Towards a standard for sustainable reporting

Balancing more than figures

Corporate financial reporting is rooted in centuries of practice and is largely tone deaf to shifting societal and environmental priorities. Every company has an impact on society and the environment, and those impacts come with costs – either positive or negative. Thus, companies have a citizenship duty to reflect those costs in their financial reports, and the state has a role to play to ensure everything balances. The research of Benoit Lascols, director of Accounting for Externalities, seeks to find ways to link business and citizenship.

If a company’s balance sheet healthy if that company is financially profitable, employs thousands of people, pumps millions of dollars into the economy, but pollutes the environment and harms the health of its workers? What if a figure was on that balance sheet that reflected the benefits versus the harms of that company? These are questions central to the issue of social costs, externalities, and Benoit Lascols’ quest to define a new value for sustainable reporting.

The methods of measuring a company’s worth have changed little over the past couple of centuries, but the societal and environmental priorities in which companies operate have shifted considerably. Companies whose products harm others face increasing regulation, and environmental activists target companies – even entire sectors – that pose a threat to human health. Where once companies could measure their value for sustainable reporting.

Measuring a company’s economic health boils down to four standard financial statements reflecting the balance sheet, profit and loss, cash flow, and statement reflecting the balance sheet, profit and loss, cash flow, and changes in equity. Together, these financial statements provide a common set of rules that enable companies to compare performance. Importantly, the information on them is quantifiable.

Every company – be it a resources conglomerate or a local café – impacts either negatively or positively on the environment and society in general. If those impacts are outside of an agreed transaction between parties, they are termed ‘externalities’. For example, a customer buying a cup of coffee is an agreed transaction; the externality is the environmental impact the manufacturer of that coffee produces in getting the product to market. In essence, according to Lascols, externalities – whether negative or positive – fall into three categories: environmental, in that they deplete or enrich natural resources; social, in that they impact on human connections, including health, education, safety, justice, and culture; and economic, in that they correspond to economic flow.

Whereas we can sometimes measure these impacts, they largely escape our current valuation system, and little is done to include them in financial statements.

Externalities – whether negative or positive – fall into three categories: environmental, social, and economic. Impact its manufacturing has, say, on groundwater. If companies are to include such externalities in their accounting, they need to have universal principles for their evaluation. According to Lascols, three basic principles should guide the process.

Firstly, let’s consider a planet with limited resources as a closed system, as environmental economists define it. Therefore, we should apply the fundamentals of the first law of thermodynamics: any withdrawal of resource stock induces a social cost equal to the reconstitution of the withdrawn stock. In essence: any damage to the environment comes at a commensurate cost which society must carry to maintain natural and common wealth.

Secondly, what is done for natural resources can be done with social resources such as education, security, and justice. The equilibrium between economic activities and society is maintained by taxes covering these social needs. Companies could therefore reduce their taxes by decreasing their social costs which generate externalities, and must be incorporated within the balance of externalities.

Thirdly, someone needs to be the arbiter of general interest – to weigh up the private costs of a company and the social costs of its externalities, monitor them, and have the necessary authority to demand that those balance. Lascols argues that the state – with its laws, taxation, and justice systems – must be the guarantor of this balance between private and public interests.

PUTTING FIGURES TO EXTERNALITIES

If externalities are to be balanced and included in any ‘new’ financial reporting...
Every company has an impact on society and the environment, and those impacts come with costs, either positive or negative. The challenge is that the state is the only actor available if not the state, then who else? The reality is that the state is the only actor available to manage the common interest and that has the measures in place – regulations, taxes, and pure muscle – to affect the necessary counterbalances.

Lascols acknowledges two challenges to his premise: the issue of complexity and the state’s role as a regulator. Reducing the complexity of externalities to figures on a balance sheet would involve multiple levels of monitoring, compiling, and authentication; getting all stakeholders to agree on the procedures and values will, in itself, be a Herculean task. But should that deter consideration?

Secondly, the presumption that the state is in the ideal position to act as the guarantor of the balance of externalities invites scrutiny. Lascols admits that states do not systematically defend the common interest. Political agendas steer any state. However, given that every stakeholder in the equation has an agenda, we must ask: if not the state, then who else? The reality is that the state is the only actor available to manage the common interest and that has the measures in place – regulations, taxes, and pure muscle – to affect the necessary counterbalances.

What these challenges shouldn’t do is deflect focus away from the opportunities offered by the concept of balancing externalities. In the face of shifting societal and environmental priorities, companies need a way to measure up to those priorities and compare their performances. In the face of shifting societal and environmental priorities, companies need a way to measure up to those priorities and compare their performances.

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References


Lascols, B, (2021) The weakness of our economic system on our society and on the environment. The starting point is to recognize the need for a new value that can monitor our economy, and than – thanks to what has been done by GRI, SASB, and TCFD – enhance each impact in terms of social costs. The balance of externality is the continuation of the efforts engaged in corporate social responsibility, and a target for comparing the impacts that companies have on society and on the environment.
