CHAPTER 4

How Do We Know? Measuring Impact

TEN LESSONS ABOUT IMPACT

Understanding positive and negative impact of social investing when tackling Wicked Problems requires investors to discern uncertain, hazardous, and conflicting information. It requires moral judgment, transparency, and intentionality. This chapter begins by sharing key lessons learned intended to guide social investors as they develop strategies for measuring impact. It provides context by highlighting current thinking and best practice from across the field. It explains why now is the right time to scale impact measurement, and the challenges that will involve.

Later in the chapter, Jeremy Nicholls pushes us and the field forward by offering new ways to scale measurement of social value by adapting accounting principles to improve equity, well-being, and sustainability outcomes. However, we begin with ten lessons to keep in mind when developing impact measurement strategies, using Deliberate Leadership as a framework.

Lesson 1: Evaluation and measuring social impact isn’t magical, mystifying, or new.

Researchers have been trying to find the causes and solutions of social problems since the 1800s—from the work of social work pioneer Jane Addams who sought to improve the lives of urban poor to James Lind, a doctor of the British Royal Navy who used a design and a control group...
to find a cure for scurvy by eating citrus fruits. Participatory, community-based evaluation was formally launched in the early 1950s. Business has been assessing financial impact in real time since the invention of capitalism and the bottom line. Evaluation, monitoring, and learning have evolved into a field of professionals across sectors devoting themselves to understanding the numbers and nuance of social change. The American and International Evaluation Association embodies the large global community of strategic learning and is a resource for knowledge and innovation.

**Lesson 2: Evaluation and learning is a group sport—learn from, and with, colleagues and avoid reinventing the wheel.**

Many colleagues can help a social investor learn and craft a meaningful impact measurement process. Figure 2.3 shared in Chapter 2 shows a network of diverse organizations supporting social change, exemplifying the collaboration that is part of Deliberate Leadership. Each of these organizations spends financial resources on problem-solving and is trying to understand the impact of their investments. They have knowledge to share about their experiences and lessons learned having impact. Swiss Triple Impact initiative, run by B Lab Switzerland, engages Swiss businesses of all sizes and from all sectors to measure their social and environmental impact using B Lab’s B Impact Assessment and SDG Action Manager tools, identify concrete opportunities for improvement, and learn from their peers. There are also several global tools that use systems analysis to understand and measure impact including the UN Sustainable Development Goals (SDGs), the Impact Management Project, and the International Finance Corporation’s Operating Principles for Impact Management, each of which we describe briefly below.

**SDGs and Impact Measures**

The SDGs offer the most globally accepted set of major impact goals (Fig. 1.3). The 17 impact goals have 180 specific target goals for 2030, and 245 impact indicators (ranging from 8 to 27 per goal) for determining progress toward those target goals. Table 4.1 shows the diversity of goals, targets and indicators drawing on three of the 17 SDGs.
Table 4.1 Illustration of select SDG goals, targets, and indicators

| Goals and targets                                                                 | Indicators                                                                                                                                                                                                 |
|----------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| **Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture** | 2.1 By 2030, end hunger and ensure access by all people, in particular the poor and people in vulnerable situations, including infants, to safe, nutritious and sufficient food all year round  
2.1.1 Prevalence of undernourishment  
2.1.2 Prevalence of moderate or severe food insecurity in the population, based on the Food Insecurity Experience Scale (FIES)  
2.2.2 Prevalence of malnutrition (weight for height >+2 or <-2 standard deviation from the median of the WHO Child Growth Standards) among children under 5 years of age, by type (wasting and overweight) |

| **Goal 4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all** | 4.1 By 2030, ensure that all girls and boys complete free, equitable and quality primary and secondary education leading to relevant and effective learning outcomes  
4.1.1 Proportion of children and young people (a) in grades 2/3; (b) at the end of primary; and (c) at the end of lower secondary achieving at least a minimum proficiency level in (i) reading and (ii) mathematics, by sex  
4.2 By 2030, ensure that all girls and boys have access to quality early childhood development, care and pre-primary education so that they are ready for primary education  
4.2.1 Proportion of children under 5 years of age who are developmentally on track in health, learning and psychosocial well-being, by sex  
4.2.2 Participation rate in organized learning (one year before the official primary entry age), by sex |

| **Goal 6. Ensure availability and sustainable management of water and sanitation for all** | 6.1 By 2030, achieve universal and equitable access to safe and affordable drinking water for all  
6.1.1 Proportion of population using safely managed drinking water services  
6.2 By 2030, achieve access to adequate and equitable sanitation and hygiene for all and end open defecation, paying special attention to the needs of women and girls and those in vulnerable situations  
6.2.1 Proportion of population using (a) safely managed sanitation services and (b) a hand-washing facility with soap and water |


Impact Management Project

The Impact Management Project (IMP) plays a critical role in the social finance field as a convener, facilitator, and consensus builder on measuring, comparing, and reporting social impacts. Created by experts and practitioners, it seeks to build consensus-developed best practice for the field of impact investing and social finance. It intentionally works to ensure its services and products integrate with the SDGs as well as other frameworks. An important recent contribution is its five dimensions of social impact that investors and enterprises need to consider:

- **What** are the outcomes the enterprise is contributing to and how important the outcomes are to stakeholders.
- **Who** (i.e., which stakeholders) are experiencing the outcome and how underserved were they prior to the enterprise’s effect.
- **How much** impact is the impact including, how many stakeholders experienced the outcome, what degree of change did they experience, and how long did they experience the outcome for.
- **Contribution** of an enterprise’s and/or investor’s efforts to outcomes that were likely better than what would have occurred otherwise.
- **Risk** as to the likelihood that impact will be different than expected.

Aligned with best practices of evaluation, this framework offers a thoughtful entry into the types of impacts you should consider in your investing, how you should consider them, and how you should report them.

IFC’s Anticipated Impact Measurement and Monitoring System

A third tool for understanding and measuring impact has been developed by the International Finance Corporation (IFC). To help implement its nine Operating Principles for Impact Management (Principles) for its own investing and provide guidance to the 93 signatories of the Principles, IFC has developed its own impact assessment and monitoring framework. Launched in 2017, its Anticipated Impact Measurement and Monitoring (AIMM) system “seeks to give IFC a more rigorous, evidenced-based, end-to-end approach for achieving its triple bottom
From planning and due diligence through implementation and exit, AIMM assesses, monitors, and evaluates each investment across two dimensions—project and market outcomes. Project outcomes include investments’ direct effects on stakeholders including neighboring community, and indirect effects on the economy and on society and environment. Its approach has been recognized for its thoughtful, detailed rigor (Chavez 2020; Gabor 2018). Like Iris+, it offers a set of detailed sector-specific frameworks (25 unique sector frameworks) that all follow the same approach.

Together these efforts converge on some basic principles, general ways to approach impact measuring, and some details on what to actually measure. Definitely necessary, the question is whether they are sufficient. The following section explores ways community feedback and feedback learning loops bring the much needed community voice—those beneficiaries of the social, environmental, and hopefully, market impacts—into the impact measurement and management processes.

**Lesson 3: Build ground up through community feedback.**

“We should listen to the people we’re trying to serve because that’s ethical and moral, and in a philosophical sense they are the ones who should be the ultimate arbiters of what it takes to make their lives better, and whether their lives are getting better.”

Dennis Whittle

It should be common sense that communities being served by social investment should be at the center of impact measurement. Yet, often they are last to be consulted about either the support and services they need or whether the funded program had a positive or negative impact on their lives. Dennis Whittle calls community feedback, “the smart and right thing to do” (Sarkisova 2016). “Smart” because resources can be best used when target effectively and “right” because it is ethical to have people be the ultimate arbiters of what they need to make their lives better.

There are many ways to build the communities that can apply pressure for change. One example is the ourEconomy media hub run by openDemocracy. openDemocracy uses its media platform as part of an effort to disrupt and challenge prevailing economic orthodoxies in the media; communicate the growing consensus around a new economic paradigm to a wider global audience; influence public opinion and the policy debate;
and accelerate the transition to a fairer and more sustainable economy. Similarly, the Economic Change Unit seeks to amplify efforts to realize a more sustainable, just and resilient economy by providing critical functions in communications, network-building and strategic coordination that will enhance and amplify aligned efforts within the economic systems change movement, particularly within the United Kingdom.

Lesson 4: Community engagement is not a new concept.

Consumer-facing companies have long tried to nurture communities so that they can promote and test their products, and position themselves as brands that are part of people’s everyday lives. But if the concept of community engagement, today consumer-driven communities have reached levels that were impossible to manage in the past. It is estimated that there are over 5.5 billion Google searches per day in 2020 or an estimated 63,000 search queries done per second (Ardor SEO 2020). The world is awash with constant, instant data and feedback. Opinions are shared widely and on-demand, when flights are delayed, or restaurant service is poor. Thoughts, ideas, and even lifestyle choices on social media are shared in a nanosecond. With the proliferation of high-speed internet and low-cost mobile devices, the classic business mantra that “the customer is always right” has evolved into the far more demanding notion of “customer-centricity,” where products and services are built to be tailored to varying, individual needs. Whether they like it or not, companies have come to embrace customer feedback and the most successful among them, such as Amazon and Facebook, have used it to build market dominance.

Lesson 5: Community feedback and the glass ceiling.

Yet, as Walmart collects over 2.5 petabytes of customer data per hour (and globally, the company processes about $36 Million an hour in sales each day) (Gunelius 2014), Fay Twersky, Vice President, William and Flora Hewlett Foundation (Hewlett Foundation) points out that community voices “haven’t yet broken though the glass ceiling of philanthropy” (Twersky et al. 2013). This is not to suggest that big data and customer relationships are without significant failings in the business world, or that they are always transferable or appropriate for the social sector, but the social finance and social service community (the social sector) have not embraced fully the norm of seeking out and adapting to user feedback with quite the same fervor as a variety of other disciplines, ranging from social work and design thinking to manufacturing and politics.
According to a survey of US nonprofits by the Center for Effective Philanthropy, 37% collect and use “beneficiary” feedback during the planning, implementation, and reflection phases of their programs, and most believe that foundation funders “lack a deep understanding of their intended beneficiaries’ needs” (Buteau et al. 2014). This suggests an underappreciation for listening to community feedback, to say nothing of the quality or authenticity of this feedback, or the social sector’s propensity to learn and share from it.

**Lesson 6: Overcome the Excuses.**

As Twersky explains that for many in the philanthropy world, “Feedback takes too much time; it feels uncomfortable; it is another thing to do,” and while customers drive revenues in the for-profit sector, money flows top-down in the nonprofit world, leaving little direct incentive for funders and grantees to listen to community.

To address this field-wide shortcoming, Twersky co-founded Fund for Shared Insight and Listen4Good to help the field of philanthropy support innovative ways to institutionalize its commitment to community voice and feedback. More than 100 social investors are members of these two affiliated groups to support the practice of community listening and feedback. Hewlett supported a case study, *The Power of Feedback: Solving Wicked Problems through Listening and Learning* (pfc 2017) to help social investors find ways to integrate community feedback loop into their investment strategy. Our final four lessons are ones taken from that study.

**Lesson 7: Feedback should be integrated with an overall learning strategy.**

Twersky believes that feedback is one of three legs of a stool for creating well-rounded learning organizations: “Monitoring allows for pulse taking; evaluation provides independent rigor on determining whether outcomes were achieved; and feedback loops allow for real-time learning and innovation.”

**Lesson 8: A commitment of leadership is essential for a successful impact measurement strategy.**

Our team believes that Twersky’s three-legged stool needs either a fourth leg or a seat to create stability. Leadership within the investor organization and beneficiary make the commitment to learning to be successful. Accepting challenges when confronted with complex challenges often requires changing behavior in organizational culture and expectations. Without committed leadership, systemic learning may not
happen. Kathy Reich, co-chair of Fund for Shared Insight and the Director of the Ford Foundation’s Building Institutions and Networks (BUILD) initiative, adds that learning, listening, and reflecting must be part of the DNA of organizations—and for many organizations, they simply aren’t: “Culture change is really hard,” she says, “It’s one of the toughest things that you can do.”

**Lesson 9: Power and fear are obstacles to feedback.**

Social investors have the power to control resources. Unless there is a culture of trust and candor, investees are fearful of sharing negative experiences, even if they can ultimately improve performance. This issue is tied to power dynamics, the fear of failure and preoccupation with success at the investor level trickles down to the investee and community level where it gets reinforced. This can be described as a “doom loop” that can dog organizations when they are faced with failure and are afraid to report negative community feedback to funders.

**Lesson 10: Examine examples of feedback models.**

More honest, useful feedback can be acquired in a number of ways. Feedback Lab, for instance, uses a five-step approach illustrated in the diagram below to incorporate community feedback: design, collect, analyze, dialogue, and course correct (Fig. 4.1).

Concern Worldwide (Concern) is a 50-year old international humanitarian organization that offers great examples of how deep community feedback mechanisms are central to success. Its 3500 member staff and consultants work in 24 of the most fragile countries challenged by deep Wicked Problems—war, natural disaster, violence, poverty, and profound gender inequality (Concern 2018). Its work in Kenya and Pakistan illustrate its approach.

Since 2002, Concern has worked in Kenya predominantly with vulnerable communities living in rural, arid, and semi-arid lands in the north and informal settlements in Nairobi. Its work is driven by its Community Conversations (CC) project. CC is a participatory, socially transformative approach that empowers communities to analyze complex social-economic and cultural issues associated with low community development, ultimately producing behavioral change within vulnerable communities. It is a facilitated community dialogue where members of the community come together to discuss the causes of underdevelopment, arrive at potential resolutions, and plan for and implement actions to change their circumstances (Fig. 4.2). The process in Kenya addresses the underlying causes of health concerns by creating a space for relationship
Fig. 4.1 The feedback loop (Source Adapted from Feedback Labs, 2017)

building; analyzing and gathering community data and context; deepening community dialogue; emphasizing community decision-making and action; and reflecting and learning together.

Like Feedback Lab and in keeping with Deliberate Leadership, it is an iterative process engaging the community in codesign, data collection and analysis, and reflection and adaptation. Working with and for the community helps prevent harm and maximizes positive impact.
Fig. 4.2 Concern’s community conversations methodology (Source: Developed from Concern Worldwide Community Conversations Trainer of Trainers Manual, 2013)

**TIME TO SCALE IMPACT MEASUREMENT**

Jeremy Nicholls has been doing evaluation for several decades. As a co-founder of Social Value International, he and his team have taught best practice to social investors globally. Jeremy’s thinking on the best way to
scale community-based and integrate Deliberate Leadership into the ethos of an organization’s learning approach is to build on practices honed through accounting practices relating to materiality.

The more than $200 trillion under investment isn’t static. It marches to the tune of increasing returns informed by reported profits. As we have discussed in Chapter 3, investment decisions will increasingly need to be informed by information on social and environmental impact, and so we need to change the tune. Investment must be underpinned by a system of impact accounting in order to facilitate continuing, and increasing, investment for organizations doing good, to ensure transparency for investors and accountability for the people and communities affected by Wicked Problems and the efforts to address them.

This chapter continues with the basis of financial accounting, and how this system can serve as a model for impact accounting that facilitates comparison and decisions that ultimately increase impact and ultimately to fundamental change in how society accounts for value. To do so, impact accounting must come to shared answers to the questions of why measure, who measures, what to measure, and how to measure it? Drawing on examples from the United Kingdom, financial accounting also serves as a model for standardization of terms, metrics and reporting. While financial accounting has contributed to many of the Wicked Problems impact investing aspires to solve (e.g. the social and environmental consequences of externalizing company behavior), a common basis for financial and impact accounting will facilitate the integration of impact to transform the ways we assess value, returns and externalities, and ensuring the broader consideration and valuing of social and economic impacts beyond impact investing.

To develop a common approach to creating value that takes account of economic, social and environmental worth in allocating resources, we need to understand how our increasingly global approach to understanding financial value developed. There is much to celebrate in this approach. It is global, socially constructed, and yet good enough to support investment decisions which have contributed to increases in global GDP. The key to successfully integrating the triple bottom line of people, planet, and profits lies in the building blocks of financial accounting. Before we journey into those foundational pieces, we first need to discuss the issue of impact—how we define it and whose benefit is to be considered.
The Challenge for Impact

While there is a growing convergence on what we mean by impact, not all impacts are equal and not all are universally accepted. We may all be keen on empowerment until we realize it’s a relative measure; if I have more power, you have less. Whoever is at risk of having less power is going to cling to it and argue for ways of defining “impact” and “more” in ways that don’t change anything too fundamental.

If financial investments are moving to new opportunities, this is all about the allocation of scarce resources, politics, and power. Impact can be seen as a response to the world’s Wicked Problems, but it can also be seen as a response to saturated markets and declining long-term returns, where investors search out new opportunities for return and enterprises seek to differentiate and compete based on their sustainability or impact performance. We run the risk of creating an industry around impact that, in the end, may mean slightly different types of investment, but doesn’t actually change anything fundamental about the allocation of resources, power and quality of life.

Just in case there is any doubt, we do need to change something fundamental. Even without the COVID-19 pandemic, the global economy was suffering a crisis—climate change and widening inequality threaten the lives of billions on lower incomes, increasingly the lives and stability of the middle classes, and certainly the lives of future generations. The global economy is not designed to stop this happening. Only by embedding the consideration of social and environmental outcomes alongside financial outcomes when making decisions about the allocation of resources will we be able to change the basis of our global economy.

Impact investing offers such considerations. But it also could reinforce inequality if the existing order of power and wealth does not change (Foxworth 2018). We need a fundamental change in how resources are allocated, and this will have implications for how impact is defined, measured, and managed.

The Current Economic System, Climate Change, and Inequality

Since investment already has a way of measuring performance—financial accounting—it is useful to see how this system developed as the basis for decisions to increase financial value. This will provide useful insights into what we need in order to successfully measure and increase “impact.” If
decisions are going to take both impact and financial value into account, there also needs to be some read across between the two.

After all, in terms of financial value, our financial system has been incredibly effective, playing its part in increasing GDP (see Fig. 4.3). A system that unleashed an equivalent amount of “impact,” alongside financial value, will surely address our current challenges.

Our financial system has been successful in supporting a general increase in wealth. Alongside it, however, is increasing financial inequality and degradation of the natural resources, including advancing climate change. Just before the 2008 financial crisis, an Oxfam report noted that 82% of wealth created worldwide was going to the top 1%. “The poorest half saw no increase at all. All over the world, the economy of the 1% is built on the backs of low paid workers, often women, who are paid poverty wages and denied basic rights” (Oxfam 2018). That situation did not improve in the wake of the crisis, and it took a decade or longer for the incomes of the many to return to pre-financial crisis levels. As the well-known “elephant graph” shows (Fig. 4.4), the increasing wealth of the middle classes in India and China meant that not all growth has been captured by the richest 1%. But a lot of it—27%—has. Moreover, the growth of the middle classes in emerging economies has flattened out

![Graph showing GDP per capita over time](image)

**Fig. 4.3** Estimates of average world GDP per capita (Source: Adapted from Bradford De Long 1998)
over the last five years. And that was without taking into consideration the economic consequences of COVID-19. If this trend continues this will become a “cobra curve.”

The reported success in reducing inequality is also based on the proportion of people in poverty. Although the proportion of people in extreme poverty (under $1.90 per day) has declined, it is debatable whether the absolute number, around 800 million, has changed much since 1800. And there are now several billion people on low incomes between $1.90 and $10 per day.

Recognition that this is a problem extends beyond academic critiques (for example from Stiglitz et al. 2018); mainstream finance organizations like the International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) have published work on inequality and growth. A growing number of business initiatives reference inequality, including the Coalition for Inclusive Capitalism and the Social and Human Capital Coalition. As noted in the first chapter, the UN’s SDGs include a specific goal to reduce inequality in addition to a goal to end poverty. Governments support policies for inclusive growth and poverty reduction. Yet, despite these interventions, wealth inequality has continued to increase.
At the same time, global efforts to reduce carbon emissions have had mixed success. Despite some international agreements and targets, as well as national policies, carbon levels continue to increase, now standing at over 414 parts per million (Scripps 2019), with the UK’s Metoffice predicting a further increase of 2.75 ppm in 2019 (United Kingdom National Meteorological Service 2019). Although predictions of increases in temperature from further increases in carbon are difficult, levels of over 500 ppm are likely to mean the temperature increase would exceed the international consensus goal of keeping the global average temperature to below 2 °C above pre-industrial levels (Gao et al. 2017).

This is the context for impact, whether as part of impact investing or any other activity. The test is whether impact investing contributes to reducing both inequality and the rate of climate change.

**Capturing Economic, Social, and Environmental Value**

The above examples show that economic value alone is insufficient to capture the full range of meaningful impact organizations such as businesses can have. Society has recognized that defining economic value solely in financial terms has left out other significant sources of value—environmental and social—often resulting in them being negatively affected. This has given rise to a critique of GDP as an inaccurate measure of development, and a number of proposals to either supplement or replace it, for example the social progress index (2019 Social Progress Index 2019) and approaches to measuring happiness (Helliwell et al. 2019). It also gave rise to sustainability reporting, cost–benefit analysis, and impact measurement, all addressing social and environmental outcomes and supplementing economic value.

At the same time, our approach to what we mean by “economic” has been driven by our international economic system rather than by the science of economics. Definitions of economics include the study of production, consumption, and distribution, all of which have social and environmental consequences. For the economic system, economics has too often come to mean financial; and social and environmental issues have been treated as externalities. Yet, treating these issues as externalities downplays their relevance and significance to the economy.

The cause of this separation dates back to before the start of economics. Although there are two main international legal systems,
common and civil, the influence of common law on approaches to economics, and social and environmental sustainability, is important.

Our current economic system and much economic theory starts with contract law, and financial reporting focuses on the performance of a businesses’ contracts: of purchase and sale; of employment; as well as legal liabilities for taxes. In pursuing its legal contracts there may be consequences for contracted people, but also, through equity law, for people with whom there is no contract. Economics considered these to be externalities, a language rooted in the separation between common law and equity law. Impact often addresses externalities, both intended and unintended. If financial value refers to the performance resulting from contracts, then impact can be thought of as referring to the performance of issues that relate to equity, to externalities. Although law has since become more integrated, economics and the understanding of value has retained this separation.

**Financial Value and Financial Accounting**

Financial value is determined by an accounting process approximating the value being created or lost by those involved. This process is predominantly driven by the idea that the amount people pay for goods or services represents the value those goods or services hold for them. In a complex supply chain, this is an imprecise estimate that has real consequences on access to resources.

Financial accounting has been around for a long time, dating back as early as the twelfth century (Smith 2018). In its current form it arose from the development of the limited liability company in the nineteenth century. The current approach to accounting can be explored through some basic questions that any accounting process will address: Why measure? Who measures? What do we measure? How do we measure?

**Why Measure?**

Financial accounting measures financial value for the people who are investing so they can make decisions on whether to buy, sell, or hold their investments, most commonly so that they can increase the financial value they receive from their investments. In practice this has led to behavior, especially in investment managers who have a duty to act in the interests of their clients (i.e., the underlying asset owners), that seeks to increase
financial returns over the short to medium term. The decision of what
to measure is then those things that would matter to help people make
decisions to “increase their financial returns.” If information doesn’t help
choose between investments’ ability to generate financial value, then it
doesn’t matter.

The purpose of this measurement is not to measure the financial
value per se, but to assess performance. Accounting is the way in which
investors (and governments in relation to tax) hold businesses account-
able and the drive for business to respond to their investors’ objectives
is relentless. The question of how to measure is not just about a series
of techniques, but also how well to measure, and how accurate the
measurement needs to be to inform these decisions.

Investors are aware that there are risks in any investment and expected
returns are risk-adjusted. Financial accounting seeks to minimize the risk
that the accounts are incomplete or inaccurate. It does not address the risk
of expected future returns which relate to the underlying business model,
future markets, the management team, etc. Financial accounting is gener-
ally considered a record of past performance but in making investments
and choosing between options an investor has to assess both financial
projections and risk, and seek other information alongside any financial
accounts and projections to assess this risk. For public listings where profit
forecasts are included, they will be examined by the reporting accountants
or auditors in accordance with established standards. This forms only a
small part of the requirements for public offers, the complexity of which
is explored, for example, in “Initial Public Offers: A guide to the UK
listing regime” (Clifford Chance 2018). As limited liability and the devel-
opment of secondary markets for shares has increased alongside the scale
of investment, there has been a drive to protect investors and to stan-
dardize accounts to address the needs of large numbers of investors who
rarely know the people running the enterprises in which they invest.

The recognition of risk has created a secondary market for insuring
against risk (for example, derivatives), and a risk-based approach to port-
folio management, balancing riskier investments with potential higher
returns with safer investments with lower returns.

Measurement is designed to assess performance: organizations can be
held to account for that performance and investors can move their invest-
ments where they are not satisfied with performance. As a stakeholder
there is a feedback loop that drives performance.
Who Measures?

Clearly, it’s the organization that has received the investment that is going to prepare the accounts. When managers’ ability to increase salaries or keep their jobs is dependent on maintaining and increasing investment in the business, there is a conflict of interest. Consequently, accounts are checked, or audited, by a third party acting on behalf of investors (even if they are paid by the organization).

What Is Measured?

The UK Companies Act requires accounts to be prepared that are true and fair. Although what this is has not been legally defined, Section 393 of the Act states: “(a) in the case of the balance sheet, give a true and fair view of the state of affairs of the company as at the end of the financial year, and, (b) in the case of the profit and loss account, give a true and fair view of the profit or loss of the company for the financial year.” Meanwhile, Section 395 states: “(1) A company’s individual accounts may be prepared—(a) in accordance with section 396 (‘Companies Act individual accounts’), or (b) in accordance with international accounting standards (‘IAS individual accounts’).”

This would suggest that “true and fair” can mean what is in accordance with international standards, although the Financial Reporting Council (FRC) has released separate guidance that allows true and fair considerations to override international accounting standards (Financial Reporting Council 2014). International standards are designed to ensure that financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity.

True and fair are both heavily laden words given the degree of judgment necessary in preparing accounts, and especially in determining what should be included or excluded. Given the level of subjective judgment required, it is of course difficult to see how accounts can be “true” in the sense of being in accordance with fact and objective reality. Accounts are expected to reflect economic reality though (Financial Reporting Council 2014). Economic reality is not defined, and the current legal debates over, for example, when or whether people are employed by a business or are self-employed, shows why this is not easy to define.

If economics are generally defined as studies of the production, consumption, and distribution of goods and services, then accounts
would need to reflect all three; yet accounts do not provide much, if any, information on distribution. In practice, economic decisions quickly become interpreted as restricted to financial decisions, specifically to decisions to increase financial returns and the wealth of individual investors. This is the basis for financial accounting, to provide current and future investors with information to make decisions to buy, sell, or hold investments in order to increase financial returns.

In reality there are many investors, with many different motivations (even if we limit the definition of economic to the financial) and different requirements for risk and return. They may have an even greater range of difference among their motivations if economic value including distribution. It would not be possible to produce different accounts reflecting the different information that each investor requires. We have to standardize, and we have standardized around an assumed individual only interested in financial returns.

In addition, the scope of accounting is limited to those things that matter that are the responsibility of the reporting organization within the accounting period. This is not limited to contracts, although contracts to buy and sell services are generally the starting point. There will be other legally enforceable liabilities such as taxes. There may be quasi-contracts where the law has imposed liability independent of an agreement between those involved. There can also be provisions which have not yet been legally imposed, but where they are probable the value should be included in the calculation of profit. If not probable, or if reliable measurement is not possible, they are included as a note to the accounts as a contingent liability (and of course a standard, IAS 37, that provides guidance).

**How to Measure?**

How should this all be measured? Measurement needs to be good enough to allow investors to make these decisions, decisions that will generally involve a comparison with a forecast. The question of whether selling one investment and buying another leads to higher returns is a prediction, an informed guess. Accounting information should be good enough for this purpose and not for any other. Good enough requires measurement to be consistent, to compare performance against past results, to compare different businesses, and against expected future performance.

There are then two further questions.
How do we decide what should be included in accounts in practice? This is not only the question of what matters, but also the question of when things that matter should be recognized. For example, when does a sale become included in a business’ income statement? Revenue recognition is a complex area and there is a separate standard, IFRS 15 (IFRS Foundation), dedicated to the question. Liability recognition is relatively easy for legally binding contracts, but where the business may have incurred liability, for example as a result of fraud, liabilities will be more difficult to identify and depend on the control environment.

How do we value what has been included? Again, this might be simple enough for cash transactions reflecting market prices, but there are many other resources available to a business that underpin its ability to create financial value and therefore matter to our investors. There is the assumption here that market prices represent the “true” value. The fact that the value of an extra dollar is lower to a rich person than it is to a poor person, or that negotiating power between those involved in contracts is rarely equal, is not addressed.

There is a standard on Fair Value Measurement, IFRS 13, to provide guidance in the absence of market prices. IFRS 13 states that when measuring fair value, the objective is to estimate the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions (i.e., to estimate an exit price).

Most importantly, accounting practice and accounting standards have developed to address these questions and provide guidance to preparers and auditors of accounts. These are necessary but not sufficient requirements for an effective ecosystem.

The Wider Ecosystem

Financial accounting sits within a wider ecosystem that is designed to support individuals in creating financial value. The need for audit has already been raised and is a fundamental protection for investors giving their money to third parties and receiving reports from them. Secondary markets have developed to support investors with different skills and different risk appetites, complete with analysts, investment managers, and financial advisors. Customers provide feedback all the time in different ways.
Critically, there is extensive regulation. Contract law underpins the system. In the United Kingdom the Companies Act sets out the duties of directors and the requirement to produce accounts, the standard to which they should be prepared, and the need for audit. Directors have extensive duties, including to act within powers; to promote the success of the company; to exercise independent judgment; to exercise reasonable care, skill, and diligence; and to avoid conflicts of interest. Advisors and other intermediaries are regulated and supported by professional bodies. There are separate bodies to oversee the system, like the FRC. Finally, there is an active and free press that reports on all aspects of the ecosystem, good and bad. The system is expensive but necessary to support the levels of ongoing investment that underpin our economies.

All this means that there are consequences. Organization that do not perform in line with expectations, whose accounts are not materially accurate, or who break the law will face consequences. Staff may lose their jobs, the cost of capital may increase, and ultimately the organization may have to close.

The financial accounting ecosystem is not value-free or distribution-neutral. Simply because it is not interested in distribution and equity issues does not mean that the system has no effect on distribution. In fact, by limiting itself to a narrow definition of economic, financial accounting contributes to widening inequality and climate change. Financial opportunities and returns are not equally distributed. In any period, by chance, some people will do better than others. In the next period some of them will do better again. Inequality will arise by chance. In reality this will be reinforced by unequal access to opportunities and the actions that people can take to maintain their position.

**What Are the Lessons for Impact Investing?**

The consequence of financial accounting has been to focus on individual wealth-maximizing behavior without accountability for the global consequences. The nascent impact field presents an opportunity to develop a method of accounting that incorporates the values of Deliberate Leadership: creativity to imagine new approaches to an established practice; collecting the data required for courageous accountability and compassionate decisions that lead to more impact; building collaborative community that brings along the existing financial accounting ecosystem—and
its capital—to incorporate social and environmental returns; and candor in acknowledging risks and managing any perverse incentives.

If there is to be a holistic approach to accounting for value, then we need to be able to account for the missing value, or at least as much of it as possible. Impact accounting will need to underpin impact investing in the same ways financial accounting underpins financial investment. It will need to assess performance in creating positive impact and include effective feedback loops to those experiencing the impact with consequences for poor performance. The approach that financial accounting took to answering the questions in this section will be useful in developing impact accounting, especially as integrating the two approaches will mean that they need to be comparable and consistent. Moreover:

- The approach we take to understanding what we mean by impact will not be value-free or distribution-neutral but has to empower those experiencing impact
- Financial accounting contributes to the Wicked Problems impact investing is seeking to address and yet will need to be used alongside approaches to understand and manage impact.
- The basis of financial accounting needs to be updated, but the principle that impact accounting needs to start with a single user with a single purpose will be necessary for consistency.

### The State of Impact: What Do We Mean by More Impact?

As noted in the previous chapter on ESGs, investing for social and environmental impact is a growing field. Not all impacts are equal, it’s nothing like as common as financial accounting, and impact reports remain the exception rather than the rule. The approaches to accounting for impact remain varied in practice, and the extent to which decisions are being made based on impact data is uncertain. However, to get a better idea of where thinking and practice to do with impact accounting stands today, let us ask some of the same questions we posed in relation to financial accounting. Questions about why, who, what, and how helped explain how financial accounting has taken the directions it has, and why it has limitations when we want to understand value in a broader sense. Now we
ask those same questions again, but with a focus on social and environmental impact as well. We will also look at the institutional ecosystem to support impact accounting because we have seen that one of the reasons financial accounting has become so dominant is because of the strength of the institutions that support it. Finally, we will ask what needs to be done if the new types of accounting and impact measurement are to become as strong as those focused on financial value.

**Why Measure Social and Environmental Impact?**

The purpose of measurement would seem to be so that we can make decisions that increase positive impact and reduce negative impact and at an effective rate. However, there are other related reasons to measure impact, including accountability, legitimacy, and marketing, though all these would benefit from increasing impact. So, the purpose of measurement could be to choose options for allocating resources that have a more positive impact. Like financial accounting, the focus will be on decision-making, but unlike financial accounting, where there is clarity on what is meant by finance, the same is not true for impact.

Impact is all the rage, but it is not often clear what it means. *A Guide to the Impact Revolution* (Cohen 2018) defines impact as “the potential of an action to improve lives and the planet,” while, for Social Value International, impact relates to social value, “the quantification of the relative importance that people place on the changes they experience in their lives.” One focuses on people, the other on people and planet. Both recognize the importance of increasing impact, although the focus on improvement risks failing to account for changes that make things worse. The Future-Fit Foundation’s Business Benchmark tries to address this through its “break-even goals.” (See Case Study in Chapter 6.) The Business Benchmark is rooted in the social and environmental systems conditions that a body of scientists argue are the minimum requirements for a sustainable, regenerative planet. The break-even goals are the bare minimum an organization needs to achieve in order that its actions do not breach those systems conditions. By using a common set of systems conditions that can be applied to any organization or industry, and by defining the minimum that is needed to avoid social and/or environmental degeneration, the Business Benchmark provides a holistic and consistent vision for demonstrating impact.
The fundamental lack of consistency that is typical of much of the ESG and sustainability space will inevitably produce different measures of impact that cannot be easily used for making comparisons and therefore decisions to allocate resources between organizations to create more impact. We saw an example of this in Chapter 3 when we compared the very different valuations of Tesla and ExxonMobil that were made depending on what ESG indicators were used. Organizations that measure impact within their own operations can make internal comparisons, but the degree of impact will depend on what is chosen. For example, excluding negative impacts from what is measured means that a decision to move resources to do something with an expected higher positive impact could have a larger, but ignored, negative impact. Overall, it would reduce impact and yet still be selected. Avoiding this risk inevitably leads to an approach to impact accounting that considers all impacts, positive and negative. However, like financial accounting, it is neither possible nor necessary to account for every impact, only the ones that matter need to be included. So, like finance, impact accounting will need to determine materiality.

Focusing on the question of more impact means making comparisons of relative importance. There are different perspectives about how to account for changes to the planet, environment, and ecosystem compared to changes to people’s lives. Some argue that these changes result in changes to people’s lives, both current and future generations, and that therefore a focus on changes in peoples’ lives will address changes to the planet. Others argue that they should be considered separately. While both people and our planet have intrinsic value, the focus is on whether one course of action has a more positive impact than another. Somewhere in this comparison, people’s perception of relative importance will be inescapable.

As these issues are resolved, more options can be compared, and more decisions made to increase net impact. The focus is still on obtaining good enough data to make that comparison and choose an option, remembering that these are based at least in part on forecasts of the future.

In finance, the driver is investors and their choices between investments. This, and the ecosystem that supports it, effectively forces organizations to constantly choose how they allocate resources, and redesign existing products and services to increase financial value. A well-established ecosystem doesn’t exist for social and environmental values
and impact; there is as yet no consistency in what and how people measure (or even identify what should be measured) in practice. Organizations seeking investments, or to enhance their brand, or to better understand the “external” risks, can still make comparisons based on their own standardized approaches even if these approaches are not shared. The people investing in impact could assess performance based on the frequency at which options are generated, considered, and implemented, but they may not be able to assess performance based on the impact generated.

We discussed standardization in Chapter 3, noting that although there are various initiatives to move in that direction, it is a long way from the uniformity and cross-organization transferability that exists for financial accounting. It is also a long way from valuing impact rather than just performance. If the drive for standardization of measurement and reporting so that investors can make comparisons ignores this, then organizations run the risk of creating less impact than they could with the same resources. In addition, there is a risk that standardization for investors is not based on data that is useful for organizations to make comparisons and is therefore not useful for anything other than reporting. Any standardization should be based on data that is necessary and useful for comparing options for increasing impact. External pressure should first encourage data use and second encourage consistency in what is necessary for data to be useful.

Who Are We Measuring for?

A quick answer might be the investors. However, if the impact is being received by people then the measurement is really for the people experiencing the changes to their lives. This is analogous to financial accounting which is for the people who receive the financial returns. Impact accounting is for the people who get the social returns.

But there is a disconnect now. Financial accounting measures so that the people getting the financial returns can make decisions about those financial returns. Impact accounting measures so that the people receiving the change in their lives can make decisions about the changes in their lives—only they can’t, or at least not to the same extent as financial investors. Impact investing addresses issues of equity and distribution, where the populations of intended impact have less power or are relatively underserved. In neither case are they as able to make decisions and,
critically, are, by definition, less able to hold organizations accountable than investors are in relation to financial returns.

Alternatively, we could say impact accounting measures so that investors can make decisions about the change in other people’s lives. Either way there is a breakdown between principal and agent. Investors are making decisions on behalf of the people getting the impact and are acting in their interest. This would mean that the people receiving the impact are the principal and the investor is their agent (Fig. 4.5). The investor could be argued to have a fiduciary duty to those that receive the impact. This would bring impact into the realm of common law and it would no longer be an externality.

Traditionally the responsibility for the impact is seen as resting with the organization creating the impact. In this case it would now be indirect, and the primary responsibility would rest with the investor. While we are measuring for the people who get the impact, the organization collecting the data will be reporting to the investor so that the investor can fulfill their responsibility to the people who get the impact.

Fig. 4.5  Investors’ agency and fiduciary duty to whom?
The consequence of this current gap in accountability is that there is no relentless pressure to increase impact in the same way there is for financial value, and reported impact is likely to be lower than it could be. There is also less pressure for standardization. Although the fact that the majority of people (whose lives are changing) rarely know the managers of the enterprises (that are creating that change) should drive standardization, the breakdown between principal and agent stops this from happening.

Better perhaps would be to say that impact accounting measures as if the people experiencing the change in their lives could make decisions about the change in their lives, and as if they could hold the organization to account. This won’t be enough to ensure that the data is used but it should lead to the data that will be the minimum necessary. As already noted in the case of the Future-Fit Foundation’s Business Benchmark, a rounded understanding of how an organization impacts on the different elements of a regenerative social and environmental system is important so that organizations do not pick and choose what areas they want to be held accountable for.

Focusing on those getting the impact also provides an insight into what is meant by impact. While impact will be a change, it is likely to be a change in things that matter to people, a change in their well-being. Well-being can be defined as a balanced state where no fundamental psychological or physical human needs are significantly deficient, and the foundations of physical and psychological health are present in enough measure to meet challenges faced. It is also referred to as a state of flourishing or a “good life” and exists at individual, household, country and global level. This definition incorporates people’s sense of self-worth and this would include addressing inequality.

**Choosing the Option with a “Better” Impact**

As with financial investments, investment that took impact into account will inevitably require a choice between different mixes of return and impact. These choices are generally informed by the investor’s personal subjectivity of the relative importance of the impact.

There will be trade-offs in the impact, between long term and short term, and between some people experiencing more impact than others, but also between people experiencing positive and negative changes in their well-being. This has consequences for inequality. There will also be
trade-offs in the type of impact made; social or environmental; education or health; and financial or social.

Creating a formal accounting relationship would mean that these trade-offs will need to be transparent and accounted for. They exist even for an organization solely creating financial value, particularly in trading off between short- and long-term values. There is no right answer to these decisions, but more transparency and more involvement of those experiencing the changes will create a body of practice and social norms. There are various initiatives to make these trade-offs more transparent through valuation, for example the Value Balancing Alliance (VBA 2019), Harvard University’s Impact Measurement Project (IWAI 2019) and Social Value International’s standard on valuation (SVI 2020). These kinds of initiative are essential to help stakeholders identify what “better impact” means, and to develop common definitions and interpretations.

What to Measure?

The ability to choose between different options which may affect different groups of people in different ways means that data will be needed on all the effects, or at least the ones that matter. Deciding what matters will be a critical part of deciding what to measure, and how to measure it.

Once you decide what matters, data will be needed on the specific changes in well-being that may be experienced: data on how many people, how much change (from a baseline), over how much time. Care will be needed to ensure the reported impact relates to the activity funded. Given the potential for different changes in different outcomes for different people, the relative importance of these will need to be explicit and transparent. In summary, an account of the relative importance of material changes in well-being, positive and negative, caused by the organization.

As with financial risk, impact risk will now be a concern.

Impact accounting will need to address the risk that the information is not complete or not accurate for the stated purpose. As with finance, risk also relates to the underlying business model, the wider context, and the management team’s experience. The variations in possible purpose for impact accounting make this assessment harder. Additionally, impact investing carries a larger risk, that the people whose lives are being changed are not changed as expected. The consequences of this risk are not experienced by the organization or the investor, but the people and communities they act on behalf of. Lower levels of accountability and the breakdown of the principal–agent relationship means that there will be
few or no consequences if impact is not as expected. Consequently, impact risk assessment is underdeveloped and market mechanisms to manage and offset impact risk are rare. There are no secondary markets to offset impact risk, and portfolio approaches for example balancing high impact investments with a high impact risk against lower impact but lower impact risk investments are exceptional.

While there is variation in the purpose of impact accounting, there is growing convergence in the basic requirements. The Impact Management Project (IMP 2018) is facilitating a structured network of standard setters that is working toward greater convergence. Some of the organizations involved in this network include the IFC which supports principles for impact investor managing impact, Social Value International (SVI) which supports principles for the process of impact accounting, and the UNDP which is developing Practise Assurance Standards for SDG Impact (UNDP 2019). These standards will cover the practice of impact management in Private Equity, Bonds and Enterprise and include independent assurance. Also connected to the UN, the UN Global Compact and Future-Fit Foundation (FFF) are collaborating so that the SDG orientation of the former is linked more closely with the systems change thinking of the latter. FFF is also looking at how its benchmark can be used with the Sustainability Accounting Standards Board (SASB) metrics. Despite this, there are relatively low levels of reporting impact, more variability in practice, and few examples that would be consistent with emerging good practices.

However, given that there is not yet a fully established impact ecosystem (see below), and recognizing that impact accounting should reflect performance, there is a need for other metrics that allow performance to be compared. One approach is to consider the rate and extent to which organizations respond, make changes to their goods and services, in response to impact information, where those affected are the building block for that information. Accountability’s Assurance standard includes Responsiveness and Keystone Accountability have developed an Improvement Rate Metric to address this.

How to Measure?

Again, the first question will be, how well to measure? Good enough for investors to make decisions in the interests of the people who get the impact. Again, consistency will be important across all the dimensions of
impact covered in what to measure. Consistency will also be needed for the basis for trade-offs, comparing the relative importance of different impacts for different people. As with finance, the relationships between impacts will be dependent on their context, so consistency will not be the measure as much as the process by which it has been derived. Within organizations making their own decisions with a different perception of risk and the consequences of making the wrong decision, what will be good enough will vary.

One of the perceived challenges of measuring impact is the need for the assessment of relative importance. There is a growing body of theory and practice on how to use financial proxies to value social and environmental outcomes including the work of the Capitals Coalition, and more recently in the Value Balancing Alliance (2019) and the Impact Weighted Accounts Project at Harvard Business School.

These motivations do not necessarily require the same level of reliability for the inclusion and valuation of social and environmental outcomes. We can also assume that the investor interest in these outcomes errs on the side of inclusion rather than exclusion to give them comfort about the impact of their investments. This information can sit alongside financial accounts, and can contribute to decision-making, but it does not fully integrate with it under our current approach to accounting. That would require a more fundamental change.

**Who Measures?**

As with financial accounting, it will be the organization that is receiving investment and providing a good or service—in this case, causing the changes in people’s lives. There is a potential conflict of interest if the organization’s ability to attract and retain investment depends on the level of impact they measure and report. Especially as the people whose lives are changing are less able to hold the organization to account and the lack of consistency in how impact is defined and measured, and the lack of legislation that sets equivalent requirements for true and fair means that impact accounts are likely to over-claim impact. As with finance, the need for accounts to be audited, by someone acting on behalf of both investors and the people whose lives are changed, is fundamental but lacking.
### The Wider Ecosystem

For all the reasons above, the wider ecosystem is underdeveloped compared to the financial ecosystem (Fig. 4.6). However, there are the beginnings of a comparable ecosystem. There have been some changes in legislation that have increased requirements to report on impact. There is increasing convergence around the requirements for impact accounting. There are standards that address the assurance of impact accounts for example Social Value International’s Assurance standard (SVI 2019) and the IAASB is currently consulting on guidance on Assurance of Extended External Reporting (IAASB 2020) that address impact and the challenge that impact is often experienced by people who are not the intended users of impact accounts. However, there is still a long way to go to replicate the coverage of the financial ecosystem.

### Nonfinancial Statements

Legislation is expecting more from directors. In the United Kingdom, directors now have to say more about how they have considered the

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**Fig. 4.6** Financial ecosystem vs. social impact ecosystem

| Finance – designed for an investor who gets the financial return | Ecosystem | Impact – for an investor who doesn’t get impact |
|---------------------------------------------------------------|----------|-----------------------------------------------|
| Critical/Plentiful                                             | Press    | Limited                                       |
| Professional bodies, CFA                                       | Analysis | Fledgling                                     |
| Legal requirements, FRC                                        | Reporting| Rare, inconsistent                            |
| Generally accepted, IAASB                                      | Audit    | Standard but not generally accepted, in practice rare and opposed |
| Generally accepted, IAASB                                      | Accounting| Convergence on principles and dimensions |
| Significant investor protection                                | Legislation| Limited, but growing |
effects of their decisions on other stakeholders. The EU nonfinancial reporting directive requires companies, albeit very large companies, to report on their impact through a nonfinancial statement.

This directive requires companies with at least 500 employees to “include in the management report a nonfinancial statement containing information to the extent necessary for an understanding of the undertaking’s development, performance, position and impact of its activity” (European Commission 2019). Reports should cover both positive and negative impacts “in a clear and balanced way,” that “reflect[s] a company’s fair view of the information needed by relevant stakeholders” (European Commission 2017).

The UK Government’s Civil Society strategy in 2018 stated that “central government departments will be expected to apply the terms of the Act to goods and works, and to ‘account for’ the social value of new procurements, rather than just ‘consider’ it as currently.”

If investors are now deemed to be acting in the interests of people experiencing an impact, they become, in effect, the agent of those people, who are upgraded to be the principal. Enterprises report to and are accountable to their investors in an ecosystem that requires far more transparency where effects of decisions on other stakeholders have to be accounted for. This may seem a radical change but the FRC’s new stewardship code (FRC 2019) has moved in this direction, raising the bar on the requirement for investors to account for environmental, social and governance (ESG) factors.

**Designing an Impact System**

Any impact ecosystem has to be considered in the context of the financial ecosystem. While it is possible to produce financial returns that have of themselves a positive impact, alongside any social or environmental impact, the current approach to financial accounting makes this less likely. An enterprise that has a positive impact, creates financial returns, and increases executive pay will have widened inequality and ultimately had a negative impact on SDG10. This returns us to the challenges in how impact is defined and what is considered material.

Whatever we do to address inequality, the rest of the market, currently at a substantially larger scale, will still be producing financial accounts. These accounts will continue to give price signals to investors and affect resource allocation decisions in a way that increases inequality. An impact ecosystem designed to create more impact needs to:
• Be clear about what is meant by impact, converge around one meaning, and recognize that compromises should result in more impact than holding out with a wide number of different definitions;
• Recognize choices between options and enable assessments of relative importance of different impacts;
• Have consistency, recognizing that consistency within organizations, even if not more broadly shared, is an important step;
• Address the disconnect between principal and agent, between the people paying for impact and the people getting the impact;
• Recognize that the people getting the impact are going to be interested in increasing the impact;
• Recognize that some people will resist approaches to increasing impact that have a negative effect on their perceived power and well-being;
• Share basic requirements for data in order to make comparisons and choose options that increase impact.

**BRIDGING THE GAP BETWEEN FINANCIAL AND IMPACT ACCOUNTING**

Getting impact accounting on a level with financial accounting, and established as a separate discipline, will be challenging unless legislation recognizes that the people getting the impact, whose lives are being changed, should have at least the same protection as is available to financial investors. Indeed, given that this group of people are underserved in relation to investors, perhaps they should have more protection. Not only do these people need a voice, there needs to be recognition that what they value is included in definitions of impact. If there is no agreement on what should be covered in impact, the effort put into impact accounting is unlikely match that put into financial accounting. Moreover, the organizations reporting will not be pressured to change and increase their impact with the same relentless energy that is demanded by the financial ecosystem.

New legislation and industry-led developments function to increase the quality of information provided by organizations of all types, reporting the additional information alongside the financial accounts. But despite these change, financial accounting remains immutable. The values embedded within it continue to drive resource allocation in ways that
undermine impact. Those who benefit from the existing economic system reflected in financial accounting are unlikely to relinquish power and control voluntarily, and there is a risk that impact is defined and managed in ways that will not change underlying power dynamics (Giridharadas 2018). It is this unwelcome possibility that makes it important to seek out evidence that supports the notion that impact is more important than concentrating solely on financial performance.

One argument for impact accounting is that enterprises that are allocating resources in activities that take impact into account perform better. It is not the purpose here to review the literature on this, suffice to say that the jury is out and there is research that supports a relationship and research that argues there is no relationship. Challenges include the relationship between reporting and the effect on resource allocation; the relationship between specific sustainability investments where there may be data and performance, as opposed to a more holistic approach to resource allocation, where there is much less data, and performance; the risk that well-managed companies also manage sustainability issues and it is the management that drives performance; the inconsistency in what is considered as sustainability and what is included, especially effects on inequality, and so on (for example, see Kim and Lee 2018). Either the information does lead to better performance, in which case there is no reason to believe we have reached a limit for this and we can do more, or it doesn’t, and given that fact, we need to address the way resources are allocated, in which case we need much more.

One of the challenges for impact and sustainability reporting more generally is that there are many stakeholders. This has led to multi-stakeholder reporting. If deciding what goes into an account for a single stakeholder is challenging, it will be so much harder when there are many stakeholders with many different purposes in mind for using the information. It may be possible to produce the information, but if the information is going to be useful and used by different people to reach different types of decision, then either the same information matters for all people and all decisions, which is unlikely, or it will be necessary to organize it so that each user can clearly identify what matters to them for a particular decision. Without this clarity there are risks that the information isn’t used or that the decision is influenced by information that isn’t material. And if a different decision would have been made without information that is not considered material, there is a problem.
Materiality is a debated subject in sustainability since it determines what an enterprise has to account for and potentially become accountable for. These decisions are made with reference to social norms and tested by an assurance process, acting on behalf of investors. Materiality of impact would now be outside an enterprise’s control, determined by social norms tested by an audit process acting on behalf of investors now also acting in the interests of the people who experience impact.

However, there is a possible way around these challenges. Accounting can continue to have a single user in mind if that user’s motivations are changed to recognize the interests of other stakeholders. Adam Smith in the *Theory of Moral Sentiments* posits that all humans recognize in themselves the interests of others:

> How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. (Smith, 1759: section 1, chapter 1, para 1)

We could decide that the basis of financial accounting is not only financial returns. There are many alternate possibilities, and to maintain the consistency that is fundamental to comparison, we will need to focus on one. This would be a fundamental change that would permit integration between financial and impact accounting.

We could argue that the basic motivation is simply to generate financial, social, and environmental returns, or perhaps financial returns subject to net positive impact or subject to no increase in inequality. This is what we try to do in thinking about future generations, arguing that our current decisions should not negatively affect future generations. For example, Islamic accounting had a different starting point, based on the interests of the community rather than on the interests of private investors and included a sense of fair and just transactions between people (Islamic accounting, 2018). (This has changed since both the Islamic Financial Services Board in Malaysia and the Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) have moved to align with IFRS.)

It is not necessary that these returns be easy to measure or that the inevitable trade-offs are resolvable. Even in the established uses of financial information, investors have to make trade-offs in pursuit of financial returns. The point is that the inclusion of social and environmental
returns should be transparent. What might constitute norms will evolve in practice, driven by the same processes that have made it possible to standardize the judgments that are required in financial accounting—an increase in the number of accounts that address these issues, the influence of an audit process that has to consider them, and social and policy norms. If we leave financial accounting as is, preferring to add supplementary information, it will not drive behavior to the extent required. The ecosystem with its incentive salaries, bonuses and returns will continue to focus on financial value alongside a burgeoning research base for the usefulness of other data. Relying on analysts to make judgments on our behalf based on this additional, but separate, information is not only being overly trusting of their ability to make the best decisions on our behalf without clear accountability, but won’t provide the level of transparency society requires.

We are used to treating financial accounting as a given and relying on laws to improve behavior. But expectations of how much laws focused on acts of commission (as opposed to acts of omission) can accomplish are probably unrealistic. Identifying potential breaches is one challenge; enforcement is another entirely. Changing the basis of accounting, rather than corporate law, would reduce the gap between enterprise behavior and society’s expectations. The effect of changing the basic motivation would be that social and environmental outcomes would have to be identified, valued, and included in accounts; this is what happens with financial accounting and there is no reason for that to change.

Some people argue that valuation boils everything down to numbers, that this is part of the problem and that this level of reductionism isn’t useful. Valuation is the process by which people’s subjective preferences and values are made more transparent. It’s not the end of the decision-making process; it means decision-making and argument start from a common place, one where valuations are at least informed by the people experiencing impact. Arguing that these values are not correct forgets that decisions are being made all the time based on far more subjective prejudices of relative value that cannot be informed by social norms. Measurement requires a common measure to compare. Even if there are a range of metrics being used, the relative importance of each in a decision is either implicit and variable or can be made transparent. Including a financial value for these outcomes also means that the choice between financial return and impact is clearer, it is on the table, and if the values are informed by the people who experience the impact it puts their values on the table in a tangible and meaningful way.
There is a possible trade-off between completeness and reliability. In finance, reliability is more important. Perhaps for impact it will be completeness that is more important in order to represent investors’ motivations.

Profitability and the amount that can be distributed to owners would also be affected. Enterprises that on balance have higher negative impacts would be less attractive to the investment managers and the enterprises cost of capital would increase. This would also provide an incentive for enterprises to generate new products and services where impact considerations were automatically incorporated in design and potentially a shift in the industrial, commercial and service landscape toward business creating a far more holistic value for customers and investors.

**Conclusion**

The separation between impact and financial value is a social construction. It is neither inevitable nor necessary. Imagine a future where this was not the case. The Roosevelt Institute’s study of neoliberalism’s negative consequences for natural and social system health, and OECD’s NAEC initiative examining the degenerative nature of the relentless pursuit of economic growth are examples of how impact is being reexamined. Accounting has been around for so long that it is hard to remember that it’s not a given. It’s not the same as a law of thermodynamics.

It’s perhaps not commonly realized that accounting has chosen to exclude environmental or social value, or that it requires significant judgments about what is valuable in preparing accounts. In a recent survey, 65% of people were not aware that businesses did not have to account for social and environmental value created or lost (Thomas 2019). Financial accounting is only financial because it has been designed to deal with one perspective of investors’ decision motivations, describing these as economic, with a limited definition of what economic means. There is nothing that says accounting has to be limited to economic decisions—however defined.

Through impact accounting, we can expand the underlying motivation of investment beyond a single wealth-maximizing individual to encompass the well-being of our neighbors, other communities and the planet. While financial accounting has contributed to the world’s Wicked Problems by singly focusing on financial returns at the expense of people and planet, it also provides a successful model for impact investing. It provides a method
for measuring value irrespective of a company’s location, industry or size. It is socially constructed and global, and successful at gathering and reporting data necessary to facilitate informed choices that lead to desired outcomes and ultimately growth. Impact investing can learn from, adapt, and reimagine this system to provide accountability for those experiencing the changes driven by investment, to measure and account for how investment decisions affect people, inequality and our climate. Through its support of initiatives such as Netzwerk Plurale Ökonomik and Promoting Economic Pluralism (PEP), advances thinking about what an economy that values impact and financial value looks like, and how activities within it can be measured. Oikos’s Curriculum Change Initiative also aims to prepare young people to address urgent global sustainability challenges by providing an education that fosters system thinking and heterodox, transdisciplinary economic approaches that assume strong sustainability as a prerequisite for a working economy. The Institute for New Economic Thinking at Oxford University offers a three-day intensive course—Boot Camp—to help philanthropic funders get up to speed in a non-technical way on leading-edge new economic thinking drawing on the social and physical sciences to make economics better serve humanity.

In their different ways, these initiatives are highlighting that financial accounting is not value-free and, unless changed, will continue to drive resource allocation in ways that undermine impact. Those who benefit from the existing economic system are unlikely to relinquish power and control voluntarily, and there is a risk that impact is defined and managed in ways that will not change underlying power dynamics (Giridharadas 2018). Getting impact accounting to the same state as financial accounting will require common practices and shared standards, and widespread integration in order to match the same relentless energy that is demanded by the financial ecosystem. It will also require changes in public policy, in what we think of as value and in how we hold enterprises to account in creating that value.

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