Appendix A

The Accountability Cycle

According to the accountability cycle proposed by Epstein and Birchard,[1] four elements play a role in corporate accountability: governance, measurement, management systems, and reporting. These elements serve as the core of the accountability cycle. When management bases critical activities (e.g., setting budgets, measuring performance, and reporting on performance) on these elements, corporate value should increase.

Governance, the first major element, includes an independent board of directors that holds the chief executive officer and his or her management team accountable to the corporation's shareholders and outside constituencies. In recent years, the Ontario Securities Commission, the US Securities and Exchange Commission, and US groups such as the Blue Ribbon Panel,[2] have raised concerns about the state of corporate governance. In addition, major pension funds, for example the Canadian Union of Public Employees Pension Fund, now control significant amounts of stock, and are concerned with corporate managers being held accountable to shareholders. All of these groups have played a major part in implementing a number of reforms in the area of corporate governance. The bottom line here is that good corporate governance can lead to better accountability.

Measurement is the second element in corporate accountability. Historically, corporations have been concerned with financial measures. However, many corporations have adopted a balanced scorecard approach that meshes nonfinancial measures with existing financial measures. Corporations establish objectives and critical success factors, and then measure their performance in terms of their attainment of those objectives and factors. As part of the balanced scorecard approach, a corporation may track operational measures, such as customer and supplier satisfaction, and may also track and report on social performance, including its environmental record and the health and safety of its employees. For example, the Royal Dutch/Shell group of companies is one of the world's leaders in the areas

[1] M. J. Epstein, and B. Birchard, *Counting What Counts: Turning Corporate Accountability to Competitive Advantage*, (Cambridge, MA: Perseus Books, 2000).

[2] See the *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*. The report can be found at www.nyse.com or www.nasd.com.

of health, safety, and environmental reporting. The company reports on the details of its management system and its performance against its goals for sustainable development.[3]

The third element of accountability is management systems, which focus on planning and control. Planning and control starts with the corporate strategy. This leads to objectives and critical success factors, and the establishment of measures. Management plans initiatives to achieve the objectives, and establishes targets and budgets for each initiative. Pay and incentives are often tied to meeting these targets and budgets. Finally, internal and external reporting provides feedback to the board of directors and shareholders on management's performance. Strong planning and control systems allow management to monitor the company's activities in a timely and efficient manner.

The last element of the accountability cycle is reporting. Traditional reporting involves two levels. First, there is detailed internal reporting based on various measures that are seldom disclosed to external parties. Second, there is the required financial reporting to shareholders and regulatory agencies. It is with this second aspect of the fourth element of the accountability cycle that the auditor is primarily involved. All publicly listed companies must, and many privately held companies choose to, have their annual financial statements audited.

[3]See Shell's websites (www.shell.com) or Eccles et al., Chapter 9, for a detailed discussion of Shell's reporting on sustainable development.