IMPACT-WEIGHTED ACCOUNTS FRAMEWORK

Summary

The case for IWAF
What IWAF contributes to the field
Documents of IWAF
Work-in-Progress - February 2022
version 0.2.1
EXECUTIVE SUMMARY
WHY IS IMPACT MEASUREMENT ESSENTIAL?

- Current financial value is created at the expense of society and the environment
- Organisations cannot continue to do so. Their licence to operate requires them to create sustainable value.
- Without measurement, management is impossible.
- However, measuring sustainable value creation is challenging:
  - How to reliably measure and compare (non-financial) value?
  - How to engage stakeholders and ensure organisations act?
- Sustainable value can be measured through impacts. Impacts show how activities affect the welfare in society. Impacts can reflect different types of value (“six capitals”) and include effects on different stakeholders.
HOW CAN COMPANIES MAKE INTEGRATED DECISIONS?

- **Impact-Weighted Accounts** (IWAs) supplement traditional financial accounts with positive and negative impacts on stakeholders such as employees, customers, the environment and the broader society through quantitative and valued accounts:
  - The **Integrated Profit & Loss** (IP&L) extends the “normal” P&L. It shows all impacts on stakeholders in one year.
  - The **Integrated Balance Sheet** (IBaS) extends the “normal” balance sheet. It shows impact assets and liabilities.

- IWAs help companies steer on purposeful and intentional impact that benefit society, while ensuring their own licence to operate.

- The Impact-Weighted Accounts Framework aims to fill the gap of a missing international standard that ensures complete and consistent IWAs.

*The figures represent a hypothetical example*
The Impact-Weighted Accounts Framework (IWAF) supports organisations to make IWAs. It gives specific guidance on how to measure impact such that it can be used to make management decisions. IWAF builds on the current impact literature and identifies 5 topics for specific guidance. 10 principles answer common challenges and ensure IWAs inform integrated decisions.

WHAT DOES THE IMPACT-WEIGHTED ACCOUNTS FRAMEWORK ADD?

- **Topics**
  - Identification: Which impacts are my responsibility?
  - Measurement: How do I measure societal impacts?
  - Comparability: What are the relative sizes of impacts?
  - Aggregation: How to make sense of many impacts?
  - Presentation: How to comprehensively present impacts?

- **Principles**
  - Multi-dimensional: Impacts can reflect different forms of value and value for different stakeholders
  - Materiality based: An impact is material if it affects future earnings or if it affect welfare of stakeholders
  - Welfare based: IWAF includes at least two welfare categories: wellbeing and the respect of rights
  - Value chain responsibility: Organisations have a responsibility for the impact of their value chain partners
  - Impact-pathway based: Impact is about outcomes – how the welfare of stakeholders is affected
  - Complete reference view: Impact is defined with respect to a specific reference scenario
  - Valued in commensurable unit: Monetary valuation allows impacts to be compared
  - Only within welfare categories: Negative impacts (of the rights dimension) shall not be netted against positive impacts
  - Conservation of impact: Impact contribution ensures total impact is counted exactly once.
  - Statements of IWAs: Integrated Profit & Loss, Integrated Balance Sheet and derived statements
CASE FOR IWAF
01
WHY DO SUSTAINABILITY AND VALUE CREATION BEYOND FINANCIAL VALUE MATTER?

• Current financial value is created at the expense of society and the environment and is not sustainable in the long term.

• **Sustainable economic development** happens within planetary boundaries and with a solid social foundation.

• Therefore, organisations should aim to create **integrated value** for all its stakeholders.

• Organisations have the **responsibility to measure** and internalise unwanted effects of their activities on social and environmental values.

Photo by René Molenkamp on Unsplash
WHY MEASURE AND REPORT ON SUSTAINABILITY AND VALUE CREATION?

• Without measurement, both the positive and negative societal impacts are de facto valued at zero.

• This leads to an incomplete view of an organisation’s societal value creation and/or degradation.

• In the past decades, progress has been made beyond managing and reporting on financial value creation only.

• With a holistic approach on value creation, regulatory requirements have caused the field of sustainability reporting to mature.

The EU regulations serve as an illustrative example.
WHICH CHALLENGES REMAIN FOR VALUE CREATION MEASUREMENT AND SUSTAINABILITY REPORTING?

Several challenges remain for value creation measurement and sustainability reporting:

• Organisations need **comparable and reliable information** to make integrated decisions, but how to measure and compare (non-financial) value?

• How to **engage stakeholders** and ensure organisations act upon their promises?
WHY IMPACT SOLVES THESE CHALLENGES?

• **Impact** reflects changes that affect the welfare of an organisation’s stakeholders. Organisations create or destroy value for society through their impact.

• Impacts can be **measured and compared**. IWAF specifically uses monetary valuation for comparability – see below for details.

• Impacts should be measured within an **accounting framework** with the aim of harnessing our economy to improve our society and planet. IWAF provides such a framework.

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WHY IMPACT-WEIGHTED ACCOUNTS?

- Impact-weighted accounts (IWAs) are a forefront of a broader field of measuring, reporting & managing sustainability and impact.
- IWAs supplement the financial performance of an organisation with its positive and negative impacts on employees, customers, the environment and the broader society.
WHY A FRAMEWORK FOR IMPACT WEIGHTED ACCOUNTS?

• Impact measurement, valuation and accounting is a relatively new field and in rapid development.

• The field lacks an international standard for making IWAs. Such a standard should ensure a complete and consistent impact assessment including all capitals and stakeholders.

• The Impact-Weighted Accounts Framework (IWAF) aims to close this gap and guides organisations to create their own IWAs.

• IWAF builds on many existing frameworks, specifically:

• Other adopted impact reporting frameworks, such as IRIS+, IMP, Capital Coalitions and SDG reporting.
IWAS A HOLISTIC VIEW ON ORGANISATION PERFORMANCE

• IWAF defines Impact-Weighted Accounts as:

“A set of comprehensive quantitative and valued accounts containing impact information about an organisation that the organisation and their stakeholders can use to make informed integrated decisions.”

• IWAs consist of two building blocks:
  • Integrated Profit & Loss (IP&L) expands a traditional profit & loss by taking into account value created for all stakeholders in the form of the six IIRF capitals
  • Integrated Balance Sheet (IBaS) expands a traditional financial balance to include stakeholder value created over a longer term
Benefits of IWAS for Companies

Benefits for companies
1. Steer on purposeful and intentional impact;
2. Retain their social licence to operate;
3. Better understand internalisation risks and act upon them;
4. Understand the value of their impact;
5. Meet transparency expectations of stakeholders;
6. Comply with future regulations; and
7. Remain an attractive employer for future talent.

Benefits for investors
BENEFITS OF IWAS FOR INVESTORS

Benefits for **companies**

Benefits for **investors**

1. Understand an organisation’s **integrated value creation for all stakeholders**;
2. Assess the **likelihood and speed of internalisation**;
3. Get additional insight in an organisation’s **long-term financial viability**; and
4. Increased transparency of potential **long-term risks**.
WHAT IWAF CONTRIBUTES TO THE FIELD

02
WHAT ARE IMPACT-WEIGHTED ACCOUNTS?

• IWAs are a set of comprehensive quantitative and valued accounts containing impact information about an organisation that they and their stakeholders can use to make informed integrated decisions.

• IWAs consist of multiple statements, just as financial accounts do (income statement, balance sheet, ...)

• All line items in the statements are impacts, such as contribution to climate change, wellbeing of employees, increase in social cohesion, ...
IWAF SUPPORTS ORGANISATIONS TO MAKE IMPACT-WEIGHTED ACCOUNTS

• The goal of the Impact-Weighted Accounts Framework is to support organisations to make IWAs.

• The framework covers five topics to ensure the IWAs inform the integrated decisions of organisations.

• In literature, we see great examples of impact assessments – but often these fall short to be used to manage impacts. A number of challenges for successful impact assessments remain.
# TOPICS OF IMPACT ASSESSMENTS AND THEIR CHALLENGES

<table>
<thead>
<tr>
<th>Topic</th>
<th>Related challenges</th>
<th>Examples</th>
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</table>
| Identification | Impact measurement is based on assessing 1 or more impacts. The literature lists hundreds.  
• Practical guidance: how to get started selecting impacts for an assessment?  
• Moral guidance: what is the responsibility of an organisation – how should this affect the scoping? | Where do I start?                             |
| Measurement  | Without measurement, organisations can only make very limited claims about the size of impact and therefore only make intuitive decisions  
• How to get started measuring impacts?  
• Impact is defined as the difference an organisation makes. But the difference compared to what? | ![CO₂ vs CO₂ A lot vs Really a lot](https://via.placeholder.com/150) |
| Comparability | Impacts are naturally expressed in wildly divergent units  
• How to get meaningful insights on their relative sizes?  
Some units are naturally expressed in monetary units – These risk being prioritised in decision making | ![Impact on Biodiversity > Impact on Climate change](https://via.placeholder.com/150) |
| Aggregation  |  
• Lack of aggregation – difficult to make meaningful claims on total performance based on dozens of impact numbers  
• Overaggregation – a single total impact metric can lead to the idea that it is OK to accept harm to some for the benefit of others. This view is often seen as problematic  
• Incorrect aggregation – may lead to double counting | ![1 impact metric or 200 impact numbers](https://via.placeholder.com/150) |
| Presentation |  
• Which statements to show?  
• How to relate that to ‘good performance’ of an organisation? | How to visualise all of this?  
How to manage impact? |

Pictograms from the Noun Project: filter by scott desmond, and report by Irvan Rhomadhani
IMPACT ASSESSMENT REQUIRES CHOICES TO BE MADE

• Some elements of **impact measurement and valuation** are relatively straightforward. All methods in the literature take a similar approach.

• Other elements require **choices to be made**, when no clear ‘right’ or ‘wrong’ option exists. In these cases, the Impact-Weighted Accounts Framework gives guidance on how to move forward in a way that we believe is the most correct and consistent.

• These choices are **captured in principles** that relate to the topics and challenges of impact assessments and enable organisations to manage their impact.
## PRINCIPLES OF IWAF BASED ON CHALLENGES OF IMPACT ASSESSMENTS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identification</td>
<td>Multi-dimensional</td>
</tr>
<tr>
<td></td>
<td>Materiality based</td>
</tr>
<tr>
<td></td>
<td>Welfare based</td>
</tr>
<tr>
<td></td>
<td>Value chain responsibility</td>
</tr>
<tr>
<td>Measurement</td>
<td>Impact-pathway based</td>
</tr>
<tr>
<td></td>
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</tr>
<tr>
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<tr>
<td></td>
<td>Conservation of impact</td>
</tr>
<tr>
<td>Presentation</td>
<td>Statements of IWAs</td>
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</tbody>
</table>
IMPACT PRINCIPLE 1 MULTI-DIMENSIONAL

• IWAs consist of accounts - Just as financial accounts do (income statement, balance sheet, ...)

• In these accounts, all line items are impacts, such as contribution to climate change, wellbeing of employees, increase in social cohesion, ...

• One account can include multiple impacts (up to a few dozen). This makes impact statements inherently multi-dimensional.

• Impacts can reflect different forms of value (belonging to different capitals) and reflect value for different stakeholders.

• For reference a list of standard impacts is provided.

Pictogram from the Noun Project: Cube by LAFS
IMPACT PRINCIPLE 2  MATERIALITY BASED

• An impact is material if it satisfies one of the following criteria (double materiality):
  • The impact materially affects the future earning potential of the company
  • The impact materially affects the welfare of one or more (external) stakeholder groups

• An impact is assessed as material when it
  • Is material based on empirical data, for example, based on scientific research or previous IWAs;
  • Is perceived to be material by at least one of its stakeholder groups.

• The longlist of impacts undergoes a prioritisation process from a multi-stakeholder perspective

• Regarding assessing materiality, IWAF does not provide (much) guidance. The user is referred to GRI (stakeholder focus)/IIRC/IFRS/... (enterprise value)
IMPACT PRINCIPLE 3 WELFARE BASED

• Welfare consists of various categories, such as well-being, respect of rights, spiritual value, equity and equality, and more.

• (Aggregated) human well-being is *not* the only thing that matters

• **Violating rights** of a stakeholder is seen as problematic – Even if it only leads to a limited decrease in human well-being.

• Violating rights of one stakeholder can never be justified with an increase in well-being of another stakeholder (e.g., “the pollution is OK as the company provides employment”)

• Therefore, IWAF defines at least two welfare categories\(^1\) that should be assessed separately and that can never be netted:
  - **Well-being**
  - **Respect of rights**

\(^1\)Other welfare categories are currently not in scope
IMPACT PRINCIPLE 4 VALUE CHAIN RESPONSIBILITY

- Organisations have a **responsibility** for the impact results of their value chain partners.

- In impact models, this translates to the requirement to include both
  - **Direct impact**: the impact of own operations
  - **Indirect impact**: the impact of value chain partners
IMPACT PRINCIPLE 5 IMPACT-PATHWAY BASED

- IWAs consistently use **impact pathways** to assess impacts

- Impact pathways make explicit that value creation is not directly about the activities (or intentions) of an organisation. And neither do the inputs (materials and other means used) or outputs (what an organisation can directly control) tell the full story.

- Impact is about **outcomes** – how the welfare of stakeholders is specifically affected.

- In addition, impact is always defined with respect to a reference (see next principle).

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Pictograms from the Noun Project: Pathway by Iconbox

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IMPACT PRINCIPLE 6 COMPLETE REFERENCE VIEW

- Impact in impact pathways is defined with respect to a reference.
- Often impact claims have only implicit references
  
  “Electric cars limit CO$_2$ emissions”
  (true if the reference are gasoline cars)
  
  “Electric cars lead to CO$_2$ emissions”
  (also true, and particularly relevant with an absolute reference)

- Both the so-called absolute and marginal reference are relevant and are assessed within IWAs
- Additionally, the organisation should clearly describe the references used in impact calculations

Absolute impact is the impact as compared to a no-alternative reference scenario in which no activities occur.

Marginal impact is the additional impact as compared to a reference scenario in which alternative activities continue in the organisation’s absence.
IMPACT PRINCIPLE 7 VALUED IN COMMENSURABLE UNIT

• Impacts all have their own quantities and units:
  • Kilotons of CO$_2$ emissions (for climate change)
  • DALYs lost (for health & safety accidents)
  • Wellbeing points gained (for wellbeing of work)
  • ...

• This leads to a lack of **comparability**

• **Valuation** is the assessment of the normative desirability of an impact, which therefore reflects its value to stakeholders.
  • The wellbeing and the rights category are assessed separately

• Valuation expresses impacts in a **common unit**.
  • This unit is often monetary, with the additional advantage of comparability to financial metrics
IMPACT PRINCIPLE 8 AGGREGATE ONLY WITHIN WELFARE CATEGORIES

- Financial accounting is in a sense one-dimensional as it has a single bottom line: the annual profit.
- Impact is inherently multi-dimensional. There is more than one bottom line: each impact represents one on itself.
- Aggregation could lead to loss of important information and definitely should not be used to hide important information.
- Aggregation of impacts should be done with caution – aggregate only within welfare categories
- Impact should not be aggregated into a single number (or ‘total impact’)
- In particular, negative impacts of the stakeholder rights dimension should not be netted against positive impacts in the IWAs (unless they are also shown disaggregated explicitly elsewhere)
The principle of **value chain responsibility** argues both direct and indirect impact should be included.

Naively including both the impact of own operations and that of value chain partners leads to double counting.

**Impact contribution** avoids double counting: An organisation’s impact is a linear combination of (parts of) the total direct and indirect impact.

The total amount of **impact remains equal** throughout contribution.

Four supporting principles guide the assessment of impact contributions using attribution.

**Supporting principles that guide impact contributions**

- **Additivity of impact**: the impact of two organisations can be summed.
- **Sensitivity to impact**: if one element of impact contribution increases/decreases while the other impacts remain constant, then the total impact contribution should increase/decrease.
- **Sufficient resolution**: differences between organisations should be clear in their impacts.
- **Co-responsibility**: Impact is part of an organisation’s impact contribution if, and only if, that organisation is co-responsible for that impact.
TOPICS AND PRINCIPLES LEAD TO A WORKFLOW TO MANAGE IMPACT

FRAME
- Identify rationale
- Understand context

SCOPE
- Define organisational goals and functions
- Establish impact assessment methodology

APPLY
- Manage impact based on the Impact-Weighted Accounts

01
- Get Started
- Define the objective

02
- Define boundaries
- Identify potential impacts

03
- Set scope
- Select impacts for further analysis (based on materiality and feasibility)

04
- Measure impacts
- Make impact pathway
- Establish accounting model
- Acquire input data
- Calculate impact

05
- Value impacts
- Value impacts relating to stakeholder well-being
- Value of impacts relating to stakeholder rights

06
- Attribute and aggregate
- Attribute impact over the value chain
- Assess impact contribution
- Calculate other aggregates

07
- Compile impact statements
- The results are combined into the IP&L and IBaS
- Statements derived from the IP&L are compiled (value creation and sustainability statements)

08
- Interpret and test the results
- Verify numbers (insofar not yet done): internal quality control and/or external audit

09
- Take action: report the IWAs
- Make reports for the Impact-Weighted Accounts

10
- Take action: manage impact

Sub-step
- Identify organisational goals and functions
- Establish impact assessment methodology
- Select impacts for further analysis (based on materiality and feasibility)
IWAS HAVE TWO BUILDING BLOCKS THAT SUPPORT INTEGRATED DECISIONS

- Two key building blocks of conventional financial reporting are the **Profit and Loss Account** and the **Balance Sheet**
- In IWAs both are generalised into **impact versions**: showing value creation or destruction in multiple forms for multiple stakeholders

**Integrated Profit and Loss Account (IP&L)**
- Generalises the financial profit and loss account
- Shows all information the organisation makes during a time period (typically 1 year)
- Instead of a single bottom line ('profit'), there are multiple bottom lines, each representing one of the impacts (spheres in the figure below)

**Integrated Balance Sheet (IBaS)**
- Generalises the financial balance sheet
- Contains information on the impact an organisation had until a certain moment (typically assessed at the end of every year)
- Indicates responsibilities the organisation has based on their past impact
- Currently less developed than the IP&L
INFORMATION FROM IWAS ON ORGANISATIONAL GOALS

• To provide useful impact information, IWAs additionally contain derived statements that inform the reader how they perform with respect to four key organisational goals.

• Managing these goals simultaneously is not easy. Instead of one goal (maximise profit), there are multiple potentially conflicting goals.

• But without any quantified information it is even harder to steer on value creation beyond profits.

Goal 1: Create value to society and its stakeholders
Goal 2: Act sustainably within planetary and social boundaries
Goal 3: Contribute to the SDGs
Goal 4: Manage integrated value creation potential

Information on the first three goals is included in the IP&L. The fourth goal is linked to the IBaS.
GOAL 1 CREATE VALUE TO SOCIETY AND ALL ITS STAKEHOLDERS

• Healthy companies create value for all of their stakeholders.

• This includes the neoclassical goal: create value for investors. Indeed, this must be sufficiently large to keep operating (most businesses are not charities)

• It also includes value creation to employees, clients and wider society – Creating positive value to them is part of the license to operate

• Based on the IP&L, value creation can easily be assessed by selecting the right impacts
GOAL 2 ACT WITHIN PLANETARY AND SOCIAL BOUNDARIES

• Users of IWAs should be very careful about justifying negative impacts by the existence of positive ones.

• It is not OK to justify human rights violations or environmental pollution by pointing to positive impacts elsewhere (e.g., positive effect on employment).

• In fact, companies should have a second goal: to act sustainably within planetary and social boundaries.

• This translates to a duty to minimise negative impacts associated with rights violations (human rights, labour rights and environmental rights).

• Impacts in the IP&L can reflect rights violations in the organisation’s own operations, or in their value chain. Organisations have a duty to reduce both.
GOAL 3 CONTRIBUTE TO THE SDGS

• The Sustainable Development Goals (SDGs) are 17 interlinked global goals as a "blueprint to achieve a better and more sustainable future for all" formulated in 2015 by the United Nations General Assembly.

• Companies can contribute to the SDGs, and this is a third organisational goal.

• This goal is relative: an organisation can contribute to a reduction of negative sustainability impacts and an increase of positive sustainability impacts.

• The SDG statement can be made by selecting relevant impacts for each SDG – Note that some impacts may be associated with more than 1 SDG.

The figures represent a hypothetical example.
GOAL 4 MANAGE INTEGRATED VALUE CREATION POTENTIAL

- Over the years, organisations accumulate positive and negative impact on their stakeholders.
- Especially the negative impacts pose a risk. Even if they are not large on an annual basis, the accumulated effect can – literally – pose a liability.
- The fourth goal is directly addressed by the Integrated Balance Sheet.
- Specifically, the accumulated negative impacts should not be too large. Note that they can often be reduced by remediating the negative effects, although this is typically not free of cost. It would then affect the company’s equity.
Documents of the Impact-Weighted Accounts Framework
CONCEPT

A crucial missing piece to realise the impact economy is impact-weighted accounts. Given the absence of a framework to compile Impact-Weighted Accounts, the Impact Economy Foundation sets out to incubate such a framework, together with thought leaders and leading practitioners in an inclusive and scientific manner. IWAF is being developed in partnership with the Impact-Weighted Accounts Initiative from Harvard Business School, Singapore Management University, Rotterdam School of Management and Impact Institute.

Impacteconomyfoundation.org

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