

Recommendations for Non-Financial GAAP

As of November 20, 2021, the model put forward in this presentation (GAAP-NF) has been superseded by the **Generally Accepted Integrated Accounting (GAIA) Principles**, a presentation on which can be found here: <https://bit.ly/3nJdgv3>

Sustainability Accounting and the Advent of *Generally Accepted Non-Financial Accounting Principles (GAAP-NF)*

A Working Proposal by the
Center for Sustainable Organizations

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Executive Summary

- In order to be credible, measurement and reporting systems of any kind must be grounded in generally accepted accounting principles appropriate to their scope
- None of the leading sustainability reporting standards or frameworks, however, are able to meet this requirement because no such generally accepted *non-financial* accounting principles exist!
 - Leading standards for sustainability reporting are therefore premature, not to mention inconsistent with one another
- We therefore need the equivalent of GAAP for non-financial accounting principles (GAAP-NF)
 - One such model for GAAP-NF is provided herein

Sustainability Performance

- How credible are leading reporting standards for sustainability or non-financial performance?
 - Global Reporting Initiative (GRI)
 - International Integrated Reporting Council (IIRC)
 - Sustainability Accounting Standards Board (SASB)
- One test of a standard's credibility is its consistency with underlying generally accepted accounting principles (e.g., financial reporting and 'GAAP')
 - Question: What, then, were the pre-existing generally accepted *non-financial* accounting principles upon which today's leading sustainability reporting standards were based at the time of their development?
 - Answer: There weren't any, nor are there any today! At best, they are therefore all ad hoc; at worst, they do not address sustainability performance at all.

Sustainability Performance (cont.)

- Indeed, neither GRI, IIRC nor SASB actually assess, much less disclose, sustainability performance
 - How could they? There are no generally accepted accounting principles for non-financial performance for them to refer to
 - Thus, even the three leading standards themselves have taken inconsistent approaches to the subject, thereby begging the question of what the underlying principles are or should be
- And if their intellectual grounding in sustainability accounting is so dubious, how can they possibly be trusted as indicators of organizational performance?
 - Answer: *They can't!* Even ostensibly positive performance per the leading standards can be accompanied by (unsustainable) behaviors that put vital resources & human well-being at risk.

We Need Non-Financial GAAP!

- Thus, to obtain meaningful measures of sustainability performance, we need the functional equivalent of GAAP for financial accounting, albeit for *non-financial* accounting instead – *we need GAAP-NF!*
 - GAAP-NF would provide a rigorous basis for sustainability measurement and reporting (to which GRI, IIRC, SASB and others would have to conform)
 - Thereby making meaningful non-financial, sustainability accounting (and reporting) possible

**Proposed Framework
for Generally Accepted Non-Financial
Accounting Principles (GAAP-NF)**

Recommendations on GAAP for Non-Financial Accounting (GAAP-NF)

	Generally Accepted Accounting Principles – <i>Financial (GAAP-F)</i>	Generally Accepted Accounting Principles – <i>Non-Financial (GAAP-NF)</i>
Regulative Ideals (Intrinsically Valued Goal States)	Shareholder Well-Being	Stakeholder Well-Being
Core Theories of Change/Performance	<i>Value Creation</i> ¹	<i>Sustainability</i> ²
I N D I C A T O R S	Resources (capital stocks and flows)	Multi-Capital Sufficiency (capital accounting applies here; and possibly non-financial analogues to balance sheets)
	Transactions (impacts on stocks and flows)	<i>Sustainability Performance = Actual Impacts / Normative Impacts (S=A/N)</i> ; impacts measured in units of carrying capacities of capitals; context-based metrics and TBL scorecards apply here ³
	<i>Equity = Assets - Liabilities</i> (balance sheets apply here)	
	<i>Profitability Performance = Revenue - Costs</i> (impacts measured in units of money; double-entry bookkeeping and income statements apply here)	

Some Historical Postulates in GAAP-F⁴ and Whether They are Extensible to GAAP-NF (Yes/No)

1. Accounting entity	Yes
2. Algebraic opposition (dual aspect concept)	No, there is no zero sum enforced here
3. Single monetary unit	No; uses non-monetary units of measurement instead (i.e., of the <i>carrying capacities</i> of capitals as indicated below)
4. Proprietors' equity	No, stakeholder entitlements more broadly construed are prioritized instead (see below)
5. Profit or loss	No
6. Accounting period	Yes
7. Materiality	Yes, but broader in scope (see below)

Additional Foundational Postulates Applicable to GAAP-NF (for a total of twelve)

1. Stakeholders	Individuals or groups to whom duties & obligations are owed to manage one's impacts on vital capitals in ways that can affect their well-being. ³
2. Duties and Obligations	Responsibilities to have, not have, or otherwise manage one's impacts on vital capitals in ways that can affect stakeholder well-being. ³
3. Vital Capitals	Stocks and flows of resources that people rely on for their well-being (i.e., human, social, constructed, economic, intellectual, and natural capitals that yield valuable goods and services). ^{3,5}
4. Carrying Capacity	The extent of demand for its goods or services that a capital can fulfill without exceeding the limitations of its stocks and/or flows.
5. Thresholds	Upper and lower limits in the carrying capacities of capitals that must be maintained in order to ensure human well-being. ^{3,6}
6. Allocations	Entity-specific fair, just, and proportionate shares of duties or obligations to maintain thresholds in vital capitals at levels required to ensure stakeholder well-being. ^{3,6}
7. Materiality	The degree to which actual or possible impacts on vital capitals correspond to any duties or obligations owed to stakeholders. ^{3,7}
8. Sustainability	The degree to which human impacts on vital capitals have the effect of maintaining them at levels required to ensure stakeholder well-being (i.e., in accordance with normative thresholds and allocations of responsibilities to preserve and/or produce them, as the case may be). ³
9. Substitutability	The extent to which the diminishment or loss of one type of capital can or cannot be compensated for by the excess availability or production of another (i.e., the view that capitals of different kinds are generally not interchangeable and must therefore be separately maintained at required levels). ⁸
10. Commensurability	The degree to which measures of impacts on disparate capitals are expressed in terms of sustainability performance on a corresponding meta-scale on which the otherwise parochial and incongruent measures of such disparate impacts are translated and reported in common terms (i.e., in sustainability performance terms).

¹ For the sake of maximizing shareholder value with due consideration, therefore, of impact valuation and risk management.

² Reflects the idea that the real construct of interest in sustainability or non-financial accounting is *responsibility performance*, for which *sustainability performance* serves as a proxy indicator – i.e., does the organization's behavior have the effect of working for or against stakeholder well-being?

³ McElroy, M. (2008) *Social Footprints – Measuring the Social Sustainability Performance of Organizations*, University of Groningen, dissertation; see also McElroy, M. and Van Engelen, J. (2012) *Corporate Sustainability Management – The Art and Science of Managing Non-Financial Performance*, Earthscan; and Thomas, M. and McElroy, M. (2016) *The MultiCapital Scorecard – Rethinking Organizational Performance*, Chelsea Green Publishing.

⁴ The specific GAAP-F postulates shown here are admittedly incomplete and are limited to only those which are historically foundational and which therefore call for immediate attention as to whether or not they are applicable or extensible to GAAP-NF in some way; based in large part on Lee, G. (1977) "Coming of age of double entry: The Giovanni Farolfi ledger of 1299-1300", *Accounting Historians Journal*: Volume 4: Issue 2, Article 6, and Lee, G. (1986) *Modern Financial Accounting*, 4th Edition, Van Nostrand, Berkshire.

⁵ See also Gleeson-White, J. (2014) *Six Capitals, or Can Accountants Save the Planet?* W.W. Norton, New York; and "Some Important Works in the Literature on the Capital Theory Basis of Sustainability": <https://www.sustainableorganizations.org/Capital-Theory-References.pdf>

⁶ See also McElroy, M. (2013) "The Carrying Capacities of Capitals" GreenBiz Group: <https://www.greenbiz.com/article/carrying-capacities-capitals>, and "An Intellectual History of Thresholds and Allocations" (2018), Center for Sustainable Organizations: <https://www.sustainableorganizations.org/TA-Timeline.pdf>

⁷ McElroy, M. (2019) "Making Materiality Determinations – A Context-Based Approach", UNRISD: <https://www.unrisd.org/mcelroy>

⁸ See, for example, Dresner's treatment of 'strong' versus 'weak' sustainability (Dresner (2002) *The Principles of Sustainability*, Earthscan, London).

12 Recommended *Generally Accepted (Non-Financial) Accounting Principles (GAAP-NF)*

Generally Accepted (Non-Financial) Accounting Principles (GAAP-NF) ¹	
1. Accounting Entity	The concept of a business or accounting entity whose books record its performance, as distinct from its owners or shareholders.
2. Accounting Period	A defined period of time for which performance is measured.
3. Stakeholders	Individuals or groups to whom duties & obligations are owed to manage one's impacts on vital capitals in ways that can affect their well-being.
4. Duties & Obligations	Responsibilities to have, not have, or otherwise manage one's impacts on vital capitals in ways that can affect stakeholder well-being.
5. Vital Capitals	Stocks and flows of resources that people rely on for their well-being (i.e., human, social, constructed, economic, intellectual, and natural capitals that yield valuable goods and services).
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¹As proposed by Mark W. McElroy, PhD, and in accordance with *Context-Based Sustainability* theory and practice: https://en.wikipedia.org/wiki/Context-Based_Sustainability

How the “Value Creation” Doctrine (GAAP-F) Stacks Up Against the Eleven Proposed Principles for GAAP-NF

Extent to Which GAAP-F Conforms to GAAP-NF ¹	
1. Accounting Entity	Yes – fully conforms
2. Accounting Period	Yes – fully conforms
3. Stakeholders	No – is concerned only with the well-being of shareholders, very often by law
4. Duties & Obligations	Yes – but only with respect to shareholders
5. Vital Capitals	Yes – but only with respect to shareholder value (economic capital)
6. Carrying Capacity	No – not per se, but does seek to maximize value of economic capital
7. Thresholds	Yes – but only with respect to growth targets for economic capital
8. Allocations	Yes – organizations are solely responsible for growing economic capital
9. Materiality	Yes – but only with respect to investor-related needs
10. Sustainability	No – externalizing costs in ways that degrade capitals is the norm
11. Substitutability	No – GAAP is concerned with only one type of capital, economic
12. Commensurability	No – GAAP is concerned with only one type of capital and denomination

¹As proposed by Mark W. McElroy, PhD, and in accordance with *Context-Based Sustainability* theory and practice: https://en.wikipedia.org/wiki/Context-Based_Sustainability

Summary

- **Mainstream non-financial accounting standards lack generally accepted principles of any kind**
 - And are further fragmented into two broad ‘camps’:
1) value creation, and 2) sustainability
- **Conventional sustainability reporting, in particular, disregards longstanding principles in the field (e.g., capital thresholds and allocations)**
 - Resulting in a form of reporting that claims to describe sustainability performance, but does no such thing
- **The need for GAAP-NF is therefore urgent!**

Thank you!

Comments and suggestions most welcome

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