

## **REPORT TO SHAREHOLDERS ON SOCIAL RESPONSIBILITY**

Kohl's is committed to high standards of behavior and performance on issues of social responsibility. Through our Terms of Engagement ("our Policy"), we hold all of our Vendor Partners to these same high standards. Our Policy is based on internationally accepted standards of conduct and the laws and regulations applicable to the country in which merchandise we sell is produced. It is designed to protect the interests of workers engaged in the manufacture of merchandise procured by Kohl's. Our Policy focuses on compliance with local labor laws, working conditions and spells out to our Vendor Partners Kohl's expectations regarding wages, child labor, health and safety issues, forced labor, respecting the right of workers to free association and more. Our Policy is posted on our Website at [www.connection.kohls.com](http://www.connection.kohls.com) ("new vendors" tab).

We do not own or operate the manufacturing facilities in which merchandise we sell is produced, nor do we control the production capacity of such facilities, which is available to customers throughout the world. We do not manufacture the merchandise we sell. We purchase goods from independent suppliers. We contract with numerous Vendor Partners who contract with hundreds of manufacturing facilities in the United States and throughout the world to procure the merchandise we sell in our stores. It is critically important to us that each Vendor Partner's manufacturing facility treats its workers fairly and in compliance with our Policy.

We have several ways to ensure that the merchandise we sell is produced in compliance with our policy: seeking Vendor Partners who share our commitment to the principles contained in our Policy, monitoring our Vendor Partners' compliance efforts and exercising our ability to take corrective action, when necessary.

This report summarizes Kohl's progress in further developing and

implementing our compliance program for our Vendor Partners. While the foundation for our efforts is our Policy; we believe compliance is a process which requires working closely with our Vendor Partners to identify and address challenges in a responsible manner, that considers the needs and expectations of the affected Vendor Partner, its suppliers, employees, and our shareholders. This means that we will continually challenge our Vendor Partners to protect the health, safety and human rights of workers.

**Kohl's Compliance Philosophy.** We select Vendor Partners who we believe share our commitment as expressed in our Policy. If deficiencies in adherence to our Policy are discovered, we exercise our ability to take corrective action. Our compliance philosophy focuses on remediation and continuous improvement. We demand, as a condition of doing business, that our Vendor Partners and suppliers adhere to our Policy and eliminate unacceptable conditions in their facilities and that they respond appropriately and swiftly to correct conditions that fall short of our expectations. From time to time, we review our Policy to determine whether in light of new developments, Policy modifications would be appropriate. Our Board of Directors is kept apprised of our compliance program and any new developments or issues that arise.

**Our Policy.** Kohl's adopted a formal human rights policy in October 1996 entitled "Terms of Engagement for Kohl's Business Partners," which emphasized our longstanding philosophy that no merchandise purchased by us will be manufactured through use of labor conditions contrary to our Policy. Our Policy sets forth our requirements with respect to working conditions, wages and benefits, working hours, nondiscrimination, compliance with laws, and prohibitions against child and prison labor. Our policy has been translated into 46 languages. It is distributed to all of our Vendor Partners and suppliers each year. It is available on Kohl's Website, [www.connection.kohls.com](http://www.connection.kohls.com) ("new vendors" tab). We also distribute our Policy to all of our buying agents and all potential Vendor Partners from whom we are considering procurement of overseas merchandise.

Our buying agents and all prospective and current Vendor Partners must fully comply with our Policy as a condition of doing business with Kohl's. Compliance with our Policy isn't just mandatory at the outset of production; it is an ongoing requirement for doing business with Kohl's. Regardless of

which factors led to the selection of a particular Vendor Partner, manufacturing facilities must comply with our Policy throughout the manufacturing process. Prospective manufacturing facilities which do not meet the requirements of our Policy after being given ample opportunity to do so are not permitted to manufacture merchandise for us. For those Vendor Partners producing merchandise for Kohl's where deficiencies are identified, our expectation that Vendor Partners move into full compliance is clearly communicated to them.

Our Policy was written to help Vendor Partners understand and apply these standards to their day-to-day operations and adopt them as "company policy." Words like "shall" and "must" are included in our Policy instead of words like "should" or "may," because we want our Vendor Partners to take our Policy seriously and to have no misunderstanding that keeping Kohl's business depends on how their facilities are run.

We require all Vendor Partners to certify that each facility used to produce merchandise for Kohl's will operate in compliance with all applicable laws. To ensure that all Vendor Partners and all manufacturing facilities understand our Policy and specifically the consequences which will result from noncompliance, Kohl's requires Vendor Partners to notify and discuss our Policy with each manufacturing facility used for the production of merchandise sold by us.

Our Policy is posted in each manufacturing facility that produces merchandise for Kohl's in the language of the workers and of management in the facility. Our Policy has been translated into 46 languages and made available to every Vendor Partner with whom we do business. We provide training to Vendor Partners on our Policy and our expectation of compliance.

In addition, we require our suppliers of diamonds and jewelry to ensure that the merchandise they sell to us meets the requirements of the Clean Diamonds Trade Act and the Kimberly Process Certification and that this merchandise does not contain conflict diamonds.

**Oversight of Our Policy.** Implementation of our Policy is subject to the

review and guidance of a group of senior executives who are responsible for our corporate and business operations and personnel directly responsible for the day-to-day efforts of our Compliance Program. These executives are responsible for the overall direction of our Compliance Program in addition to assessment of ongoing monitoring and remediation efforts of our Vendor Partners. These executives also are responsible for strengthening our policies and procedures as they believe is in the best interests of Kohl's. A committee of our Board of Directors also reviews our efforts with respect to our Policy and Compliance Program on an annual basis.

**Compliance Program.** We expect our Vendor Partners to take all steps necessary to ensure compliance with our Policy in their manufacturing facilities that produce merchandise for us, whether the facility is operated by them or by one of their subcontractors. We require our Vendor Partners who produce private label and exclusive merchandise for us to identify all manufacturing facilities, domestic and foreign, that they plan to use to produce such merchandise and to provide us with written certification that each facility will operate in compliance with our Policy. Subcontractors a Vendor Partner desires to use in the manufacturing process must be approved by us.

For private label and exclusive merchandise that is produced by Vendor Partners who are designated the "importer of record," we require participation in a manufacturing facility compliance survey. Under this program, the facilities that the Vendor Partner intends to use must first conduct a self-survey of the Policy requirements and then submit to inspection by third party monitors. If a deficiency is discovered, the facility is given the same opportunity to correct deficiencies as are made available to those Vendor Partners from whom Kohl's acquires the merchandise, when Kohl's is designated the "importer of record." We reserve the right to review all Vendor Partner facilities—including the use of unannounced, on site inspections of manufacturing facilities. During fiscal 2006, Kohl's further developed its risk based factory monitoring methodology. Factories that are deemed to have higher-than-average risk receive 'unannounced' visits. The following methodology is used to assess risk and to determine if monitoring visits are announced or unannounced.

Risk assessment is based upon the following factors:

- social conditions in the geographic location of the factory

- factory management attitude towards social compliance
- vendor historical performance across all factories used to produce goods for Kohl's
- past monitoring visit results, if the factory was previously visited

The risk ratings for each of the above factors are reviewed to establish an overall risk rating for each factory.

We recognize that publication of a statement of principles is insufficient to achieve compliance with those principles and that aggressive enforcement of our Policy is required. To achieve this goal we began to monitor factories in 2000. We support this effort with a Policy Compliance team appointed to ensure consistency and quality in our monitoring efforts. To date we have performed in excess of 10,200 monitoring visits to over 3,000 manufacturing facilities in 73 countries around the world. Each audit involves close inspection of a factory to examine working conditions, but also involves a review of compensation and benefit records and interviews with manufacturing facility workers.

To support our monitoring efforts, we have also developed an extensive database that permits us to actively summarize and manage the information we receive through our monitoring efforts. It enables us to identify emerging issues and particular regional problems so that we are able to focus our efforts in areas with the greatest risks.

Monitoring of Vendor Partners is performed by professional, independent third party monitors and is ongoing. Vendor Partners are monitored by third party monitors as a condition of a business relationship with Kohl's. Once deemed compliant with our policy, Vendor Partners are monitored by third party monitors periodically, based on established risk level.

To ensure compliance with our Policy, Kohl's requires its principal buying agent, who is trained to recognize violations of our Policy, to notify us of such matters when they are observed. Our principal buying agent's personnel also visit manufacturing facilities at the inception of the engagement and at least two times during the manufacturing process. For certain high-volume

merchandise purchased by us, our principal buying agent's personnel is onsite at the manufacturing facility each day for the duration of the manufacturing process. Our principal buying agent also confirms that corrective action of previously observed Policy violations by our third party monitors has been undertaken. Our internal sourcing staff also watches for and reports issues of noncompliance with appropriate parties if violations of our Policy are observed during factory visits made by them for follow up and, when appropriate, corrective action.

## **Our Monitors**

We have retained the services of two professional, independent third party monitors to monitor Vendor Partner compliance with our Policy. Kohl's has retained the services of Intertek Testing Services and Bureau Veritas. We work closely with these monitors as well as Business for Social Responsibility to develop a monitoring program that enables us to consistently assess compliance with our Policy and to track our compliance efforts. These monitors were selected on the basis of their reputations as experienced, independent and world-renowned compliance and monitoring firms and to avoid even the appearance of a conflict of interest. Out of this effort, we developed a lengthy, detailed and comprehensive set of materials, which were designed to enable monitors to evaluate production facilities used to manufacture Kohl's private and exclusive brand merchandise.

We continue to retain professional third party monitors, who have auditing professionals located in the territories in which manufacturing facilities are located, able to speak the language of the workers working in the facilities monitored, and who each have extensive experience with monitoring for compliance for social responsibility on behalf of numerous companies.

## **Monitoring Visits**

Our professional third party monitors monitor the manufacturing facilities in which Vendor Partners produce merchandise for us. The monitors spend one or two days in each manufacturing facility, interviewing factory

management and workers. During such visits, the monitors perform a facilities walkthrough where manufacturing facility conditions are observed, detailed testing of factory payroll is conducted and other business records are reviewed. A manufacturing facility floor plan is also reviewed to ensure the entire facility is inspected.

Third party monitors conduct an opening meeting with manufacturing facility management during which the monitor reviews our Policy with management and the monitoring procedures are described in the language understood by the manufacturing facility management. Our emphasis on remediation to correct any deficiencies found is also stressed. Workers are selected to be interviewed at random and all worker interviews are conducted in a private place and in the local language of the workers. The content of these worker interviews is kept strictly confidential.

During the course of each monitoring visit, the monitoring representative documents all violations or deficiencies related to our Policy and promptly reports findings to us within seven days. Upon completion of each monitoring visit, the monitor summarizes and discusses each violation with the facility's management and the management team, once so notified, is asked to remedy all identified violations or deficiencies. Our Policy Compliance team carefully reviews the monitor's report and promptly sends a letter summarizing the monitoring results in detail to the manufacturing facility and our Vendor Partner, notifying each of them in writing of any Policy violations and deficiencies that have been identified by our third party monitor. Serious noncompliance issues require submission of a corrective action plan within three days. In all communications, our Policy Compliance team provides recommendations of corrective action needed to bring the manufacturing facility into compliance with our Policy.

To further ensure that manufacturing facilities comply with our Policy, we require our principal buying agent, who is trained to recognize deficiencies in Vendor Partner compliance, to notify us of such matters when they are observed. Such personnel visit manufacturing facilities at the inception of the relationship with Kohl's and several times during the manufacturing process. For certain high-volume merchandise purchased by us, our principal buying agent is onsite at the manufacturing facility each day for the duration of manufacturing process. Our principal buying agent also confirms that

corrective action of previously observed Policy violations by our third party monitors has been undertaken, as necessary. Our internal sourcing staff raises issues of noncompliance which are observed during manufacturing facility visits with appropriate individuals at Kohl's.

**Corrective Action and Remediation.** Helping our Vendor Partners change to comply with our Policy helps everyone and we believe our approach is balanced, fair, and effective. If noncompliance with Kohl's Terms of Engagement is brought to our attention, either through our monitoring efforts or otherwise, we take appropriate action, which ranges from working with our Vendor Partner to ensure that adequate steps are taken to address the deficiencies discovered and to prevent reoccurrence, to canceling affected orders, terminating our relationship with our Vendor Partner, working with the authorities or other actions as warranted. We require our Vendor Partner to adopt a corrective action plan whenever possible. If deficiencies are discovered during factory visits by our principal buying agent, our buying agent reports such deficiencies to us for follow up by our compliance team.

We prefer to work with Vendor Partners who address deficiencies that are reported to us. Timely remediation must be undertaken as necessary. In those cases where particular factories do not develop a corrective action plan or fail to comply with one, serious noncompliance issues will result in immediate termination of the vendor relationship with Kohl's. Refusal to comply with our Policy may result in cancellation of purchase orders, termination of future business relationships with the Vendor Partner or notification of responsible authorities. Follow-up evaluations are completed to verify subsequent adherence to our Policy. If a deficiency is discovered and a decision is made to continue the business relationship, follow-up inspections to verify compliance are undertaken. Our principal buying agent provides direction and training to our vendor partners for implementation of needed corrections identified through our monitoring process and follows up as necessary. Our response to Vendor Partner noncompliance is dependent on the severity of the noncompliance, but we make every effort to try to bring noncompliant facilities into compliance rather than terminate them.

**Education and Training.** We regularly communicate with our Vendor

Partners on legal compliance issues. We encourage educational programs and collaborative efforts by our Vendor Partners to enhance compliance with our Policy and support efforts by industry and government to provide guidance on such issues. In 2006, we conducted nine group training sessions and numerous individual vendor training sessions for Vendor Partners to promote understanding and compliance with our requirements. These training sessions brought together Vendor Partners supplying Kohl's with softlines, hardlines, home textiles and footwear. In this way we communicated our monitoring expectations and in turn, our Vendor Partners had the opportunity to explain their practical challenges to us. We expect our Vendor Partners to cooperate in such efforts and to take the steps necessary to ensure their contractors and manufacturing facilities are also fully informed.

The following topics were covered in these discussions:

- Expectations for suppliers;
- Definition of each element of our Policy;
- Review of site verification methods;
- Reporting of findings and assessments;
- Remediation methods;
- Actions for compliance improvement.

We also conduct regular training on the requirements of our Policy for our merchants who are responsible for procurement of the merchandise we sell.

**Program Developments.** During Fiscal 2006 our monitors visited 1,520 manufacturing facilities of which 57% were in compliance with our policy and 19% were still in the monitoring process at yearend. In 13% of the cases, our Vendor Partners decided that more appropriate manufacturing facilities were available and they withdrew these factories from consideration. 11% of manufacturing facilities last year failed to meet our standards and were not authorized due to an inability to comply with our Policy. During this period we uncovered areas of opportunity for many of our Vendor Partners.

We are a participant in the Ethical Sourcing Working Group, sponsored by Business for Social Responsibility (BSR) to allow members to share ideas and experiences regarding their social responsibility compliance efforts and to identify "best practices" relating to such issues. In addition, members of our Policy Compliance team attended several national conferences on corporate social responsibility.

We have continuously refined and improved our compliance program. Specifically, we are exploring ways to further encourage our Vendor Partners to meet Kohl's compliance expectations.

## **Environment, Health and Safety**

### **Environment**

In choosing our paper mill partners, we consider a variety of factors including but not limited to pricing. We look at factors such as sustainable and certified forestry, environmentally friendly processes and the use of recycled content. We also look internally for production and distribution efficiencies and believe that working with mill partners who share our commitment, over time, will help improve the environmental aspects of our program and the paper we purchase.

In 2006, Kohl's recycled over 132,000 tons of cardboard, over 18,000 tons of plastic, 43,000 fixtures and over 180 million hangers.

We have partnered with the EPA in purchasing 80 million kWh in renewable energy credits.

### **Health and Safety**

We are committed to protecting our associates and customers through dedicated workplace safety initiatives.

### **Workplace Health and Safety**

Since 2002, we have significantly reduced our associate injury rate per store and distribution centers. While encouraged by these reductions, we continue to expand our safety initiatives in all of our facilities:

**Retail Stores**---Our Risk Management department partners with other corporate departments and store associates to improve shopability experience to our customers by identifying and mitigating potential safety concerns. In addition, key safety initiatives are rolled out/monitored to ensure that our associates are safety conscious on an every day basis.

**Distribution Centers**----We maintain comprehensive safety programs which provide a safe working environment to our associates and reduce workplace injuries. Such programs involve safety training and awareness initiatives which provide a safe and productive work environment.

### **Product Integrity**

At Kohl's, delivering a quality product is our business. In order to ensure that we are living-up to our deliverables, the role of the Product Integrity department has been built into the product development process. During every phase of the product process, we are continually checking to ensure that what is developed is a safe product and that it meets the applicable Federal and State mandates.

Prior to shipment, every product is subjected to a full package of tests at a Kohl's approved testing facility. Depending on the end product, tests being conducted can range from checking for mechanical hazards, choking hazards, chemical hazards to flammability of fabrics. It is only when the product that is being tested has passed Kohl's quality standards, can it be shipped to our stores.

Our Product Integrity department is continually working with government agencies, industry watchdogs and trade associations to keep itself abreast of any changes in consumer product regulations. It is the responsibility of the department to ensure that such changes are incorporated into our product development culture. In addition, the department is responsible for the training of our internal staff, agents and vendors on topics ranging from Product Safety, Children's Sleepwear to Footwear Testing. The end goal is to deliver a safe quality product.

### **Policy on Cosmetic Testing**

The primary cosmetic manufacturers used by Kohl's do not perform any testing on animals.

## **IN SUMMARY**

We believe our Policy and our efforts to achieve compliance with it is a sound approach to promoting responsible working conditions in those factories that produce our private and exclusive brand merchandise. We have made progress during the course of the past year in further developing and implementing our compliance program for Vendor Partners.

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