Value Beyond Accounting – from Sustainability Disclosure to Meaningful Business Steering

Research Paper

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The Value Balancing Alliance e.V. (VBA) is a non-profit organization with the ambition to change the way company performance is measured and valued. The alliance's objective is to create a global impact measurement and valuation (IMV) standard for monetizing and disclosing positive and negative impacts of corporate activity and to provide guidance on how these impacts can be integrated into business steering.

The Helmholtz Centre for Environmental Research (UFZ) is a member of the Helmholtz Association of German Research Centres and internationally renowned for its expertise within environmental natural, political and economic science. The research unit Environment and Society has a strong focus on science-policy interfaces and regularly advises governments, regulatory agencies, NGOs and corporates.

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ABSTRACT
The availability of reliable, transparent and truly holistic sustainability information is a prerequisite for meaningful and transformative business and investment steering. Up to now, such data remains highly fragmented, difficult to interpret and generally scarce. As a consequence, numerous jurisdictions intend to significantly increase and standardize corporate reporting requirements of physical impact data (e.g., metric tons, m³, ha). Although such information might be sufficient for regulators or science to understand and track a company's sustainability performance, it is less suitable for and compatible with established corporate and investment decision processes. To address this challenge, the Value-Beyond-Accounting approach converts reported information into monetized and thus decision-ready data. This conversion makes reported sustainability disclosure directly employable within established management and investment steering approaches such as Cost/Benefit, Cash Flow or Net Present Value analysis. The Value Beyond Accounting approach is aligned with the Impact Measurement and Valuation (IMV) methodology jointly developed by the Value Balancing Alliance (VBA) and the International Foundation for Valuing Impacts (IFVI) and piloted by an increasing number of multinational corporations such as BASF, Bayer, DHL/Deutsche Post, Holcim, Novartis or SAP.

THE PIVOTAL ROLE OF REPORTING DATA FOR DECISION MAKING

The fundamental task of accounting and reporting is to transparently and objectively present useful information or data. This focuses on aspects, activities and – ultimately – the substance of the disclosing company, which are deemed relevant for concerned stakeholders such as regulators, tax authorities, investors or the public

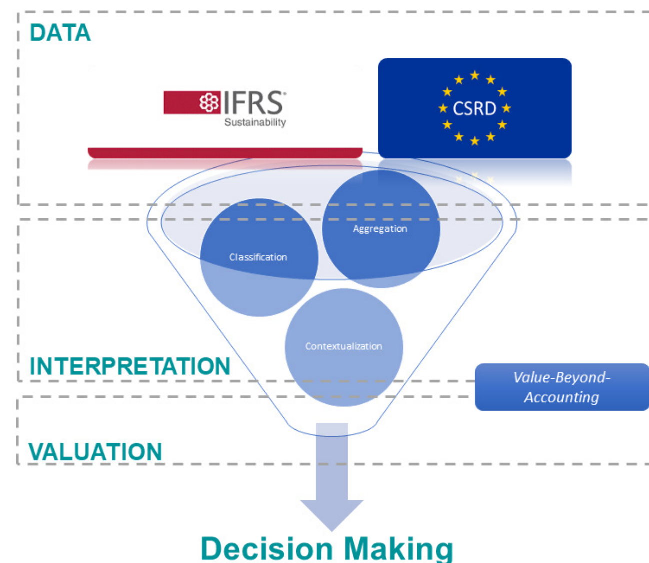


Figure 1 outlines the importance of reporting data for decision making and the role of the ***Value-Beyond-Accounting*** approach.

at large. As a consequence, reporting data is the fundamental building block of corporate, financial and regulatory decision making (Figure 1) (Wildner et al., 2022).

»Reliable, transparent and truly holistic sustainability information is a prerequisite for meaningful and transformative business and investment steering.«

The types and amounts of information necessary to intelligibly yet adequately visualize and describe the reporting entity and its activities is traditionally defined by reporting standards that reflect the concerns of predominantly financial stakeholders. These standards generally establish principles and general quality requirements about the type, scale and scope of information to be disclosed as well as concrete practical procedures regarding the collection, measurement, presentation and communication of such processes and information (Wildner et al., 2022).

If understanding and monitoring the activities and condition of the reporting entity is material to society in general or to vulnerable groups in particular, it is in the public interest to enforce reporting standards that mandate transparency – and thus obligatory disclosure of relevant information. The development of generally accepted the financial accounting standards within and across jurisdictions over the past century exemplifies such a process.

With the development of national and international capital markets towards the middle of the nineteenth century, and their increasing importance for both private capital investors and national economies as a whole, significant fluctuations in capital market values were commonplace. Often, this was due to an asymmetrical distribution of important information on the economic situation of individual market participants, entire sectors or national budgets, up to and including deliberate misrepresentations or disclosures of misleading or irrelevant information. In order to put an end to this behavior – and to be able to prosecute it – duties to keep accounts and to disclose economic circumstances were introduced in numerous states according to codified specifications or legal frameworks (e.g., the General German Commercial Code of 1861). With increasing globalization and interconnectedness of national capital markets, an internationally recognized financial reporting standard, the International Accounting Standard (IAS), was introduced in 2001. Based on an ongoing discussion and development of generally accepted reporting characteristics since the early 1970s, the IAS is a highly successful and widely recognized framework of relevant accounting/reporting features, which is recognized by 166 nations to date. It has been instrumental in defining what is "useful" information with regards to regulated reporting requirements, thus promoting transparency and comparability of economic information within and across almost all economies (Wildner et al., 2022).

THE LINK BETWEEN FINANCIAL AND SUSTAINABILITY REPORTING

The outlined process is well established for financial reporting and has led to a high, albeit not all-encompassing, level of transparency and general trust with respect to the usefulness of reporting data. By contrast, nearly a decade on since the first non-financial disclosure regimes, such as the EU's Non-Financial Reporting Directive (NFRD) came into force, the outlined process for visualizing relevant socio-ecological impacts and dependencies of market participants is still in its infancy (Laine et al., 2022).

Compared to traditional financial metrics, sustainability-related concerns such as poverty, climate change or biodiversity loss interact in highly complex and non-linear ways – with the magnitude of consequences on business and society often unknown. Reliable, useful and truly holistic sustainability data are a prerequisite to visualizing and understanding these intricate processes to enable meaningful and transformative business steering and decision making (Figure 1). To date, sustainability data remains highly fragmented and generally scarce, substantially inhibiting urgent transformation processes both within society and, especially, within industry.

To tackle this fundamental flaw in light of runaway climate change and nature loss, both the European Union (EU) and the IFRS Foundation are about to transform the scale, scope and quality of corporate sustainability reporting for a significant part of the global economy. Within the EU, the Corporate Sustainability Reporting Directive (CSRD) defines and enforces mandatory sustainability reporting requirements relating to socio-ecological impacts and dependencies, as well as associated risks and opportunities – commonly referred to as "Double Materiality." Eventually, these requirements will affect more than 50,000 entities (EFRAG, 2023).

»Complete transparency around individual valuation coefficients [...] is paramount in creating reliable, faithful and ultimately useful sustainability data.«

On a global scale, the IFRS Foundation's International Sustainability Standards Board (ISSB) intends to develop a voluntary global baseline for sustainability reporting, building on its significant expertise and international acclaim established within financial reporting. As a consequence, and in contrast to the EU's approach, the IFRS has focused on the disclosure of socio-ecological risks and opportunities – commonly referred to

as Financial Materiality – only indirectly addressing impacts and dependencies – commonly referred to as Impact Materiality (IFRS, 2023).

THE SIGNIFICANT ROLE OF A COMMON UNIT OF ACCOUNT

While, to increase market acceptance and minimize compliance costs, both the EU and IFRS sustainability reporting standards are built on established financial accounting frameworks, a fundamental difference between financial and sustainability disclosure is rooted in the way performance is measured, reported and ultimately valued (i.e., the unit of account). Financial accounting predominantly reports quantitatively and in monetary terms, while qualitative data (or otherwise physical units such as kg or m³) prevail within established sustainability accounting.

Increased reporting of qualitative or physical impact data (e.g., metric tons, m³, ha) might be useful for scientists and regulators to sufficiently understand and track a company's sustainability performance, but it remains less suitable for and incompatible with established societal, corporate and investment decision-making and monitoring processes. As long as a significant part of non-expert society and corporate decision-making processes cannot adequately translate and contextualize this reported data, the potential for transformative change of both the real economy and the financial markets remains seriously restricted.

»Monetary valuation allows translation of qualitative or physical information […] into comparable and decision-ready data.«

HOW MONETARY VALUATION MAKES A DIFFERENCE

While decision makers are increasingly aware of the negative socio-ecological impacts and dependencies of their business activities, many – intentionally or unintentionally – disregard these aspects in their strategic agenda. For example, activities with high water utilization in arid regions cause more damage to both the environment and society compared to the same activities in regions with an abundance of water. Yet such nuances of high societal value fall short under current asset valuation and sustainability reporting approaches. Although it is possible and commonly required by established reporting standards to visualize these effects qualitatively or by using a variety of physical units of account, such reported data remains subjective and difficult to understand and compare, especially in the eye of the non-expert beholder.

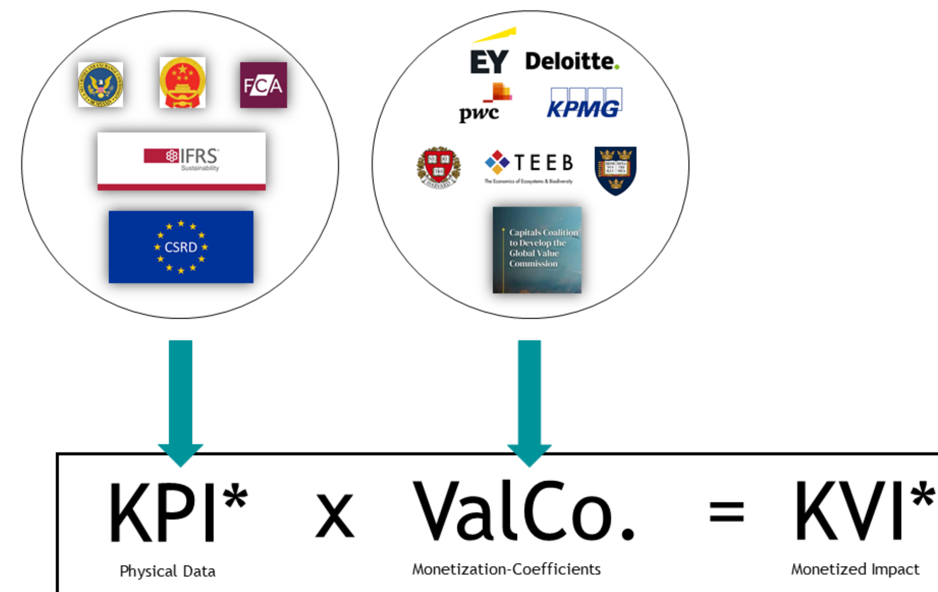
Sensibly and transparently reflecting non-monetized data, e.g., in asset valuation or cash flow forecasts, is difficult, if not impossible. This seriously inhibits the usability of current sustainability reporting data for corporate decision making. However, decision makers tend to disregard more than just the exploitation of natural resources like water that may affect the balance sheet once the risk is uncovered, but also other realms like loss of biodiversity, climate change or social injustice. As a consequence, socio-ecological impacts and dependencies giving rise to risks and opportunities in connection with the business model may be severely underestimated, mispriced and potentially wrongly managed and mitigated.

Enabling decision makers to better assess the positive and negative effects of business models, as well as the scale and magnitude of these effects, requires corporate impacts and dependencies on the environment and society to be made tangible and compatible with financial accounting-based decision-making processes. Monetary valuation allows translation of qualitative or physical information related to a company's environmental and social footprint into comparable and decision-ready data, which can be used together with established financial performance data to express the corporate value contribution more holistically, transparently and intelligibly.

HOW TO CONTEXTUALIZE SUSTAINABILITY DATA – THE *VALUE-BEYOND-ACCOUNTING* APPROACH

To render reported sustainability data more accessible for societal, and especially corporate, decision making, the Value-Beyond-Accounting approach con-

Figure 2 describes the Value-Beyond-Accounting approach: translating patchy sustainability reporting information into intelligible and comparable decision-ready data.



*Key Performance Indicator (KPI); Key Value Indicator (KVI)

verts reported physical data, or Key Performance Indicators (KPIs), into monetized and thus contextualized Key Value Indicators (KVIs), using context and location-specific, strictly science-based valuation coefficients (Figure 2).

This simple and transparent process makes reported sustainability data directly employable within established management and investment steering approaches such as Cost/Benefit, Cash Flow or Net Present Value analysis. It allows corporate as well as societal decision makers to consider sustainability-related concerns at par with financial performance data and, crucially, within established means of risk management and regulatory compliance, such as stress tests or resilience analysis.

Contextualization of vastly disparate types of data within one common and accepted unit of account significantly improves comparability between reporting entities or specific economic sectors while significantly improving the accessibility of disclosed information to non-sustainability experts. This last aspect of a democratically just and fair societal uptake of sustainability-related information is often overlooked by both standard-setters and regulators, who assume that any user of reported data can understand and interpret disclosed information within the context of his/her decision process (Wildner et al., 2022). It is within these conflicting poles of reported sustainability data being both objective and comprehensible to a wide range of societal stakeholders that monetization via the Value-Beyond-Accounting approach can substantially increase both the usefulness and relevance of reported sustainability information.

The Value-Beyond-Accounting approach is informed, advanced and applied by the Impact Measurement and Valuation (IMV) methodology jointly developed and piloted by the Value Balancing Alliance (VBA) and the International Foundation for Valuing Impacts (IFVI). Leading academic institutions including the Harvard Business School, Oxford University or the Leibniz and Helmholtz Associations provide and monitor its scientific rigor, while an increasing number of leading international corporations such as BASF, Bayer, DHL/Deutsche Post, Holcim, Novartis or SAP apply the methodology in practice.

THE WAY FORWARD

Although the contextualization of reported sustainability data via the Value-Beyond-Accounting approach can significantly promote truly sustainable decision making, various challenges need to be considered. Complete transparency around individual valuation coefficients and their strictly science-based calculation logic is paramount in creating reliable, faithful and ultimately useful sustainability data that fundamentally and continually align and comply with the evolving regulatory environment, such as the Corporate Sustainability Due Diligence Directive (CSDDD) or the Sustainable Finance Disclosure Regulation (SFDR). The lack of physical reporting data or KPIs concerning downstream activities or environmental and social aspects beyond climate should be addressed proactively. While upcoming CSRD and ISSB reporting will significantly increase the scale, scope and quality of reported sustainability information, it will take several years until a reporting infrastructure that is still in its infancy will produce significant amounts of useful and comparable data. As constantly stressed by international bodies such as the Intergovernmental Panel on Climate Change (IPCC, 2023) or the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES, 2020), time to act is of the essence. Companies should therefore be encouraged to make use of and engage with existing reporting standards and initiatives to proactively reflect relevant sustainability concerns within their decision-making processes and thus sustainably increase their true value creation.

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