

## ethics

We foster a culture of integrity at Staples by maintaining a strong corporate-governance structure, setting an ethical tone at the top, and encouraging open and honest communication across all levels of the company.

We provide our associates with a variety of practical resources to enable sound decision-making and the ability to raise questions and concerns without fear of retaliation. We also set high ethical standards for our vendors and suppliers through the terms of our contracts and our Supplier Code of Conduct. Through these initiatives we hold ourselves accountable for conducting business in an ethical and legal manner, thereby strengthening our brand and ensuring that we act in the best interests of Staples and our shareholders. The foundation of our ethics program is our Code of Ethics, a set of guiding principles that applies to all Staples associates, including our Board of Directors.



## code of ethics

Staples adopted its Code of Ethics in 1995, and it has guided the company as it has grown into a \$16 billion enterprise. In February 2004, Staples created the role of Vice President, Business Ethics to increase global awareness of our ethics standards and to implement strategies to ensure their alignment with everyday business practices. In 2005, Staples updated the Code of Ethics to make it clearer and easier for our associates to understand.

### The Code covers the following areas:

- Complying with laws and internal policies
- Avoiding conflicts of interest
- Authorizing contracts
- Buying and selling Staples stock
- Protecting confidential information
- Keeping accurate books and records
- Making proper payments
- Respecting customer privacy
- Contributing to a fair, safe and inclusive workplace
- Competing fairly and aggressively
- Getting help and reporting concerns
- How Staples handles reports of misconduct and violations

A complete copy of the Code is available at [www.staples.com/ethics](http://www.staples.com/ethics). Our Code sets forth our core ethics expectations for associates around the world. In our associate handbook, which is distributed to all new U.S. associates when they join the company, we include a brief summary of our Code of Ethics and ways that associates can get help and report concerns. Staples currently requires more than 10,000 associates in the United States and Canada to complete a Code of Ethics acknowledgment on an annual basis.

We regularly communicate our ethics policies and expectations through various internal channels, and seek feedback from associates about our ethics program to determine where there is a need for improvement. To understand how associates feel about Staples' ethics programs and policies and how ethics fit into our culture, we conducted our first-ever ethics survey in the spring of 2005. Overall, feedback about our ethics programs was positive, but we identified several areas for improvement that have influenced our recent efforts, including a desire for ethics training and additional resources for getting help or confidentially reporting concerns. Staples initiated several programs in 2005 (some of which had already been in development) that helped address these issues.

We launched a company-first online ethics training program to more than 7,000 associates in the United States and Canada in the fall of 2005. The training covered key aspects of the Code of Ethics, including practical guidance on appropriate conduct relating to conflicts of interest, customer privacy, confidential business information, and accurate books and records. It also provided additional information on a variety of different options we offer our associates to get help and report concerns. Based on what we learned from this recent training initiative, we are developing a revised online ethics training program for 2006. The training will be required for approximately 10,000 associates in the United States and Canada, most of them salaried, and will include customized modules for different business units.

In 2005, Staples introduced a new global ethics helpline and reporting tool, the EthicsPoint Reporting System, to enable associates worldwide to report ethics questions or concerns openly or anonymously to a third party in their native languages by telephone or the Internet. Although most issues are best resolved locally through our open-door philosophy, we have made it a point to offer associates a variety of internal ways to raise minor concerns before they become problems. EthicsPoint supplements these internal options. It is no substitute for honest, open communication between associates and managers, but it provides a valuable safety net to protect our brand.

## corporate governance

Since our founding, Staples has sought to follow best practices in corporate governance to ensure that we operate in the best interests of our shareholders. Our commitment to sound corporate governance has created a strong framework for responsiveness and accountability that includes several significant features:



### **Director and Committee Independence**

As of the end of fiscal year 2005, a substantial portion (9 out of 12) of our directors were independent as defined under NASDAQ listing standards. Each of our Audit, Compensation, Nominating and Corporate Governance, and Finance Committees is comprised entirely of independent directors and has the authority to retain independent advisors and consultants, with all fees and expenses to be paid by Staples.

### **Lead Director and Independent Director Meetings**

Our Board annually appoints an independent lead director to chair the executive sessions of our independent directors (at least two meetings per year). The independent lead director consults with the Chairperson of the Board and Chief Executive Officer on agendas for Board meetings and other matters pertinent to the Board.

### **No Shareholder-Rights Plan**

We do not have a shareholder-rights plan and are not considering adopting one. In response to our shareholders' request, our Board adopted a policy under which we will only adopt a shareholder-rights plan if the plan has been approved by shareholders either in advance or within 12 months of its adoption by our Board.

## Senior Executive Compensation

As part of its review of senior executive compensation, our Compensation Committee uses tally sheets detailing aggregate compensation under potential retirement, termination, severance and change in control scenarios. In order to provide our shareholders with a more transparent and comprehensive discussion of senior executive compensation, summary results from these tally sheets are included in our proxy statement.

## Stock Ownership Guideline

Our stock ownership guidelines align management's interest with the interests of our shareholders by providing minimum equity ownership levels for all senior executives, including the CEO, who must own equity worth at least five times his salary.

## Recent Changes

During fiscal year 2005 and the initial portion of fiscal year 2006, we made several important advances in our Board's policies and practices:

- Our Board recommended that at our 2006 Annual Meeting our shareholders declassify our Board and provide for the annual election of each director.
- Our Board adopted a policy that any director receiving a majority of votes withheld for his or her election would be required to tender his or her resignation for consideration by our Board.
- Our Compensation Committee implemented a compensation program under which a significant portion of our executive leadership team's equity compensation consists of stock awards that vest only if we achieve specified performance targets.
- Our Board adopted a policy governing how we review and disclose corporate political contributions.

Staples will continue to evaluate and modify our policies and practices to meet ongoing developments in this area, consistent with our commitment to best practices in corporate governance. For more information about our current corporate governance principles, including our Corporate Governance Guidelines and Committee Charters, visit [staples.com/ethics](http://staples.com/ethics).



## supplier responsibility

Staples® brand products are contract manufactured for us and carry a brand name belonging to Staples or one of our affiliates or subsidiaries. Staples® brand products are a major focus of growth and differentiation for Staples. Through improved quality, packaging, design and pricing, as well as the development of innovative office product solutions, sales of Staples® brand products worldwide grew from less than 11% of total sales in 2002 to 18% of total sales at the end of 2005.

Staples does not just evaluate our Staples® brand suppliers on price, quality and capacity. We also seek to work with suppliers that operate in a manner that protects workers' human rights, workers' health and safety, and the environment. Therefore, all suppliers providing us with Staples® brand products are required to comply with our Supplier Code of Conduct, which is available at [www.staples.com/ethics](http://www.staples.com/ethics). To ensure compliance with our Supplier Code, we have independent third-party auditing firms conduct factory audits of suppliers manufacturing Staples® brand products.<sup>5</sup>

Although we have been conducting social accountability audits of factories supplying Staples® brand products since 2000, our supplier responsibility program has evolved considerably since its inception, with the goal of promoting continuous improvement across our supplier factories. For example, in 2002 we moved from auditing a sample of factories to requiring social accountability audits for the majority of factories outside the United States supplying us with Staples® brand products. In 2004, we formalized our Supplier Code of Conduct after consulting accepted international frameworks for human rights, Social Accountability International's SA 8000 standard, and other corporate codes of conduct.<sup>6</sup> That same year we asked Business for Social Responsibility to evaluate our supplier responsibility program and recommend improvements to our policies and procedures. We also benchmarked supplier responsibility program practices in the retail industry in 2004 and the first half of 2005.

Based on the information we gathered, we made additional changes to our Supplier Code of Conduct in the latter half of 2005. At that time, we also developed a new, expanded social accountability audit program for areas of high risk and hired a new independent auditing firm to conduct the new audits. This new social accountability audit program was launched in December 2005 in Southeast Asia and India. We are planning to extend this audit structure to other countries outside the United States in fiscal year 2006.



<sup>5</sup> Outside of Staples® brand products, we sell products from hundreds of vendors who in turn source from thousands of independently owned and operated factories globally. Therefore, we do not audit all of the factories supplying our vendors to determine compliance with our Supplier Code. Instead, we encourage our vendors to adopt and enforce our Supplier Code or a similar code of conduct to ensure that their products are manufactured ethically. Moreover, in our global vendor contracts we reserve the right to terminate a relationship with a vendor at will if we discover the vendor has violated standards specified in our Supplier Code in its sourcing of products.

<sup>6</sup> Outside of our Supplier Code, we require potential suppliers of various paper products such as copy and print paper, multiuse paper, and notebook paper to complete a detailed questionnaire on their environmental practices, policies and the environmental characteristics of their supply chain. We cover this process in more detail within the Environment section of this report, under Environmentally Preferable Products.



### supplier responsibility continued

While we've made several improvements to our factory-auditing program over the past several years and have more improvements planned for 2006, we recognize that poor factory working conditions are caused by a multitude of factors that auditing alone cannot resolve. Violations can occur due to one or more of the following root causes, among others:

- Limited understanding of labor standards and requirements at the factory management and/or worker level
- Inaccurate forecasting by buyers caused by unexpected swings in demand
- Unreasonable demands made by buyers with respect to delivery time
- Poor business management skills at the factory level
- Competing level of demand and enforcement from different buyers for compliance with labor standards, some of which may conflict
- Competitive pressure in the manufacturing industry that leads some factories to violate certain labor standards
- Inadequate enforcement and regulation of working conditions at the local, regional or country level

Staples and other retailers are challenged to seek additional methods to address some of these root causes, whether through industry cooperation, improved internal procedures, or more direct involvement with key supplier factories. Despite its limitations, factory auditing can help drive improvements in factory conditions and will remain a critical part of our supplier responsibility program.

## factory auditing and compliance

As of December 2005, more than 290 factories in 18 countries supplied Staples® brand products. When seeking a new supplier partner for Staples® brand products, we prescreen supplier factories to ensure that our requirements for cost, quality and capacity can be met. Once we select a potential supplier factory as a source, we schedule a factory audit to ensure that the factory meets our requirements for quality, social accountability and security.

All audits are conducted using independent third-party auditing firms. We require new supplier factories to undergo an initial audit to determine if violations exist before we will source products from them. Active factories must be recertified periodically to remain suppliers. Factories that score poorly on audits are placed on probation and are required to complete corrective action to rectify any violations. Once on probation, factories must also agree to follow-up audits and a post-probation audit to confirm that required improvements have been completed and that the factory meets all of our other requirements.



Auditors visiting a factory in Zhejiang province, China that produces highlighters for Staples.

### factory monitoring and compliance continued

We currently maintain two audit programs. Prior to December 2005, we were only auditing supplier factories producing Staples® brand products using a combined quality and social accountability audit. Our combined audit involves a 12-person hour visit by our third-party auditing firm and covers quality systems, critical social accountability issues, and a Customs Trade Partnership Against Terrorism screening for any products produced outside the United States and destined for the United States. The seven critical social accountability areas of focus in this audit program include minimum age, wages and benefits, health and safety, overtime, environmental protection, forced or compulsory labor, and disciplinary practices. Any violation in the critical social-indicator areas results in the factory being placed on probation.

In December 2005, Staples launched a new social accountability (SA) audit program specific to Southeast Asia and India — where the majority of our supplier factories are located — to better address continuing issues with working conditions in those areas. Rather than receiving the combined quality and social accountability audit, supplier factories located in Southeast Asia and India must now pass a separate full-day SA audit in addition to a stand-alone quality and security audit. In fiscal year 2006, we plan to roll out the full-day SA audit and separate quality and security audits to factories in all other countries, thereby replacing the combined audit program.

The new SA audit covers the majority of the factories we audit that supply Staples® brand products to us; more than 80% of the factories we audited in 2005 were located in China, other countries in Southeast Asia or India. Our supplier factories in these regions typically experience the most frequent social accountability violations, and we believe that a dedicated SA audit program is required to help ensure that we are sourcing products from these areas responsibly. We expect the new SA audit program to provide a better understanding of specific factory conditions in these geographic areas, to better encourage continuous improvement in factory conditions, and to ensure that appropriate and comprehensive corrective action is implemented to resolve issues.



Workers in a Chinese factory producing Staples® brand shredders.



The new SA audit covers eight key areas, including minimum age, wages and benefits, health and safety, overtime, environmental protection, forced or compulsory labor, disciplinary practices and freedom of association. It also includes more than 100 indicators, ranging in designation from critical to minor. Each factory is rated on a scale, with factories required to achieve a specific score to become certified. If any critical indicators are violated, the factory is placed on probation and corrective action is required. If no critical violations occur, but the factory does not score high enough to become certified, it is required to complete corrective action. A new third-party auditing firm is performing all of our SA audits. Every auditor performing the audits has been trained under the SA 8000 standard, one of the leading social accountability audit standards currently available. All factories must be certified annually.

Regardless of whether a factory receives a new SA audit or a combined quality and social accountability audit, the process used to address critical issues or probationary status remains the same. Within two weeks of a violation, factories must sign a corrective action plan (CAP) developed by Staples and sign a letter of commitment (LOC) pledging to improve conditions to continue to have a relationship with Staples. If a factory refuses to participate after we explain our policies and requirements and why they should invest in improvements, we will end our relationship with the factory.

Once the CAP and LOC are received, the factory is considered in probationary status and follow-up audits are scheduled. These are half-day audits focusing on specific violation areas typically conducted at 30- to 60-day intervals after probationary status to determine progress against required corrective action. A post-probation audit occurs six months after the initial violation. Factories that do not pass the post-probation audit remain on probation and can remain a supplier if they demonstrate significant progress on additional follow-up audits and a second post-probation audit. We strive to work with our supplier factories to drive improvements in working conditions and achieve compliance with our standards over time. However, we will discontinue our relationship with factories that choose not to make progress toward resolving corrective action items.

Violations for overtime, health and safety, and wages and benefits are prevalent within the factories we audit in China, India, Indonesia and Thailand. All three concerns are common in factories operating in these countries based on feedback from auditing firms, social accountability nonprofits, and a review of social audit violations that other corporations have reported. As demonstrated in our performance metrics in the following tables, these specific problems have persisted over time and in some cases worsened, despite an increasing focus on auditing and monitoring among companies sourcing from these areas.



Considering our focus on continuous improvement, we are pleased to see that factories undergoing recertification audits have demonstrated better compliance rates than new factories undergoing initial audits. However, our post-probation audit results showed an increase in the need for continuing corrective action from 2004 to 2005. We are working to improve post-probation audit results, and we will continue to seek timely and sustained compliance as we fully implement our new SA audit program.

## factory social accountability audit data<sup>\*</sup>

Indicators	2004	2005
Number of initial, recertification and post-probation audits conducted	184	241
Number of factories audited for compliance with Staples' Supplier Code	172	223
Percentage of factories completing initial audits required to take corrective action to address violations of Supplier Code	32%	33%
Percentage of factories completing recertification audits required to take corrective action to address violations of Supplier Code	19%	24%
Percentage of factories completing post-probation audits required to take corrective action to address violations of Supplier Code	13%	27%

<sup>\*</sup> Number of factories audited reflects factories undergoing initial, recertification and/or post-probation audits, and is less than the number of audits conducted because factories that fail initial or recertification audits undergo post-probation audits within six months and therefore can have multiple audits per calendar year. All information is presented on a calendar-year basis. For 2005, factory audit data is only through the end of November.

## violations of supplier code standards<sup>\*\*</sup> (percentage of audited factories with violations worldwide)

Category	2004	2005
Minimum age <sup>^</sup>	1%	2%
Wage and benefits	18%	21%
Occupational health and safety	16%	11%
Overtime	20%	23%
Environmental and hazardous waste	3%	2%
Forced or compulsory labor <sup>^</sup>	1%	2%
Disciplinary practices	1%	0.4%
Two or more critical violations	20%	22%

<sup>\*\*</sup> Percentages of factories worldwide in a specific calendar year with a violation in one of the seven social accountability areas and the percentages of factories worldwide that have two or more violations across our initial, recertification and post-probation audits. All information is presented on a calendar-year basis. For 2005, factory data is only through the end of November.

<sup>^</sup> Minimum age violations are typically cited due to a lack of proper paperwork and identification rather than due to proof that underage laborers are working in the factory. Forced labor violations have been related to pay withholding or improper loans from factory managers rather than prison labor or indentured labor situations. Staples does not tolerate factories using prison, bonded or indentured labor or knowingly employing underage workers.

## 2005 factory social accountability audit data by country

Country	Factories audited	Factories with one or more Supplier Code violations (%)	Factories violating Supplier Code provisions, by type of violation (%)						
			Minimum Age <sup>^</sup>	Wage and Benefits	Health and Safety	Overtime	Environment	Forced Labor <sup>^</sup>	Disciplinary Practices
Brazil	2	0%							
Canada	10	0%							
<b>China</b>	147	39%	2%	25%	12%	27%	2%	3%	<1%
England	2	0%							
Germany	1	0%							
India	4	50%	50%	50%	50%	50%	0%	0%	0%
<b>Indonesia</b>	3	33%	0%	33%	0%	33%	0%	0%	0%
Japan	1	0%							
Korea	3	0%							
Malaysia	2	0%							
Mexico	3	0%							
Poland	1	0%							
<b>Taiwan</b>	14	14%	0%	7%	0%	7%	0%	0%	0%
<b>Thailand</b>	6	50%	0%	17%	33%	33%	0%	0%	0%
<b>Turkey</b>	1	100%	0%	0%	0%	100%	0%	0%	0%
UAE	1	0%							
USA	21	0%							
Vietnam	1	0%							
<b>Total</b>	<b>223</b>	<b>30%</b>							

\* Calendar year 2005 data up until December of 2005. No results from the new social accountability (SA) audit program launched in December 2005 are included here; they will be reported at the end of fiscal year 2006. Those countries highlighted within the table are where the new SA audit program is currently in use. All percentages in the table reflect the percentage of audited factories in violation across any initial, recertification or post-probation audits.

<sup>^</sup> Minimum age violations are typically cited due to a lack of proper paperwork and identification rather than due to proof that underage laborers are working in the factory. Forced labor violations have been related to pay withholding or improper loans from factory managers rather than prison labor or indentured labor situations. Staples does not tolerate factories using prison, bonded or indentured labor or knowingly employing underage workers.

## future efforts

In the first few months after launching our new SA audit program, we're finding the results we expected. Specifically, a much larger percentage of factories require corrective action to meet our social accountability standards now compared to 2004 and 2005, because we're digging much deeper into specific working-condition issues. Rather than focusing strictly on the percentage of factories requiring corrective action, we're more concerned with driving improvements in the factories we audit over time.

We expect that a greater percentage of factories will require corrective action in the future compared to previous years due to the increased standards of our new SA audit program. But we also expect that our new SA audit will serve as a more complete evaluation tool, enable us to identify specific issue areas across factories, drive greater improvements in factories working to change their practices, and ensure that we promptly end our relationships with factories that choose not to meet our standards.

As our supplier responsibility program continues to evolve, we will seek to understand how we can better address some of the root causes of poor factory working conditions beyond making changes to our audit program. In fiscal year 2006, we will closely monitor our supplier responsibility program and develop a strategic plan to inform future improvement efforts. Depending on our internal assessment, we may decide to engage with a nonprofit partner with expertise in the supplier responsibility area to evaluate our overall program and recommend additional changes.