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The Rise of **Impact Accounting**

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Sustainability is now a fixed item on most C-suite agendas. But to drive real change and meet the growing demands of stakeholders for openness and clarity, enterprises need to harness the new data and measurement frameworks offered by impact accounting.

Historically, companies have struggled to holistically account for their benefits and costs to society and the environment. Impact accounting is now driving a shift toward a more complete valuation of financial and non-financial capital. It promises to make accurate measurement and valuation of corporate impact, both negative and positive, a reality.

The rise of impact accounting is based mainly on increasing stakeholder interest and demand for greater disclosure and transparency. Companies recognize that customers are making more sustainable buying choices based on an organization's commitment to society and the environment; investors are more concerned about how and where their money is being used, as well as the new risks and regulations companies are confronting; and employees are choosing to work for companies based on their approach to climate change.

According to Chantal Contijoch, a partner at the business consultancy Wipro and leader of their impact intelligence business line, "Impact accounting provides organizations with a more standardized way of reporting their global impact with a common unit of monetary measure. It also helps leverage data in business decision-making that is backed by a rigorous data ecosystem. This allows organizations to reframe how they manage and share their more values-based impact efforts and sustainability journey to their stakeholders."

> ***Impact accounting allows organizations to reframe how they manage and share their more values-based impact efforts and sustainability journey to their stakeholders.***

WHAT IS IMPACT ACCOUNTING?

Some view impact accounting and intelligence as the 'next evolution' of impact reporting practices, a method of reporting that accounts for things that aren't necessarily tracked by normal accounting processes. These externalities are both positive and negative. The thinking is that the value of a company is connected to its capacity to contribute to the evolution of society. The first step is to measure the impact of being part of the broad positive changes that the world needs.

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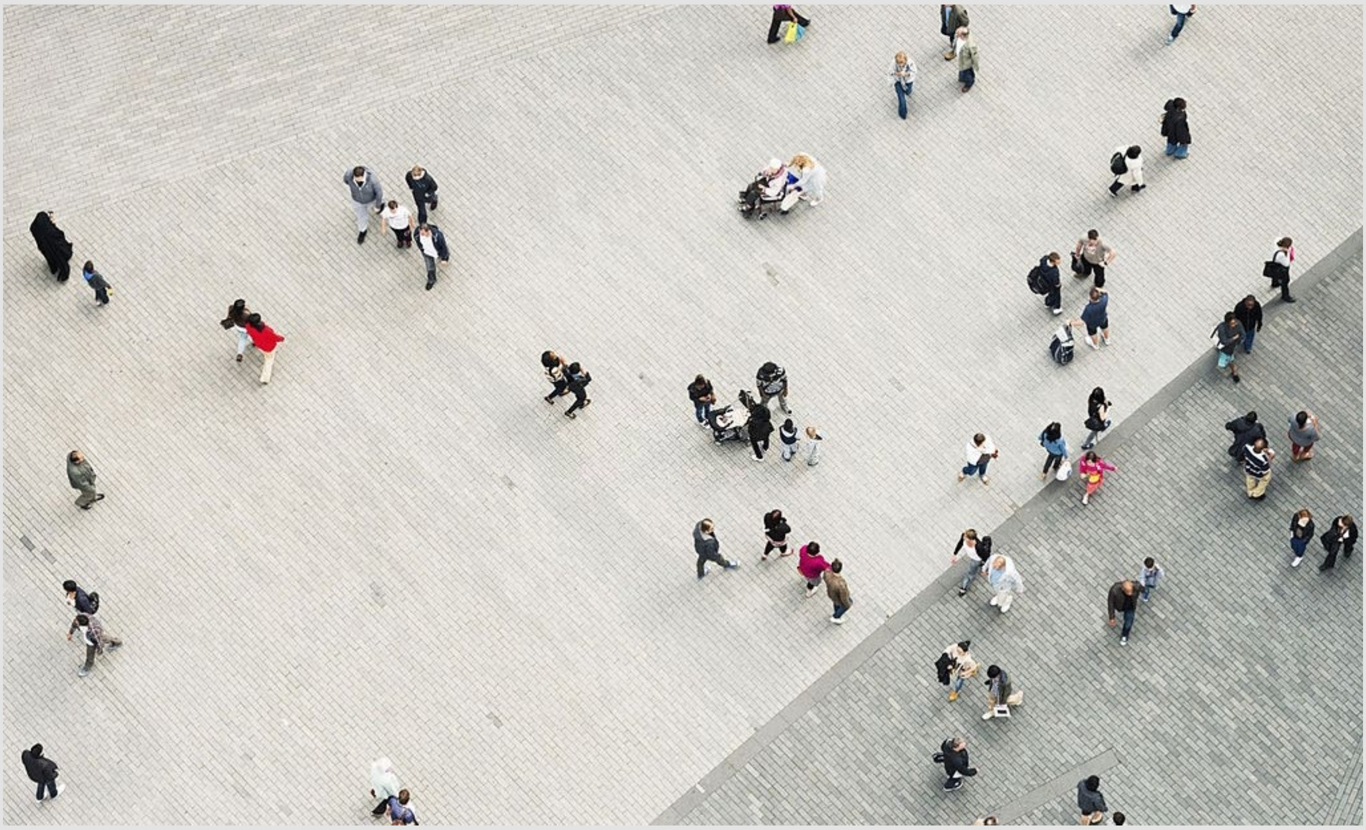

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A framework developed by the Capitals Coalition can help companies understand how to account for their impact across three main areas: natural, human, and social capital.

This capital approach underpins impact accounting, explains Tom McKenna, a senior manager at the Capitals Coalition, which wants to ensure that by 2030, most businesses, financial institutions, and governments include the value of natural, social, and human capital in all of their decision-making.

Natural capital is environmental assets, described by the Capitals Coalition as the stock of renewable and non-renewable natural resources, from plants and animals, to soil water, minerals and the entire atmosphere, that combine to yield a flow of benefits to people. Human capital relates to people, their skills and productivity and the benefits these bring to a business. Social capital covers networks, relationships, and the advantages of working together. In traditional accounting, these are intangibles that don't fit into a company's balance sheet.

But this is starting to change as organizations look at their impact from a financial capital point of view and then use that as part of an integrated assessment that considers natural, human, and social capital, too.

"It is about disclosing the impact that you are having on all of these capitals," continues McKenna. For example, he says, if a company is found to be polluting a local river that they also rely on for water – a business dependency – they can't show this through traditional reporting. However, impact accounting goes further.

"It's about understanding where businesses are impacting the environment, as well as social and human capital," he continues. "It is about businesses being more socially conscious and understanding where their impacts are having externalities, those factors that aren't priced into their business case but are having an impact elsewhere."

QUANTIFYING HOLISTIC IMPACT

A holistic capital accounting approach provides a more directionally consistent and accurate way of measuring and quantifying a company's overall sustainability impact.

> ***Impact accounting helps to monetize a company's broader impacts.***

Today, most reporting looks at inputs, the resources a business uses, and the outputs it produces, including factors such as greenhouse gas emissions, water usage, and employee training. However, these factors are measured in tonnes, liters, and hours, which makes them difficult to compare. Impact accounting puts a monetary value on these outputs, making it easier to compare them and, therefore, look at a company's total impact.

"You can't compare the impact of CO_2 emissions... (and) the fact that some employees were underpaid," explains Rob Zochowski, chief executive at the International Foundation for Valuing Impacts (IFVI). "The thesis is that if you are able to take those impacts... and monetize them, that is something that can be introduced to boards of directors, investors, and C-suite decision-makers in a way that is far more comparable (and decision-useful)."

Doing so can show dramatic results in accurately depicting impact, continues Zochowski, who was part of the team behind a Harvard Business School report in 2020 on corporate environmental impacts. The report looked at 400 companies that had reported healthy profits in their last accounts but revealed that if they'd fully considered the extent of the environmental degradation and negative externalities caused by their operations, their earnings would have been zero. The research showed that many companies were creating environmental costs that exceeded their total profit, says Zochowski. "Impact accounting helps to monetize a company's broader impacts," he says. "You can't grasp real impact from a financial report."

INTRODUCING STANDARDIZATION

In June 2023, a new framework, Transparent, was launched by The Value Balancing Alliance, a non-profit organization made up of over 25 multinational companies and the Capitals Coalition. McKenna explains that it has been developed in line with the European Green Deal as a public-private partnership to establish standardized natural capital accounting and valuation principles to mobilize the private sector to support the green transition. It is about harmonizing impact measurement and valuation methods, using a robust approach to accounting for natural capital that is generally accepted and commonly used by all businesses.

The framework leans on the idea of Environmental Profit & Loss (EP&L) to include both the monetary value and the price of environmental impacts of business activities. Traditional profit and loss ignores the unpriced transactions with the environment.

At the moment, says McKenna: "The terminology and approaches to this whole subject are very piecemeal, which is why we are working with businesses to try and standardize this as much as possible. If you have a standardized approach for integrated profit and loss accounts, you can compare them between companies.

"Impact accounting also reflects another shift: Raters and rankers will no longer accept estimates," adds Contijoch, "and they expect real data that tells a more accurate and transparent performance narrative across the company's value chain."

> ***Impact accounting reflects the shift that raters and rankers will no longer accept estimates***

Natura, the Brazilian company behind brands such as The Body Shop and Avon, was one of the first major businesses to start looking at its entire value chain and measuring its impacts across all these capitals through its own Integrated Profit & Loss system.

Connecting business activities to impacts allows Natura to attribute value to them, both positive and negative. This provides quantitative information that supports better strategic decision-making to leverage positive impacts and mitigate negative ones, such as improving supply chain processes and vendor selection.

RECOGNIZING THE IMPORTANCE OF HUMAN CAPITAL

An impact accounting approach can also be an essential differentiator amid tightened labor markets and the battle to recruit and retain talent. It encourages companies to think of employees as 'someone and not something' and stresses the importance of investing in human capital.

Importantly, says Zochowski, impact accounting emphasizes human capital and encourages companies to pay attention to the widening social and employee issues.

"Companies in the US were complaining so much about the 'Great Resignation' and that we can't find any talent," he explains. "But for the first time in decades, there was a pro-labor economic climate, and people said: '"I can't live on those wages, so I'm going to take my labor elsewhere."'

STANDARDIZATION APPLIED FOR BETTER DECISION-MAKING

While it took a long time for accounting standards to become standardized, they have since become a real driver to help stakeholders evaluate reports and make investment decisions. Now, a similar development needs to happen to the suite of sustainability, climate, and transitioning financing targets that banks and others have committed to, which are currently based on different methodologies, making them difficult to compare.

McKenna believes it is about making companies think about their broader impacts and externalities and then developing a way where these begin to be seamlessly incorporated into the decision-making process. "Once a business understands their dependencies, they are in a better position to see where it's worth investing in different areas for better outcomes for the company," he says.

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First and foremost, says Contijoch, it can give companies a competitive edge, with accurate performance against targets building stakeholder trust and confidence. "It boosts transparency, providing stakeholders with a new level of

understanding about how an organization works," she says. "For investors, that means a new level of insight about the impact of their investments."

"We're at a tipping point where we no longer need to ask why we should use impact for measurement but instead to apply impact measurement," she adds. This includes driving improvement across the business, reducing footprints and costs, and reconsidering business strategies. "It is about helping companies to grow with a line of sight to responsible growth."

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In some organizations, there is still the mentality that assessing a company's impacts is a 'nice to have' rather than 'must have'. This viewpoint is changing. Some of those pushing for the change are the CFOs wanting to see impact progress alongside business savings (e.g., energy reductions and efficiencies), says Contijoch. This is a natural shift as social, human, and natural capital begin to be shared as part of financial reporting.

MEASURING IMPACT IN THE REAL WORLD

Shifting to any new measurement system brings challenges, and with impact accounting, one of the biggest hurdles companies need to address is data and data quality.

"Currently, there is a lot of data fragmentation," explains Contijoch, "from how it's collected to how it's formatted, which can often be in a way that prevents the data sets from talking to each other. Impact accounting offers an effective process that helps match up all kinds of data."

Making this even more difficult is the expansion of what exactly is being measured. Data is no longer confined to a company's operations but also includes supplier footprints across their value chains. This dramatically expands the impact areas and measures around social, human, and natural capital that must be assessed and collected by an order of magnitude. Many companies are still adjusting to these new data requirements, in particular, the challenges of gathering required data from other companies within their supply chains.

Some consultancies and technology providers are developing impact ecosystems and accelerators that digitize assessments and data collection. These ecosystems can gather data, and integrate and manage it to automate regulatory reporting, disclosures, and analytics—all leveraging regulatory required standards, guidelines, and protocols. This improves data governance and data quality, ultimately giving companies a more accurate picture of their progress relative to their goals and targets. These new solutions also provide guided experiences to help employees and stewards with best practices and 'dos and don'ts'.

With these new more enterprise-level impact accounting ecosystems comes a new and vibrant capability connecting and managing impact data across the enterprise and reporting, says Susan Kenniston, global head of sustainability at Wipro.

"Many companies now report on their emissions and how they are working through plans to reduce their footprints. But this kind of reporting is very static; impact accounting makes it more dynamic," she explains. "It uses a company's data to assess where they are with their sustainability goals in real-time, with more timely feedback loops around the progress to plan, and ultimately helps them move and adjust towards those goals with more confidence, as opposed to the predictive reporting that many are doing now.

> ***Impact accounting is dynamic and allows companies to assess progress against sustainability goals in real-time.***

"The big shift around impact accounting ecosystems is that they are including both impact data around actuals and reductions, as well as the financial savings and revenue generated from these efforts. You are beginning to see a fundamental shift in valuation management and reporting for impact, which is helping to change the paradigm of what running a responsible business looks like," continues Kenniston.

Wipro, for example, has been calculating an Environmental Profit & Loss (EP&L) for the last seven years and is now moving to an Integrated Profit & Loss (IP&L) that brings together natural, social, and human capitals alongside financial capital into a more holistic impact accounting view. This work, in collaboration with impact and data analytics provider GIST Impact, shows that impact valuation is not only possible, its replicable and scalable. Together the companies will bring these learnings and capabilities to clients through Wipro's sustainability practice impact intelligence solutions.

"With a greater focus on expanding the corporate impact lens beyond carbon, as well as emerging double materiality regulatory requirements, we're at a key turning point in how companies are measuring and evaluating their performance," said Pavan Sukhdev, CEO of GIST Impact. "For a long time monetary valuation was seen as a laborious and academic exercise, but with the availability of big data and advanced technology solutions we can - and do - now work with companies and investors worldwide to quickly, efficiently, and coherently quantify their impacts in monetary terms."

PROTECTING REPUTATIONS THROUGH TRANSPARENCY

When it comes to impact accounting, transparency is crucial in helping enterprises guard against the reputational damage of being attacked by charges of greenwashing or impact-washing.

"We're in the Wild West at the moment, where there are claims about being net zero or nature-positive, yet they are difficult to substantiate," continues McKenna. "But as this whole area develops and becomes more standardized, those companies that are already moving towards greater openness around their actual impacts will be in pole position.

"The hope is that if you consider all four capitals at the same time, you are going to avoid greenwashing."

> ***By considering all four capitals at the same time, companies can avoid allegations of greenwashing.***

He says suggesting that any business only positively impacts the world is impossible. Still, disclosing those negative impacts and then talking to stakeholders and those affected to mitigate issues can lead to much better outcomes.

"It's brave but can bring huge dividends," he says.

"There are a lot of people that genuinely think that looking after the planet and the environment is important," McKenna continues. "If you're going to have a business that is going to carry on for the next 30 years, then it's unsustainable to carry on as we currently are."

Zochowski says that impact transparency will have far-reaching consequences, yet acknowledges that there is a prevalent fear of what he dubs "first-mover disadvantage."

Revealing the extent of a company's negative impacts, from polluting a river to paying below the minimum wage, may expose them to criticism, says Zochowski. "Companies that first publicly report on their impacts in very transparent terms potentially expose themselves to criticism relative to less transparent competitors."

But the flip side of this is that by knowing what these impacts are, companies can do something about them. There is also the potential for governments to provide incentives, such as reduced taxes or preferential procurement opportunities, for companies that can show they are delivering a positive impact.

"Assessing impact isn't just about numbers; it's about securing resilience in business decisions," added Sam King, SVP corporate, GIST Impact. "Nature's decline poses significant risks. This is why integrating non-financial risks and holistic measures into decision-making is so crucial. In doing so, businesses can mitigate rising financial and systemic risks, including those linked to biodiversity loss, and embrace opportunities to foster positive contributions, including towards ecosystem protection and regeneration. This ultimately steers us towards a more sustainable future."

Then there's the advent of a whole raft of new rules and legislation, which is changing the expectations of companies, with a greater onus on them to demonstrate their impact.

New nature-based frameworks such as the Taskforce on Nature-based Financial Disclosure (TNFD) are examples of emerging metrics and standards through which companies' impacts will be assessed. By tracking these, organizations can make strategic decisions that will help them to pivot to meet new demands, especially around biodiversity and other emerging areas.

Boardrooms should also be motivated by this openness. Firms with more significant negative impacts may generate less investor interest, continues Zochowski, raising the cost of capital. Management ought to see this as a challenge to improve, not as an excuse to hide the figures.

But the point is, he says, is that "it's not about the final number... it's about the composition of that number, with impact accounting bringing in all the capitals, and also factoring potentially positive impacts in terms of jobs, wages, or the benefits that a company can bring, as well as highlighting the specific areas for improvement."

Companies will also need to decide whether or not they go public with their data, with some choosing to use a more significant assessment of their impacts for internal decision-making rather than public disclosure, which can run the risk of alienating stakeholders.

Others have started to include information in their annual sustainability reports. However, Zochowski sees the ultimate goal as a fully integrated report that includes both overall company results and those covered by sustainability.

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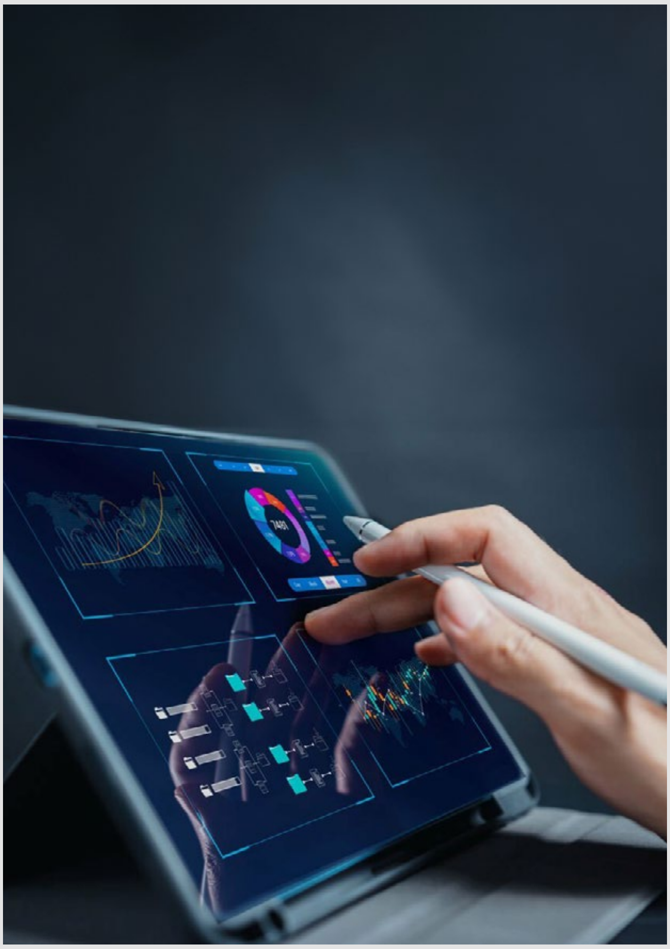
"Companies need to see this as an add-on, not an entirely new batch of reporting requirements," says Zochowski. He says it is a process that can easily be bolted on to existing disclosures and functions, helping them complete reporting frameworks already out there, which he believes can also help minimize incremental costs and prevent pushback from jittery finance teams.

He also believes that standardization can help ensure that capital accounting isn't just something large companies can deploy. He points out that around 95% of all European businesses are SMEs. Through its Value Commission initiative, the Capitals Coalition is looking at ways in which it can help smaller companies find and input data in a relatively simple way so that it produces outcomes that will support their decision-making.

Similarly, he adds, impact accounting should be influential far beyond Global North, and we need tools ensuring that it can be used globally.



CONCLUSION

Increasing stakeholder interest in a company's impact drives the need for improved transparency. Impact accounting and intelligence sets out standardized accounting and valuation principles to track and disclose the impact an organization is having on all its capitals, including natural, social, and human capital.

Moving from an Environmental P&L towards an Integrated P&L introduces a monetary value and prices the positive and negative impacts of businesses growth. This allows for more directionally consistent, accurate, and comparable data while recognizing the importance of all capitals and helping organizations think about their broader impacts and grow responsibly.

There will be hurdles, including negotiating the emerging impact data ecosystem, managing brand reputation expectations, reducing impact while growing, and more. However, these challenges are manageable. Those organizations that proactively adopt a more holistic and integrated approach to their negative and positive impact on the world will be more resilient, competitive, and strongly differentiated than their competitors.