

PHILIPS

Beyond Auditing

Philips' approach to
supplier sustainability



Better care for more people

Responsible business practices drive our innovation, ways of working and business impact. Philips has aspirational goals that drive environmental and social practices beyond simply auditing for compliance, supported by diligent governance.

To this end ...

We want our supply chain to be economically, environmentally and socially sustainable.

We take a systematic approach to social impact and improving the environmental footprint of our supply chain.

We drive continuous improvement and measure impact through a structured, phased approach.

We focus on collaboration, increased transparency, clear commitments and accountability in meeting supplier targets.

We encourage our suppliers, industry peers and cross-industry partners to adopt our approach.



We want our supply chain to be economically, environmentally and socially sustainable.

We expect our suppliers to take responsibility and to continually improve in this area. Philips is committed to supporting this process by helping suppliers address key issues such as health and safety, fair remuneration, employee benefits, workforce protection and turnover – just as we do within our own operations. Such collaboration requires openness, transparency and honesty. Philips believes that this joint approach and collaboration with suppliers is in everyone's best interest, delivering long term benefits for people and the planet, and strengthening our suppliers' continuous improvement skills, with a positive knock-on effect on overall quality and cost management.

We take a systematic approach to social impact and improving the environmental footprint of our supply chain.

By being transparent and engaging with a wide variety of stakeholders – ranging from customers, governments and NGOs to suppliers, employees and investors – we are identifying risks and opportunities and gaining insights to refine our supplier sustainability strategy. We then translate this strategy into dedicated programs designed to help our suppliers improve their social and environmental performance. One of these programs is called Beyond Auditing (formerly Supplier Sustainability Performance).

We drive continuous improvement and measure impact through a structured, phased approach.

We use Philips' Supplier Sustainability Declaration (Philips code of conduct) as the foundation of our frame of reference.

We address these core aspects: organization at site level (e.g., manufacturing or operations), environment, health and safety, business ethics, and labor and human rights. We have defined nine elements to identify and rate the maturity level of a specific supplier site regarding their sustainability performance. These nine elements are: policy, procedures, implementation, management responsibility, communication, risk control, target setting and tracking, corrective action approach, and supplier management. A maturity score is determined after a code of conduct assessment, through document and on-site verification, including direct engagement with workers. Suppliers who score medium and above and have demonstrated a reliable foundation of code of conduct implementation are invited to participate in deep-dive assessments. These deep dives support suppliers in reaching higher maturity levels in the domains of human rights, carbon reduction and tier 2 supplier sustainability.

We focus on collaboration, increased transparency, clear commitments and accountability in meeting supplier targets.

By setting clear expectations from the start, we aim to reduce the pressure on our suppliers and eliminate the supplier's fear of not meeting the requirements in the supplier sustainability declaration (SSD). When moving beyond compliance, suppliers are assessed and grouped based on their sustainability performance.

These categories help determine the most effective and impactful approach for improvement, ensuring each supplier can meet agreed-upon targets. Support mechanisms include intensive coaching and remote support from Philips, peer-to-peer networking or self-directed action by the supplier. We emphasize that creating an improvement plan is not about quick fixes but about driving long-term, sustainable business improvements.

We encourage our suppliers, industry peers and cross-industry partners to adopt our approach.

Together with our suppliers and their suppliers, we increasingly face rapidly changing customer demands, resulting in a wide variety of codes of conduct. These codes may vary within industries or be company-specific, creating challenges such as audit fatigue, operational disruption and a lack of structural improvement due to a 'quick fix' mentality. Through a controlled, open-source approach, individual suppliers should be able to extend their performance and improvement actions to a broader group of known customers. In this way, all relevant stakeholders can benefit from greater transparency while recognizing that a supplier has strict focus when executing an agreed improvement plan and can respectfully decline the right to audit. We encourage not only vertical collaboration in our supply chain, but we also strive, even more, for horizontal collaboration among peers to drive long-term sustainability.

Partnering in this structured, maturity-based way has resulted in greater transparency and insights, accelerated our environmental and social practices, and enabled cross-learning across the value chain.

By demonstrating that environmental and social improvement in supply chains is possible, our proactive and collaborative approach serves as an example for other like-minded and committed companies. We want to have a positive impact and improve the lives of people in our supply chain.



Program structure

The Beyond Auditing program is a structured and systematic approach that drives continuous improvement in different ways for participating suppliers. Identifying areas that need attention leads to a structured, long-term implementation of improvement actions. This enables Philips to gradually improve the overall sustainability maturity level of its supply base and at the same time set a clear threshold. All aspects are related to a set of boundary conditions that need to be met by potential suppliers before being allowed to enter the Philips supply base.

Managing improvements structurally over time requires a systematic approach, using a set of recognized and global references, an executable process, specific customized agreed actions, a set of KPIs, ambitious targets and, of course, a group of suppliers that will be in scope. This systematic approach is shown in the figure below (Figure 1) and is a simplified, high-level representation of the overall Beyond Auditing program. The content is first developed with a set of references (e.g., RBA code), international standards (e.g., ISO) and Philips requirements (e.g., supplier sustainability declaration [SSD]).

The 'frame of reference' captures the relevant aspects covering organization, management systems, environment, health and safety, business ethics, and labor and human rights. For each aspect except organization, the maturity level can be identified based on a Plan–Do–Check–Act (PDCA) approach.

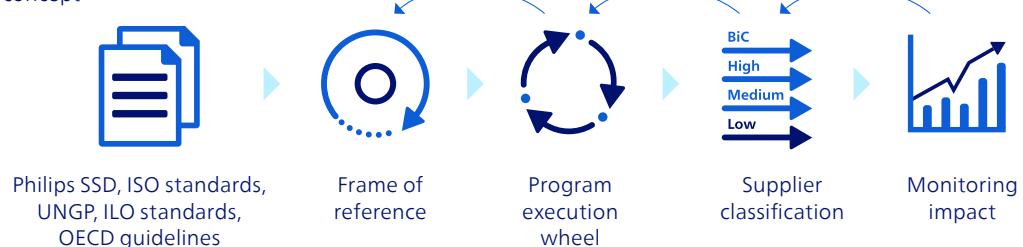
The most important tool for executing the Beyond Auditing program is the four-stage process

in the 'program execution wheel'. We begin by selecting suppliers in scope, ensuring their commitment and then structurally implementing, monitoring and sustaining improvements.

Suppliers in scope are classified using a 'supplier classification' framework that differentiates them based on maturity level and/or potential zero-tolerance issues. This results in a tailored proposal for supplier-specific improvements. Progress and performance in the Beyond Auditing program are continuously monitored and shared with both internal and external stakeholders, with insights used to amend the requirements when needed or adapt the approach through a controlled change management process.

The building blocks are defined to ensure that the Beyond Auditing program is robust and reliable, includes specific controls and results that can be integrated into procurement processes, ensures structured execution and that any improvement activities are clearly defined so that results can be monitored and influenced.

Figure 1.
Beyond Auditing concept

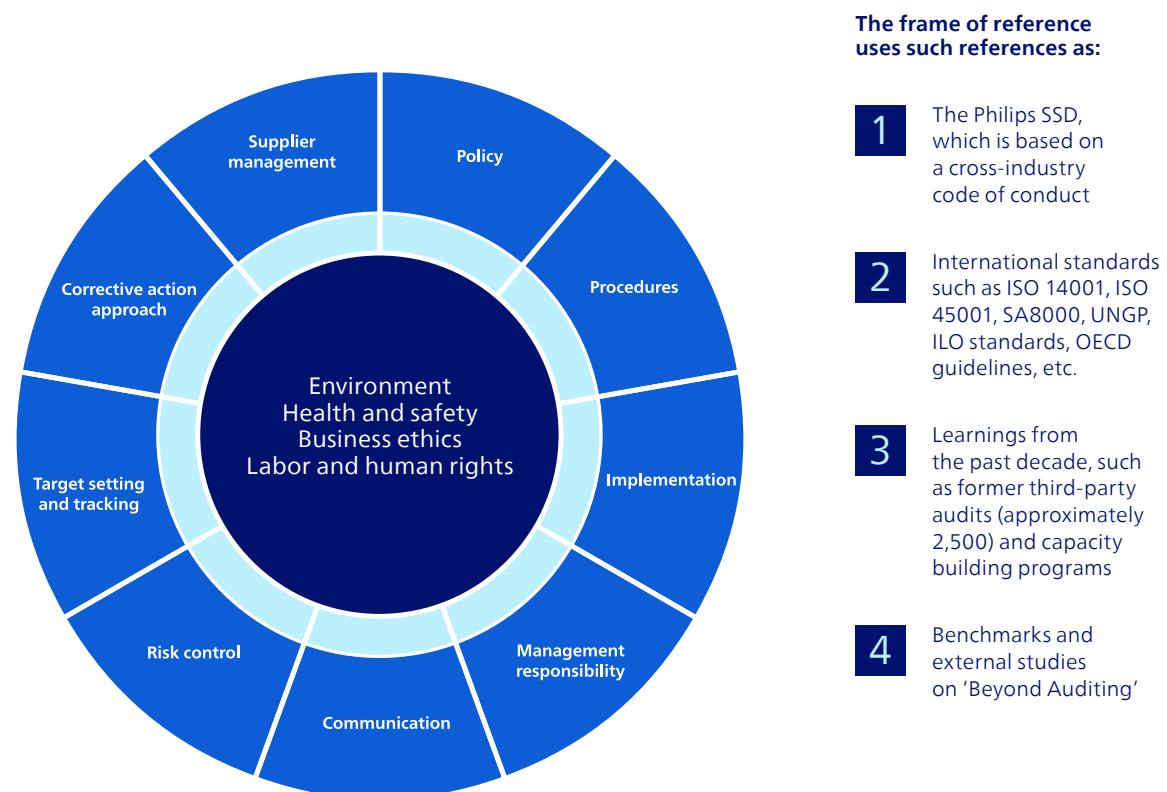


Frame of reference

The frame of reference addresses two distinct axes that outline predefined requirements and topics used to assess the maturity level of a supplier. The resulting matrix enables mapping and monitoring of each supplier's sustainability maturity level over time.

The first axis refers to aspects as defined and addressed in the Philips SSD, which is based on a cross-industry code of conduct. The second axis sets clear directions for identifying and measuring maturity across nine elements. By combining both axes into one schematic (Figure 2), it's possible to identify the maturity level of each core aspect. Together, this framework provides an impression of an organization's sustainability capabilities.

Figure 2.
Core aspects and nine elements



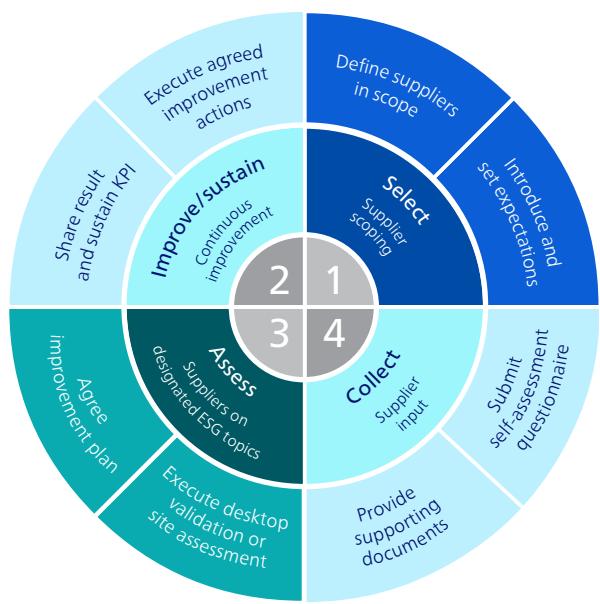


Program execution

For each supplier within the scope of our approach, the core elements in the frame of reference are identified and measured in an annual cycle through a structural process based on four key stages (Figure 3).

Figure 3.
Program Execution wheel

- 1 Select**
Defines at-risk suppliers and topics in scope, introduces the Beyond Auditing program, and sets expectations for Philips procurement department and suppliers through an annual process that covers direct procurement and indirect procurement suppliers.
- 2 Collect**
Invites suppliers in scope to complete a self-assessment questionnaire (SAQ)¹ and provide sufficient supporting evidence, enabling subject matter experts to validate responses against predefined criteria.
- 3 Assess**
Performs desktop validations via document and/or on-site verification by Philips subject matter experts, including direct engagement with workers. Suppliers are then assigned a maturity score. Suppliers are segmented into four maturity levels: low, medium, high and best in class (BiC). The minimum requirement – a prerequisite for all active suppliers in scope and all potential suppliers – is defined as potential zero tolerance (PZT).²
The supplier is guided to develop a detailed improvement plan based on their maturity levels, including targets and objectives. Both the supplier and Philips agree to a timeframe, and the supplier commits to executing the plan and meeting agreed-upon targets.
- 4 Improve and sustain**



¹ SAQ – supplier assessment questionnaire suppliers in scope need to resubmit and update the SAQ annually with upload relevant evidence.

² PZT: describes the process of managing one or more of the six defined zero tolerances that restrict suppliers from new and/or future business with Philips.

Figure 4.
Structured process



The execution of the Beyond Auditing program begins by assigning at-risk suppliers in scope. The program applies to selected existing 'active' suppliers and new 'potential' suppliers that will be onboarded into Philips' supplier base. Figure 4 shows a detailed description of the process and key activities in each of the four stages.

Suppliers must pass two milestones in each stage before moving to the next stage. This structure also enables program management and subject matter experts to track individual suppliers

and overall progress and performance against set targets. Suppliers will be validated against the four aspects for each of the nine elements (Figure 5). Validation can either be a desk based validation to review the SAQ and provide supporting evidence or an on-site assessment where desk-based validation is continued at the supplier site.

The outcome of any type of validation will be captured in a color-coded dashboard.

Figure 5.

Example of beyond auditing code of conduct dashboard

Dashboard											
Topics	Weighted section scores	Policy	Procedures	Implementation	Management responsibility	Communication	Risk control	Target setting and tracking	Corrective action approach	Supplier management	
Environment	90%	100%	92%	94%	100%	70%	100%	70%	100%	40%	
Health and safety	86%	100%	85%	87%	100%	70%	100%	100%	100%	40%	
Business ethics	64%	100%	70%	85%	0%	100%	0%	40%	0%	0%	
Labor and human rights	87%	100%	93%	88%	100%	100%	70%	100%	70%	40%	
Weighted average	82%	100%	85%	89%	75%	85%	68%	78%	68%	30%	

Supplier classification

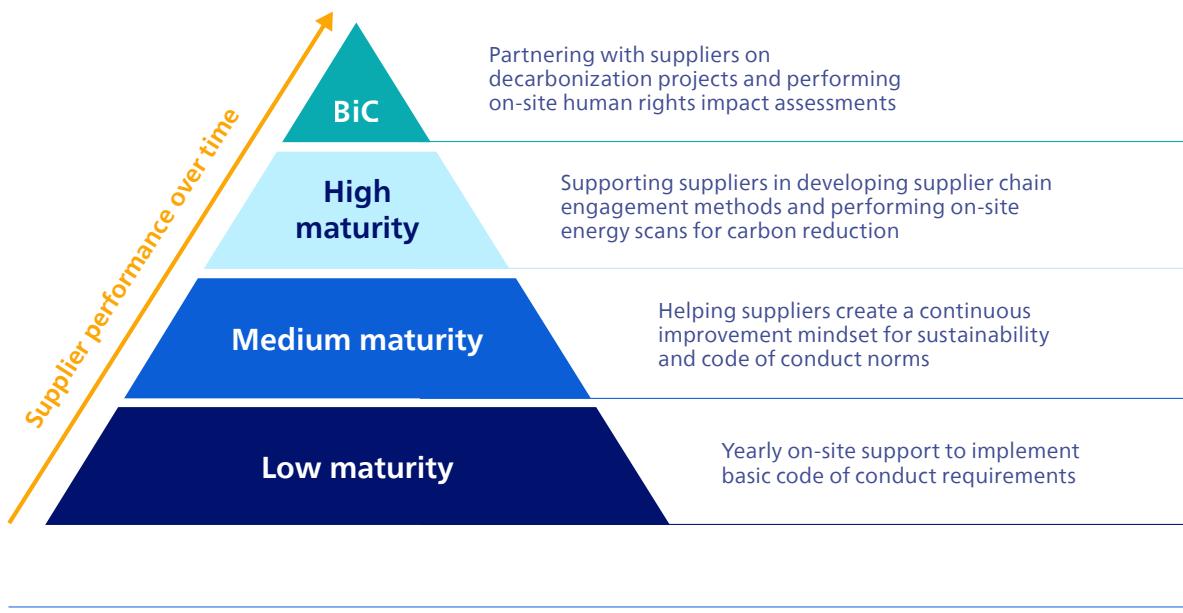
The Beyond Auditing program is a series of maturity-based assessments designed to drive continuous environmental and social improvement throughout the supply chain. It consists of two components: a foundational code of conduct assessment and a set of deep-dive assessments.

The code of conduct assessment is the foundation for managing suppliers' sustainability performance against the Philips SSD.

Suppliers are segmented into four different maturity levels based on their code of conduct assessment results: low, medium, high and best in class. Each category receives tailored engagement programs with specific assessment frequency and topics (Figure 6).

Figure 6.

Supplier classification and maturity-based assessments



Best in class (BiC)

These suppliers are very mature and a leading example to other suppliers. Philips partners with these suppliers to seek opportunities for decarbonization, perform human rights impact assessments and develop supplier chain sustainability management.

Medium maturity level

These suppliers have the basics in place but have not achieved perfect scores for all elements. Philips helps these suppliers to create a continuous improvement mindset for sustainability and the code of conduct norms.

High maturity level

These suppliers demonstrate a high level of maturity and capability, enabling them to independently manage necessary improvement areas. Philips supports them in advancing supply chain sustainability management and decarbonization efforts.

Low maturity level

These suppliers either do not have the basics in place or (potential) ZT are identified during the assessments. Philips provides annual support to ensure the mandatory requirements are met. Philips drives these suppliers to resolve (potential) ZT in an agreed timeline.

The three deep-dive programs include:

Carbon reduction (CR)

Working with key suppliers to take concrete improvement steps to reduce and remove greenhouse gas emissions

Tier 2

Partnering with designated suppliers to improve sustainability performance in the areas of environment, health and safety, business ethics, and labor and human rights

Human rights impact (HRI)

Helping suppliers identify and address severe human rights risks while pursuing improvement opportunities across their operations



Zero tolerance approach

ZT are severe violations of the Philips SSD (Philips code of conduct). They can be identified during supplier engagement programs, through grievance mechanisms or via public screening. Philips is committed to mitigating, remediating and preventing the recurrence of ZT cases. Mitigation and remediation are preferred over phasing out suppliers.

If a (potential) ZT has been identified, immediate and further actions will be taken. The first objective is to collect sufficient evidence to verify whether the case constitutes a structural ZT.

If the evidence shows that there is no structural ZT, the supplier's status will be changed and they return to the original track in the program.

If the evidence confirms a structural ZT, the supplier will be required to:

- Propose a corrective action plan to mitigate and/or resolve the identified ZT
- Commit to structurally resolving the ZT
- Provide regular updates and evidence
- Implement measures that go beyond quick fixes to prevent recurrence

ZT will be internally reported to the procurement commodity leads, the procurement leadership team and the corresponding business units so that appropriate measures can be taken.

Philips has defined seven ZT:

- Fake or falsified records
- Child labor
- Forced labor
- Immediate threats to the environment
- Immediate threats to worker health and safety
- Failure to comply with regulatory and/or Philips requirements
- Workers' monthly income (including salary for regular hours and overtime, tax deductions and social insurance) structurally failing to meet regulatory requirements



Structural improvement increases supplier performance

Measuring impact

The impact of improvements – in other words, the results of our joint efforts – is measured as a single score on a scale from 0% to 100%. For example, in the code of conduct assessment, this score is calculated for each supplier by combining the nine element values per aspect into one overall number (Figure 5). Each element score is derived from a weighted average of validation results, obtained through either desk-based or on-site verification. A similar methodology applies to the deep-dive assessments.

After the first assessment, the 'assessment score' becomes the baseline. This baseline score is locked to serve as the reference point for measuring progress over the course of the engagement programs.

Communications with stakeholders

Through this more specific and customized approach, we found that suppliers are more committed and willing to raise awareness and improve their sustainability maturity in a structural manner. During the execution of the Beyond Auditing program, we aim to be as transparent as possible. **Collaborating with and learning from diverse partners** across the value chain helps us address environmental and human rights challenges from multiple perspectives. We have set ambitious targets to move beyond auditing and strive for structural, long-lasting improvement in our supply chain.

The approach has proven effective with the majority of engaged suppliers demonstrating improved conditions for workers compared to their previous assessments.

While the ultimate goal is to achieve a perfect score, the primary focus today is to drive measurable improvements based on each supplier's agreed-upon improvement plan.

More information about the Philips supplier sustainability program can be found on the website:
Supplier Sustainability Performance | Philips

Every year, Philips publishes progress and achievements on the Beyond Auditing program in the company's **Annual Report**.

