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Building sustainability and impact into accounting

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Can it be done? The answer is yes but it depends on solid academic research, investor pressure, and good old lobbying

At the 2019 United Nations Climate Action Summit, **Hajar Yagkoubi** attended a delegation dinner where she spotted the CEO of one of the world's largest oil companies. The UN Youth Representative approached him and asked about his role at the conference.

"I was genuinely curious to know," says Yagkoubi, who recalls the senior executive giving a cursory answer before beating a hasty retreat. "Just shy of six months after we spoke, his company got an audit risk and eventually had to forcibly write off 22 billion dollars of assets from their balance sheets due to, amongst other things, the foreseeable influence of climate risks in the company that were not calculated in.

"If we do not measure the environmental impact of companies, we won't know which companies are healthy and which will have assets destroyed by stranded asset risks."

Yagkoubi related that anecdote at an Impact Economy Foundation (IEF) webinar launching the beginning of the public consultation for the Impact-Weighted Accounts Framework (IWAF). She adds that the young today will inherit not only the environment handed to them, but also the economy which is based on current accounting systems that, like in the case of the oil company mentioned, excludes risks that are not narrowly financial.

"If it is an economy in which the true value of corporations is not properly represented, then that is a hazard to the stability of that economy that we will inherit. Now, through the impact weighted accounts framework, we are able to account for that accountability."

She adds: "When we can measure the true value of corporations through IWAF, we can also manage it. And by making it visible, we could decide to even pay up for the negative impact we have on the environment. We can make sure that we pay for deforestation, for toxins and chemicals released into the atmosphere, to deincentivise it."

IS SUSTAINABILITY FINANCIALLY VIABLE?

Eelco van der Enden, CEO of the Global Reporting Initiative (GRI), believes that adopting the best practices of his organisation with those of the International Sustainability Standards Board (ISSB) represents the two pillars of a new way of looking at accounting.

"One pillar (ISSB) focuses on the enterprise value effect of sustainability topics and on the value creation of the reporting entity, and on the other side (GRI) we have the impact companies make on the environment and social economic cohesion when they try to achieve their strategic objectives.

“Two sides of the same coin: one on the financials, the other one in impacts. One with the lens on investors, the other with the lens on society as a whole, but both equally important because we see investors looking more and more into the impacts.”

Indeed, ISSB and GRI have been working together since March to harmonise sustainability standards. **Eszter Vitorino**, moderator of the webinar, and Lead Expert of Sustainability Advisory at Dutch wealth manager Van Lanschot Kempen, made the point of “integrating sustainability factors into executive compensation”.

She notes: “It's in the hands of chief financial officers to tackle the sustainability issues, but in order to get the chief financial officers to embrace sustainability and really take action, we need to learn to speak the language of the chief financial officer.”

But does it work in real life? **Reynir Indahl**, CEO of private equity firm Summa Equity, testifies to the benefits of accounting for the risks that were ignored by the oil company CEO.

“The good news is: The companies we invested in would actually have four percent more revenues if we had to pay for our biological degradation and climate effect but at the same time got paid for the credits for what we are doing to saving the Earth,” he observes.

“On the social side, our portfolio would actually have 11 percent more revenues, and we've done also the product pillar, looking at two of our companies to pilot it and they would have three times as much revenue if you actually took the full product benefit and financialised that.

“it's a good measure when we are showing our investors that our companies and our portfolio's future-proofed. If there is a carbon tax and a carbon credit, they will actually be more profitable than currently, and it's a good way for us to drive the strategy and our value creation plan.”

MAKING IT HAPPEN

With the first IWAF draft due out later this year, Vitorino asked: How can we speed up the adoption of sustainability accounting practices?

“Two things: The first one is to get academic acceptance so that you have quantitative and qualitative evidence on the methodology,” says van der Enden. “The second one is lobbying. Speak to decision makers and keep marketing what you believe with the backing of academic evidence.”

Tjeerd Krumpelman, Global Head of Advisory, Reporting & Engagement at ABN AMRO: “I think investor pressure is relevant here. If investors start asking these questions, then companies will be more inclined to do this.”

Hajar Yagkoubi, Eelco van der Enden, Eszter Vitorino, Reynir Indahl, and Tjeerd Krumpelman were participants at the webinar “Launch of public consultation – Impact-Weighted Accounts Framework (IWAF): Paving the way to long-term value creation for all” that was held on June 2, 2022.