Expert Roundtable on Business, Human Rights and Accounting: a summary report

Executive Summary

As part of the Valuing Respect project, Shift convened an expert roundtable on 24 April 2019 to explore the ways in which accounting methods and models could evolve to better reflect value associated with business respect for human rights. Participants came from key organizations in the accounting profession and academia, standard-setters, oversight bodies and organizations innovating new approaches to sustainability accounting. Key headlines from the discussions include:

- A general call for a 'leap change' rather than a 'step change' in approaches to accounting, to address the gulf between current financial accounting models and the need to understand how companies create and erode value more generally for society and business itself.

- Recognition that human rights are not just an additional list of things to tackle within a sustainability or 'ESG' framework; they articulate the very concept of human dignity and equality and constitute a cross-cutting category of a company's most critical economic, environmental and social impacts on people.

- The need to find a shared 'language' of value that can reflect business respect (or neglect) for human rights – ideally a language that helps managers understand their companies' impacts and – at least over time – enables convergence and comparison of metrics between companies.

- General agreement that financial accounts themselves are poorly placed to accommodate the value of respect for human rights; but that the broader construct of financial reporting offers more promising terrain to do so.

- A call for the IFRS Foundation and IAASB to play a key role in developing generally accepted standards to account for human rights related value creation and erosion alongside financial accounts.

- A call for asset owners to use their weight to push for progress in this aspect of accounting and reporting, given their interest in companies' long-term performance and their ability to steer the decisions of asset managers.

- A conclusion that it would be valuable to identify one or two discrete human rights issues and model them carefully in accounting terms to show how value might be identified and measured in meaningful and generally applicable ways.

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Introduction

On 24 April, Shift organized an expert roundtable on business, human rights and accounting in collaboration with Manchester Business School, St Andrew's University, and hosted by the Institute for Chartered Accountants of England and Wales. The event was informed by a discussion paper and held under the Chatham House Rule. This note summarizes the key strands of the conversation. Participants are listed, with their agreement, at the end.

Looking for a leap change

There was a widespread recognition among participants that the world in which traditional accounting methods are applied today is very different to the world for which they were designed: a world where the majority of a company's value was captured in its books, intangibles were limited and there was little societal and regulatory attention to the impacts of business on the planet and people. Today, none of those factors hold true.

Participants called for a 'leap change' rather than 'step change' in approaches to accounting to make up the resulting gulf between current models and current needs. A new vision should look beyond what is good for business to something more transcendental that works for society, understanding that profit is not a measure of prosperity and that it is necessary to address the whole system within which companies exist, rather than tinkering with incremental change at the margins.

Understanding the place of human rights

Despite the enthusiasm for new models and new thinking, the proposition became hardest when discussion honed in on human rights. Much of the innovation to date has looked at companies' 'social impact', often focusing on narrow and very measurable areas within a company's own workforce, such as health and safety (injuries/fatalities) or diversity and inclusion (gender and ethnic representation in management and board rooms). Other new models have focused on positive benefits from business such as job creation and growth and not the negative impacts on people from their business, nor even the positive benefits of effectively addressing those impacts.

It was noted that human rights needed to be understood not as another list of things to consider or count, or as a sub-set of 'social' impacts, but as a cross-cutting category that articulates the very concept of human dignity and equality. Negative impacts of business on human rights are the most severe economic, social or environmental impacts a company can have on people. Cumulatively, these impacts have become both a primary cause and consequence of the gross inequalities that characterize societies today, and the resulting social and political backlash these have generated.

Rather than being relegated to the sidelines, human rights therefore need to be elevated to the headlines of how accounting needs to change. The challenge participants were grappling with was how to do so where the effects of company actions are often poorly understood and hard to measure and attribute. However, it was recognized that there is also a considerable opportunity for companies to articulate through accounting the tangible and intangible benefits they can generate for society and business from operating with respect for human rights.

Key Discussion Points

Against this backdrop, participants explored various dimensions of accounting, including a range of innovations that were touched upon in the discussion paper, and the potential to better accommodate measures of value related to human rights. The following summarizes key points from the discussion:

1. <u>The language of money</u>

Discussions came repeatedly to the concept of a common 'language'. On the one hand, it was felt that the language of monetary value can help make issues digestible and comparable within and outside companies. It could also highlight interdependencies between various inputs to and outputs from a business. With regard to human rights it could help practitioners within companies make the business case for changes in practice.

There was also discussion of the inherent limits on expressing human rights impacts in monetary terms, whether due to their nature (e.g., freedom from discrimination or privacy) or due to a lack of clear public data from which to model a company's positive or negative impacts (e.g., data on the numbers and location of people in forced labor or subject to sexual harassment in the workplace). More generally, there were concerns of principle about monetizing human life and other goods that society values in very different terms, and the high risk that this would lead to perverse trade-offs in decision-making.

2. <u>Other forms of value</u>

Participants shared experience developing and working with other units of value in relation to the environmental and social performance of companies. These innovations and experiments are happening in the context of management accounting, and can be tailored to what internal decision-makers need to know. Some are focused more on measures of value to a company under a traditional materiality lens, and others more on value to society, taking a broader view of a business' purpose.

On the one hand, it was felt that it may be too hard – or at least very premature – to expect these non-financial units of value to become in some way universally accepted, such that they could mirror financial information. Unless and until they did so, they would remain harder to assure, be open to contestation and typically not be comparable across companies. This would constrain their utility to investors. However, it may still leave important room for companies to learn valuable lessons about their impacts and perhaps find points of convergence within industries on the most useful metrics.

On the other hand, it was felt that non-monetary forms of value might indeed become equally useful and used alongside financial information. It was proposed that if a company is applying certain measures of value to understand risk, link it to strategy and make decisions, investors are and should be keen to learn the basis for those decisions. That would enable them in turn to understand which companies are striving to understand their broader impact and account for it in a meaningful way. Assurance could look at the quality of methodologies where it was not viable to assure final numbers.

3. Comparability and Context

The draw of finding a shared 'language' of value was in large part because it enables comparisons between companies. This was seen as particularly relevant from an investor perspective. At the same time, it was noted that things that appear comparable are often only superficially so. This is no different for business and human rights metrics: for example, a measure of the number of child labor incidents identified in supply factories is not in fact comparable across companies absent significant context and explanation.

The importance of context for understanding either financial accounts or other forms of value creation and erosion by a company was therefore another recurrent theme. It tied directly to discussions of the need for integrated thinking and accounting by companies across all the 'capitals' they use and affect. It was noted that current ESG reporting and analysis was all about the 'numerator' of negative and positive impacts and could never really speak to sustainability unless it included a 'denominator' that reflected the global context and provided thresholds and allocations against which to measure progress.

4. Financial accounts vs financial reporting

There was fairly broad agreement that financial accounts themselves are poorly placed to accommodate the value of respect for human rights. They suffer from the considerable disadvantages of being a historical snapshot in time, out-of-date at the point of publication, of very limited predictive value and narrowly focused in their purpose. As a case in point, recent scandals at Facebook – with their considerable human rights consequences – show up uniquely in their market value (at a loss equivalent to the entire value of McDonalds) and not in their book value.

Yet the ability of financial *reporting* to accommodate – indeed necessitate – other forms of disclosure besides the financial accounts, was seen to be more promising terrain. Many participants highlighted that investors are keen to understand how a company has assessed risk and what it is doing to address it; it was seen as a fallacy that they are purely interested in numbers.

Requirements in the UK to issue a Strategic Report, Viability Statement and Corporate Governance Statement alongside financial accounts were also seen as demonstrations of how complementary disclosure could be accommodated under the broader umbrella of financial reporting. And expectations in the UK Corporate Governance Code and the Stewardship Code that both companies and investors have regard to the interests of broader stakeholders and society point in the same direction.

5. Key agents of change

This observation led to a call for the IFRS Foundation and IAASB to play a role in setting generally-accepted standards for reporting on aspects of performance beyond the purely financial. While there have been efforts to develop agreement on non-financial metrics for disclosure through bottom-up initiatives involving business and investors, it was agreed that this is highly challenging and needs to be complemented by top-down efforts, for which these standard-setters are uniquely positioned.

There was a particular call also for asset owners to bring their voice and weight to bear in favor of more diverse and comprehensive disclosures as part of financial reporting. Their focus on long-term value and their ability to drive the decisions of asset managers were seen as placing them ideally to lead the charge for change.

6. A starting point for human rights

It was felt that one reason human rights were largely ignored or treated simplistically in current accounting innovations was that it is genuinely hard to get one's head around the full diversity of issues involved. One suggestion was to take one or two discrete issues and really model them carefully in accounting terms. This should include identifying appropriate units of value and their measurability; looking at value to people and society as well as the business; and including positive outcomes from companies' efforts, not just the negative impacts they are tackling. This approach could help to show the art of the possible. And selecting issues that are themselves enablers of other human rights – such as living wages or land-related rights – could give them far greater reach and relevance in terms of both accounting and accountability.

Next steps

The Shift team will reflect further on these discussions and consider what role we could play, alongside others, in advancing some of the ideas that were raised, in order to support a 'leap change' towards accounting practices that appropriately reflect respect for human rights.

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Roundtable Participants

Mike Ashley	Chair of Audit Committee, Barclays Bank plc Member, International Ethics Standards Board for Accountants
Richard Barker	Professor of Accounting, Said Business School, University of Oxford
Jane Berney	Business Law Manager, ICAEW
Paul Druckman	Chair of Corporate Reporting Council, FRC Board Member, Shift
John Ferguson	Professor of Accounting and Head of School, School of Management, University of St Andrews
Mark Gough	Executive Director, Natural Capital Coalition
Loree Gourley	Director of Regulatory & Public Policy, EY
Marek Grabowski	Steering Committee Member, IAASB Director of Audit Policy, FRC
Christian Heller	Senior Manager, Corporate Sustainability Strategy, BASF
Mark Hodge	Senior Associate, Shift
Rodney Irwin	Managing Director, World Business Council for Sustainable Development
Bill Kennedy	Portfolio Manager, Fidelity Investments Adjunct Professor, University of Notre Dame
Richard Howitt	CEO, International Integrated Reporting Council
Susannah McLaren	Advisor, Shift
Luke McLaughlin	Manager of Sustainability and Accounting, Accounting for Sustainability
Atul Patel	Director, PWC
Ken McPhail	Director of Research and Deputy Head, Alliance Manchester Business School
Wilhelm Mohn	Head of Sustainability Initiatives, Ownership Strategies, Norges Bank Investment Management
Andrew Ratcliffe	Chair of Sustainability Committee, ICAEW Board member and Audit Committee Chair, Barclays Bank UK plc
Caroline Rees	President, Shift
Ralph Thurm	Managing Director, Reporting 3.0

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