically has been stranded gas and move it to market in an economic and feasible way.

In many cases, because natural gas was associated with oil production, it was flared rather than stored and used, and that contributes to greenhouse gases.

Now we’ll be able to recover that gas and use it to generate power, energy, and heat for countries that need it. It’s certainly a win / win solution.

PwC: Does the liquefaction and global transportation of natural gas raise corporate social responsibility issues?

Mr. Ridge: I’ll refer again to local stakeholder panels. At one end of the supply chain, we liquefy the gas and transport it. At the other end, we gasify it to get it back into the distribution system. Recently we received approval for a regasification facility in Freeport, Texas, and part of getting that approval was to meet with community leaders and residents in the area to provide information about the facility and engage in dialogue. These facilities are so new that people aren’t familiar with them. A lot of stakeholder engagement is in order to educate and answer questions and concerns. And of course there’s another point: Natural gas is a very clean-burning, low-carbon fuel, and so it contributes to a reduction in greenhouse gases.

PwC: What you’ve just said ties together many of the issues we’ve discussed. Is there anything further you would care to communicate to our readers?

Mr. Ridge: Many people are still unsure of the meaning of sustainability. From my perspective, the key question is simple. I’m aware that I said this earlier in our talk, but it bears repeating. When tomorrow’s leaders in the energy industry look back 30 or 40 years from now, will they view today’s leaders as visionary, value-added contributors—or will they look at us as people who made some bad decisions for the future? I want to be viewed as a good manager 30 years from now.

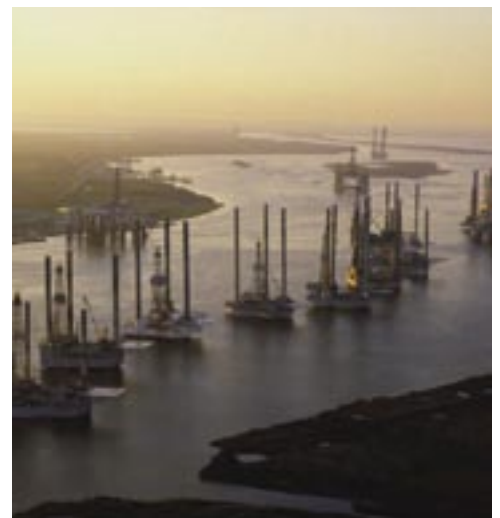
PwC: Thank you Mr. Ridge.

Mr. Ridge: Thank you.

Emerging Market Perspectives

An Interview with Igor Zaikan, Head of Department, Environmental Protection, Safety and Health—OAO LUKOIL

“LUKOIL is the leading vertically integrated oil company in Russia. The Company’s main activities are oil and gas exploration and production, and production and sale of petroleum products. LUKOIL is the second largest



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private oil company worldwide by proven reserves. The Company has around 1.5% of global oil reserves and 2.1% of global oil production. LUKOIL dominates the Russian energy sector with 19% of total Russian oil production, and 19% of total Russian oil refining.”

PwC: How does LUKOIL compare to other oil companies in the region with respect to sustainable business and corporate social responsibility (CSR)?

LUKOIL: OAO LUKOIL is a responsible corporate member of the business community and a bona fide market participant.

For the purpose of ensuring sustainable development and corporate social responsibility, the Company has approved and is efficiently implementing a number of corporate documents, including OAO LUKOIL's Social Code, OAO LUKOIL's Industrial Security, Labor Safety and Environmental Policy in the 21st Century.

In order to efficiently implement the latter document, the Company and its subsidiaries have developed and adopted the Regulations for Industrial Security, Labor Safety and Environment Management Systems. The appropriateness of the Company's approach to the development of the above indicated management systems was confirmed at a later stage, when the systems underwent a certification procedure for their compliance with the requirements of the international standard ISO 14001 and the standard OHSAS 18001.

The systems efficiency was further proven in 2000, when a group of the Company's experts was awarded the State Prize for their project called "Development and implementation of the environmental and industrial risk management system and socially responsible use of natural resources in OAO LUKOIL."

PwC: Why has CSR / sustainability become a strategic issue for LUKOIL?

LUKOIL: Such issues as globalization and corporate governance, accountability and corporate social responsibility are currently the focus of political and managerial debates. The global economy, which is not restricted by national boundaries, requires equally unrestricted boundaries for management structures. This would facilitate favorable private business activity with parties aimed at results both from the social / environmental, and from the economic points of view.

OAO LUKOIL pays much attention to the significance of maintaining mutual

relations with external parties – from consumers to investors and the local population – as a key element of a successful business activity. Openness and a forthright dialogue concerning the efficiency and effectiveness of sustainable development plans for the future will allow LUKOIL to develop partnership and enhance confidence.

One of the steps in this direction taken by OAO LUKOIL will be the 2004 sustainable development social report which is currently being drawn up in accordance with the guidelines of the Global Reporting Initiative (GRI).

PwC: Are the processes and objectives of LUKOILs' environmental, health and safety operations aligned with the company's overall business model and strategy, and how?

LUKOIL: OAO LUKOIL's environmental, health and safety, industrial security procedures and corporate objectives have been incorporated in and are fully aligned with the Company's general strategy and business model.

In its activities, OAO LUKOIL has invariably adhered to the principles of transparency and voluntariness. This is substantiated by complete transparency of OAO LUKOIL's industrial and environmental security arrangements. For example, the Company organizes public consultations in connection with any of its projects to be implemented, notably regarding its operations in environmentally sensitive regions (e.g., the continental shelf of the Caspian and Baltic Seas, the terminal in Vysotsk), arranges open presentations and discussions with the public on the objectives and aims of LUKOIL Group of Companies' Environmental Security Program.

The Company's strategic target is to ensure economically efficient and sustainable operations subject to the priority of meeting the challenges of health protection / labor safety and environmental protection. Underlying OAO LUKOIL's approach to wildlife preservation and use of natural resources is the principle of ensuring the environmental / economic equilibrium between the development of production facilities and the environment's sustainability.

PwC: For LUKOIL, what is the business case or the value in sustainable development / CSR? How does this relate to critical business issues facing the petroleum industry in Russia?

LUKOIL: For OAO LUKOIL, the drivers for introducing sustainable business



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development principles include the Company's Industrial Security, Labor Safety and Environmental Policy in the 21-st Century, which is closely aligned with the Russian government's strategy in the field of industrial and environmental security and sustainable use of natural resources.

OA O LUKOIL's most important objectives in this regard include:

- Sustainable use of natural resources;
- Health protection and labor safety for OA O LUKOIL's personnel and local population living in the regions where the Company's facilities are located;
- Attainment of a level of industrial and environmental security which would correspond to the current state of development of science, technology and the society in general;
- An increased level of industrial and environmental security of the Company's production facilities, a reduced level of negative impact on the environment as a result of enhanced reliability, secure and accident-free operation of the Company's production equipment;
- Definition of the key objectives in connection with elaboration and implementation in each of the Company's subsidiaries and entities of Programs for Environmental and Industrial Security and Work Environment Improvement;
- Stabilization and subsequent reduction of the quantity of pollutants, as well as further reduction of the level of emission toxicity, dumping of pollutants and waste products in the time of building up of production volumes through introducing new up-to-date technologies, equipment, materials as well as attainment of an increased level of automation of the process management systems.

The factors relating to an increased level of industrial and environmental security are relevant for any company of the oil and gas industry, since enterprises representing this industry are potentially hazardous in terms of their environmental impact and adverse health effects. In this regard, OA O LUKOIL, which acts on the basis of the principles of voluntariness and openness, seeks to be in the forefront.

PwC: Looking into the future, is sustainable development / CSR critical to the viability of companies in the energy sector in Russia? Why?

LUKOIL: Sustainable business development is critically important for the viability of companies in the Russian energy sector. The significance of approaches based on sustainable development principles for the business community is becoming clearer with every passing day, while sustainable development reporting is acquiring real value for those whose job it is to evaluate the current business situation and the current business trends.

This is true also because under the pressure of growing demand on the part of investors for socially significant financial instruments, new socially responsible financial indexes are currently making their appearance. Simultaneously, research is underway into the links between companies' sustainable development activities and the value of their shares.

The links between the companies' sustainable development performance and the key value drivers are motivating the market to search for new instruments for analysis and forecasting of the market value of the companies' securities.

The key factor relating to any arising problems is the need to ensure a higher level of openness.

PwC: Thank you Mr. Zaikan.

Asia: Emerging Issues

Managing the Risks in Your Supply Chain

Over the last 10 to 15 years, companies large and small have been expanding the capabilities of their supply chains in an effort to reduce costs and meet customer needs. While supply chain improvement initiatives have helped to improve performance, they have also, in some areas, increased complexity and susceptibility to risks – events that could prevent the company from achieving its supply chain and overall business objectives. In this article, PwC professionals Martin Brown and Andrea Oschetti discuss the key risk drivers that impact global supply chains, and share recent activities of PwC's Supply Chain Risk Management Services.



Supply Chain Risk Management: Drivers and Risks

Over the last 10 to 15 years companies have focused on reducing business costs and expanding capabilities through supply chain improvement initiatives. Low-cost country sourcing, multi-tiered supplier networks and business process outsourcing are just a few of the initiatives that companies, large and small, are deploying throughout their supply chains. The benefits from many of these initiatives are clear – e.g., lower cost of goods, growth in new markets, the freeing-up of resources to focus on core value adding activities, and development of new partner relationships and capabilities.

However, the above benefits are often accompanied by “necessary evils” – increased supply chain complexity and exposure to risk. Risk for this context is defined as events that could prevent the company from achieving its supply chain and overall business objectives. There are two major areas of risk that impact the typical supply chain – macro-economic / environment related risk, and supplier / supply chain specific risk.

We have seen a number of recent examples of macro-economic and environment related issues that drive supply chain risk—natural / pathological disasters, e.g., the 2004 South Asia earthquake-tsunami, BSE in North America and the U.K., Asian bird flu; adverse weather, e.g., 2004 hurricanes and floods in the Caribbean and Southeastern United States. In addition, infrastructure problems, e.g., the 2003 power outage in Northeast US / Canada had significant impacts on supply chains. The political / social situation of a country, e.g., social unrest and security, and economic issues including interest rates and tax rates are also drivers of risk that challenge the company’s ability to achieve its business objectives. These risks, combined with ever changing regulations and terrorism / security issues are key factors that should be assessed and adequately taken into account for effective supply chain management.

In addition to the external risks above, specific risks to achieving supply chain objectives are associated with suppliers and the supply chain itself. These may include operational failures, e.g., process accidents or quality issues. Other such risk include:

- Supplier financial stability issues – e.g., bankruptcy, accounts payable issues

- Intellectual property protection vulnerabilities – security breach, counterfeit products
- Legal and regulatory compliance challenges – non-adherence to contract requirements, regulatory non-compliance
- Labor and social issues – union strike, violations of labor guidelines
- Unaccounted for demand volatility – change driven by technology changes and sales incentives
- Insufficient and ineffective supply chain visibility and control procedures – demand, inventory and capacity information
- Environmental issues – groundwater contamination, adverse environmental impact

The impact of these risks on the supply chain and business objectives typically include the costs to address issues such as remediation, fines and penalties, decreased quality and performance, damage to customer and supplier relationships, general reputation damage and revenue loss.

PwC Supply Chain Professionals Meet in Hong Kong

Companies with business critical sourcing needs and complex supply chains are just starting to appreciate the new supply chain risk environment. They realize that effective risk management requires considering risk mitigation and contingency activities throughout the lifecycle of supply chain activities – from needs and capabilities assessment, through setup, execution, and termination – but are often challenged with finding the appropriately skilled resources or capabilities to effectively address these areas.

PwC supply chain professionals from around the world recently convened in Hong Kong to focus on addressing the growing issue of global supply chain risk. On December 20-21, 2004, Sunil Misser, PwC’s Sustainable Business Solutions Leader, and Patrick Fitzgerald PwC’s Global Risk Management Solutions Leader for Hong Kong and China hosted a global supply chain meeting for PwC supply chain professionals in Hong Kong. The meeting focused on three areas: 1) a discussion of global supply chain risk management issues; 2) the current capabilities of corporations to address issues; and 3) developing a

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A PwC Case Study

A US-based global Fortune 500 pharmaceuticals manufacturer sourcing key raw materials from Asia was experiencing product quality and intellectual property protection issues with several major suppliers – suppliers were unable to meet delivery requirements due to quality issues and to help defray process repair and remediation costs sold “off specification” products to unauthorized customers. PwC was engaged to review existing sourcing processes to identify control weaknesses and improvement opportunities. The joint US / Asia team assessed supply chain processes in the US and Asia and developed improved risk identification, prevention and mitigation processes for the four key sourcing activities – strategy, set-up, execution, and termination. In implementing PwC’s recommendations, our client realized improvements in identifying and managing potential supply chain issues.

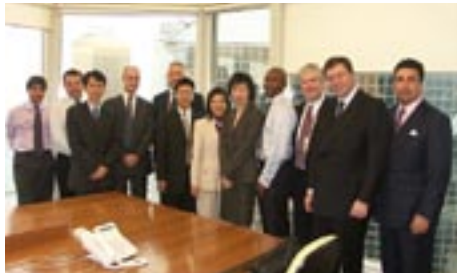
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globally coordinated and integrated PwC response to current and future supply chain issues, with a focus on sourcing in China. Attending the meeting were PwC partners—Carry Yu from Hong Kong / China's Retail and Consumer Products industry group, Thierry Raes, SBS Leader, PwC France, John Robinson, World Trade Management Services, Hong Kong / China, Paul PS Ngai, Hong Kong / China's Social Compliance Practice leader, and Liang S Goh, Tax Practice, Hong Kong / China.

The group observed a need for coordinated professional services that address the needs of foreign companies conducting business in China. Many companies contemplating or currently conducting business in China require professional services in the areas of commercial and partner due diligence and selection, government permitting and business set-up, customs, tax, and performance monitoring support.

Supply Chain Risk Management Solutions

To respond to these growing needs in China and around the world, PwC has developed an integrated risk management diagnostic and related services to help clients identify, prioritize and address the key risks in their supply chains.



The picture above is the Supply Chain Risk Management group in the Offices of PwC in Hong Kong.

For more information, please contact Martin Brown, SBS the United States at martin.brown@us.pwc.com or call +1 646 471 8815. Alternatively, you may contact Andrea Oschetti, SBS Hong Kong at andrea.oschetti@hk.pwc.com or call +85 2 2289 1983.

PwC Solution Focus

Climate Change: Carbon Buyers Beware

With the Russian ratification of the Kyoto Protocol and the launch of the European Union's Emissions Trading Scheme, this year marks the start of the carbon

constrained economy. In this article, Richard Gledhill and Christine Schuh look at the process of buying carbon credits generated under Joint Implementation (JI) and the Clean Development Mechanism (CDM) of the Kyoto Protocol and how PricewaterhouseCoopers can help you to both realize the opportunities and manage the risks.

Our fictional memo to the CEO isn't necessarily too far from the truth. In fact, it is based on a real-life client experience; but in that case, the client / buyer engaged PwC to help analyze the opportunity and manage the risk. So, thankfully, the second memo wasn't needed!

The problem with buying carbon credits from so-called "project-based mechanisms" in developing countries is, well, just that—they involve new projects and are in developing countries. Initially, the project may be little more than a twinkle in the eye of someone on the other side of the world whom you've never met, working for a company whom you've never heard of, in an industry and in a legal and regulatory environment which you don't understand.

Of course, you have no intention of putting up any cash until you've seen the color of their credits (though some early buyers did just that); but what if they fail to get regulatory approval, or can't finance the project, or the process fails, or their market collapses, or the counterparty absconds with the cash or the contracts are unenforceable? Moreover, what if the carbon market suddenly moves against you? What then?

Pass the Aspirin...

The Carbon Conundrum

When the EU Emissions Trading Scheme opened for business at the start of this year, EU Allowances were trading at around €8 t/CO₂. At the same time, carbon credits (or emission reductions) generated from projects in the developing world and transition economies—which may also be used to meet EU regulatory requirements—were changing hands for prices between €3-6 t/CO₂. Similar price discrepancies exist in other Kyoto compliance markets as well.

Nonetheless, if CDM and JI credits are just as good as EU allowances for compliance purposes, why are they selling at such a discount? And, why do the prices vary so much between projects? The simple answer is: delivery and acceptance risk – how certain is the delivery of credits and how certain is their acceptability for compliance purposes.

(see next page)



Memo to the CEO From the Greenhouse Gas compliance officer

We have a great opportunity to meet our green house gas compliance targets for the next five years at well below market and to steal a march on our competitors. You won't have heard of the company that's selling the credits – it's in India – and no, the broker that introduced the deal to me isn't regulated. But just as soon as the UN board that is responsible for dealing with these things gets its act together on the methodology for calculating the size of the greenhouse gas reduction, I am sure it will be all right. Trust me, it's a great deal...

Memo to the Greenhouse Gas compliance officer From the CEO

You're fired!

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Understanding these risks, and managing them effectively through to delivery and compliance, are going to be key skills for tomorrow's carbon-savvy entrepreneur. But you'll also need to contend with transaction costs, opportunity costs and uncertainty.

Companies need a suite of tools to contain risk and maximize value from the carbon issue, including:

- Market intelligence
- Internal abatement
- Arbitrage and fuel switching
- Demand side management
- Hedging and trading strategies
- Futures, options and derivatives
- Trading limits and procedures
- Accounting and tax planning
- Portfolio management
- Carbon due diligence

Many companies will want to use each of these tools to try to leverage advantage from the new carbon markets; but for companies that want to access lower cost credits through project-based mechanisms, carbon due diligence will be especially important. For transactions to succeed, buyers need to adopt a strategic approach to identifying and assessing risk, underpinned by a rigorous analytical and commercial approach.

Why is carbon due diligence so important?

With existing policies and measures, the EU-15 will not achieve its Kyoto target – there is expected to be a structural shortfall of at least 250 MtCO₂/year during the Kyoto compliance period (2008-12). The new Member States may provide some low-cost carbon abatement opportunities and the sale of “surplus” Russian reductions will also contribute to addressing this shortfall. Nonetheless, it is likely that CDM and JI projects will be a key component of the compliance strategy of many countries and corporate clients in Europe.

From the perspective of individual companies, buying credits forward from the CDM (known as CERs) and / or JI projects (known as ERUs) is certainly inherently more risky than buying regulated allowances (known as EUAs) on the spot market using an established market maker or exchange. The key is

to evaluate and price that risk, to be selective and, of course, not to put all your eggs into one basket.

Like most sound due diligence and transaction advice, there is no particular magic to it. It is all about experience – experience in the industry, in the market and regulatory environment, in project due diligence and in transaction structuring. PwC has a network of experienced professionals in all the key territories where you might be looking for carbon, which brings together all the core skills you are likely to require, including:

- Carbon markets and regulation;
- Project structuring and financing;
- Commercial due diligence and financial analysis;
- Tax structuring and planning;
- Transaction structuring and documentation; and
- Industry expertise.

We know what to look for and can leverage the time of your key staff, reduce investigative costs and travel time. We aim to help you to prioritize and execute value-added carbon transactions.

Understanding carbon risks

The first step in undertaking carbon due diligence is to have a methodological framework against which to consider the risks. Below are some of the generic risks involved with carbon credit procurement – whether originating directly or purchased through collaborative arrangements such as funds or buyers' clubs:

Volume risk - you buy more / less than you require and the price moves against you.

Delivery risk - you contract with suppliers who then fail to deliver the specified quantity or in accordance with the schedule agreed. This risk can be mitigated to some extent contractually, by insurance or by contracting with a portfolio of parties - although this clearly increases transaction costs. Delivery risk could also include administrative bottlenecks within the CDM Executive Board that delay credit issuance.

Technology risk - essentially a type of delivery risk that could arise when a new technology fails to deliver the credits or a (previously approved) methodology is subsequently revoked.



Richard Gledhill is the global leader of Climate Change Services and Emissions Trading at PwC

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Counterparty risk - you agree on a contract with a supplier who subsequently reneges on the agreement and the contract (for whatever reason) becomes unenforceable and a “short” position re-emerges. This risk will exist throughout the lifetime of any project, but will be particularly critical during the design / construction phase of new-build projects.

Country risk - this is the risk of the external operating environment influencing the project and can be divided into regulatory risk (underdeveloped legislation, changes in laws, restrictions on foreign investment or exports, uncertainty over Kyoto, energy pricing and subsidy schemes, taxation schemes), political risk (host country approval, policy change, confiscation of property, changes in political regime, civil war etc) and economic risk (currency devaluation or other instability affecting contractual terms).

Price risk – where you agree to a forward contract at a fixed price and then the market price of carbon credits or EUAs decreases to a level below the contracted price. In this case, there is an opportunity cost of the resources committed. This risk can be mitigated by contract prices linked to market prices, though there are practical constraints in this regard, at least until the market is further developed.

Our approach to carbon due diligence and transaction support centers on four main areas of work:

- Project identification;
- Pre-assessment;
- Detailed investigation through discussion with the counterparty and review of evidence; and
- Final negotiation over the terms of the Emissions Reductions Purchase Agreement (ERPA).

(See chart on right)

PwC has advised clients in North America, Europe and Australasia on strategies to manage risk and has assisted clients in analyzing projects and structuring transactions in carbon markets across the globe. Typically, we work with clients through a phased process of due diligence as illustrated above.

To discuss buying carbon credits and carbon due diligence in more detail, please contact Richard Gledhill in London or Christine Schuh in Calgary, or speak to your local PwC climate change team. Details of our climate change network can be found on our webpage: www.climatechangeservices.com

Richard Gledhill is the global leader of Climate Change Services and Emissions

Trading at PwC (Direct Line: +44 20 7804 5026 or e-mail at richard.gledhill@uk.pwc.com). He leads work on carbon credit transactions and emissions trading policy and strategy.

Christine Schuh is the Climate Change Services Leader in Canada (Direct Line: + 1 403 509 7500 or e-mail at christine.schuh@ca.pwc.com). She provides assurance services related to environmental, health and safety, corporate social responsibility management systems and data. Dr. Schuh is also a certified ISO 14000 EMS Lead Auditor.

The UN Global Compact: Moving to the Business Mainstream

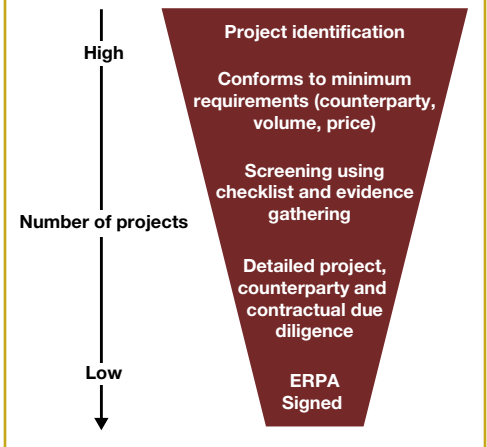
An Interview with Georg Kell, Executive Head

“The Global Compact is a voluntary international corporate citizenship network initiated to support the participation of both the private sector and other social actors to advance responsible corporate citizenship and universal social and environmental principles to meet the challenges of globalisation.” Now in its sixth year of operations and housed administratively at the highest level of the United Nations, the Global Compact has become a source of ideas and a platform for action for nearly 2,000 companies worldwide, including some of the world’s largest and most respected. Its work has only begun. Under the able direction of Georg Kell, an economist and engineer by training who joined the Office of the Secretary-General in 1997, the Compact is gaining the engagement of the world’s companies in voluntary programmes that combine corporate social responsibility with a new level of rigour in global risk management. Information about the Global Compact is available at www.un.org/Depts/ptd/global.htm.

PwC: Does the Compact have a governance system that effectively monitors and measures whether companies are living up to their commitments?

Mr. Kell: The Global Compact is not an enforcement mechanism. From the beginning, Kofi Annan has made clear that this is not a benchmarking system that measures good and bad. It’s a learning dialogue and a platform for action. It assumes that over time, once principles are embedded in organisations through new practices, improvement will occur. This approach is quite an innovation—it has little to

PwC approach to carbon due diligence and transaction support



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do with conventional thinking about the value of close measuring and monitoring versus voluntary initiatives. The Compact is a principles-based initiative that starts with CEO commitment, effective communication to employees, implementation within the organization, and communication through corporate documents. There is ample evidence that this approach can be effective—in fact, ample evidence that a principles-based change process achieves far greater positive change than any threat mechanism can achieve.

You can look at the Global Compact as a voluntary initiative that assumes leadership commitment and implementation within organisations. We are concerned about the “brand management” of the initiative. Of course we are concerned to avoid free riders who might use it for purposes other than its stated goals. And of course we are interested in listening and in learning, especially about the most promising initiatives and change processes that have been set in motion. We do have an array of quality measures at our disposal, many of which have been designed by our participants who want to protect their investment in the Global Compact and ensure that the good name of the Compact is not only maintained but increases over time.

PwC: What would be an example of an effective quality measure in the environment of voluntary initiatives you've created?

Mr. Kell: Local networks now active in over 40 countries are creating their own organisational entities. And business leaders are keeping an eye on each other to ensure that the Global Compact commitment is taken seriously. We have currently about eight networks with formal structures that include some form of self-governance and quality standards—but such organisations can take many forms.

At the global level, naturally we stress quality. On our website, we're about to focus on the theme of communications progress. We do expect companies to communicate on Global Compact issues in their annual reports or other public documents such as corporate social responsibility (CSR) or sustainability reports. The guidance we offer about communications is a flexible framework, and we are not about reporting. The Global Compact stresses actions. Nevertheless, you want to have credible communications, and therefore we recommend three elements.

The first is CEO commitment. It should

be there every year; change can only be driven if it's supported from the top. Secondly, telling a good story—when there is a good story—really matters. There's much to be learned from good stories. I wish we had more good stories, but we are hearing them now, increasingly. The third component is reporting on performance in the four areas the Compact addresses: human rights, workplace issues, environment, and anti-corruption. And there we do suggest some broad performance indicators. Companies with in-house performance indicators are of course free to apply them to the measurement of Compact issues, and many are doing so. Alternatively, companies can look to the outside world for professional expertise to help them define suitable performance indicators.

If companies ask us, we recommend the Global Reporting Initiative (GRI) as a framework for performance measurement, but we recognise that there is a big market out there. We assume that, over time, the market will increasingly pick up on these issues and come forward with credible performance benchmarks. So consider us a flexible change agent, promoting good performance with a heavy emphasis on leadership commitment, organizational change, and practical projects. Don't consider us an end-of-the-pipeline benchmarking system—that is not our mandate and not our goal.

PwC: It sounds as if you have deliberately decided not to monitor, at least for now.

Mr. Kell: We do not have the mandate, competency, or resources even to think seriously about monitoring. We have today nearly 2,000 companies in the Global Compact, and this is the United Nations: we must be open to companies. We want to draw companies into the fold rather than keep them out. We are making good progress in China, for example. We are very proud to be established in Egypt and Pakistan. In these countries and others, the demand simply for a good understanding of Global Compact concerns and issues is immense. What does human rights mean in the workplace? What does it mean to treat your workers well? How can I perform in an environmentally sound manner? The demand for basic tools is immense, and our best and highest impact is to bring companies into the fold. For example, we have a learning forum soon in Saint Petersburg. And there we expect to offer basic concepts and simple, useful toolkits. As a global initiative, we work both with market leaders and with



Georg Kell, Executive Head, UN Global Compact



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companies at the entry level where our issues are concerned.

We recognize that market leaders—large corporations with well-established reporting mechanisms—are in search of robust responses. And to such companies we say, “Look, the market must sort this out. The GRI is out there. Use it. And if you want to certify your performance through a third party, go for it.” National legislation varies greatly from country to country, and that too has to be respected.

PwC: What is the return on investment for companies that commit to the Global Compact?

Mr. Kell: There are, of course, well-established general arguments. For example, we advocate the CSR gospel to some extent—you know, more employee satisfaction with the company, greater ability to attract young, talented people who expect more than just strong financial performance. But more specifically, there are opportunities for partnerships with the UN, and they can be beneficial. The UN is active in many field offices around the world, and partnership opportunities are quite plentiful. Secondly, the Global Compact is multi-stakeholder; our learning and dialogue meetings always involve business, labour, and civil society. Such meetings offer an opportunity for partnerships to overcome divides.

But here, to my mind, is the most interesting point, and it's not at all a classical corporate social responsibility argument. It's new, and it's becoming powerful. I think that CSR is somewhat losing its innocence, if I may call it that, and increasingly moving to the business mainstream. Why? Because the whole issue is ultimately one of risk management.

More companies are seeing that getting it wrong can be very costly. They are seeing that if they make a mistake on the environmental front, on the social front, on workplace issues such as sweatshops—you name it—the costs can be huge. So they want to protect themselves. Social, environmental, and governance criteria are also increasingly perceived as criteria for long-term viability. They can serve as a compass to navigate the risks associated with exposure to global markets.

The risk paradigm is increasingly taking over much of the dynamics that initially were kicked off by other kinds of CSR values—by the wish to do the right thing or to be perceived as doing the right thing. Now, the issue

is at least as much protecting against damage and proactively managing risks. So I would argue that the biggest benefit of the Global Compact, if taken seriously, is to further at the top levels of companies a more strategic perception of the role, impact, and vulnerabilities of businesses with global exposures to different markets, cultures, and risks. Risk management increasingly requires corporate leaders who understand the social and environmental dimension within which companies operate and create value.

PwC: Could you give us an example, however well-disguised, of a specific company that is thinking along these lines?

Mr. Kell: I've just come back from a high-level meeting with a global company in the financial arena. The discussion was almost exclusively about how to combine a global philosophy with local value-added capacity. And the bottom line was the company leaders' recognition that the company must have its values correct everywhere, irrespective of where they operate. They must have a common ethical framework. They acknowledge that this is expected of them, and that it represents the only way to be viable over time. For this reason, the company knows that it needs a much deeper understanding of the social, environmental, and governance risks and opportunities that surround it wherever it operates.

I think that this kind of strategic thinking, which overlays traditional business opportunity thinking around products and services, is increasingly taken seriously.

PwC: If we may ask, what specifically did this company want from you?

Mr. Kell: They wanted advice, based on our experience. Among other things, they wanted to know whether their way of evaluating the issues is a global trend, or are they more or less on their own. I confirmed for them that there is indeed a trend—we are picking up observations from a variety of developments. For example, we have a forum here in New York at which major financial institutions are exploring how to analyse environmental, social, and governance criteria at the industry level, as part of assessments of the long-term viability of individual companies. That is a major shift. Only 12 months ago, it was almost unthinkable that what some people might call “soft” issues would now become analytical tools for long-term viability assessments. There is quite a dramatic



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change under way. CSR is no longer just a do-good affair or a device to protect reputation. It is becoming a strategic index of the long-term soundness of companies.

PwC: What was insufficient about doing the right thing and protecting your reputation? From many points of view, those are compelling motivations.

Mr. Kell: I would agree with you—that should be enough. But the world is more cynical and complex than that. And there's something else to consider: doing the right thing can generate more damage than good if it's not tied into a holistic, long-term perspective. For example, arranging scholarships for 10 bright kids in a poor country while ignoring other young people may contribute to social unrest. Similarly, if pharmaceutical companies hand out a few packages of life-saving medicine but give no thought to the long-term robustness of a poor country's healthcare system, they may well be "doing the right thing" but failing to get to the heart of the matter.

We are speaking of complicated issues: how to get development going, how to ensure that a more accountable and enabling environment is created. In most countries where there are grave problems and where corporations are exposed to those problems, the root cause has to do with the fact that governments are not doing what they are supposed to do—either because they are too poor to do it and public institutions just don't have the needed resources and training or because governments are corrupt and abusive.

There are civil wars in 15 countries right now. There are situations closely resembling civil war in some 30 other countries. There is systemic corruption in nearly 60 countries. This suggests that what companies can accomplish in the spirit of "doing good" is fine and needed but unlikely to tackle the long-term problems. Whatever companies do, they need to be aware of its relation to public policy making and to long-term development trends.

Business is part of society, part of the DNA that grows the future. And if you grow the future, you have to be aware of how you shape the future. You cannot afford to be naïve, to close your eyes in front of a corrupt or abusive government, or to avoid looking at the fact that public education or public health services may be going nowhere.

PwC: What response are you receiving from companies in the United States? CSR doesn't seem to raise as much enthusiasm and commitment there.

Mr. Kell: Let me be quite frank. I think American companies are the leaders in so many fields—in technology, management, organizational change, total quality management, and so on. Much of the benefit that business brings with it comes from the US, either directly or from business models developed in the US and adapted elsewhere. It remains the number one innovation centre, and that is unlikely to change. I respect US business.

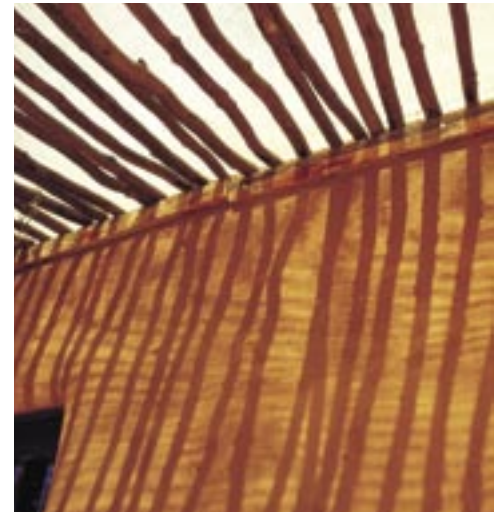
What I'm saying relates to CSR, as well. Wealth creation allows business to contribute to society. From that perspective, I would say that American companies are doing better than others. Are American companies indifferent to CSR? I think American companies have shown a high level of engagement with CSR issues around the world. Most of our partnership initiatives include American companies—among the greatest companies in this country. Now, you could ask, why are not all US companies participating in the Global Compact? On that point, there is some good news: over 70 companies are signatories. That is still a small number, given the huge pool, but not insignificant.

PwC: Seventy is a very small number!

Mr. Kell: We still have a long way to go, and there are three structural challenges to overcome. First we have to continue to demonstrate that the Global Compact is about action and not about trying to impose. In this regard, we have a solid five-year track record, and Kofi Annan has made this point time and time again. People are starting to believe it now. Secondly, the US is a very litigious society. Therefore, the challenge of getting a CEO to sign on to principles is much greater than in any other culture. Luckily, we now have what we call a litigation-proof letter endorsed by the American Bar Association. As we spread knowledge about this letter, it should help to overcome the legal barrier.

PwC: That letter can be used by a company to state its intentions concerning participation in the Global Compact?

Mr. Kell: Engagement in the Compact starts with the CEO's commitment. The CEO writes to Secretary-General Kofi Annan more or less as follows: we have looked at the Global Compact, the principles are relevant, we want to use them as an ethical framework, I will drive them through my company, and once a year in our internal publication we will communicate how our performance is changing with respect to Global Compact principles. The CEO might also write



that he or she is interested in entering into partnerships with UN offices around the world, and committed to fighting poverty and to creating opportunities and employment.

This initial letter is a big headache for US legal counsel. They always say “No, don’t sign anything”—especially in the current climate. To save the day, the American Bar Association letter we can now offer to CEOs is litigation-proof. It was vetted, I think, by 20,000 business lawyers. The Bar recommends it as a CEO engagement letter.

PwC: What is the third structural challenge?

Mr. Kell: In smaller countries—Switzerland and Singapore, for example—the Compact is very strong and large corporations embrace it, in part as a way to reach out to the world. The US, on the other hand, is a big country and market. An outward-oriented focus is probably not as widespread, although US-based global corporations are increasingly aware of the Compact. Given world trends, we believe time is on our side.

PwC: What would you care to communicate through our publication about your vision for the future of the Compact?

Mr. Kell: We still have some distance to go to reach critical mass in some markets. I hope that American corporations increasingly see the benefits of engagement in the Compact through partnerships on the ground and through working with other actors. My message to the American corporate community is to look at the track record of the Global Compact, to look at the consistency of our message, and to overcome real or perceived barriers to engaging with us.

On the broader world front, my wish is that we learn how to scale up good practices. We know of so many good examples at individual companies—great contributions. But even these contributions are small compared to the problems we face. We need more companies involved in order to scale up. And over time we need companies to deepen their commitment to the Compact.

PwC: Thank you for your time Mr. Kell.

Region Focus

SOACAT: Sustainability in South America

2004 - A Strong Recovery for the Economies of South and Central America

After several consecutive years of stagnation, the economies of South and Central America began to recover in 2004. The growth is reflected in the improvement of traditional indicators such as fiscal solvency evident throughout most Latin American countries.

At first, the recovery was due to an increase in both global demand and commodities prices. Recently, growth has been due to an increase of internal consumption and private investments (both local and international). In 2004, the Latin American economy grew approximately 4.5%, the largest percentage increase since 1997.

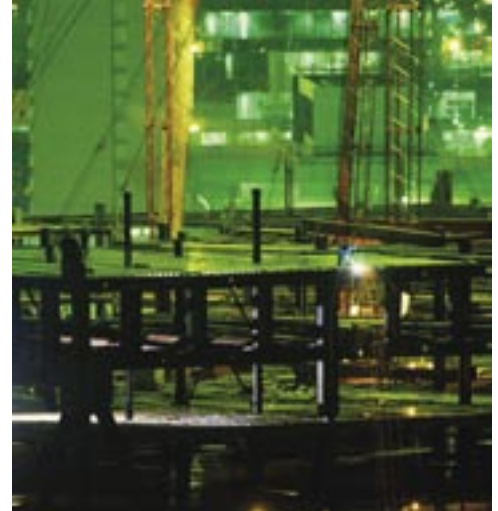
New Challenges and Opportunities

Against this backdrop of economic growth, the SOACAT region foresees an increase in social reports verification and climate change transactions, regulated by the Kyoto Protocol.

The Kyoto Protocol, which became legally binding on February 16, 2005, establishes goals of green house gases emission reduction and mechanisms to help countries in achieving their goals (Emissions Trading, Joint Implementation, and Clean Development Mechanisms (“CDM”)). Those goals are segregated according to country background: Annex I countries (developed countries) and non-Annex I countries (developing countries). Latin American countries are part of the non-Annex I group.

The Clean Development Mechanism (CDM) defined in Article 12 provides Annex I parties with the option of financing or buying credits in developing countries where remediation project activities often are more feasible and cost-effective. The certified emission reductions (CERs) generated by such project activities can be used by Annex I parties to help meet their emissions targets under the Kyoto Protocol. Article 12 also stresses that such projects are to assist the developing country host parties in achieving sustainable development and

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in contributing to the ultimate objectives of the Convention. The Kyoto Protocol presents an important opportunity for Latin American countries to attract external funding.

The current modalities and procedures for the CDM focus on activities that reduce emissions. A CDM project might involve, for example, a rural electrification project using solar panels or the installation of more energy efficient boilers. Annex I Parties are to refrain from using CERs generated through nuclear facilities to meet their emission targets.

On February 16, 2005 all parties that have ratified the agreement must take action to meet their stated targets. This pressure will enable a growing climate change services market in the SOACAT region.

Conference of Parties (COP 10) – Buenos Aires, Argentina

The COP 10 took place in Buenos Aires from December 6th to 17th, 2004. The purpose of the conference was to convene developing countries to discuss climate change impacts, mitigation strategies and adaptation.

During the COP 10, the Buenos Aires Programme of Work on Adaptation and Response Measures was adopted. The Programme will further scientific assessments of climate change vulnerabilities and options for adaptation. In addition, the following issues and outcomes developed from the conference:

- The conference asked the Convention Secretariat to convene a meeting in May 2005 of all the Parties' governmental experts to discuss mitigation and adaptation plans and current adopted government policies and progress.
- New CDMs were discussed.
- Brazil and China submitted their first national communications outlining their strategies for addressing climate change.

The conference created a global business forum where governments, NGO's, PwC (Argentina, Brazil and India) and other businesses in the private sector could share their knowledge in the development of CDM projects and sustainability programs.

The next annual conference, COP 11, will be held from November 7th to 18th, 2005.

SOACAT PricewaterhouseCoopers Climate Change Services Help Clients Meet New Challenges and Opportunities

- In an increasingly carbon-constrained business climate, PwC professionals have expertise in providing climate change solutions. The firm has Corporate Finance teams providing strategic advice, global transaction management and certification services.
- PwC SBS experts approach clients' challenges in climate change with a focus on aligning climate change risk mitigation and climate change strategy with the company's core business strategies and operations.
- PricewaterhouseCoopers has over 150 experienced Climate Change Services practitioners across the globe, with a dual expertise in environmental risks and solutions, and Corporate Finance.
- PwC works with the United Nations Framework Convention on Climate Change, the European Commission and within local governments to provide a unique insight into policy and regulatory development.

Client Projects:

Sadia (largest food company in Brazil) Greenhouse Gas (GHG) Capture and Combustion from Swine Manure Management Systems

- The first CDM project in the Brazilian Food Sector.
- Sadia and PwC Brazil are working on the development of a sustainability program. The project is supported by CDM initiatives.
- The program is aimed at improving the sustainability performance of its main activities and its outsourced producers activities.
- The project involves PwC integrating social responsibility criteria into the company's operations, incorporating a corporate governance structure and developing environmental performance indicators for a program that will fund swine farmers.
- Main client benefits: (i) production increase; (ii) improved supply chain integrity; (iii) use of new technologies and renewable energy sources; (iv) improved



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environmental performance; and (v) enhanced governance and compliance.

Great Eastern Energy Corporation: Demethanation of Coal Beds and Use of Methane for Power Generation

- GEEC is part of YKM Holdings Group.
- GEEC has obtained permits to demethanize by exploring and producing coalbed methane in Eastern India.
- This CDM project is the first initiative of its kind in Asia. The project has drawn on the expertise of PwC India.
- The baseline has two components: (i) fuel switching to power generation, and (ii) methane emissions avoidance.
- The main benefits are: (i) fire reduction in coal mine areas, (ii) improvements in mine safety, (iii) clean sources of energy, and (iv) technology development / transfer.

What's New at PwC: A Profile of SOACAT Sustainable Business Solutions

SOACAT now has five Key SBS Centers in Argentina, Brazil, Columbia, Chile and Costa Rica. Each Center has dedicated resources and local alliances totaling 60 professionals (23 professionals were added in July 2003).

This growth includes not only country hires but also the transfer of two PwC France professionals to PwC Chile and the integration of a local firm in Costa Rica.

SBS Partners & Directors

Argentina:	Marcelo Iezzi
Bolivia:	Boris Mercado
Brazil:	Paulo Vanca (*)
	Marco Fujihara
Chile:	Luis Perera
Colombia:	Carlos Acosta
Ecuador:	José Aguirre
Interamericas:	Axel Castellanos
Paraguay:	Daniel Elicetche
Peru:	Nancy Yong
Uruguay:	Javier Becchio

(*) SBS SOACAT Leader

SOACAT International Assignments

Alexandre Rossin, a PwC US professional born in Brazil, worked for PwC SBS Brazil for two years. Alexandre returned to the US where he is recognized as a top performer after the SBS Brazil experience.

SBS Chile has just added two new members to the team: Clement Lefevre and Mathieu Vallart. They come from SBS France and will be in Chile for two years, bringing relevant experiences and enhancing the network.

Clement has worked for three years in SBS France. His experience is in the waste treatment and water management sectors and his specialties include: ethics, social compliance, fair trade, verification of sustainability data and economic data linked with environmental issues, economic analysis of recycling industries, and national strategies.

Mathieu has worked for three years in SBS France. His areas of expertise include: verification of sustainability data and reporting processes (including GHG verification), corporate social responsibility strategy projects, environmental due diligence, and financial audits.

SBS Academy – Santiago, Chile

PwC established the SBS Academy as a forum for permanent directors and senior managers to network on strategic business issues. The SBS Academy opened its doors for the first time in August 2004 to 16 practitioners from the regions—Argentina, Bolivia, Brazil, Chile, Columbia and Uruguay. The inaugural event was organized by SBS leaders from Chile and Brazil, Luis Perera and Paulo Vanca, respectively.

The Academy offered a broad range of informative seminars to participants on topics including:

- Life Cycle Analysis Training**
- SBS Solutions Case Studies
- Country Presentations on SBS Structure, Key Services and Clients
- SBS Strategy / Action Discussions

** Presented by Philippe Osset and Jean-Michel Hebert (SBS France)

If you have any questions about Sustainable Business Solutions in the Central and South American region or would like to be informed of upcoming SBS Academy events, please feel free to



Paulo Vanca, Partner, SOACAT Leader

contact Paulo Vanca at paulo.vanca@br.pwc.com

Alternatively, please call +55 11 367 43803.

New Publications from PwC:

2005 Trends in Corporate Reporting

More and more companies are embracing the ever increasing demands from participants in the capital markets for greater transparency by communicating above and beyond the requirements of the existing financial reporting model.

The pressure in the markets is being supported by worldwide regulatory change. Much of this change is driving companies in the same direction; to report broader information. The regulations spell out the detail of what is required, however, a gap exists, as they cannot demonstrate what good reporting actually looks like.

PricewaterhouseCoopers is ideally placed to fill that shortfall. Our 6th annual publication of *Trends 2005: Good Practices in Corporate Reporting* (*Trends 2005*) highlights the key trends in regulation worldwide and identifies reporting from 42 forward-thinking companies worldwide that provide information on their markets, strategies, how they manage for value, and performance. These examples are structured around the ValueReporting Framework, which is the codification of nearly a decade of capital markets research. They demonstrate how these companies are already embracing the demands for greater transparency that is the ultimate goal of much of the new legislation worldwide.

Trends 2005 is not the kind of publication you should read through quickly and then relegate to the shelf. Ideally this publication should be viewed as a “textbook” to assist in meeting the challenges of increasing demands for greater transparency.

To order your own copy of *Trends 2005* or find out more information about ValueReporting, please contact the Trends team directly at Trends2005@uk.pwc.com or alternatively, visit their site at www.valuereporting.com

Global Sustainability Events

The 2005 Business and Sustainability Conference: The Promise and Challenge of Sustainable Development

Pre-Conference Forum: June 13, 2005
Conference: June 14 - 15, 2005
New York , NY

PricewaterhouseCoopers' 18th Annual Global Forest and Paper Industry Conference and Global Forest and Paper Summit 2005

June 1 - 3, 2005
Vancouver, BC Canada

4th European Forum for Sustainable Development and Responsible Company Management

March 31 - April 1, 2005
Paris, France

5th International Sustainability Leadership Forum—“Business Investment in Development: Experiences and Perspectives”

August 26 - 27, 2004
Zurich, Switzerland

Please visit www.pwc.com/sustainability for more details.

The Corporate Responsibility Report:

