IFVI/VBA: General Methodology 1 Public Comment of Positive Impacts®

Along with an impact washing case study and recommendations how to avoid impact washing

positive impacts (PI) GmbH | Cologne | 27 October 2023

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Bad Practice: Impact Washed “Integrated P/L” Statement – a Case Study – this should not be the result of the IFVI/VBA methodology

Bad Practice: Impact Washed “Integrated P/L Statement”

CASE STUDY FOR AN IMPACT WASHED IP/L STATEMENT – OFF BY 32%!

	Company and Investors	Employees	Clients	Suppliers	Government, local communities and others	Beneficiaries of nature	Total
Financial	**10,000,000**	**15,000,000**	**-100,000,000**	**40,000,000**	**20,000,000**	**0**	**-15,000,000**
Payments from clients			-100,000,000				-100,000,000
Payments to suppliers				40,000,000			40,000,000
Employee salaries (and related taxes)		15,000,000			10,000,000		25,000,000
Interest payments	5,000,000						5,000,000
Income tax paid					10,000,000		10,000,000
Net profit/loss	20,000,000						20,000,000
Cost of capital	-15,000,000						-15,000,000
Manufactured	**0**	**0**	**150,000,000**	**-35,000,000**	**0**	**0**	**115,000,000**
Client value of products and services			150,000,000				150,000,000
Value of the goods delivered by suppliers				-35,000,000			-35,000,000
Intellectual	**2,000,000**	**0**	**0**	**0**	**0**	**0**	**2,000,000**
Development of immaterial assets and technology	2,000,000						2,000,000
Human	**2,000,000**	**3,500,000**	**0**	**1,000,000**	**2,500,000**	**0**	**9,000,000**
Creation of human capital	2,000,000	5,000,000		1,000,000	3,000,000		11,000,000
Well-being effects of employment		4,000,000			2,000,000		6,000,000
Workplace health and safety incidents		-500,000			-500,000		-1,000,000
Opportunity cost of labour		-5,000,000			-2,000,000		-7,000,000
Social	**1,000,000**	**0**	**0**	**0**	**-4,500,000**	**0**	**-3,500,000**
Change in brand value and customer loyalty	1,000,000						1,000,000
Child labour (in the value chain)					-1,000,000		-1,000,000
Forced labour (in the alue chain)					-500,000		-500,000
Underpayment (in the value chain)					-3,000,000		-3,000,000
Natural	**0**	**0**	**0**	**0**	**0**	**-6,400,000**	**-6,400,000**
Use of scarce materials						-500,000	-500,000
Use of scarce water						-400,000	-400,000
Water pollution						-1,000,000	-1,000,000
Fossil fuel depletion						-400,000	-400,000
Contribution to climate change						-2,500,000	-2,500,000
Land use and transformation						-600,000	-600,000
Air pollution						-1,000,000	-1,000,000
Mystery position*							**15,000,000**
TOTAL	**15,000,000**	**18,500,000**	**50,000,000**	**6,000,000**	**18,000,000**	**-6,400,000**	**116,100,000**

KEY ISSUES AND IMPACT WASHING CASES

COMPANY AND INVESTORS, EMPLOYEES AND SUPPLIERS

> Most positions are ultimately part of the revenue of a firm, impacting the P/L and balance sheet, while “washing” (mixing) P/L and balance sheet elements

CLIENTS

> No auditor would approve a financial statement that includes the revenues, profits, or value to the firms’ tier 1-n customers (consumer surplus). Using them in the company IP/L statement is just an attempt to impact wash one’s own results

HUMAN CAPITAL

> Human capital impacts represent estimates of future revenues without accounting for the related negatives. Furthermore, negative positions for the government and the competition to provide human capital to the company “for free” are not shown

GOVERNMENT, LOCAL COMMUNITIES, AND OTHERS

> The only position that should be counted for Societal Earnings are the income taxes, adjusted by subsidies that are also not included in the statement. The other positions presented in the column mix various positions that should not be mixed

BENEFICIARIES OF NATURE

> Mixes environmental, social and economic impacts; however, only a presentation issue

TOTAL INCL. A MYSTERY POSITION

> As a result, the total position is completely overstated! The correct total – free from impact washing – should be 88,100,000 and not 101,100,000 (when ignoring the mystery position) – an error of 15% or even 32% when including the mystery position

Source: Table 2: Example IP&L Statement from the Framework for Impact Statements of the Impact Institute 2019; * The final total of the table lacks 15,000,000 that are not presented anywhere in the table.

Bad Practice: Impact Washed “Integrated P/L Statement”

IMPACT WASHED STATEMENT

CASE STUDY FOR AN IMPACT WASHED IP/L STATEMENT: A SOCIETAL EARNINGS MARGIN OFF BY 19%-points

1) See next slide for the same case study data used for our model

SE MARGIN

Other’s Societal Earnings Margin: +16 %

IMPACT WASHED STATEMENT

vs.

PI’s Societal Earnings Margin: -3 %[1]

IMPACT WASHING FREE

KEY ISSUES

SOCIETAL VALUE – LIKE REVENUE

> The **overall contribution** of a company to society at large is completely overstated: no one would judge a firm’s success only on revenues

> It **mixes absolute and influenced impacts** and deliberately impact-washes the results to make them look good

SOCIETAL EARNINGS – LIKE PROFIT

> Such concepts typically ignore the socio-political contribution of a company

> They do not consider subsidies received and neglect the fact that externalities are typically granted by governments and not private individuals who have benefited from generating the externalities through their salaries, wages, or dividends

SOCIETAL EARNINGS MARGIN

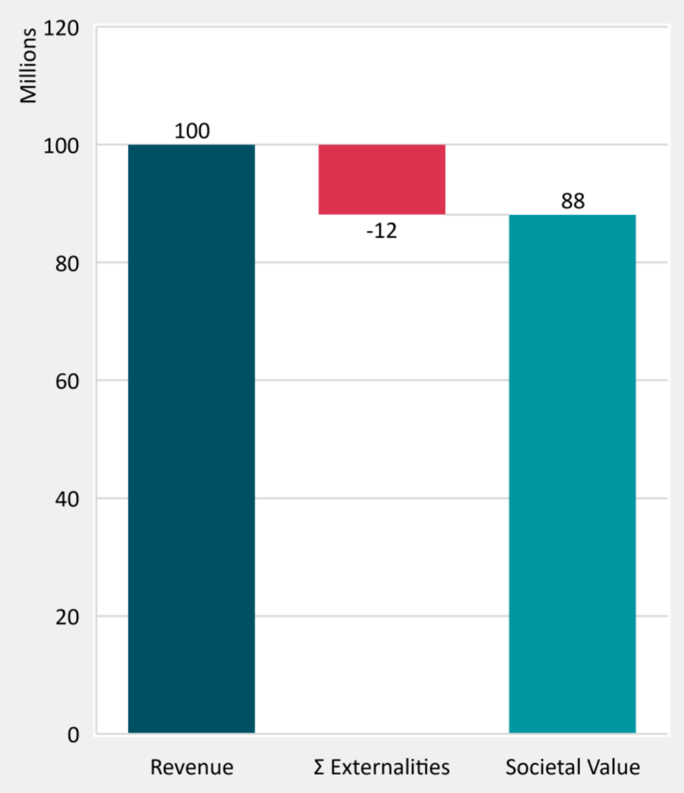
> As a result, the Societal Earnings Margin could be impact washed to +16% whilst the impact washing free SE Margin would be -3%[1]

> Instead of being “net positive”, the company should be called “net negative”

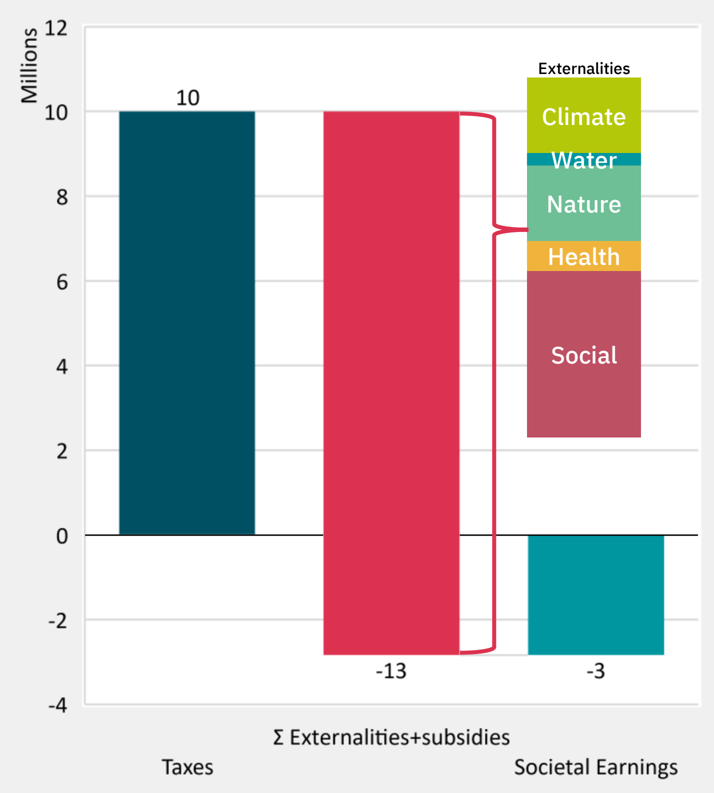
Positive Impacts® Societal P/L Statement Case Study (Impact Washing Free)

Positive Impacts® Societal P/L Assessment Case Study[1]

SOCIETAL VALUE (SV) – MIRROR FOR REVENUE



SOCIETAL EARNINGS (SE) – AS A MIRROR FOR EBITDA



SE MARGIN[1]

Case Study's Societal Earnings Margin[2]: -3 %

vs.

Case Study's Operating Margin: 20 %

IMPACT WASHING FREE

KEY TAKEAWAYS

SOCIETAL VALUE

- Measures the overall contribution of a company to society at large
- The Case Study creates a positive societal value of 88 mn € as the revenue is larger than the monetized externalities

SOCIETAL EARNINGS

- However, the Societal Earnings of the Case Study, measuring the socio-political contribution, are negative by 13 mn € as the taxes (net) are smaller than the monetized externalities
- Thus, the Case Study company was net negative regarding its sustainability impact
- Most of the impacts are social impacts, followed by climate and nature-related impacts

SOCIETAL EARNINGS MARGIN

- Builds a ratio of the Societal Earnings to the revenue, acting as a KPI to benchmark a company against peers

1) Using most of the same data as presented in the Bad Practice Case Study of slides 3 and 4, while estimating subsidies; **2**) Defined as Societal Earnings divided by revenue.

Our constructive feedback to the IFVI/VBA: General Methodology 1

Things to consider[1] to avoid impact washing (I/IV)

2. PURPOSE AND APPLICATIONS OF THE METHODOLOGY

2.1 PURPOSE STATEMENT

17. The purpose of the Methodology is to produce impact accounts and generate impact information that enhances decision-making by entities and investors related to the *sustainability performance* of an entity. The same impact information can be used alongside financial information to assess trade-offs between sustainability topics and financial topics. Sustainability performance refers to the effectiveness of an entity in reducing negative impacts and increasing positive impacts.

18. The Methodology is established by the societal obligations of entities and investors to meet the needs of the present without compromising the ability of future generations to meet their own needs.[16]

19. The Methodology is useful for entities and investors seeking to manage sustainability-related risks, opportunities, and impacts, but it further supports decision-making aimed at generating positive impacts that improve the lives of affected stakeholders as an objective in and of itself.

2.2 PREPARERS OF IMPACT ACCOUNTS AND USERS OF IMPACT INFORMATION

20. Any entity in any business sector, in any geography, and at any organizational level can use the Methodology to measure and value its impacts and prepare impact accounts. The Methodology can also be applied by any investor in an entity from an external perspective to prepare impact accounts.

21. For the avoidance of doubt, the Methodology should not be applied to present impacts in a manner that is slanted in favor of positive impacts or is not neutral, for example by emphasizing an organizational level of an entity that has better sustainability performance than the entity as a whole.

RECOMMENDATIONS OF POSITIVE IMPACTS®

- (17) Considering the level of inherent impact washing, the methodology to date does **not meet its own ambition** to **enhance decision-making** by entities and investors related to the **sustainability performance** of an entity
- One of the key reasons for this is that the **definition of sustainability performance** is **detached from the sustainability definition** (18). Thereby, it also does not meet its objective of improving the lives of affected stakeholders (19) and will **lead to presentations of impacts** in a manner that are **slanted in favor of positive impacts** (21)

1) Numbers in the titles and in brackets () refer to chapters and paragraphs in the General Methodology 1 paper.

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Things to consider[1] to avoid impact washing (II/IV)

3. QUALITATIVE CHARACTERISTICS OF IMPACT INFORMATION

3.3 FAITHFUL REPRESENTATION

29. Impact information should not only represent relevant impacts, it should also faithfully represent the substance of the impact that it purports to represent. Faithful representation requires impact information to be:

a. complete;

b. neutral; and

c. free from error.

30. A complete depiction of an impact includes all information necessary for the users to understand that impact. This includes information related to assumptions, data, and methods used to measure and value the impact.

31. Impact information is neutral if it is not slanted, emphasized, de-emphasized or otherwise manipulated to make it more likely that the users will receive that information favorably or unfavorably. It should consider positive and negative aspects of impacts. Positive impacts should not be used to obscure negative impacts in the presentation of impact information.

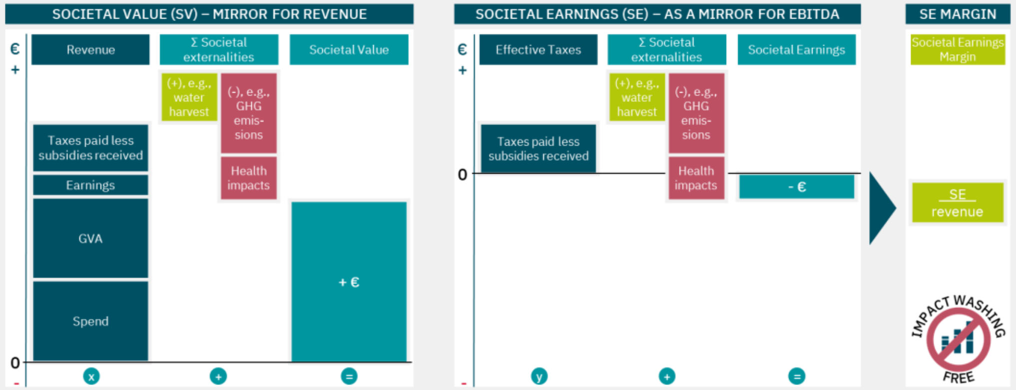
32. Neutrality is supported by the exercise of prudence which is the exercise of caution when making judgments under conditions of uncertainty. The exercise of prudence means that positive impacts are not overstated and negative impacts are not understated. Equally, the exercise of prudence does not allow for the understatement of positive impacts or the overstatement of negative impacts. In cases of uncertainty, preparers of impact accounts should default to avoiding the overstatement of positive impacts and the understatement of negative impacts.

RECOMMENDATIONS OF POSITIVE IMPACTS®

> The methodology does not adhere to its principles of neutrality (31-32) as it uses influenced positive impacts to impact wash negative impacts in the presentation of impact information

> No company would include in their financial statements the consumer surplus, the downstream revenues, use the downstream profits to justify their own losses or include the revenues of a subsidiary but not their losses

> Instead, consider mirroring revenue and profits from a societal perspective by using Societal Value as the overall net impact on society to mirror revenues and Societal Earnings as the overall net socioeconomic impact on society, enabling decision-useful benchmarks with the SE Margin[2]:



1) Numbers in the titles and in brackets () refer to chapters and paragraphs in the General Methodology 1 paper; 2) Defined as societal earnings divided by revenues. This was changed compared to our report, as the societal value KPI can also be negative and as it relates to an indicator known by everyone, even the end consumer (the price of the product).

Things to consider[1] to avoid impact washing (III/IV)

4. FUNDAMENTAL CONCEPTS OF IMPACT ACCOUNTING

4.2 THE DEFINITION OF IMPACT

46. Impact can be defined as a change in one or more dimensions of people's well-being directly or through a change in the condition of the natural environment. An impact can be actual or potential, intended or unintended, and positive or negative.[24]

4.7 VALUE CHAIN

61. The value chain of an entity is the full range of activities and business relationships related to

63. A direct impact of an entity is an impact caused or contributed to by the entity's own operations. An indirect impact is an impact directly linked to the entity's own operations, products, or services through its business relationships in the upstream and/or downstream value chain. While the cause of indirect impacts is outside of the entity itself, the entity exerts an influence on the pathway that determines the scale and scope of the impact.

4.10 ATTRIBUTION OF IMPACTS

69. The attribution of an impact refers to the portion of an impact that is reflected in an entity's impact

70. An entity can be wholly or partially responsible for an impact. The attribution of an impact should consider the responsibility of the entity. If the entity has control over the activities that cause an impact, even if the impact exists in a system that other entities are linked to, it is likely that the entirety of the impact should be included in its impact accounts. Direct impacts that are caused by an entity are likely fully attributable to the entity, whereas direct impacts that are contributed to by the entity and indirect impacts may be either wholly or partially attributable to the entity.

71. The inclusion of the entirety of an impact by an entity in its impact accounts does not preclude another entity that is linked to the impact from including the entirety or a portion of the impact in its impact accounts. The direct impact of one entity can be the indirect impact of another entity in the same value chain. This approach to attribution creates the potential for double counting of impacts across the value chain. Double counting occurs when an entity wholly or partially recognizes an impact in its impact accounts and another entity in the same value chain wholly or partially recognizes the same impact. This approach to attribution allows for complete information on value chain responsibility at the entity level.

RECOMMENDATIONS OF POSITIVE IMPACTS®

- (46) **Impacts can also be absolute, influenced, or marginal** compared to a reference scenario
- (63) It is quite common to present upstream and downstream as the same, namely "indirect" impacts, while **upstream impacts are the entity's decision**. In contrast, **downstream impacts are the decisions of the customers/consumers**. The IFVA should require preparers to report **all material impacts linked to revenues** (from upstream and own operations). **Downstream** impacts are insightful but should always be **presented separately** as **influenced emissions**. This impact coloring typically goes hand in hand with impact washing by adding positive impacts without including their related negative impacts
- (70-71) The current text leads to the **mixing of absolute and influenced impacts**: While every impact tied to spend can directly be allocated to the organization that makes the purchase decision, downstream impacts are always at least the decision of one more entity/person, usually the decision of multiple actors. No one considers including customers' surplus or profits in one's financial statements to wash away the losses. The IFVA should instead account for this issue by demanding a **separate presentation** of **downstream impacts** along with using the **revenue share approach** as the standard, with the **option to explain the extent of influence** in a range (from-to) as a supplementary information

1) Numbers in the titles and in brackets () refer to chapters and paragraphs in the General Methodology 1 paper.

Things to consider[1] to avoid impact washing (IV/IV)

5. IMPACT MATERIALITY AND THE PREPARATION OF IMPACT ACCOUNTS

5.1 IMPACT MATERIALITY AS THE BASIS FOR IMPACT ACCOUNTS

73. Before a preparer, whether an entity or an investor from an external perspective, can use the

75. As part of generating impact accounts, the relative importance, worth, or usefulness of impacts to people and the environment is assessed through monetary valuation. As a result, the impact information derived from impact accounts provide a data driven and empirical foundation to support an entity's materiality assessment process. Ultimately, the process of identifying impacts, measuring and valuing them to understand their significance, and assessing them from an impact materiality perspective is an iterative and ongoing process.

81. A material impact will always affect one or more stakeholder groups of the entity. To identify impacts, a preparer should identify impacts for each affected stakeholder category at each stage of an entity's value chain. A map that displays stakeholders and value chain stages may be a helpful tool for the identification of potential impacts (see *Figure 4*).

Stakeholder Categories	Value Chain Stage				
	Upstream	Own Operations	Downstream		
			Distribution	Use-Phase	End-of-Life
Nature					
Consumers & end-users					
Employees & other workers					
Government & regulators					
Local communities					

Figure 4: Example of a materiality map for impact identification

RECOMMENDATIONS OF POSITIVE IMPACTS®

- (75) Perception-based **monetary valuation is useful for assessing impacts within a category** in most circumstances (e.g., 1 fatality vs. 1 occupational injury). In addition, in **certain circumstances,** they can **support** the assessment of the **relative importance of impacts between impact categories** (such as climate, water, subsidies and health). Positive Impacts® will **shortly release more on how this can be the case.** Stay tuned
- (81) Just because **one stakeholder group** is **affected** does **not** make an **impact material**, as it says nothing about the **magnitude of the impact** and its legitimacy. Stakeholders can even **mislead on purpose** to justify the impact washing of a statement

1) Numbers in the titles and in brackets () refer to chapters and paragraphs in the General Methodology 1 paper.

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Appendix: Approach comparison of Positive Impacts® vs. VBA vs. Harvard & issues of current GHG accounting standards

What others say about our approach

PAPER SERIES PRESS COVERAGE (GERMAN)

Handelsblatt

> PART 1, PART 3

Börsen-Zeitung
Zeitung für die Finanzmärkte

> PART 1 , PART 3 (SPOTIFY#30)

PART 3:

TAGESSPIEGEL BACKGROUND

> PART 1, PART 2, PART 3 (see right)

Forum
Nachhaltig Wirtschaften

> PART 1, (02/2022),PART 3 (04/2022)

TAGESSPIEGEL BACKGROUND COMPARES HARVARD, VBA AND POSITIVE IMPACTS APPROACH

The renown Tagesspiegel Background Sustainable Finance **compares** the **PI approach to** the one from **Harvard** and of the **VBA**:

“**Positive Impacts** has developed a similar concept to the one of [...] Harvard's, and the **Value Balancing Alliance**, an industry alliance, that is also working on it. They all convert emissions and other environmental impacts of corporate activities into monetary amounts and compare these with certain payments made by companies, such as taxes or salaries.

There are several ways in which companies can be made to look more positive or more negative, i.e., more beneficial or more detrimental to the common good: Which factors are considered positive or negative and what price tag is put on environmental damage, such as a ton of CO2, are such **set screws.**

Salaries or taxes as a positive effect? [...]

In the Positive Impacts methodology, there is a ‘societal value’ and a ‘societal gain/loss.’ The external effects are offset against sales in the case of the former, and against taxes paid in the case of the latter – after all, only these are used to finance services for the general public, whereas salaries flow into private accounts.

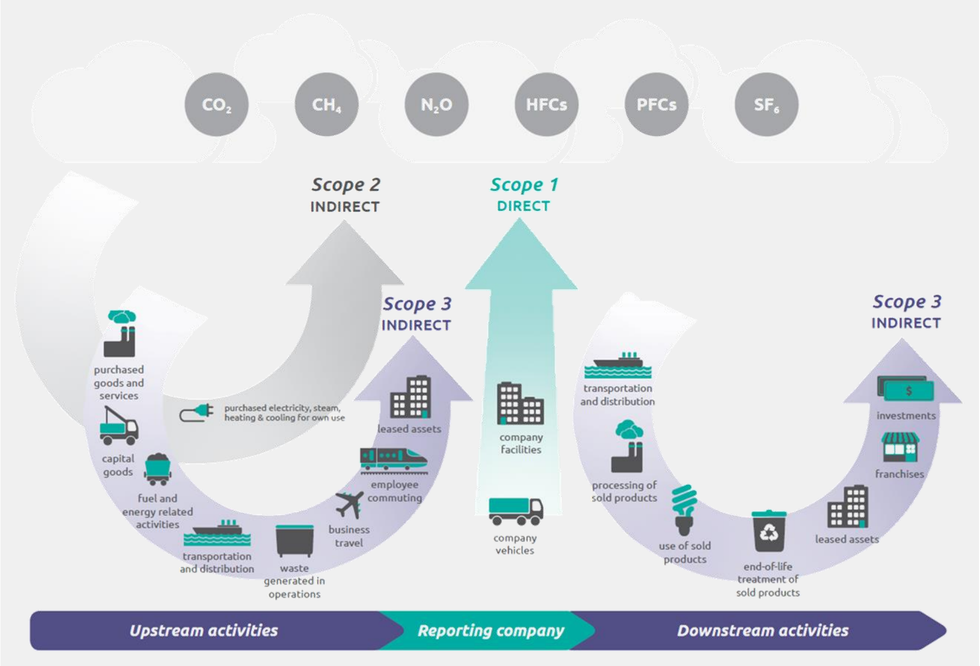
The Value Balancing Alliance [...] gives its backers a method that makes them look good: [...] its methodology [...] considers **profits, interest payments** and depreciation in addition to salaries and taxes.”[1]

Harvard Business School's approach, which is continued by the **International Foundation for Value Impacts (IFVI)**, also uses amongst others earnings and interest payments.

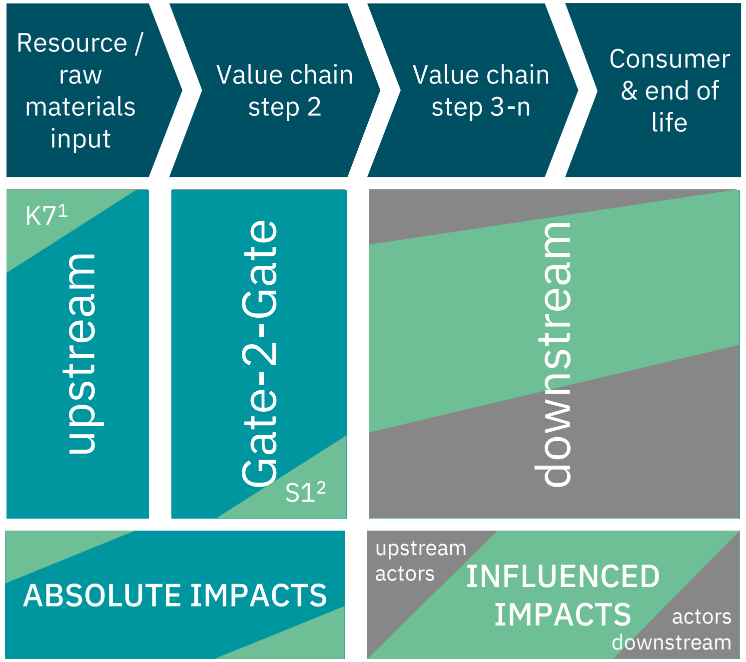
1) Tagesspiegel Background Sustainable Finance from 10. November 2022, own translation

Current ESG accounting mix absolute & influenced impacts

GHG PROTOCOL



CURRENT ESG ACCOUNTING PRACTICES



RECOMMENDATIONS

- **Separately report cradle-to-gate emissions that cannot be linked to your revenues** (employee commuting)
- **Separately report downstream emissions** with by using the **revenue share approach** that can be complemented with an explanation of the level of influence
- **Apply a step-wise approach** to improve **data quality**, e.g., when assessing scope 3 emissions: start with a **spend-based**/average data analysis to identify hotspots and ensure completeness and then **complement** the data with **supplier-specific data**

1) Employee commuting; **2**) Scope 1 emissions of a lessor (e.g., for a leased car)

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Click to book a meeting with the CEO

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