

Improving nature's visibility in financial accounting

A Primer for Business

April 2020



CAPITALS
COALITION



It is time to act

In January 2020 the World Economic Forum's Global Risk Report identified all the top global risks as environmental for the first time in its history. There is no longer any doubt that nature's degradation threatens our businesses. The case for change is here: the time for action is now.

Businesses have a key role in leading this movement. The Edelman Trust Barometer 2020 shows a moment of global lack of people's trust in institutions, from government, business, media and civil society. This Barometer also shows that people point to business for leading and addressing global challenges (such as nature loss, climate change and inequality) while serving people's interests.

For businesses to build public trust, they must demonstrate leadership for positive change – and be accountable for achieving it. Disclosure and accountancy, therefore, play a crucial role in building the social, environmental and economic resilience of businesses. And sustainability reporting no longer can be an add-on in corporate reporting, but needs to be integrated in regular accounting and reporting.

As society responds to environmental challenges, businesses, finance institutions and governments need better information to understand their dependencies and the consequences of their action or inaction. An integrated multi-capital approach enable businesses to include their relationship with nature, society and people, as well as the economy in their decision making.

When combined with accounting rules and principles, capital assessments use financial, socio-economic and environmental data to enable comparisons of impacts and dependencies across space and time. However, as natural, social and human capital accounting is usually separate from financial accounting, these insights are not fully taken into account in decision making.

Those interested in this discussion can be briefed by this primer, intended to open the appetite for further explanation in the full report on Improving nature's visibility in financial accounting. The report describes and illustrates methods to integrate natural and other capitals into financial accounting. The methods offer novel improvements to current accounting approaches, without promising yet the perfect solution. Accountancy as an institution has to evolve continuously as new questions are asked of it: the fact that a broader gamut of issues must be taken into account by businesses reveals that the existing accounting framework needs to adapt. This report offers potential first steps to change the trajectory of sustainability reporting's evolution to build an accounting system fit for purpose.

Becoming accountable is possible

Natural capital considerations are not currently integrated into financial accounts, resulting in financial accounting focusing on an incomplete picture of corporate performance.

Significant progress in natural capital accounting has taken place in parallel to financial capital accounting. Accounts for different capitals are not integrated and very limited natural capital impacts and dependencies, such as those relating to marketed products and operational costs, are captured under current financial accounting standards. Material natural capital-related financial returns (e.g. reduced costs and risks from clean water and fertile soil) are omitted from financial accounts.

The report, **Improving Nature's Visibility in Financial Accounting**, explores how to link financial and natural capital accounting better. It is focused on building the bridge between the two accounting streams, so that decisions are taken with consideration of multiple capitals (natural and/or social, human and financial/produced). The result is integrated accounts that businesses can use also to inform better internal decisions and strategies.

Taking four methods, the report showcases how each of them can contribute a different aspect within the integration picture (see Figure 1), expanding on or adding to the current development within this space.

Would you like to know which innovative method could be useful for you? Asking **How? What? Why?** and **So What?** can help you identify which method(s) will suit you best.

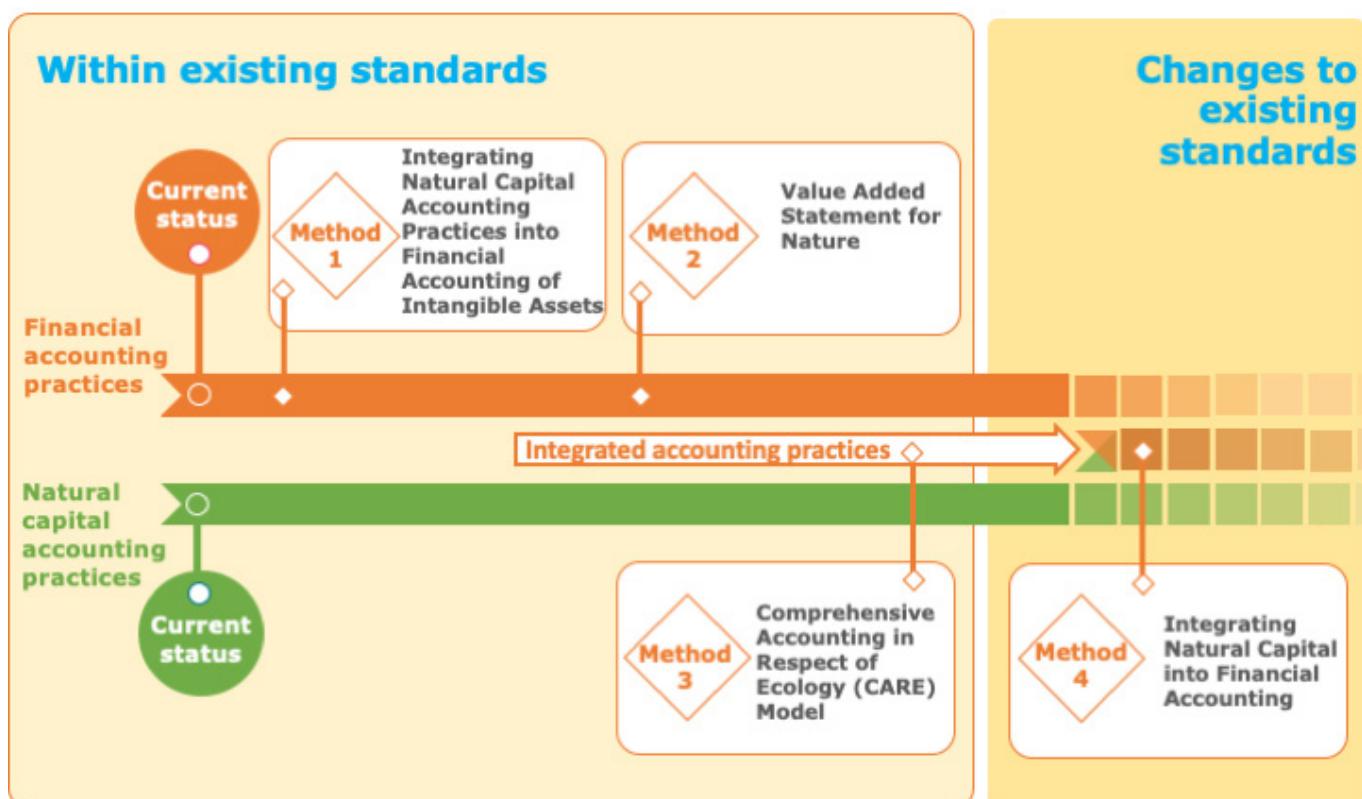


Figure 1. Innovative methods within the accounting landscape

Method 1

Integrating Natural Capital Accounting Practices Into Financial Accounting of Intangible Assets

- Why?** How can you capitalize your efforts in enhancing natural capital?
- What?** Are you developing training, new solutions and/or fostering your brand's value in relation to sustainable practices?
- How?** These efforts can be included as capitalised expense in your balance sheet.
- So what?** This will give greater visibility to foster engagement with your investors.
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Method 2

Value Added Statement for Nature

- Why?** How can you recognize the value created by and returned to nature?
- What?** Are you making provisions to guarantee the availability of natural capital in the long run?
- How?** You can shift towards a Value Added Income statement where a 'provision for nature' is added and highlight the need for reintegrating natural resources through the establishment of a Fund for Nature in the Balance Sheet.
- So what?** This will help to change firms' and people's behaviour by raising awareness about the impact and dependencies and the consequences of internalising them.
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Method 3

Comprehensive Accounting in Respect of Ecology (CARE) Model

- Why?** How can you recognize your 'debt' with nature for the values it provides to you?
- What?** Are you accounting for the preservation cost of capitals to assure a sustainable income from nature?
- How?** Adjusting both (i) your Balance Sheet to reflect the different capitals (liabilities) and their uses (assets) (financial, natural, mixed) and (ii) your Income Statement to reflect the consumption of these capitals and costs for their preservation.
- So what?** The results support dialogue with different internal and external stakeholders, such as investors, customers, public authorities, etc.
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Method 4

Integrating Natural Capital Into Financial Reporting

- Why?** How can you better understand the risk to your overall business results if environmental impacts were taken into account.
- What?** Are you already assessing and accounting your impacts through an Environmental Profit and Loss statement?
- How?** By expanding your income statement to showcase your impact on society, which enters into the balance sheet through retained earnings. The natural capital benefits and the costs of maintaining those (natural capital assets and liabilities respectively) are also reflected in the balance sheet.
- So what?** This methodology could help inform the debate, especially in the transition towards more integration of capital issues.

Moving ahead for a positive system transformation

The shared blueprint set out by the Sustainable Development Goals provides the case for a positive system transformation that will offer significant opportunities for first movers. As with any change, it requires the participation of all the different parts of the system. Public finance needs to lead the way while private actors need to provide the scale of investment. Improving integrated reporting is crucial to integrate the private sector and wider stakeholders in the successful achievement of the Goals.

The accounting methods presented in this report contribute to the need of making accountancy fit for purpose. All four methods would still benefit from further piloting/application to test their practicality with existing data, their scalability across spatial areas and applicability to different sectors. Any progress requires the involvement of all different stakeholders' groups, from accounting standard-setting bodies, accounting professionals, asset owners (investors), business, policy makers, academics and practitioners.

Some examples of engagement processes that we hope can utilise on this report include: (i) forthcoming initiatives, such as the **Value Balancing Alliance** or the EU funded project to develop **Environmental Generally Accepted Accounting Principles** (EGAAP), (ii) the potential development of a **Task Force on Nature Financial Disclosure** and (iii) the **Impact Management Project** that is trying to build global consensus on how to measure and manage impact, including a 'structured network' of standard-setting organisations.

The current global context has made it clear that business action to tackle global challenges can no longer be dismissed as impractical. This report demonstrates a number of practical options for financial accounting processes to pursue to make natural (and other forms of) capital visible. The conversation going forward should be on which of these four approaches (or others) is best suited to respond to specific accounting questions on natural capital.

We launch this report in the spirit of open enquiry, of identifying issues and raising questions rather than providing complete answers. We hope that it will be of broad appeal and will act as an invitation to engage. We invite you to join this effort, support the capitals movement, and contribute to the discussion around harmonizing capital approaches to improve all of our decision making by explicitly valuing the resources and relationships upon which we depend.

[**Read the full report here.**](#)