SOCIAL VALUE INTERNATIONAL

The Materiality Files

By Ben Carpenter & Jeremy Nicholls

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About the Materiality Files

SVI have asked Ben Carpenter and Jeremy Nicholls to develop a series of blogs and webinars on the subject of **materiality**. Why? The existential threats of climate change and social inequality are real for us all.

In an attempt to reverse these negative trends and create a more sustainable world there needs to be a transformation in the way capitalism works and that means a change in the way decisions are made. Central to this transformation is changing the purpose behind investment decisions and then the information that **matters** to inform decisions with that purpose will also change. The concept of materiality is central to this.

About the Authors

Ben Carpenter is the CEO of Social Value International. He graduated with degrees in Politics, Communication and Property Development. During his early career Ben worked in Asset Management, Social Housing and the Homelessness sector before moving into the SROI Network in 2013. Over the last decade Ben has supported the growth of the social value movement fulfilling various roles including CEO of Social Value UK (2018-2021) and Social Value International (2018-now).

Ben Carpenter oversees the strategic direction of SVI and leads technical facilitation with partners including UNDP, OECD and other international sustainability standard setters. Dedicated to reducing inequality and improving the well-being of people and the planet, Ben is honoured to be leading the global network for social value practitioners working to change the way the world accounts for value.

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He originally qualified as a chartered accountant, including time as the Finance Director for Tanzania Railways. After four years as a house parent, he became involved in social enterprise, sustainability and regeneration, and was one of the founders and then CEO of SVI.

Financial materiality and human rights, pineapples and profits

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Blog 1: Financial materiality and human rights, pineapples and profits

In June 2023, the *Guardian* and The Bureau of Investigative Journalism (TBIJ) published an investigation into allegations that four people had been killed and many more had suffered violent assaults over a four year period from the security personnel of a Del Monte pineapple farm in Kenya.

These alleged human rights abuses were perpetrated in the name of protecting pineapples and the profits they represent. This blog uses this story to illustrate how human rights abuses like those alleged in this investigation occur regularly and will continue until there is a fundamental change to the way our economy works and the way businesses make decisions.

In this first blog in the Materiality Files, we outline how the global economy currently works and introduce the idea of '**financial materiality**' before examining the case of Del Monte to illustrate the shortcomings of this approach. Lastly, we describe an alternative approach that could lead to more sustainable decisions.

Financial materiality and the economy

In the current global economy investment managers and business leaders focus first and foremost on financial returns. Even when thinking about sustainability issues (Environmental, Social and Governance, or ESG), these are treated as ***risks to***

financial value. The newly formed International Sustainability Standards Board (ISSB) states that sustainability information is useful to investors because:

> ***"an entity's ability to generate cash flows over the short, medium and long term is inextricably linked to the interactions between the entity and its stakeholders, society, the economy and the natural environment throughout the entity's value chain."*** [1]

This is what has come to be called 'financial materiality'. It is not about achieving sustainable development or improving the wellbeing of people and planet, it is about financial risk management.

Supporters of financial materiality argue that business decisions will be made to avoid negative impacts on people because all negative impacts, at some point (*short, medium long term*), limit the business' ability to *generate cash flows*. Perhaps the pursuit of profits will force businesses to be more responsible – to treat people with dignity and not exploit our natural resources? In theory then, a business would not abuse members of the local community because this leads to bad press, a damaged reputation, a drop in share price, reduced sales and maybe fines or compensation packages.

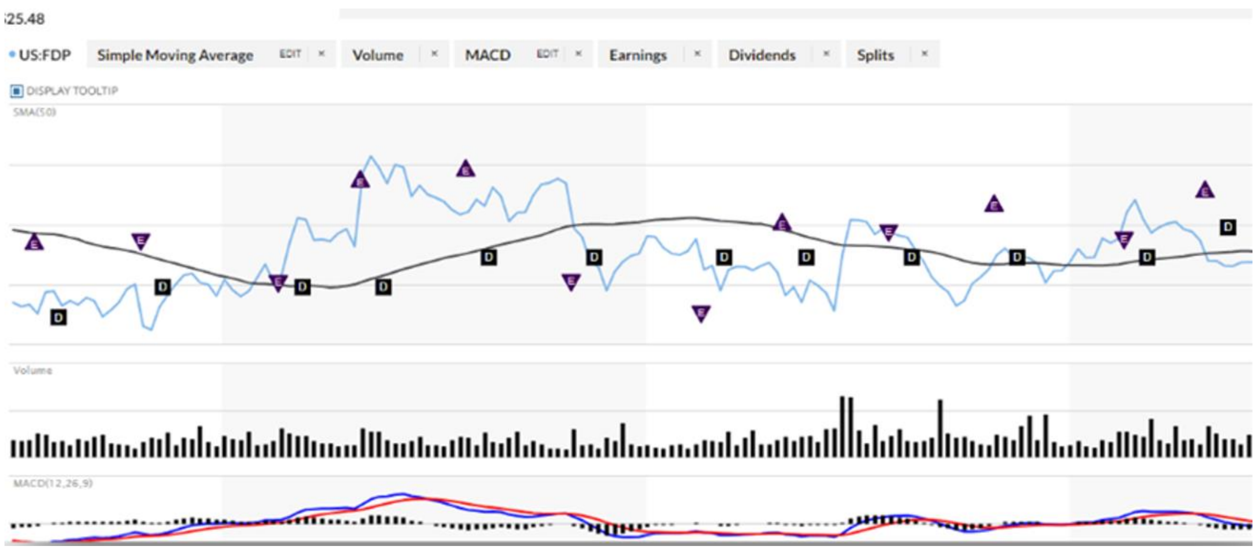
How this idea of financial materiality works … in real life … when pineapples, profits and people's lives are all at stake

Why were the alleged human rights abuses committed by the security firm employed by Del Monte? Why didn't the risk of reduced financial performance prevent the reported violence from happening? Comparing the consequences of these events for the Del Monte business owners and shareholders with the consequences experienced by victims and their friends and family may provide the answer.

What are the consequences for Del Monte shareholders? These headlines about violence and deaths are obviously not 'good for business'. Perhaps there was an immediate drop in share-price? If the scandal continues there may be a drop in sales. Once any investigations have been concluded there may be a fine that the company might have to pay.

[1] https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements/

It is quite clear that the consequences for Del Monte shareholders and business leaders were not severe enough to prevent what law firm Leigh Day called "serious human rights abuses.". In fact, news articles reveal that Del Monte have been embroiled in similar scandals for the past four years but the share price for that period does not show any significant downward trend (*see below*). It appears that a business can absorb the consequences. Any negative effect on company reputation or 'license to operate' is short term and passing. Pineapple will be back on our menus soon enough.



Del Monte's share price has remained stable despite the allegations

What are the consequences for the people who experience impact? The families of the victims will forever be grieving the loss of life of a loved one. They will also suffer as a result of the loss of income. Other victims who survived may be suffering from physical injuries and emotional harm, a loss of dignity and respect, and a drop in income.

> ***"Joel wants Del Monte to act. Speaking about the guards he believed attacked his son, he said: 'They don't value life. What they value most is pineapples.'"*** [2]

These consequences are not accounted for by Del Monte. There is no ledger that includes the negative value experienced by these people. What would the world

[2] https://www.theguardian.com/world/2023/jun/21/kenya-plantation-deaths-families-fight-for-answers-del-monte

look like if these impacts were accounted for? Imagine what business decisions would be made if all these impacts were included in company reports but valued from the perspective of the alleged victims?

Not only are the financial consequences low but the lost value to investors is completely different to the lost value to those affected. Whether or not this information was reported does not appear to have changed investors decisions. The argument is now that including it in the company's own reporting as opposed to in a news report is more likely to affect decisions. But if the (risk adjusted) financial consequences are low, it may still not be included in those reports. However, if the loss of value from the perspective of the victims was taken into account, and into the account of profits made, the business would be making very different decisions and a lot faster.

An alternative approach: from financial materiality to 'wellbeing materiality'

Social Value International believe in a world where, in calculating profits, businesses account for the impacts they have on people's wellbeing. Since 2007 SVI have been growing a body of practice for 'accounting for value' where impacts on wellbeing can be accounted for and integrated alongside financial value. Today, SVI's community of practitioners, spanning 60+ countries, are proving that measuring impacts on wellbeing is entirely possible. Through a principles-based approach, these practitioners can produce a social value account or a 'wellbeing account' that can inform decisions where the purpose is expectation of improvements in wellbeing. We could even call this 'wellbeing materiality'.

If Del Monte were producing wellbeing accounts they would be collecting and analysing data on how their activities impact the wellbeing of a range of stakeholders including local villagers. These accounts would include valuations of the impacts – from the perspectives of the people who experience the impacts. This information matters and if integrated with the financial accounts would lead to very different decisions being made.

However, we believe that there is a more fundamental problem with how materiality has been used in sustainability accounting and reporting, that relates to how materiality is treated in financial accounting and so in a company's financial statements. We argue that the way materiality is used in sustainability reporting, and even in how financial materiality has come to be understood by many, is inconsistent with what happens in financial accounting.

This is the subject of our second blog.

Blog 2: Every pencil matters

In the first blog, we illustrated how a financial materiality lens would fail to prevent human rights abuses and how SVI are advocating for a 'wellbeing materiality' approach.

In this blog we get a bit more technical to explore how the concept of materiality is actually applied in financial accounting and in doing so we reveal how sustainability accounting and impact management have (generally) not followed the same logic or approach. We conclude by illustrating what it might look like if sustainability accounting was more analogous to financial accounting.

Materiality in financial accounting

Speak to a financial accountant and they will probably explain that **materiality refers to the risk that information is missing from the financial statements (or irrelevant information has been included) that would affect the decisions of the primary users of those financial statements**. They may go further to say that information should be relevant and should be faithfully represented. This means the first issue is to define what information will be in the scope and the second will be the risk that the information is subsequently materially misstated.

Information in scope

The Conceptual Framework for Financial Reporting, which provides guidance on applying accounting standards, is primarily a framework for determining **relevant information** that can be **faithfully represented**. At the risk of over-simplification this is information that informs decisions by primary users with an interest in expected financial returns. This information is defined as those economic phenomena that meet the definition of asset, liability, income or expenditure or equity and that meet a required level of certainty.

There is a risk here that information that should be included is missing – and the information is incomplete. Or that information has been included that shouldn't be. Or that information that has been included has not been faithfully represented. If any of these occur those primary users may now make different decisions. **This is the risk of material misstatement**. The misstatement matters because it may influence decisions.

It's worth referring to the paragraph in the Conceptual Framework that addresses materiality, para 2.11.

> *Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of those reports, which provide financial information about a specific reporting entity.* ***In other words, materiality is an entity-specific aspect of relevance*** *based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.*

An accounting system should be designed to minimise the risk that relevant information is missing and it is the function of the auditor to design an audit program that reduces audit risk, the risk that the audit does not identify missing information, to an acceptable level. Auditors have a whole standard on this; ISA 315 on Identifying and Assessing Risks of Material Misstatement.

So to manage the risk of material misstatement **we need to know the user, the decision, the purpose behind the decision** to determine relevant information and then the **level of uncertainty** the user is willing to accept that information is missing (or included that shouldn't be) or not faithfully represented. This has to be generalised for the maximum number of users. In *general purpose* financial reporting (i.e. standard financial accounts) the primary users are "*current or potential investors, providers of loan finances or suppliers, who cannot get the information from other means, making decision to provide economic resources to an entity in the expectation of financial returns.*" [3]

Let's imagine that a company buys a single **pencil** and see how this is captured in financial accounting:

Is it in scope?
This purchase is an economic phenomenon and meets the definition of an expenditure. The pencil exists, it works (otherwise you would send it back) and we know how much it costs. It is in scope and it meets the required level of certainty. So, yes, we account for it.

Is there a risk of misstatement?
If the purchase of this one pencil was not included, it would be a misstatement but not a material one because it would not affect the decision of an intended user of financial accounts – i.e. it would not change a decision to provide resources to an entity in the interest of expected financial returns.

Even if the expenditure on all the pencils were missing (because of a mistake in accounting or because of fraud) it would not be material. Quite possibly, if expenditure on all stationary were excluded it would still not be material.

Nonetheless, all these things are accounted for because they are in scope. And then aggregated – pencils are aggregated into stationary, stationary into office supplies, office supplies into operating costs. All possible because there is a common unit of measurement.

Whether or not something is material – i.e. if it were missing it would affect decisions – is assessed at a high level of **aggregation** – e.g. for expenses like the pencil in relation to the overall profit or loss, for assets like a photocopier, in relation to the balance sheet. So if the expenditure on office supplies totalled less than a certain percentage of the total of the profit or loss, it might not be

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[3] Para 1.3 in *Conceptual Framework Financial Reporting*, https://www.ifrs.org/issued-standards/list-of-standards/conceptual-framework/

considered material if it were omitted. A **threshold** is needed to do this, and this is set by the auditors. Guidance from KPMG suggests this is between 3% and 10%.

So, if the total expenditure on stationary exceeded the threshold percentage – which it might if the company was an arts school – then this would be material information if it were not included. It could mean investing in the art school rather than elsewhere because the expectation of financial returns is higher than it should have been had the information been included.

Let's compare this with how materiality is assessed in sustainability accounting and reporting.

Generally, sustainability accounting and reporting does not follow the same logic and the same process. In sustainability, there is no attempt to account for every single ***sustainability*** phenomenon (the equivalent of the single pencil as an economic phenomena). **Scope is not defined first**. Instead, the starting point for determining whether information is relevant, the scope of the account, is to consider whether it is material and to do this at some level of aggregation (topic, subtopic or perhaps aspect of wellbeing), considering whether if the aggregated information were missing it might influence users. And if the information is considered, at this stage, to be not material, the information is not included in the account. This is completely the reverse to financial accounting. **But this presents a Catch-22 situation**. We are second guessing what information that we think might be useful. The equivalent of those pencils may very well not be included in a sustainability account.

This approach may have arisen from reading of para 2.11 above as if this was guidance for determining relevant information. But if this was the interpretation being used by accountants, information about pencils would not be collected.

If sustainability phenomena are the equivalent level of analysis as economic phenomena then sustainability phenomena would be impacts to wellbeing. By failing to include them, we risk excluding impacts on wellbeing from scope and then making decisions that could then reduce wellbeing and so undermine sustainability. To follow the logic in financial accounting **we should account for all impacts to wellbeing that meet a required definition**. This could, for example, be aspects of wellbeing using the OECD approach[4] but would also need to

[4] https://www.oecd.org/wise/measuring-well-being-and-progress.htm

address thresholds and allocations in determining whether changes were positive or negative.

Better sustainability accounting

In the first blog of this series, we spoke about the reported human rights abuses that have taken place on a Del Monte pineapple farm. Let's imagine that Del Monte managers and investors considered impacts on wellbeing to be relevant and within scope. This would mean that efforts would be made to capture all impacts (large and small) and decisions would be made with the interest of optimising impacts on wellbeing. This would be the starting point, though only the starting point, for **an accounting system designed to prevent human rights abuses and to create a more sustainable world**.

Of course, it is not possible to account for all these changes in the same way as finance because there is no paper trail of transactions. The impacts would need to be modelled and estimated, which does increase uncertainty. The key question then is whether this uncertainty meets the requirement for the information to be useful. Whether information could be faithfully represented. Then if there were a **common unit**[5] (and leaving aside the question of how to do this well), the impacts could then be aggregated and decisions about whether their exclusion would be material would be made just like we did when we aggregated the pencils to 'stationary' and 'operating costs'. An estimate of changes in people's health including small changes would still be accounted for.

The risk of material misstatement is then whether the scale of omitting these impacts, when aggregated, would affect decisions. This needs an understanding of the level of risk that primary users are willing to take. If our purpose is optimising wellbeing and our primary users (recognising that others may act as their agents) are those with an interest in increases in wellbeing, then these users will want to have information on a more complete understanding of impacts on wellbeing. Even if there is more risk that this is less accurate.

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[5] *Most sustainability reporting does not use a common unit and therefore prevents aggregation and comparison of the relative importance of impacts. But impacts on wellbeing can be accounted for with a common unit. One way of doing this is by using money as a proxy. This approach provides transparency over the inevitable trade offs in decisions and ensures that those experiencing the impacts inform those trade offs. Where the approach recognises thresholds, it will also flag up trade offs which should not be made and where alternative options are required. It is worth noting that even within financial forecasting, proxies are often used to represent different options and help support decision making.*

Current practice in sustainability reporting tries to anticipate the sustainability phenomena that are thought to be material before information is collected and aggregated. **The problem with this approach is that a) the decision about what 'we' think might be material is rarely informed by people who experience impacts on wellbeing, and b) information is being excluded and we have an incomplete account against which to assess material misstatement**. This incomplete account will affect decisions being made.

In our third blog in this series, we will outline the **case for 'wellbeing materiality'** and how it is actually the logical approach for determining what information matters.

The Materiality Files Blog 3:
Dismantling financial materiality and transforming capitalism

By Jeremy Nicholls & Ben Carpenter

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Blog 3: Dismantling financial materiality and transforming capitalism

In the first blog, we illustrated how financial materiality is **failing to prevent human rights abuses** and how SVI are advocating for an **approach to materiality based on wellbeing**. In the second blog we outlined how most **sustainability accounting does not follow the same logic as financial accounting** when it comes to the relationship between relevance and materiality – although it could and, we think, should!

In this third blog we continue to examine the logic of materiality in financial accounting to dismantle the term and whole concept of ‘financial materiality’. We delve into the Conceptual Framework for Financial Reporting and illustrate **how a small but necessary evolution to the purpose of financial reporting is the real key to transforming capitalism and creating a more sustainable world**.

Firstly, a quick reminder of what financial materiality is:

In the context of financial reporting, financial materiality is information that is material to the decisions made by primary users, of which more later. In the context of sustainability, financially material information has become an accepted term for

information on *"those ESG issues that affect the company's ability to generate future cashflows, in other words, its enterprise value."* [6]

The overriding focus here is on profit and managing risks to financial return. This emphasis on profit is hardly surprising considering the capitalist global economy that exists today. We all know the phrase: "money makes the world go round" – *but **capital markets and financial flows only happen because of our international accounting standards***. So let's examine these accounting standards.

The Conceptual Framework for Financial Reporting (CFFR)

The best place to look is a wonderful document (published by the IFRS in 2010 and 2018) called the Conceptual Framework for Financial Reporting (CFFR). This document articulates the basis, foundations, and ideas that underpin our international accounting standards and therefore the wheels of our global economy.

We think that, to understand why our global economy works the way it does, we need to get down in the weeds of accounting. Even if you are not an accountant, it will be worth reading the 800 words in the following screen shots that set out the ***objectives of general purpose financial reporting.*** [7]

[6] https://www2.deloitte.com/hu/en/blog/esg-explained/2021/esg-explained-5-materiality-matters.html
[7] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf

Introduction

1.1 The objective of general purpose financial reporting forms the foundation of the *Conceptual Framework*. Other aspects of the *Conceptual Framework*—the qualitative characteristics of, and the cost constraint on, useful financial information, a reporting entity concept, elements of financial statements, recognition and derecognition, measurement, presentation and disclosure — flow logically from the objective.

Objective, usefulness and limitations of general purpose financial reporting

1.2 The objective of general purpose financial reporting[1] is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.[2] Those decisions involve decisions about:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

1.3 The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, dividends, principal and interest payments or market price increases. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity and on their assessment of management's stewardship of the entity's economic resources. Existing and potential investors, lenders and other creditors need information to help them make those assessments.

1.4 To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:

(a) the economic resources of the entity, claims against the entity and changes in those resources and claims (see paragraphs 1.12–1.21); and

(b) how efficiently and effectively the entity's management and governing board[3] have discharged their responsibilities to use the entity's economic resources (see paragraphs 1.22–1.23).

1 Throughout the *Conceptual Framework*, the terms 'financial reports' and 'financial reporting' refer to general purpose financial reports and general purpose financial reporting unless specifically indicated otherwise.

2 Throughout the *Conceptual Framework*, the term 'entity' refers to the reporting entity unless specifically indicated otherwise.

3 Throughout the *Conceptual Framework*, the term 'management' refers to management and the governing board of an entity unless specifically indicated otherwise.

1.5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.[4]

1.6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.

1.7 General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.

1.8 Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing Standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users.

1.9 The management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally.

1.10 Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups.

1.11 To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions. The *Conceptual Framework* establishes the concepts that underlie those estimates, judgements and models. The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the *Conceptual Framework*'s vision of ideal financial reporting is unlikely to be achieved in full, at least not in the short term, because it takes time to understand, accept and implement new ways of analysing transactions and other events. Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.

4 Throughout the *Conceptual Framework*, the terms 'primary users' and 'users' refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

Why is this so important?

1. Who are the primary users of financial reports?

According to paragraph 1.2 the information (in financial reports) is useful to: ***"existing and potential investors, lenders and other creditors"***. Who falls within this description exactly? Well, you the reader – you probably have a pension or are thinking about starting one – so that makes you an existing or potential investor. And if it is a state pension, your government is a lender (since tax due is generally paid a year after the period to which is relates) and so is also a primary user, acting on your behalf.

So, we are all primary users of financial reports!!

Let's dig further because in paragraph 1.8 it expands on the idea of primary users by saying:

"Individual primary users have different, and possibly conflicting, information needs and desires. The Board, in developing Standards, will seek to provide the information set that will meet the needs of the maximum number of primary users. However, focusing on common information needs does not prevent the reporting entity from including additional information that is most useful to a particular subset of primary users."

This bit is really interesting – honestly! It recognises that there are many different 'individual primary users' of financial reports with many different information needs – but the International Accounting Standards Board will ***seek to provide the information set that will meet the needs of the maximum number of primary users.*** Which leads us to our next question …

2. What is the information set that will meet the needs of the maximum number of primary users?

Let's assume that all primary users (remember that's all of us) want information about financial returns. Yes, of course we do – so the content of paragraphs 1.2-1.4 are not wrong! But … is there any other information that is needed by primary users? Let's try this experiment:

When you invest in shares, either directly, or indirectly through an investment manager or through a pension, what do you want from your investment?

What sort of returns are you expecting or interested in?

1. **financial returns only – I have no interest in any social or environmental returns***
2. **financial returns subject to no (material) negative social or environmental returns**
3. **financial returns subject to net positive social or environmental returns**
4. **financial, social and environmental returns**
5. **social and environmental returns subject to a minimum financial return**
6. **social and environmental returns only – I have no interest in any financial returns**

**By social or environmental returns, we mean impacts on (or consequences for) the wellbeing of people or planet.*

In our experience of asking this question (to as many people as we can), our guess is that you voted somewhere between option 2 and 4. (We are running this as a [live poll](#) to see what information set would meet the needs of the maximum number of readers – [please vote!](#)). In 2019, a [Social Value UK survey](#) found that only 15% of the population wanted their investments to maximise financial returns with no interest in the social or environmental impact of the investment. [8]

If this is what we all want from our investments then it follows that the information that meets our needs includes information about the social and environmental return (or consequences of) from our investments. Even for an investor who states they are only interested in financial returns, it is problematic to ignore social or environmental returns because they won't know when those investments are going to have consequences for their own lives. A good example of this is climate change. Having ignored the environmental returns of our investments for decades we are all now feeling the impacts of climate change.

So, it is fair to assume that information on social or environmental returns falls within the needs of the maximum number of primary users (of financial reports).

[Note: We have used the phrase social and environmental returns to be consistent with the language of financial returns. A better way to look at this is to see financial returns as an aspect of social returns, and together social and environmental returns can be thought of as changes to our individual and collective wellbeing.]

What is alarming is that the current information set being provided in financial reports is appropriate only for those who choose option 1. The Conceptual Framework for Financial Reporting makes no explicit reference to social or environmental consequences of an entity – it is solely about financial returns. But really? Who are these people that would vote for option 1? **Who are the people that have no interest in social or environmental consequences of their investments?** They would have to be people that do not care about the future of our planet and for the human rights and dignity of others. Maybe some people do hold these views – but surely this is not the majority!

The financial or double materiality debate shouldn't be about whether social and environmental consequences become material to financial returns. That is a red herring. Financial materiality should not be the basis for annual accounts. **Social and**

[8] https://socialvalueuk.org/should-businesses-be-forced-to-include-social-and-environmental-impact-when-calculating-profits/

environmental information should not be an add-on in another set of disclosures; it should be integrated into those annual accounts, and follow the same logic for creating useful information. The 2019 Social Value UK survey also found that 76% of respondents thought that social and environmental information should be made available in a company's accounts, and 40% thought it should be mandatory for companies to include financial, social and environmental value when determining the overall profitability of a company.

So, how do we change this?

Over the last 50 years global capitalism has undoubtedly led to significant developments in living standards for many but this has not happened for everyone. For example, consider that 24% of the world's population live in fragile contexts, characterized by impoverished conditions and dire circumstances; 9.2% of the global population live on less than $2.15 per day; and the richest 1% own almost 46% of the world's wealth.

As we sit here almost a quarter of the way through the 21st century it is clear to us all that the future of the planet and our shared prosperity remains in the balance. The existential threats of climate change and rising social inequalities are visible, real and harming us all. Governments, business leaders and investors are all stuck in various attempts to create a more sustainable and equal world. We believe one of the most effective solutions lies hidden under our very noses.

The solution is beautiful in its simplicity: we update the Conceptual Framework for Financial Reporting. Let's imagine that we evolved the objective of general purpose financial reporting to actually reflect and meet the needs of the maximum number of users – this could be done by simply adding references to sustainable development and the wellbeing of people and planet as relevant (and we mean relevant rather than material) information to users of financial reports.

We do not even need to change the definition of primary users (i.e. "existing and potential investors, lenders and other creditors"). This is adequate – it captures that we are all potential users of financial reports.

The change required relates to the purpose behind the decisions that users are expected to make. It would be entirely reasonable and appropriate to make the following change to this sentence in paragraph 1.3 :

1.3 The decisions described in paragraph 1.2 depend on the returns that existing and potential investors, lenders and other creditors expect, for example, ***health and social connections as well as financial returns*** *such as dividends, principal and interest payments or market price increases. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for)* ***changes to wellbeing*** *(including future net cash inflows to the entity) and on their assessment of management's stewardship of* ***the resources on which the entity depends (including its economic resources)****. Existing and potential investors, lenders and other creditors need information to help them make those assessments.*

Paragraph 1.4 would also need adapting – perhaps in the following way:

To make the assessments described in paragraph 1.3, existing and potential investors, lenders and other creditors need information about:

(a) the economic resources of the entity, claims against the entity ***including social and environmental returns (wellbeing)*** *and changes in those resources and claims; and,*

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use ***the resources on which the entity depends (including its economic resources)****.*

[For more detailed analysis on how non-financial information can be integrated into financial statements see this paper published by Capitals Coalition in 2021: *Disclosing impacts on natural, social and human capital in financial statements* , and the Conceptual Framework for Sustainability Reporting.]

These proposed changes are just an example of how we could **re-define the purpose of financial reporting**. By focussing on the purpose and the decisions made by users (of financial reports) the debate about financial materiality (and all the other silly terms – single, double, triple, dynamic, etc.) would disappear. Information is either material to a user – for a decision with our new purpose – or it is not.

The change to the purpose of financial reporting does not even need to be too radical (assuming that enhancing wellbeing for all is not controversial). Financial returns remain a part of that, and many of the structures would remain, albeit with an updated purpose and an updated statement of their public interest, and yet it would transform capitalism and help us create a sustainable and equitable world.

We must acknowledge that a narrow purpose that focuses on financial returns alone is outdated. More appropriate is a focus on enhancing wellbeing that includes financial returns. This would change how we calculate profit. **The ability to make profits with unaccounted for costs to the wellbeing of people or planet would be significantly reduced.**

Is accounting for wellbeing possible? In blog 2 we showed that it is not without its difficulties but yes – it is entirely possible. Wellbeing or life satisfaction is a well-defined concept globally. The **OECD** has a framework and is developing multinational data sets. Social Value practitioners have been developing practices for accounting for wellbeing since 2007. The **UNDP** (and soon **ISO**) have standards for decision making that contributes positively to sustainable development.

If we have the political will to embed 'wellbeing' into the purpose of financial reporting, and if it is enshrined in legislation, the innovation and practice within the accounting profession will quickly make significant strides. Humanity has shown how we can harness technology and data to do amazing things. Why not collect data on wellbeing that can improve our decision making and accountability?

We all need to live in a sustainable world where wellbeing of people and planet is enhanced alongside financial returns. It makes sense for everyone, and **we have the power to hard wire this purpose into financial reporting which is the basis for so much of our decision making**.

Appendix

Opinion poll on the returns we seek from investments

We invite you to take part in a short poll that is linked to the topic of the third blog in the Materiality Files and relates to a crucial question underpinning the basis of financial reporting.

The answers will help inform our mission to change the way the world accounts for value and support an economy that serves the needs of people and planet

Please note that we seek responses from individuals, not from investment managers responding in their professional capacity.

Take our short opinion poll!

Webinar on Materiality

On 5 September 2023, **Jeremy Nicholls**, the co-author of The Materiality Files led a Top Tips webinar for SVI members and Social Value and IMM practitioners on **Principle 4: Only Include What is Material.**

During the event, Jeremy explored a number of topics discussed in these blogs and made a compelling case for 'Wellbeing Materiality', examining how accounts of wellbeing would result in different decisions being made.

Watch the webinar recording on YouTube

For background:

- The Principles of Social Value provide the building blocks for anyone who wants to make decisions that take a wider definition of value into account, in order to increase equality, improve wellbeing and increase environmental sustainability.
- Principle 4: Only Include What Is Material requires practitioners to establish the boundaries of what information and evidence must be included in an account of value. This is because we want to give a true and fair picture, and one that is based on the evidence from stakeholders, so that the decisions taken focus on the changes that matter to the people who are directly impacted.