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The Rationale for the Social Contract Accounting Framework

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Monetary accounting provides information about the monetary flows through an organisation as a result of its activities. Monetary flows do not necessarily take place in the same period as the activity. Standard accounting practice sets out principles and guidance about how organisations should account for monetary flows that fall in a different period from its associated activity.

Monetary accounting is not designed to reflect contributions or costs to society that result from an organisations activities, but which do not flow through the organisation.

Societal Accounting provides the principles and guidance about how organisations should account for the impacts of its activities that do not result in monetary flows to the organisation. Societal is shorthand for social and environmental. The primary focus of societal accounting is the social and environmental impacts that are not fully reflected in monetary accounts. A hydroelectric damn that bursts may result in massive costs to the livelihoods of people who live and work downstream, not all of which may be born by the organisation that operates the damn.

The Social Contract Accounting Framework is an example of societal accounting. This paper sets out the rationale for the framework.

Rationale

This paper assertion that the objective of society is the provision of inclusive, sustainable prosperity for its members. It proposes to establish a standardised measure that represents societal impact, which is meaningful, consistent and capable of independent verification. This measure will provide the basis on which investors can judge an organisation's societal impact with respect to its prospects for long-term profitability. This, in turn, will provide the financial incentives to organisations to align their activities more closely with societal objectives.

The paper asserts that the term sustainability has become confusing in its use, and offers some standardised definitions. It argues that we do not yet have sufficiently reliable techniques to achieve standardised measurements of the impact an organisation has on resource sustainability. It argues that there are equivalent but different challenges in measuring the impact of systemic sustainability.

It proposes an alternative approach that offers a partial solution to the problem, but one which provides consistent and verifiable measures that offer insight into the reporting entity's long-term prospects.

Definitions

Corporate accounting for social and environmental impact has been evolving for decades. Many terms are used in a variety of ways. We define the terms used in this article to avoid ambiguity.

Accounting Definitions

Entity: Any organisation of people carrying out coordinated activities to advance a common objective. It includes businesses, charitable and social organisations, institutions and governing entities.
Social Impact: The net total impact of an entity on the state of human wellbeing
Environmental Impact: The net total impact of an entity on resources and the environment
Societal Impact: An entity's overall social and environmental impact
Societal Accounting: Accounting for societal impact
Social Accounting: Accounting for an organisation's contribution to flourishing human wellbeing.
Environmental Accounting: Accounting for an organisation's contribution to resource sustainability
Social Contract Accounting: The proposed principles and requirements for reporting entities to account for their social and environmental impact, in accordance with their responsibilities to society.

Sustainability Definitions

Sustainability: the ability of society to support flourishing outcomes for humanity now and for future generations, supporting and maintaining other life, resources and the environment to that end.
Resource Sustainability: the ability of society to maintain the resources required to support human wellbeing now and for future generations, taking account of the impact of discarded resources.
Systemic Sustainability: the ability of society to maintain healthy social and productive systems that are capable of delivering flourishing outcomes for humanity now and for future generations, within our natural constraints.
Resource Depletion: The use of scarce resources whose rate of depletion is unsustainable beyond the short-term.
Resource Destruction: The use of resources that have a destructive impact on sustainability.

Social Definitions

Culture: The complete set of an entity's values, motivators, worldviews and objectives.
Wellbeing: The degree of satisfaction of an individual's needs, desires and aspirations. It is a description of the quality of an individual's state of being.
Prosperity: The aggregate wellbeing of a society's members. It is a description of the systemic health of a society.

Definitions of Sustainability

The term "sustainability" is currently used in many ways. To some, sustainability means simply the ability to have continue access to resources indefinitely. To some it is synonymous with saving the planet from greenhouse gasses and plastic waste. To some, it covers everything that has anything to do with any human activity that impacts either the health of the planet or the health of society.

Since the different meanings are largely unconscious and the term is used interchangeably, it creates confusion.

Here are some examples to illustrate the challenges.

Basic Definition

The Cambridge dictionary defines sustainability as "able to continue over a period of time", or "causing little or no damage to the environment and therefore able to continue for a long time". This definition falls short of the UN's 2012 goal of "the achievement of a green and inclusive economy in the context of sustainable development and poverty alleviation". The World Commission on Environment and Development (Brundtland Commission) defines sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". The Cambridge Leadership Development team, a small group of people who provide leadership services for business, introduce a concept of "sustainable prosperity", where the term sustainable becomes a qualifying concept to the objective of prosperity. They define sustainable prosperity as "the sustainable development that enables all human beings to live with their basic needs met, with their dignity acknowledged, and with abundant opportunity to pursue lives of satisfaction and happiness, all without risk of denying others in the present and the future the ability to do the same". It conceives of removal of barriers to human flourishing. Paul Barnett from the Strategic Management Forum defines sustainable prosperity as the active pursuit of inclusive human flourishing, in a way that is sustainable.

Here are five different definitions, each of which has a different implication for the basis on which we structure society.

Scope

Environmental sustainability can be seen through two conflicting lenses. One perceives sustainability as being centred around human wellbeing. The consequence of unsustainable practices relates to future human suffering. In this concept, it is acceptable to appropriate fields to grow food using sustainable techniques because it serves humanity. Little regard is had to the destruction of area's natural ecosystems unless humans are impacted. Use of pesticides that may destroy bees is acceptable providing the level of destruction does not interfere with future production. This is referred to by some as shallow sustainability. The focus of shallow sustainability is making our current systems more sustainable through, say, using more sustainable materials.

The other perceives sustainability as being a function of nature. The world is a vast, single ecosystem whose protection is an objective in its own right. It bears no relation to human activity or wellbeing. Humans need to adapt to nature, not the other way around. This is referred to as deep sustainability. Its focus requires humans to restructure society, for example by living closer to where we grow food to avoid the need to transport it.

Here are two concepts of sustainability that also have very different implications for policy makers. Greenpeace advocate that we should change our farming methods to use more natural processes and to make farms more resilient. The implication constrains the level of calorific output in exchange for better environmental outcomes. It recognises that "feeding the world's growing population is no small

challenge". The big agribusiness giants are charged with feeding the growing population, with wildly differing messages on managing the environmental impacts.

Conclusion

This paper proposes definitions for sustainability that distinguish between the different types of sustainability, based on the human-centric "shallow" perspective.

Measuring Sustainability Impact

The context of this analysis of measuring sustainability is the aspiration for individual organisations to report on their individual societal impact. This section analyses resource sustainability. Systemic sustainability is covered in the next section.

Resource sustainability falls into two categories, depletion and destruction.

Resource Depletion

Organisations deplete resources when they extract or use up natural resources at a rate that is unsustainable. The rate of use is unsustainable when a resource will become depleted in the foreseeable future. It is also unsustainable when it deprives future generations of access to the resource, unless there is legitimate need for the current generation to deprive future generations.

Depleted does not necessarily mean completely used up. It means that it is no longer economically viable to use the resource, perhaps because of scarcity or because of its increasing inaccessible as stocks decline.

Resources are not depleted if they are renewed or economically renewable. Reforestation is an example. They are not depleted if they such a tiny proportion of total stocks is used that there is no realistic prospect of running out for centuries. Sunlight is an example – for the time being, at least.

The easy bit. Organisations are generally able to measure their rate of usage. There is no need to do so where resources are not being depleted.
The difficult bit. Where resources are over-used, an organisation's rate of usage is unlikely to offer much insight into its impact in isolation, because the impact depends on so many unconnected circumstae's nces.

- Are there alternative resources that can replace the depleted resource? If not, the consequence on future productivity is likely to be higher.
- How is the resource ultimately consumed by each individual? If future consumption is compromised, the impact depends on the circumstances of each consumer.
- Will depletion compromise other processes or production? If so, the impact depends on the compromise. This challenge becomes very much greater if the affected processes are part of an ecosystem. Since we live in a hugely complex ecosystem ourselves, it is likely any depletion is part of an ecosystem. This has wider implications for deep sustainability
- Resources are not spread evenly around the world. Depletion in one area does not necessarily represent depletion in another. Scarce water is an enormous problem in countries close to the equator. Excessive water is a different problem for small islands that risk being drowned by rising sea levels.
- Organisations specialise. The production chain can be very extensive. It is difficult for organisations to know what resources may have been depleted by their suppliers, which makes it difficult to include the supplier's depletion in their own accounting, even though it may be the direct result of their activities.

The list above is not complete. But it does illustrate the challenges to measuring the impact of depleting resources.

Resource Destruction

Organisations destroy the environment when their waste is discarded into nature at a rate that overwhelms natures ability to reprocess it. Plastics discarded into the seas can take centuries, or millennia to decompose. CO2 discarded into the atmosphere creates a greenhouse effect that causes global warming.

Organisations can avoid destroying the environment if they reprocess their products in ways that do not harm the natural environment. Where products or their components can be reprocessed or reused, they are not destructive, although there may be bi-products of . But in a world of 7 billion people and counting, very few types of discarded resources are not harmful.

Generally, the impact of excessive waste is its impact on the environment. Here, too, it is challenging for organisations to isolate their own contribution to harm. Even where it can, the impact on the immensely complex ecosystem, both within the foreseeable future and into future generations, is tough to quantify.

Conclusion

There are enormous challenges to assessing the impact of an individual organisation's activities that result from unsustainable use of resources. It is not a reliable basis to measure an organisation's impact from unsustainable practices.

To compensate, organisations should include a narrative report on their use of depleting and destructive resources. It is outside the scope of this report, but it is likely that narrative reporting would be enhanced if there were some standardised, globally available information that relates to scarce resources and to foreseeable dangers from inappropriate discarding. It should be clear to organisations that the challenges in measuring their impact illustrates why it is so important to look for ways to avoid exploitation and discarding of resources wherever possible, even where the current state of risk may not be fully recognised.

Measuring Social Impact – Traditional Approach

The paper Wellbeing Energy Flows describes how individual wellbeing is generated, and aggregated as society's prosperity. The social impact that is the focus of this paper is the impact of an organisation's activities on individual and aggregate wellbeing.

Two methods are currently applied in accounting for social impact, the direct impact on individuals and the organisations contribution to the system that generates wellbeing.

Direct Impact

An organisation contributes to the wellbeing of a wide array of stakeholders. Generally, it has to choose the stakeholders it feels are most relevant to its assessment. There is currently little guidance on the basis on which stakeholders are chosen, and the proportion of attention warranted by each stakeholder group. The choice is largely arbitrary, although significantly less arbitrary than traditional financial accounts that focus on an illogical slither of stakeholders.

Next, the organisation chooses a manageable number of social impacts to consider. Examples include the impact of selling make-up (by a make-up producer or retailer), and the impact of creating stress (on employees or borrowers). The experts advocate a number of different approaches to measure societal

impact. Generally, their approaches address social impact. But they are often subsumed within the overall assessment of societal impact, and the explicit focus on stakeholder wellbeing is very limited.

Part of the problem is the challenge in measuring the change in wellbeing to individual stakeholders. The impact to each individual is so dependent on their personal circumstances. So it is not practical to measure individual wellbeing. Some approaches apply methods that aim to approximate the impact on wellbeing. But the proxy measures themselves are rarely substantiated as fair reflections of reality.

Systemic Impact

We live in deeply specialised and integrated systems of production. An individual organisation's role in society is often easier to understand through its contribution to the whole. Societal accountants often talk about systemic sustainability as contributing to the health of the system overall.

The Integrated Reporting approach conceives of six capitals that an organisation builds. They include environmental capital, social capital and knowledge capital. The capitals are a conceptualisation of the way a business creates value. It has two major challenges. Firstly, it is a very complex model. Its complexity is expensive to apply, making it inaccessible to small and medium size business. This precludes around 50% of economic entities. And it is difficult for users of reports to understand. Secondly, it makes use of self-determined benchmarks against which to measure performance. This restricts the ability to compare the efforts of one entity against another. It is also open to unscrupulous entities to modify the constituent parts of the benchmark to deflect or hide poor performance. The approach is more focused on an organisation's internal capacity. It pays little attention to the organisation's contribution to the health of the wider system, and it only peripherally focuses on the social impact of activities.

The challenge is how to disentangle the impact of an individual organisation's activities on the overall system's ability to generate wellbeing.

The universal approach measures how closely an organisation's culture aligns with society's social and environmental objectives. This involves assessing the congruence between the organisation's cultural objectives with society's and how closely the organisation's practice aligns with its objectives. The indirect method does not seek to measure an organisation's direct social and environmental impact, concentrating instead on its contribution to society's culture of social and environmental wellbeing. It raises managerial consciousness of the organisation's social and environmental responsibility and practices in connection with assessing its strategy and outcomes.

The universal approach provides a measurable, independently verifiable assessment of an organisation's intent with respect to its social and environmental responsibilities, and the alignment of its actions with its intent. The measure provides investors with insight into the prospects of an organisation's long-term profitability, which is expected to be reflected in its share price. In this way, the indirect method provides financial incentives to organisations to improve the alignment of their activities with the social and environmental objectives of society.

The universal approach has its own limitations, but compliance with minimum accounting principles is not one of them. Its major limitation is its failure to recognise individual actions that conflict with its culture, which have a significant social or environmental impact.

One looks at the social impacts from a micro-perspective, conceiving of the impact of the organisation in isolation from any other organisation. The other is has a macro-perspective, assessing the organisation's alignment with other organisations and with society's wider objectives. By and large, all approaches advance the interests of people in an organisation's activities well beyond the current focus on profitable customers, shareholders and management. Social accounting requires organisations to account for their impact on a wider range of stakeholders, including all employees, customers, suppliers, local communities and the wider community, without regard to the monetary flows associated with the activities.

The Social Contract Accounting Proposal

Social Contract Accounting proposes an alternative approach. It is predicated on the limited ability of organisations to quantify their environmental impact. It tilts the balance of the triple bottom line towards accounting for social impact, as the basis on which to provide more measures that are likely to have a deeper influence in corporate behaviour relating to sustainability. It recognises that the current environmental abuse is caused by humans. This provides two routes to motivate a change in behaviour that mitigate the abuse. It can come from external regulation/pressures, and from within. The way it achieves this is explained in the next section.

The Social Contract Accounting Proposal

Social Contract Accounting will provide practical guidance on practice and reporting of the impact of an organisation's activities on social and environmental outcomes within society.

Its recommends use of the indirect method of social accounting, as outlined above.

It proposes to supplement the reported measure of contribution with reporting of social and environmental activities, both in numbers and narrative, sufficient for readers of the accounts to judge factors that are not necessarily reflected in reported social contribution. Some approaches make an adjustment to the measured social and environmental contribution of an organisation to reflect specific activities during the year that have had a perceptible direct impact.

The standards around supplemental reporting will change over time to reflect advances in social and environmental accounting techniques.

A process is underway to bring together propositions from organisations working in this field. The propositions will be circulated for comment by interested parties, and refined as appropriate. The objective is to develop a standardised method of accounting for social and environmental contribution in line with methods for the development of existing accounting standards.