Accounting for Progress Towards Living Wages

Summary of Roundtable with Accounting Experts, June 2021

Introduction

In February 2021, Shift and the Capitals Coalition launched the joint project Accounting for Progress Towards Living Wages. The aim of the initiative is to develop an accounting model for companies to measure and report publicly on progress towards living wages for workers in their workforce and the first tier of their supply chain. The ultimate goal is to leverage the power of accounting and reporting to build incentive mechanisms that inspire companies to tackle wage inequality connected with their business. A living wage is the minimum income necessary for a worker to meet the basic needs of himself/herself and his/her family, including some discretionary income. This should be earned during legal working hour limits (i.e. without overtime).

In June 2021, Shift and the Capitals Coalition held two consultations with companies and with experts from living wage initiatives respectively, to discuss early stage propositions regarding key inputs to the proposed accounting model. These consultations focused on the categorization of 'workers', principles for measuring actual wages and principles for selecting and applying a living wage benchmark. A summary of the key ideas discussed and takeaways for the project team can be found on the project resources website.

The project team held a third consultation with accounting experts and economists for which the primary focus was the potential accounting model to which data on actual wages and living wage benchmarks would be key inputs. These discussions explored an early-stage proposition for the accounting model and a range of premises that underpinned it. Participants are listed in Annex A, and discussions were held under the Chatham House Rule. The following summary reflects key issues raised by participants and initial reflections from the project team on how they suggest the accounting model can best be improved to achieve its aims.

Key points of discussion

1. PURPOSE, THEORY OF CHANGE AND AUDIENCE

Discussions highlighted the need for more clarity in the articulation of this project's purpose, audience and theory of change, due to some points of confusion. The project team clarified that while the accounting model should be of value to companies' internal decision-making, the primary purpose was to develop a sufficiently standardized and simple model that could allow for all companies to report publicly on their progress toward living wages. As such, the audience included public and private standard-setters and the investors who should have this information available to inform their decisions. The goal is to move action by companies on living wages beyond a handful of volunteer leaders by creating the incentives, through public reporting, for progress at scale. It should enable companies that are making real progress to gain recognition and reward in the market place.

2. PRINCIPLES VS RULES

There was general agreement that it was appropriate to take a principles-based approach to the inputs into the model, such that these would set parameters for how companies measure actual wages or select a sufficiently robust living wage benchmark, without applying a straitjacket. It was noted that there was an inevitable trade-off between on the one hand providing adequate latitude for legitimate variations in companies' approaches, and on the other hand ensuring comparability of the information reported. The viewpoint of investors will be significant in working out where to strike the balance.

3. BASELINE HUMAN CAPITAL VALUE

There were discussions about the use of the term 'baseline human capital value'. Three areas emerged from conversation where greater clarity would be needed in how the model uses these terms:

a. **'Baseline'**: it was noted that this has a particular meaning in economics, referring to the status quo at the beginning of an intervention against which change is then measured. The project team explained the intention here to capture a minimum threshold in relation to wages, below which harm results and value is eroded to the workers themselves, wider society and the company. All companies should therefore aim to meet and move above this 'Baseline'.

b. **'Human capital'**: a number of participants expressed concern that the model may imply that human capital is limited to wages or may ignore that further value is created by moving workers substantially *above* the living wage threshold. The project team acknowledged the need to avoid this misapprehension, notwithstanding the project's specific aim of focusing in on the issues that arise where wages fall below that level. The team will look further at how to make it clear that the model refers only to one part of what constitutes human capital value.

This also drew out distinctions from human capital impact valuation methods, which help a company value its impacts on human capital more broadly (and potentially other capitals too). While impact valuation should integrate data related to wages below a living wage, it can also conceal them by netting them off against the wider wage pool and factors such as investment in training or health and safety. In taking a much narrower scope, the proposed model would put the spotlight on the living wage as the critical threshold, where the harm resulting from falling below cannot be off-set by positive impacts elsewhere. At the same time, the model was not just about highlighting a 'negative', but should enable companies to show how they are making positive progress and therefore contributing to solutions.

c. **'Value'**: There was discussion of how the concept of value was being used. Participants pointed to the opportunity to articulate the model more in terms of the value to society that is represented through the payment of a living wage. The project team agreed that the living wage was being used as a proxy to represent that broader value: embedded into good living wage methodologies is an estimation of what it takes for a worker to be able to meet their and their family's basic needs. Achieving that threshold reduces the physical and mental health risks that go together with living in an economically precarious situation, reduces the risk that the worker's children will need to leave education early to enter the workforce, and so forth.

This proxy nature of the model's use of the living wage was also an important consideration when addressing questions about whether a different living wage level in different countries would imply placing a different value on individuals in those jurisdictions. The model should be clear that the living wage is understood *not* as conveying either the value of a person or the value provided to the business by a person, but as a *proxy* for the *value to society* of enabling a workforce to meet basic economic needs and realize wider human rights. Differing dollar amounts in different locations represent that same threshold value.

4. ACCOUNTING CONCEPTS

At various points the conversation raised questions about the appropriate application of accounting concepts. The project team set out that it had tested possible approaches to working within the bounds of existing financial accounting standards, for example through more flexible interpretations of IAS 38 (Intangible Assets), but had found that this created challenges of both concept and consequence. While the hope was that future accounting standards would evolve, the model aimed at a parallel form of accounts that could more truly and helpfully represent the significance of living wages in relation to human capital.

There was some discussion about whether the model was looking at stocks or flows of human capital and whether it should try to be clearer on this point. On a separate point, while some liked the proposition of seeing the weighted aggregated shortfall below living wages as representing a liability in accounting terms, others noted the weakness if this was not then matched by a debit to, for example, a reserve. And some suggested that this was too far removed from how such things are currently treated in accounting to make sense of using these concepts at all.

Discussions also touched on the proposition of discounting the value that can be recognized below a living wage. While the idea that value is eroded at an accelerating rate the further below the living wage one goes, it was noted that the lack of an empirical basis to justify a particular level of discounting would be open to challenge. It was queried whether some research may exist to provide a basis for such an approach. The project team will explore this possibility.

5. MATERIALITY

It was noted that the model extends to workers in the workforce who are both directly employed and employed by third parties, as well as to workers in the first tier of a company's supply chain. Yet one participant highlighted that the workers most at risk of poverty wages often sit at more remote tiers in a company's supply chain. In line with the concept of 'impact materiality', the focus should then be on them and not stop at the first tier. At the same time, discussions acknowledged the much greater challenge of securing data on actual wages at those more remote tiers. Some suggested using more general data to extrapolate what wages might be. The project team expressed caution about going that route in the context of a standard aimed at reporting, as distinct from internal company assessments.

6. SUPPORTING / CONTEXTUAL INDICATORS

Various participants pointed to other, related data that is relevant to living wages and could be of value as part of reporting on living wages – whether reflecting wage ratios (e.g. CEO:median pay; gender pay gaps) or pension contributions, or conveying the company's expected future performance in closing the gap to living wages. The project team welcomed ideas in this regard, noting that the final proposition would include a select number of supporting indicators to provide context about the company's approach towards wages and equality.

7. COMPLEXITY V FEASIBILITY

At various points, it was observed that a balance would need to be struck in any model between complexity and feasibility if it were to work as a basis for public reporting. More granular and nuanced calculations could provide greater clarity and specificity yet would create a barrier to both the ease of uptake by companies and the ease of understanding by readers, and therefore to the viability of its inclusion in reporting standards. Striking the right balance between the two would be key. The project team noted that additional consultations will be critical to testing whether future iterations of the model were achieving this.

Next Steps

Shift and the Capitals Coalition are grateful to all participants in these consultations for their time and feedback on the early-stage ideas that were shared. Over the summer, the project team will be:

a. looking at how best to integrate the feedback received into the further development of the proposed accounting model, and pursuing any additional research and conversations needed to enable that;
b. researching and developing some initial propositions for the model's supporting and contextual indicators;
c. bringing together in a single document (i) an updated version of the various inputs to the accounting model, with (ii) an updated version of the accounting model itself, as informed by the feedback received through all three consultations held in June;
d. conducting additional research into the business case for companies to advance towards living wages for their workforce and supply chains.

The project team envisages holding a second round of consultations in October with an expanded set of stakeholders. The document referred to in (c) above will provide the preparatory reading and substantive focus for those discussions. The project team hopes that this second round of feedback will provide the team with the further insights needed to finalize a beta version of the accounting model that can then be piloted by companies in early 2022.

As we continue our work in the months ahead, we warmly invite any and all further feedback on the issues addressed in this consultation summary. Please reach out to us at jana.mudronova[at]shiftproject.org.

Annex A- List of participants

Katie Panella	Impact-Weighted Accounts, Harvard Business School
Ian Dickie	Eftec
Kenneth McPhail	Manchester Business School
Gavin Marshall	Novartis
Jeremy Nicholls	Social Value International
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PROJECT TEAM

Richard Spencer	ICAEW, a member of the core project team
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