THE PRINCE'S CHARITIES

ACCOUNTING FOR SUSTAINABILITY

GOVERNANCE & COLLABORATION

Establishing an "International Connected Reporting Committee"

Contents:

Introduction

Climate change and the rapidly increasing destruction of the Earth's eco-systems are possibly the greatest challenges facing the world. If unchecked, they will dwarf our current economic difficulties, resulting in millions of environmental refugees, lack of water and uncertain production of food, increasing spread of disease and, of course, growing social instability. They will affect the well-being of every man, woman and child on our planet.

An effective response to these challenges will require deep-seated changes to our current economic model.

One element of the change required, highlighted by The Prince of Wales when he established his Accounting for Sustainability Project (A4S) in 2004, is the need for new approaches to accounting and reporting to reflect the broader and longer-term consequences of decisions taken. Without more complete and comprehensive information, companies, investors and others cannot make the fully informed decisions needed to survive and prosper in the face of these sustainability challenges.

The recent financial crisis has highlighted the need for capital market decision-making to reflect longer-term considerations and has called into question the extent to which corporate reporting disclosures highlight systemic risks. A shift to a reporting model that supports the information needs of long term investors, such as pension funds, and reflects the interconnected nature of environmental, social and governance factors, is an essential step towards the creation of a sustainable economy.

Considerable progress towards the development of this new reporting model has been made by a range of organizations, including the creation of A4S's Connected Reporting Framework and tools to integrate sustainability into decision-making. This process is now broadening and accelerating.

On 11th September 2009, A4S and the Global Reporting Initiative convened a meeting of investors, standard setters, companies, accounting bodies and UN representatives to discuss the need to integrate financial and sustainability reporting. At the meeting, the group agreed that an international body, bringing together those organizations that have responsibility for financial accounting and reporting with those that are widely recognized as leaders in sustainability and other non-financial reporting, should be convened to create a generally accepted connected and integrated reporting framework, and called for the G20 to take action to support its creation.

This paper sets out initial proposals for the creation of this "International Connected Reporting Committee" to oversee the development of a connected and integrated approach to corporate reporting and summarizes the key reasons supporting its development.

Overview

The Prince's Accounting for Sustainability Project believes that the establishment of a connected and integrated reporting framework, overseen by an "International Connected Reporting Committee", is essential to help transition towards a sustainable economy. A summary of the proposals made, and why action is important, is provided below, with additional detail in the following sections. During 2010, A4S will work with other expert and interested organizations to refine and implement these proposals.

Information and the creation of a sustainable economy

Information currently required under accounting standards and listing rules does not fully reflect non-financial factors, such as climate change, resource use or human rights, despite the fundamental impact that these factors have on an assessment of both the current and future performance of a company and its contribution to the creation of a sustainable economy. Where companies disclose this information, it is seldom presented in a manner which is connected with strategic direction and financial performance, assists comparison between businesses and years or makes clear risks and opportunities.

The need for convergence and collaboration

Many companies, investors and governments have already recognized the importance of reporting sustainability-related information. In response, some governments are implementing national regulations. However, activity is often undertaken in silos, with the risk of increasing the volume of information reported, while reducing the insight provided. International coordination would help to reduce duplication and create the cohesion and consistency in reporting that is needed to aid sound decision-making.

Proposals

1 – Creating a new connected and integrated reporting model
A new, connected and integrated reporting model is needed, one that is capable of providing a more coherent, balanced and complete picture of performance, structured around the organization's strategic objectives, its governance and business model and integrating both material financial and non-financial information.

2 – Establishing an accountable governance structure
Action is now needed to determine how best to create a governance structure to oversee the development of this more concise, connected reporting model. This work should consider the role of different organizations, how best to create the "International Connected Reporting Committee" and draw up terms of reference for its work. This would include, in particular, the interface with established institutions and standard setters and others working in this area.

Next steps

The need to establish an "International Connected Reporting Committee" was discussed by those attending The Prince's Accounting for Sustainability Forum meeting on 17th December 2009. During 2010, A4S intends to work in collaboration with these and other organizations to integrate the work of different initiatives. Through this collaboration, more detailed recommendations will be made, including action required during 2010.

Ultimately, the establishment of an international reporting framework that connects financial and sustainability outcomes and supports achievement of a sustainable economy will require support from governments, the finance and accounting community and wider stakeholder groups. However, its creation will be critical in shifting the focus onto those issues that will determine economic survival in the 21st Century.

Information and the creation of a sustainable economy

Information is the foundation of efficient markets. The information currently covered by accounting standards and listing rules does not reflect all the non-financial factors fundamental to the assessment of the current or future performance of a company and its contribution to the creation of a sustainable economy. This impairs the ability of investors and others to take informed decisions.

The recent financial crisis has raised fundamental questions about the functioning of the capital markets and the extent to which existing corporate reporting disclosures highlight systemic risks. The G20 has taken action to strengthen transparency and accountability, enhancing required disclosure by companies of their financial condition, and recognizing the need to realign incentives to avoid excessive risk-taking. This action has included the establishment of the Financial Stability Board to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability.

Climate change, depletion of finite natural resources and the rapidly increasing destruction of the Earth's eco-systems are some of the greatest challenges facing the world. At the same time, population growth and the need for economic development in emerging economies are increasing the pressure on the natural environment. If unchecked, these challenges will dwarf our current economic difficulties, resulting in millions of environmental refugees, lack of water and uncertain production of food, increasing spread of disease and, of course, growing social instability. They will affect the well-being of every man, woman and child on our planet, and the success or failure of companies operating within it.

Furthermore, social factors such as working conditions, diversity, human rights and community relationships, and governance factors such as board accountability and executive compensation, have a material impact on business risk and financial performance.

The ability to assess a company's overall governance and performance in the context of these macroeconomic factors is of central importance to institutional investors and the ultimate beneficiaries for whom they act, as well as employees, governments and society as a whole. The current reporting model, framed by International Financial Reporting Standards and domestic stock exchange rules, does not provide the necessary framework to enable non-financial factors to be taken into account systematically in reporting and decision-making.

As a result, undue focus and reliance is placed on short-term financial performance, with the risk that capital is not being directed efficiently towards those companies that have robust business models, that make a meaningful contribution towards the achievement of a sustainable society and which outperform in environmental, social and governance terms.

For companies, the piecemeal evolution of reporting from its financial roots has resulted in a cumbersome and skewed model where critical financial and non-financial information is either ignored or obscured by the volume of information presented. Rather than increasing transparency, this can act as a barrier to understanding the factors that are critical to long-term business success and sustainability.

The need for convergence and collaboration

It has taken over 100 years for financial accounting and reporting to be standardized on something approaching an internationally consistent basis. Many companies, investors and governments have already recognized the importance of environmental, social and governance information as part of the reporting framework and, in response, national regulations are being implemented. Now is the time to establish an appropriate global governance structure to support the strategic development of corporate reporting.

There is a range of organizations involved in different aspects of the connected reporting model including financial reporting, strategy, governance and remuneration, the business model and risk, and environmental and social impacts. Their activities are wide ranging and include research, the creation of guidelines, the promotion of best practice and standard setting. All this activity is valuable and has been critical to developments in reporting to date. It provides a necessary platform upon which future reporting can be built.

With the exception of financial reporting, the majority of activity has taken place on a purely voluntary basis or within parameters set at a national level. As a consequence, many of the critical components which make up the connected reporting model have evolved in isolation. This is apparent in the reporting produced by most companies today – it lacks logic and cohesion, it is disjointed, increasingly voluminous and, perhaps most critically, it lacks strategic focus and comparable disclosure of non-financial factors fundamental to long-term business success.

While there will never be a "one size fits all" answer, without greater integration and coordination, corporate reporting will cease to be relevant, efficient and responsive to the market's and society's needs. We face a situation where company reporting remains too dependent on historical financial performance, with information critical to the assessment of an organization's governance and sustainability frequently omitted or reported in a selective, disconnected or inconsistent way. Further, insufficient planning is being undertaken to avoid the global proliferation of different measurement and reporting models.

Investors consistently state that they struggle to integrate environmental, social and governance factors into investment decisions and this situation will continue until the information presented to the capital markets is more strategic, comparable and sector specific.

Companies are faced with multiple reporting requirements across national borders and a confusing array of recommendations, guidance and standards are only hindering progress and end user value.

Without the right strategic oversight and vision, business reporting will not remain relevant or evolve in a manner which is insightful, efficient and accessible.

Importantly, those organizations that each provide part of the connected reporting picture need to be encouraged to work together, under a governance structure that provides the necessary accountability, strategic road map and oversight. Through this collaboration and coordination, an integrated reporting model can develop to meet the needs of the capital markets and society in the 21st Century.

Proposals

1. Key elements of a connected and integrated reporting model

A new, connected and integrated reporting model is needed, one that is more concise, coherent and comprehensive, capable of providing a more balanced and complete picture of performance, structured around the organization's strategic objectives, its governance and business model and integrating both material financial and non-financial information.

Factors that are material to the achievement of a company's strategic objectives and which reflect business challenges and opportunities, including those arising from climate change, demographic shifts and changing consumption patterns, should be set out in a clear, concise and coherent manner in the Annual Report and Accounts. At present, the volume of information included in the Annual Report and Accounts, some of which is prone to "boilerplating", risks obscuring rather than increasing transparency. There needs to be a reassessment of the information required to focus on that which provides both a more concise and a more complete picture of the company's performance and the factors that will influence its long-term success.

Just as financial information alone can present a false picture of performance, so will the isolated reporting of other factors such as carbon emissions, resource usage and the robustness and integrity of the supply chain. If investors and other stakeholders are to understand fully the performance of a business, a connected and integrated report is essential. Such a report would present information in context and would encourage the alignment and linkage of financial, non-financial and narrative information in a form that enhances user understanding and insight. Examples of linkages include the need for strategy to be connected to the changing dynamics of the world, for sustainability issues to be linked to their financial implications and remuneration incentives to be linked to risk and organizational behaviour.

A reporting model containing the following elements and critical connection points can support enhanced business understanding and in so doing, help to create a more sustainable economy. A connected and integrated reporting model would:

- be centred around the strategic and market context within which the business is operating and how this may change over time;
- provide clarity on how the business is led and governed and how employees are incentivized and remunerated to deliver sustainable business outcomes;
- provide transparency around the dynamics of the business model and the associated risks and opportunities that emerge, including environmental factors, such as climate change and resource usage, and social factors such as employee safety, ethics and human rights; and
- describe the connection between the delivery of the organization's strategic objectives and its financial and sustainability performance.

Fundamentally, the connected reporting model aims to:

- bring reporting closer to the information used by management to run the business on a day-to-day basis;
- rebalance performance metrics away from an undue reliance on short-term financial performance; and
- provide a framework for the comparable reporting of all aspects of business performance including environmental, social and governance factors.

Proposals (continued)

2. Establishing an "International Connected Reporting Committee"

The Financial Stability Board was established in the wake of the financial crisis. Similar action is now needed to determine how best to create an international governance structure to oversee the development of a more concise, connected and integrated reporting model, and to determine its role and how it should interface with established institutions and standard setters.

The creation of an international governance structure must bring together those organizations that have responsibility for financial reporting with those that are widely recognized as leaders in non-financial reporting. To be successful and gain the support and trust of all key stakeholders, there needs to be a geographically diverse representation and access to a mix of skills spanning the different aspects of connected and integrated reporting. Organizations that have been active in the research and development of different aspects of connected or integrated reporting guidance include those summarized in Table 1 on page 7.

Additionally, a number of organizations such as those represented by the Climate Disclosure Standards Board, Transparency International and others, have developed standards with respect to specific elements of reporting for example carbon emissions and bribery.

Accountability for the oversight and development of the connected and integrated reporting model should rest with a single body. It would not be responsible for the development of accounting standards. Instead, it would provide strategic oversight and be a source of guidance in relation to the reporting model. Its remit might include the following:

- Provide the vision for the future corporate reporting model, identifying key elements and how they need to interlink to provide insight and understanding.
- Provide a road map to support its development.
- Establish structures and mechanisms to achieve collaboration between existing organizations in order to enhance connectivity and reduce proliferation.
- Identify emerging issues that may demand a global solution and future incorporation into the reporting framework.
- Sponsor and coordinate research across all aspects of the model so as to inform and shape its development.
- Assist in the transfer of knowledge and ideas across the globe.

Action to create this "International Connected Reporting Committee" should consider the role of different organizations, establish funding mechanisms and draw up terms of reference for its work. These terms would include, in particular, the interface with established institutions, standard setters and others working in this area.

Table 1: Example organizations active in the research and development of connected or integrated reporting guidance

Stakeholder groups	Example organizations
Investors	• European Federation of Financial Analysts Societies • International Corporate Governance Network • Pension funds • Social Investment Fora
Business associations	• International Chamber of Commerce • World Business Council for Sustainable Development
Inter-governmental organizations	• The UN Environment Programme Finance Initiative, the UN Global Compact and their Principles for Responsible Investment • UN Environment Programme Green Economy Initiative • UN Conference on Trade and Development • World Bank Group
Regulators and standard setters	• International Accounting Standards Board • International Auditing and Assurance Standards Board • International Federation of Accountants • International Organization of Securities Commissions
Accounting community	• Major accounting bodies • Global accounting firms
Multi-stakeholder groups and NGOs	• AccountAbility • Accounting for Sustainability • The Aspen Institute • European Laboratory on Valuing Non-financial Performance • Global Reporting Initiative • Tomorrow's Company • WWF
Academics	• European Academy of Business in Society • Centre for Social and Environmental Accounting Research, The University of St Andrews • International Association for Accounting Education & Research • Harvard Business School

Next steps

During 2010, A4S will collaborate with other organizations to build consensus around the need to establish a connected and integrated reporting model, integrating financial and sustainability information, and the creation of an "International Connected Reporting Committee" to provide the governance necessary to oversee its development. It is hoped that a meaningful and substantive conclusion can be reached by the end of 2010.

The proposals set out in this background paper build on discussions with, and the work of, a range of organizations, including a number of those listed on page 7. During 2010, A4S will seek to integrate more explicitly the proposals set out within this paper with those made by these and other organizations. The environmental crisis that we face demands swift action. Further, the quicker that international coordination of the response can be agreed, the easier that it will be to implement proposals. It is hoped that action to establish an "International Connected Reporting Committee" will have been taken by the end of 2010.

In summary, the following steps to achieve progress within this timetable are recommended.

1. Establish a working group comprising representatives from those organizations with an active interest and expertise in different aspects of a connected and integrated reporting framework to coordinate action, share research findings and consolidate recommendations.
2. Develop options for the governance structure required for the creation of an "International Connected Reporting Committee", ensuring appropriate representation and links to existing organizations.
3. Mobilize broader support for the proposals among key stakeholder groups internationally, in particular, giving consideration to the need for inclusion on the agenda of the G20 meeting in Canada next year.

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