



# IMPACT- WEIGHTED FINANCIAL ACCOUNTS:

The Missing Piece for an Impact Economy



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## The Missing Piece for an Impact Economy

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“Most of the things worth doing in the world had been declared impossible before they were done.”

**U.S. Supreme Court Justice Louis D. Brandeis (1913)**

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# Executive Summary

**R**eimagining capitalism is an imperative. We need to create a more inclusive and sustainable form of capitalism that works for every person and the planet. Massive environmental damage, growing income and wealth disparity, stress, and depression within developed economies amid a substantial economic boom are examples of how our current system of creating and distributing value is broken. We need to be able to factor into our decision-making the consequences of our actions not only for financial and physical capital but also for human, social and natural capital.

All companies have impacts, defined as changes in important positive or negative outcomes for people or the planet, almost all of which are not currently measured in a comparable or comprehensive way.<sup>1</sup> Measuring and valuing the impacts that companies have on society and the environment, while not itself a sufficient condition, is a necessary one for reimagining capitalism. In the absence of clearly defined impact metrics and transparency, these considerations are likely to be absent from decision-making. Decisions will continue to be made on existing financial metrics that do not reflect a holistic view of how an organization creates value as they ignore impacts on employees, customers, the environment and the broader society.

In order to provide actionable signals for business leaders, these impacts must be connected to accounting statements. Monetary valuation of impacts and their incorporation into accounting statements will explore whether monetization, as a form of valuation:

1. **Translates all types of social and environmental impact into comparable units that business managers and investors intuitively understand.**
2. **Can be meaningfully aggregated and compared without obscuring important details needed for decision-making**
3. **Displays financial and impact performance in the same accounts, allowing for the use of existing financial and business analysis tools to assess corporate performance.**

Just as the development of the financial accounting infrastructure has been a necessary condition for the development of large-scale capital markets, the development of impact-weighted financial accounts (“impact-weighted accounts”) is a necessary condition for the development of capital markets driven by sustainability considerations.

**What are impact-weighted accounts?** Impact-weighted accounts are line items on a financial statement, such as an income statement or a balance sheet, which are added to supplement the statement of financial health and performance by reflecting a company’s positive and negative impacts on employees, customers, the environment and the broader society.

The aspiration is an integrated view of performance which allows investors and managers to make informed decisions based not only on monetized private gains or losses, but also on the broader impact a company has on society and the environment.

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## Investors

Investors with more than \$80 trillion in assets under management have committed to integrate environmental, social and governance (ESG) data in their investment process.<sup>2</sup> By some estimates, more than \$22 trillion in assets under management are now labeled as ESG, reflecting widespread interest among asset owners in investing in sustainable enterprises.<sup>3</sup>

However, most of these asset owners and managers do not measure or report any impacts associated with their holdings. Moreover, the ESG metrics used in decision making primarily measure inputs and activities (i.e. policies, management systems, disclosures, investments) rather than outcomes and impacts on their stakeholders.<sup>4</sup> Our aim is that investors labeling their products as ESG use companies' impact-weighted accounting numbers as part of their due diligence, underwriting, engagement and reporting efforts. Asset owners could use these impact-weighted accounts as a monitoring and manager selection tool to ensure that their allocations are aligned with impact. Rating agencies and data providers could integrate them in their own data products.

## Companies

The number of publicly listed companies reporting ESG data has grown exponentially in the last two decades. While only 12% of the largest 100 companies in each of 49 countries (4,900 companies) issued sustainability reports in 1993, that number grew to 75% in 2017.<sup>5</sup>

We found 56 companies that have experimented with monetary impact valuation, producing environmental or total profit and loss accounts. Of these, 86% are measuring environmental impacts, 50% are estimating employment/social impacts, and 20% are estimating product impacts. There is broad representation across GICS Industry Sectors, however, the materials sector was represented the most with 12 companies performing monetary valuation, most from the chemicals industry. However, as in the case of many ESG managers, most companies are measuring inputs and activities rather than impacts. With the exception of a few companies that have published environmental or total profit and loss accounts, impacts are not valued nor integrated in accounting statements to illustrate their value implications. Our aim is that companies measure and disclose impact through impact-weighted accounts that eventually become standard management and governance tools.

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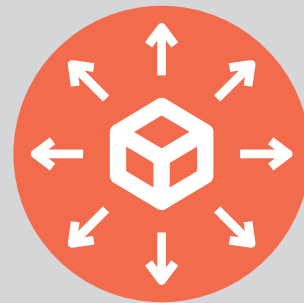
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