CATÓLICA LISBON SCHOOL OF BUSINESS & ECONOMICS

Center for Responsible Business

COMPLEMENTARY, NOT INTERCHANGEABLE:

Impact Accounting and Financial Reporting

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1. Executive Summary

This research note examines whether Impact Accounting (IA) can be incorporated into companies' financial statements. Based on conceptual analysis and existing academic and practitioner literature, the study finds that although IA has gained increasing relevance as a tool to translate environmental, social, and economic impacts into monetary terms, its integration into financial reporting remains conceptually and practically unfeasible. IA is increasingly used to support internal decision-making, sustainability strategy, and stakeholder communication by making corporate impacts more visible and comparable. It is also positioned as a complementary approach to existing ESG reporting frameworks, including the European Sustainability Reporting Standards (ESRS).

The study identifies three key barriers to the integration of IA into financial statements. First, impact measurement and valuation rely heavily on assumptions, proxies, and context-specific judgments, limiting reliability and auditability. Second, the lack of standardized methodologies significantly reduces comparability across firms and reporting periods. Third, IA is fundamentally misaligned with financial accounting principles, particularly regarding recognition criteria, verifiability, and entity-specific reporting boundaries.

To address these limitations, IA is currently evolving as a complementary reporting and decision-support tool rather than a financial reporting mechanism. Companies and standard-setting initiatives are working to improve methodological consistency and strengthen data infrastructure, while practical applications such as impact valuation pilots and internal management use cases are increasing familiarity with the approach. Despite this progress, adoption remains driven primarily by voluntary initiatives rather than regulatory requirements.

The study argues that IA should not be understood as an extension of financial accounting, but rather as a complementary framework that enhances sustainability management and corporate transparency without being suitable for inclusion in formal financial statements.

2. Introduction

As companies navigate an increasingly complex sustainability landscape, they are under growing pressure to integrate social and environmental considerations into core business decisions (Value Balancing Alliance, 2025). Investors, customers, and other stakeholders consider companies' sustainability efforts when making decisions (Buchholz et al., 2020). Furthermore, frameworks such as the EU's Corporate Sustainability Reporting Directive (CSRD) require organizations to disclose both how sustainability issues affect them and how their activities impact society and the environment. This dual perspective is reflected in the concept of double materiality, which distinguishes between the financial implications of sustainability matters for the company and the impacts that corporate activities generate on society and the environment. While sustainability-related risks and opportunities are increasingly assessed through their potential financial consequences, impacts are typically reported using a wide range of non-financial indicators expressed in different units. This creates challenges in terms of comparability and prioritization, increasing interest in approaches capable of translating diverse impacts into common language.

In this context, valuation has become one of the most prominent approaches to support the translation of corporate impacts into monetary terms, enabling the assessment and quantification of both positive and negative impacts on the environment, society, and the economy. Impact accounting (IA) is one such approach, aiming to bridge the gap between sustainability performance and financial decision-making. Early discussions surrounding IA and impact valuation frameworks were frequently associated with the ambition of integrating social and environmental externalities more directly into corporate reporting and, potentially, accounting systems traditionally centered on financial performance (Serafeim & Zochowski, 2020). By translating impacts into monetary terms, these approaches intend to reduce the separation between financial and sustainability reporting and provide a more holistic representation of corporate performance and value creation (IFVI & VBA, 2024). However, despite its conceptual appeal, significant challenges remain regarding the integration of impact valuation into traditional financial statements.

This research note argues that, at this stage and in the foreseeable future, IA cannot be incorporated into companies' financial statements due to fundamental measurement and valuation challenges, the lack of standardization and comparability, and its structural incompatibility with financial reporting systems. This note does not aim to assess the overall usefulness of IA. Rather, it seeks to examine IA's limitations through the lens of financial reporting, arguing that it should be understood as a complement rather than an integral component of such reporting.

3. Impact Accounting and Financial Reporting: Conceptual Foundations

IA has emerged as a structured approach to identify, measure, and value the social, environmental, and economic impacts of corporate activities in monetary terms, in response to

growing concerns around the lack of comparability and consistency in sustainability data (Conde et al., 2025). By translating externalities into financial metrics, it seeks to make corporate impacts more visible and decision-relevant, thus supporting more informed decision-making within organizations. More broadly, the methodology emerged partly from the ambition to connect sustainability-related externalities with mainstream corporate reporting systems and to provide a more comprehensive representation of corporate value creating beyond traditional financial performance indicators.

Particularly in the context of the double materiality adoption under the CSRD, IA complements the reporting landscape by providing a common unit of measurement that facilitates comparison across impact categories and supports materiality assessments and decision-making processes.

Beyond measurement, IA is increasingly positioned as a tool for integrating sustainability considerations into core business processes, translating reported data into actionable insights (Value Balancing Alliance, 2025). In this context, impact valuation plays a key role in converting sustainability-related data into monetary representations that can inform materiality assessments and support the identification of relevant impacts across the value chain. Its applications span multiple dimensions of corporate decision-making, highlighting its potential to drive value creation across the organization while extending beyond purely reporting-oriented purposes (Conde et al., 2025).

From a methodological perspective, IA relies on a structured process to identify, measure, and value impacts. The process typically follows an "impact pathway", which links business activities to their broader outcomes and resulting impacts. The process can be understood in three broad steps. The preparation step focuses on understanding the company's sustainability context and identifying material impacts across its operations and value chain. Next, the measurement and valuation step involves identifying impact drivers, assessing how business activities affect stakeholder well-being and environmental conditions, and translating these effects into monetary terms through predefined value factors and valuation techniques. Finally, the aggregation step consists of consolidating monetized impacts into a unified impact framework intended to support decision making and reporting (Conde et al., 2025). Frequently, the methodology incorporates stakeholder perspectives and context-specific assumptions, reflecting both the complexity of measuring impacts and the need to balance standardization with relevance.

Financial reporting is designed to provide information about an entity's financial position, financial performance, and cash flows that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity (IFRS Foundation, 2018). Financial statements act as the primary output of financial reporting, aiming to reflect the economic reality of a company's activities through a structured and standardized set of disclosures.

To fulfill this objective, financial information must meet a set of qualitative characteristics as defined in the IFRS Conceptual Framework. Fundamental characteristics include relevance and faithful representation, requiring that information is capable of influencing decision-making and accurately reflects the underlying economic scenario. Other characteristics such as comparability, verifiability, timeliness, and understandability further ensure that information can be consistently interpreted and relied upon across entities and reporting periods (IFRS Foundation, 2018).

A key feature of financial reporting is its focus on information that can be measured with a sufficient degree of reliability and is subject to consistent recognition and measurement principles. This implies the use of observable market data, well-established valuation techniques, and standardized assumptions that allow for auditability and comparability across firms. Consequently, financial statements are primarily concerned with reflecting transactions and events that have a direct impact on the financial position and performance of the reporting entity (Wüstemann & Wüstemann, 2010).

Within this framework, financial reporting is inherently oriented towards the representation of financial effects that are attributable to the entity and can be measured in a consistent and verifiable manner. This focus shapes both the scope of what is included in financial statements and the methodological requirements that underpin their preparation.

While IA and financial reporting both seek to support decision-making, they differ significantly in purpose, scope, and methodological approaches. These differences create notable challenges when considering the integration of IA into financial statements.

4. Why IA cannot be incorporated into financial statements

While there is growing interest in IA and its potential to enhance sustainability-related decision-making, significant limitations remain regarding its incorporation into financial statements. These limitations are not solely technical or methodological in nature but also reflect deeper conceptual differences between IA and traditional financial reporting frameworks. The following sections discuss three key challenges associated with such integration: measurement and valuation difficulties, the lack of standardization and comparability, and the structural incompatibility with financial reporting systems.

4.1 Measurement and valuation challenges

One of the main barriers to incorporating IA into financial statements is the inherent difficulty of measuring and valuing social and environmental impacts in a consistent, reliable, and verifiable manner. Unlike traditional financial accounting, which is a legally mandated framework grounded in observable transactions and established accounting standards,

IA frequently relies on estimates, proxies and modelling assumptions to assign value to externalities that do not have clear market prices.

The sustainability accounting literature has long emphasized the subjectivity involved in measuring non-financial impacts, as sustainability information often combines qualitative and quantitative dimensions (Bebbington, Unerman, & O'Dwyer, 2014). Environmental and social impacts are context-dependent and influenced by methodological choices, stakeholder perspectives, and organizational interpretation. While proxies and estimation techniques may be useful for internal decision-making, they introduce significant challenges in terms of auditability and faithful representation when applied to financial reporting contexts (Eccles & Krzus, 2018).

These limitations become particularly evident in attempts to monetize externalities such as carbon emissions, biodiversity loss, or social outcomes. As argued by the Value Balancing Alliance and Deloitte (2025), different valuation approaches serve distinct decision-making purposes, and many impact valuation methods function more as directional indicators than as precise representations of economic value. This raises concerns regarding the degree of objectivity required under the IFRS Conceptual Framework, particularly in relation to verifiability and faithful representation (IFRS Foundation, 2018).

4.2 Lack of standardization and comparability

The absence of universally accepted standards remains another major obstacle to the integration of Impact Accounting into financial statements. Financial accounting frameworks such as IFRS are designed to ensure comparability across firms and reporting periods through standardized recognition and measurement principles. By contrast, sustainability and impact measurement practices can be characterized by methodological fragmentation.

Corporate sustainability performance systems substantially differ in scope, indicators, methodologies, and reporting objectives, making meaningful comparison across organizations difficult. Research by Berg, Kolbel, and Rigobon (2022) demonstrates that ESG data providers frequently disagree in the construction and interpretation of sustainability metrics due to differences in methodological assumptions and institutional perspectives.

Although initiatives such as the Global Reporting Initiative, Sustainability Accounting Standards Board, and the Task Force on Climate-related Financial Disclosures have improved harmonization efforts, sustainability reporting still lacks the degree of methodological consistency typically required for financial statement integration.

4.3 Incompatibility with financial accounting principles

Beyond measurement and standardization issues, IA faces deeper structural incompatibilities with the conceptual foundations of financial reporting. Financial statements are designed under a specific set of principles that emphasize recognition criteria, entity boundaries, verifiability, and faithful representation.

A key tension arises from the fact that IA seeks to capture broader societal and environmental impacts that extend beyond the legal and economic boundaries of the reporting entity. This contrasts with the entity-specific orientation of financial accounting, which focuses on transactions and obligations that can be reliably attributed to a reporting entity (Scott, 2009).

This divergence is also reflected in debates on integrated reporting. Scholars argue that Integrated Reporting has increasingly shifted towards an investor-centric perspective, prioritizing "value for investors" rather than "value for society" (Flower, 2015). As a result, attempts to incorporate broader sustainability impacts into formal reporting structures remain constrained by the underlying purpose of financial statements.

In addition, financial reporting is governed by strict recognition and measurement criteria that require sufficient reliability and verifiability. Even environmentally related liabilities that are directly linked to firms already present significant challenges due to uncertainty in estimation and timing (Barth & McNichols, 1994). Expanding reporting to include wider social impacts would intensify these tensions, potentially undermining the conceptual coherence of financial reporting frameworks.

Based on the arguments presented above, although IA provides valuable insights for strategic management and sustainability governance, its long-term and societally oriented perspective remains difficult to reconcile with the shorter-term and entity-focused logic underpinning financial reporting frameworks.

5. Implications for Corporate Reporting

The limitations associated with integrating IA into financial statements do not diminish its relevance for corporate reporting and organizational decision-making. Rather, such limitations suggest that IA should be understood as a complementary framework designed to support sustainability management, strategic planning, and broader corporate disclosures, rather than as a direct extension of traditional financial accounting systems.

Traditional accounting practices have long been criticized for their inability to capture the full range of interactions between organizations, society, and the environment. Conventional accounting systems, historically focused on recording financial transactions and determining shareholder value, systematically fail to account for many environmental and social externalities generated by corporate activities. As a result, significant impacts frequently remain outside formal accounting boundaries, contributing to incomplete representations of organizational performance and long-term value creation (Avadhani, 2025).

This limitation becomes increasingly relevant in the context of sustainability-related risks and broader stakeholder expectations. Porter and Kramer (2011) argue that long-term competitive advantage is increasingly associated with the ability of companies to create shared

value by addressing societal and environmental challenges alongside economic performance. At the same time, investors are progressively demanding greater integration of sustainability considerations into corporate strategy and decision-making processes (Eccles & Klimenko, 2019).

In this context, IA may play an important role by extending organizational visibility beyond pure financial performance indicators. By translating sustainability-related data into monetary representations, IA can support companies in identifying material impacts, evaluating trade-offs, and integrating sustainability considerations into strategic and operational decision-making processes (Conde et al., 2025). Beyond measurement itself, impact valuation can contribute to internal management practices, including capital allocation, risk assessment, target-setting, and transition planning.

Its relevance may therefore be particularly significant for internal management purposes. Bhmani and Langfield-Smith (2007) argue that accounting systems influence organizational behavior by shaping managerial routines, priorities, and decision-making structures. In this sense, IA may help organizations better understand dependencies, externalities, and long-term sustainability risks that are not adequately reflected in traditional accounting systems.

At the same time, IA may also contribute to external sustainability reporting frameworks, particularly within the context of double materiality assessments and sustainability disclosures under frameworks such as the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS). Impact valuation can support the identification and prioritization of material sustainability matters by facilitating matters by translating environmental and social impacts into monetary terms, thereby facilitating stakeholder understanding and improving comparability of sustainability-related information (Value Balancing Alliance, 2025).

However, the usefulness of IA for sustainability reporting should not be interpreted as evidence that such information can be directly incorporated into financial statements. As discussed throughout this research note, the objectives, methodological foundations, and recognition criteria underpinning financial accounting remain fundamentally distinct from the broader stakeholder-oriented logic of IA. Financial reporting continues to prioritize faithful representation, verifiability, comparability, and entity-specific financial effects (IFRS Foundation, 2018), whereas IA frequently addresses broader societal impacts characterized by higher levels of uncertainty, contextual dependency and long-term orientation.

Despite the limitations associated with incorporation into financial statements, several companies and initiatives have already begun using IA to externally communicate the societal and environmental value generated through their activities. One example is Kering's Environmental Profit & Loss (EP&L), which monetizes environmental externalities across the company's value chain to support decision-making and stakeholder transparency. Similarly,

companies like Novartis, SAP, and Bosch have experimented with impact statements and monetized sustainability disclosures designed to complement traditional reporting frameworks. However, these initiatives continue to operate alongside - rather than within - formal financial statements, reinforcing the distinction between impact-oriented reporting and financial accounting.

Consequently, rather than replacing or merging with financial accounting, IA is more likely to evolve as a parallel and complementary reporting framework capable of enhancing corporate transparency, supporting sustainability governance, and informing long-term decision-making.

6. Conclusion

As sustainability considerations become increasingly central to corporate strategy and stakeholder expectations, organizations face growing pressure to better understand and communicate their broader social and environmental impacts. In this context, IA emerges as an important approach for translating sustainability-related impacts into monetary terms and supporting more informed decision-making processes.

However, despite its conceptual relevance and management-related usefulness, this research note argues that IA cannot be directly incorporated into companies' financial statements. The analysis highlighted three main limitations underpinning this argument: the complexity and subjectivity with impact measurement and valuation; the lack of standardization and comparability across methodologies; and the incompatibility between IA and the core principles of financial accounting.

These limitations do not imply that IA lacks value. On the contrary, IA may play an increasingly important role in supporting sustainability management, materiality assessments, strategic planning, and broader corporate reporting practices. Its ability to extend organizational visibility beyond pure financial performance may contribute to more informed discussions regarding long-term value creation, sustainability risks, and corporate impacts across the value chain.

Nevertheless, financial accounting and IA ultimately serve different objectives and operate according to different conceptual logics. While financial reporting remains centered on entity-specific economic effects that can be measured and verified with sufficient reliability (IFRS, 2018), IA seeks to capture broader societal and environmental externalities characterized by greater uncertainty, contextual dependency, and long-term orientation (Bebbington, Unerman, & O'Dwyer, 2014; Bhimani & Langfield-Smith, 2007).

Consequently, rather than converging into a single reporting system, financial accounting and IA are more likely to evolve as complementary, rather than interchangeable, frameworks within the broader corporate reporting landscape.

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