Corporate Reporting on Social Impact

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This paper is a proposal to expand the scope of accounting.

Traditional Accounting

Double entry accounting emerged in Italy in the 1300s to explain the changes in an organisation's assets over any given period. It refers to changes in an organisation's capital base as profits or losses. The system's longevity is testament to its success. Capitalism was predicated on the ability of investors with no other connection to an organisation to understand chances of the organisation's commercial success or failure.

Capitalism unleashed an explosion in economic productivity unparalleled by any prior economic system. Accounting is one of the fundamental pillars capitalism, without which it can not function. This pivotal role in the success of economic growth helps to explain the fury, and cost to participants, on the relatively few occasions that catastrophic accounting mistakes have been made. Mistakes can be extremely costly.

Accounts provide the information from which to predict the future profitability of an organisation. Almost all the challenges in accounting stem from the difficulty of allocating costs and revenues over different time periods in a meaningful and consistent way. The sheer range of methods of accounting is almost overwhelming. Since it is not possible to account for unknown future events with certainty, time allocations are judgements rather than arithmetic calculations. The judgements need to be reliable, free from bias. It can be difficult to distinguish differences in outcomes between natural patterns of uncertainty and intentional bias. The distinction can be exacerbated where political and tax influences interact uncomfortably with generally acceptable accounting practices.

The Pressures for Change

The complexities of today's global trading landscape, with its disconnection of individual consciousness from global activities, makes the complexity of accounting almost inevitable. Modern accounting is complex and nuanced, probably too complex for most people to understand. Some people state it differently - they say traditional accounting is no longer fit for purpose in the enormity of the challenges we face today. The profession needs to take head of the distant calls for change. We need to lead the change if we want to retain public trust.

There are two more issues we need to acknowledge.

Firstly, accounts measure only the monetary consequences of activities. In order to ensure integrity, we exclude from accounting any activities whose monetary consequences can not be predicted with certainty. The result is that many activities of an entity are outside the scope of monetary reporting. Yet even the activities we do include are subject to hidden imprecision. The value of money we use to measure assets and liabilities is variable. Assets used over time are affected by changing interest rates. The value of imports and exports are affected by changing exchange rates. Productivity, a key measure extracted from accounts, is affected by changes in quality of output. Monetary measures are inconsistent and inadequate as tools to quantify the impact of technological advances. In an era of unprecedented technological advance, it undermines the quality of accounts, especially when interpreting trends of over prolonged periods. These inherent limitations in the scope and quality of accounts undermine their ability to tell the story of our times in any meaningful way.

Secondly, accounts of individual entities can be evaluated in combination with others to reveal outcomes and prospects of the wider society. In an overall economic sense, capitalism is a means to an end. The purpose of corporate activity is to contribute to the wellbeing of society. Successful economic activity diverts society's scarce resources to the entities that are best able to deliver the objectives of society. Capitalism achieves this goal by ensuring the entities that can achieve the best rate of return of profits attract the greatest share of capital. But the societal rationale behind capital's allocation is undermined where entities become too powerful. Where entities achieve monopolistic profits, they attract capital without regard to whether they act in the best interests of society at large. Trickle down economics has been tried and found wanting. Populist disgust with traditional capitalism threatens the secure legal rights and structures on which entities depend to achieve their profits.

In the aftermath of the failure to predict the financial crash of 2007, economists have been developing new models that provide more reliable explanations of current trends. The challenge for the accounting profession is how best to support these new economic models, to ensure corporate accounting remain relevant.

The Next Generation of Accounting

Modern economic theories have evolved from the awareness that monetary GDP does not fairly reflect the experience of a nation's population. Generally, they are based around newly emerging measures of human experience. There are a variety of such measures. There is a confusing array of different words used to mean the same thing. Happiness, quality of life, wellbeing and prosperity, for example, can be used interchangeably by some, yet have very distinct meaning for others. All the measures have common elements – they reflect non-financial experiences of life; for example, the quality of personal relationships, the sense of self-worth and the state of people's physical and social security. Money plays a part in the level of general prosperity, and some people attempt to place a monetary value on personal sentiment. Nevertheless, attempting to representing human experience in monetary terms is too limiting as a basis for effective economic policy.

Economists have come up with solutions. To keep up, corporate accounting needs to reflect those solutions in the individual accounts of productive entities. The challenge, however, is that an individual person's quality of life comprises a complex mesh of interacting influences. The overall outcome of any single individual is the product of the outputs of a very large range of entities, cultures and circumstances. There is no direct link between the output of a single productive entity and the aggregate quality of life members of society. Terminal illness, for example, trumps almost every other contribution to quality of life. This lack of linear link between corporate activities and national prosperity obliges us to look for new techniques.

Happily, a number of appropriate solutions have been proposed. By and large, they seek to measure the social impact of an entity, in place of its direct contribution to individual wellbeing. Two examples are the Boston Consulting Group's measure of *Total Societal Impact* and the Humanity Trust's measure of *Contribution to Social Cohesion*. Total Societal Impact requires entities to define their social purpose, and to establish measures that assess the impact. Contribution to Social Cohesion measures the impact of an organisation's activities on the social cohesion of its full range of stakeholders; from staff to customers, and from local communities to global communities. Its concept is based on the direct link that exists between social cohesion and a nation's prosperity.

Call to Action

The Inclusivity Trust, along with a number of other interested parties, is launching a process to develop a new standard in accounting that reflects an entity's social impact. The process will inform accountants of the evolved economic thinking, solicit accounting solutions, consult with members of the profession along with representatives from industry, the investment sector, academia and elsewhere. The process will seek and share views on the proposals, with a view to encouraging and identifying consensus for a new accounting standard.

Anyone who wants to participate in this process should contact Nigel Cohen at the Inclusivity Trust (nigel@inclusivity.world), providing contact details and an outline of their areas of interest.