

## **Incorporating Sustainability into Indirect Procurement: The Audit Approach**

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### **Abstract**

*This study investigates how to integrate sustainability into indirect procurement and develop an efficient sustainability audit process. Using a qualitative approach, the research analyzes relevant articles, reports, and regulations from various countries. In today's business environment, incorporating sustainability into procurement is essential for enhancing corporate responsibility and efficiency. The study highlights the importance of audits in identifying and mitigating environmental and social risks in indirect procurement. Comprehensive audit procedures, including supplier evaluations, compliance checks, and performance monitoring, are crucial for promoting sustainable procurement practices. The findings show that a well-structured audit approach ensures adherence to sustainability standards, promotes transparency, and fosters continuous improvement in the supply chain. The paper concludes with recommendations for effective audit strategies to achieve sustainable indirect procurement. Global economic development varies, and corporate governance sets rules to ensure transparency and security for investors. Non-financial reporting is increasingly important, with companies evaluated on social and financial metrics, leading to more sustainability reports following GRI standards.*

**Key words:** sustainability, ESG (Environmental, Social, Governance), indirect procurement, supply chain, sustainability audit

**J.E.L. classification:** M14, M42, L14, Q50

### **1. Introduction**

In today's world, where environmental and social responsibility are crucial, organizations are actively looking to incorporate sustainability into their procurement processes. Indirect procurement, which involves sourcing goods and services that support an organization's operations, offers unique opportunities and challenges for sustainable practices. This paper explores the integration of sustainability into indirect procurement using a comprehensive audit approach, emphasizing the essential role of audits in maintaining responsible and ethical supply chain management. Indirect Spend Sustainability encompasses all efforts and practices by a company to minimize the environmental, social, and economic impacts of its indirect spending. These efforts can include various initiatives, such as assessing and engaging suppliers, selecting products and services with lower environmental impacts, reducing waste, recycling, investing in energy-efficient technologies, reducing greenhouse gas emissions, enhancing social responsibility, and regularly tracking and reporting sustainability performance to ensure transparency and continuous improvement. (Supply Shift E-book 2023) The biggest challenge remains to manage supplier social responsibility and to create a way to rate a company overall. According to (Hill, 2020) the simplest method of grading a business is to only depend on its or its industry's past reputation.

However, this approach may undervalue the efforts businesses make to enhance their performance and, on the other hand, may be susceptible to deceptive or false corporate advertising. The multifaceted nature of ESG issues adds another layer of complexity. The effectiveness of a business can be evaluated in a variety of ways, including the effects it has on the air, water, and energy; the sustainability of its customers and employees; and its recruiting, training, and promotion policies regarding women and minorities. How should I weigh and measure each of these? Companies and investors increasingly rely on outsourced services to conduct research and help on ESG issue identification, compliance, and reporting due to the challenges associated with compiling and evaluating data on a broad range of ESG issues. Some businesses have implemented a self-assessment approach in which they request suppliers to self-report their social responsibility (SR) capabilities. Since self-reported information is hard to confirm, a crucial credibility dilemma arises: can a buyer reasonably be expected to receive genuine reporting? (Tao and Brian, 2022). The chance of no violation is represented by a certain SR level that is known only to the supplier. The buyer operates in a market where reported SR infractions are taken seriously. After the supplier notifies the customer of its SR level, the buyer chooses how much to order and between two audit stringency levels to be performed on the provider. Findings: If the buyer orders a larger quantity from the high-type supplier but imposes a stricter audit than the buyer would for the low-type supplier, and the high-type supplier chooses to accept this larger order while the low-type supplier, fearing audit failure, does not, then influential truthful communication may emerge in equilibrium. As the cost of the audit increases, the buyer stands to gain.

## **2. Theoretical background**

### **2.1. Indirect procurement driving efficiency**

Purchasing has become more strategic in recent years and is frequently the source of competitive advantage (Sitar, 2012). Purchases made by a company can be divided into two categories: direct and indirect.

Indirect Procurement, or Non-Production Procurement, often seems less critical than Direct Procurement. However, sourcing goods for daily operations, like office supplies and equipment, significantly impacts a company's overall processes. Due to its broad scope, Indirect Procurement requires specialized expertise rather than leaving purchases to individual departments, which can lead to tensions and unnecessary costs. Larger global companies may have dedicated Indirect Procurement teams, while smaller businesses benefit from virtual procurement services. As digital supply chains evolve, refining sourcing strategies is essential for reducing internal costs and achieving sustainability goals. Indirect Procurement not only supports daily business operations but also offers a strategic avenue for financial and sustainability improvements. According to (Retail Technology Innovation Hub, 2022) almost 80% of purchases are made through indirect procurement. Therefore, more careful management of indirect procurement is an efficient cost-saving method for businesses where profit is the primary goal, particularly in an era of high inflation where minimizing financial strain is crucial. However, indirect procurement plays a significant role in sustainability. The hazards that procurement professionals continue to face were brought to light in (Inverto's 2022) Risk Management in Procurement Study. The survey, which was primarily centered on the engineering, automotive, and consumer industries in Western Europe, found that lowering CO2 emissions was the third most risky factor after securing supply and growing costs. It is imperative that businesses prioritize sustainability in both indirect and direct procurement due to mounting demand on them to promote sustainable supply chains by reducing their carbon footprints and environmental damage. By reducing the need for indirect materials, a more efficient and well-organized strategy to sourcing and purchasing can improve sustainability by reducing waste, transit, and storage. Purchasing indirect commodities efficiently has several advantages for companies. Specialists in indirect procurement are essential in assisting businesses in creating more robust and economical supply networks in the face of financial strains, supply chain interruptions, and sustainability initiatives.

## 2.2. Sustainability audit

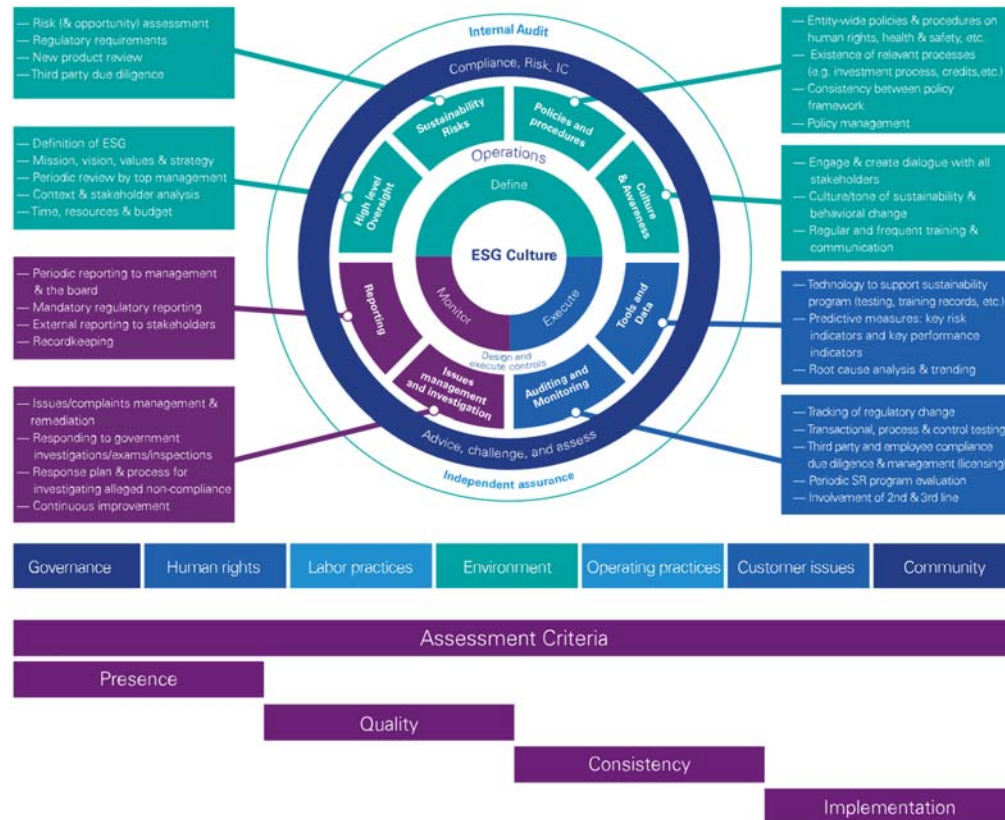
For decades, the concept of Environmental, Social, and Corporate Governance (ESG) has gained increasing attention from both the public and private sectors. Companies are now assessed not just on economic grounds, but also on their societal and environmental impacts. The growing significance of ESG is evident in the numerous standard-setting initiatives that have emerged over the years. Notable examples include the ISO 26000 standard on Social Responsibility, the Global Reporting Initiative (GRI), the guidelines developed by the Sustainability Accounting Standards Board (SASB), and the universal Sustainable Development Goals (SDGs) set by the UN Global Compact.

Sustainability audits, which prioritize an objective examination, are intended to assist organizations in controlling their sustainability activities, achieving managerial commitment, adhering to organizational sustainability policy, and meeting environmental legislation. Sustainability audits include elements including utilizing stronger rules and regulations to safeguard the environment, making decisions based on sustainable development, and peacefully resolving problems through dialogue for sustainability development. This somewhat aligns with the research conducted by DeSimone et al. (2021), which demonstrated that sustainability sensitivity had a considerable impact on sustainability audits in both listed and non-profit organizations but was not significant for unlisted enterprises in the organization type analyses. According to a continental-level analysis (DeSimone et al., 2021), sustainability sensitivity had a major impact in Asia and Oceania as well as North America, but a negligible impact in Africa, Europe, and Latin America on sustainability audits. The current study, however, disproves this conclusion by showing that Accra-based manufacturing companies must prioritize environmental friendliness in order to improve sustainability audits. (Samagaio and Diogo, 2022).

With the increasing integration of environmental assessment and auditing methods into our decision-making processes, sustainability auditing is emerging as the most potent audit style to date. A sustainability auditing framework can be developed using one of several conceptual frameworks. They all entail identifying the most important problems facing a company, creating targets and indicators for sustainable development, and regularly assessing how well one is doing in reaching the goals. Examples of such frameworks are the capital stocks, ethics-conservation-cooperation-competition, effectiveness-thrift-margin, pressure-state-response, and environment-society. (McCartney, 2003)

KPMG has created an internal audit program that integrates well-known standards with their internal expertise in internal audit and ESG. This methodology evaluates sustainability initiatives through three stages: Define, Execute, and Monitor. Auditors should review the company's ESG policy, including oversight, risk assessment, due diligence, and implementation actions. Additionally, auditors should evaluate the organization's tools, technology, controls, and monitoring activities. The organization must have measures to address issues and report according to stakeholder expectations. To assess the organization's maturity, the audit methodology elements are evaluated based on their presence, quality, consistency, and implementation level. (KPMG 2021)

Figure no. 1. All the 17 SDG Goals



Source: (KPMG Report, 2021)

### 2.3 Sustainable procurement

Since its inception at the World Summit on Sustainable Development in Johannesburg in 2002, sustainable procurement has gained significant attention from policymakers worldwide. (Zaidi et al 2021) Sustainable procurement influences all participants in the supply chain and is based on a multi-stakeholder approach. It requires a commitment to social responsibility at every level of the organization and for all types of procurement, including minor items. These practices take into account human rights, diversity, philanthropy, environmental issues, and safety considerations. There is a growing focus on purchasing from local and small-sized suppliers, which leads to life cycle costing that promotes the production of environmentally friendly products. Sustainable procurement practices encompass local and SME-oriented purchasing, eco-friendly products, and social returns on investment (Grandia and Kruyen, 2020). They address organizational procurement policies while also concentrating on reducing packaging and waste. Organizations evaluate their suppliers' social performance, their capability to produce environmentally friendly products, and their efforts to decrease carbon emissions related to the transportation of goods.

Financial constraints and product quality issues are major obstacles globally. The UK primarily faces financial barriers, while other regions struggle more with product quality. In Pakistan's education sector, government legislation and third-party pressure are significant barriers, while in Spain, supplier capacity and employee motivation are key issues. Governmental barriers include inadequate environmental laws, lack of support, and weak enforcement. Market barriers involve limited supplier availability, low consumer demand for sustainable products, unavailability of green materials, and poor collaboration in the supply chain. Strategic barriers within organizations include lack of management commitment, resistance to change, insufficient incentives, inadequate

funding for green initiatives, and a focus on cost over sustainability. Operational barriers include lack of financial support, insufficient employee skills, perceived high costs, lack of awareness, and a short-term focus. These barriers highlight the varied challenges in adopting sustainable procurement practices. (Shaikh et al., 2023)

### **3. Research methodology**

This research methodology involves a comprehensive analysis and comparison of various studies on indirect procurement, sustainable procurement, and sustainability audits (SA) mainly from the past 3 years. The methodology encompasses a systematic review of existing literature, reports from the Big Four accounting firms, and internal regulations pertaining to sustainability and indirect procurement procedures.

The analysis was structured by dividing the subject into three distinct parts: indirect procurement, sustainability audits, and sustainable procurement processes. This segmentation facilitated a thorough examination of each component, offering a comprehensive overview, and enabling a deep understanding of each area.

By employing comparative analysis techniques, we identified trends, patterns, and significant changes in legislation and policy regulations. Studies were meticulously selected based on their relevance, credibility, and the comprehensiveness of their findings. This approach ensured a holistic perspective on enhancing the sustainability of indirect procurement processes and determining the optimal sustainability audit (SA) approach. Consequently, this methodology provided detailed insights into each area, ultimately leading to a nuanced and integrative perspective on embedding sustainability into indirect procurement practices.

### **4. Findings**

Since indirect procurement accounts for a very small percentage of the expenditures of manufacturing enterprises, it is a complex and important aspect of purchasing that has received little attention from academic study. Another issue with indirect purchase is its ambiguous terminology, which makes it challenging to draw conclusions from many sources.

According to (Karjalainen, Kempainen and Van Raaij, 2009), the absence of procurement strategies for indirect spending results in problems like maverick purchasing, which is the buying of products and services outside of established contracts or procedures. These purchases are detrimental to the company because they deviate from accepted best practices and complicate the analysis of indirect spending (Sodhi, Sodhi, and Tang, 2014). Furthermore, a lot of indirect procurement strategies just consider the purchase price, not the system's overall costs (Bailey and Helms, 2007).

Strategies must be tailored to each individual subcomponent of indirect spend and will vary based on a firm's industry and value of the purchased item. Incorporating sustainability practices into procurement strategies can help ensure that purchases are not only cost-effective but also environmentally responsible. A sustainability audit can further enhance procurement by evaluating the environmental and social impact of purchasing decisions, ensuring that the organization adheres to sustainable practices and reduces its overall ecological footprint.

Sustainability reporting has shown to be a critical factor in enhancing supplier engagement and environmental management activities. According to a report by Business for Social Responsibility and the Carbon Disclosure Project (BSR 2016), suppliers often demonstrate higher levels of risk recognition and improved environmental management once they initiate regular reporting processes. This suggests that the act of reporting itself can drive suppliers to be more attentive to sustainability aspects within their operations. Furthermore, standardized approaches to supplier assessment, such as those promoted by initiatives like Together for Sustainability, help reduce confusion and overwhelm among suppliers by aligning requirements and methodologies (TfS Initiative, 2013). The Sustainable Purchasing Leadership Council is also working towards developing a rating system that aims to enhance credibility, institutional alignment, and efficiency in purchasing practices across both public and private sectors (SPLC, n.d.).

These efforts underscore the importance of consistency and standardization in sustainability reporting to foster better sustainability practices among suppliers.

While indirect procurement accounts for a small portion of total expenditures, its complexity and importance are significant. Developing tailored strategies that include sustainability practices and audits can ensure cost-effective and environmentally responsible purchasing. Sustainability reporting and standardized supplier assessments, as promoted by initiatives like Together for Sustainability and the Sustainable Purchasing Leadership Council, enhance supplier engagement and environmental management. These efforts underscore the importance of consistency and standardization in fostering better sustainability practices across supply chains.

## **5. Conclusions**

The study looks into creating an effective sustainability audit process and incorporating sustainability into indirect buying. To improve operational efficiency and corporate responsibility in the modern company environment, procurement practices must incorporate sustainability. The study emphasises how crucial audits are for spotting and reducing social and environmental hazards associated with indirect procurement.

Implementing sustainable practices is made more difficult and presents special opportunities when it comes to indirect procurement, which is purchasing products and services to support an organization's operations. The research is divided into three main sections: sustainable procurement methods, sustainability audits, and indirect procurement. This allows for a thorough comprehension of each section as well as a thorough summary. This methodical methodology made it possible to conduct a comprehensive analysis of the topic and identify trends, patterns, and important modifications to laws and policy regulations.

According to the findings, supporting sustainable procurement methods requires thorough audit procedures that include supplier evaluations, compliance checks, and performance monitoring. Audits are essential for guaranteeing that sustainability guidelines are followed, forging open communication, and encouraging ongoing supply chain development. Evaluating a company's ESG policies, performing risk assessments, carrying out due diligence, and guaranteeing compliance with internal and external regulations are just a few of the components that make up an effective sustainability audit. These audits support companies in meeting stakeholder expectations, managing their sustainability initiatives, and upholding responsible supply chain management.

The relevance of non-financial reporting is also emphasised in the study, given the growing trend of evaluating businesses using both financial and social criteria. The increasing interest of investors in companies adhering to ESG criteria is reflected in the increased demand for sustainability assurance statements and responsible investing methods. It has been demonstrated that strong ESG performance has a beneficial effect on economic metrics, lowering financial risks and boosting company reputation.

The report also emphasises the difficulties with ESG ratings, pointing out the lack of uniformity and openness in the standards applied by various rating firms. The disparities in ESG ratings highlight how the assessment process needs to be more transparent and standardised. According to the study, more research on suitable ESG standards for assessing businesses' social responsibility, environmental, and governance practices would be advantageous for several stakeholders.

The study concludes by offering specific insights into how sustainability is incorporated into indirect procurement procedures as well as suggestions for successful audit tactics. These tactics are essential for improving corporate responsibility, attaining sustainable indirect procurement, and guaranteeing long-term operational efficiency. The study also emphasises how different countries' economies are developing and how important corporate governance is to providing investors with security and transparency. Organisations can support ongoing improvement in their supply chains, uphold sustainability standards, and encourage sustainable procurement practices by implementing thorough and organised audit procedures.

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