



TRANSPARENT CONSULTATION: A METHODOLOGY PROMOTING STANDARDIZED NATURAL CAPITAL ACCOUNTING FOR BUSINESS

Issued 14 December 2021

ICAEW welcomes the opportunity to comment on the Transparent consultation: A methodology promoting standardized natural capital accounting for business published by Capitals Coalition on 28 July 2021, a copy of which is available from this [link](#).

SUMMARY OF KEY POINTS

- Greater clarity is needed on why there is a need to standardise management accounting information, or whether this is actually intended to be used for external reporting. Decision-useful information needs flexibility if it is to provide context specific, decision-useful and actionable information for management accounting purposes.
- It would be useful to have greater context to understand the principles behind natural capital accounting, and how it fits with other frameworks such as CDSB's Framework; GRI; natural capital frameworks such as BS8632; as well as work in progress such as that of EFRAG and the upcoming ISSB.
- We recommend reconsidering who the intended audience is, and specifically who would be applying the more technical aspects of natural capital accounting.
- Materiality is a concept that is based on professional judgement and cannot be reduced to a check list. Greater guidance is needed on the materiality assessment process, and how this works alongside the minimum requirements for impact drivers.
- Greater transparency of the methods used as a basis for the technical measurement and valuation guidance will help users to judge and communicate the credibility and appropriateness of these approaches for their organisation.
- Support specifically targeting SMEs' implementation of this guidance would be welcomed.

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OVERARCHING SUPPORT FOR THIS WORK

ICAEW fully supports work to develop guidance on natural capital accounting for the accounting profession. Accountants play a crucial enabling role in providing the information, systems and governance necessary to embed natural capital in decision-making. Supporting the profession with guidance to better understand natural capital, as well as how it can be valued and integrated into decision-making supports the provision of better information, as well as a better understanding of the business risks and opportunities associated with natural capital.

ACCESSIBILITY OF THE GUIDANCE FOR ACCOUNTANTS

As most accountants will be new to the topic of natural capital accounting there is a need for more background information on natural capital, how it can be accounted for, and the risks and opportunities for business in this guidance. For example, an introduction to the Natural Capital Protocol; an explanation of how this fits as part of a business strategy; how this may benefit an organisation financially; how it fits with other frameworks such as Climate Disclosure Standards Board's (CDSB's) Framework; Global Reporting Initiative; natural capital frameworks such as BS8632; as well as work in progress such as that of the European Financial Reporting Advisory Group (EFRAG) and the upcoming International Sustainability Standards Board (ISSB).

Accountants (and others involved in business decision-making) are already juggling huge demands on their time from a myriad of reporting and assessment initiatives – they will need support to understand why they should apply this one, and how it fits with other frameworks they may be using/assessing.

The guidance goes into some technical detail on environmental economics approaches to measurement and valuation. An accountant does not have the training to understand or apply these approaches (and it would not be appropriate for them to do so). We recommend reconsidering who the intended audience is, and specifically who would be applying the more technical aspects of natural capital accounting. For areas of the guidance where it may be appropriate for accountants to be the primary audience, terminology such as double materiality could be helpful in explaining the core concepts, as it is already familiar to accountants.

CLARITY ON THE INTENDED APPLICATION OF THIS METHOD

CONFUSION BETWEEN MANAGEMENT ACCOUNTING AND FINANCIAL ACCOUNTING

Whilst the aim of this guidance is to support natural capital management accounting, there are several references to external reporting and processes associated with this (e.g. page 13 'Accounting period' refers to the concept and principles of financial accounting, whilst page 7 notes that the focus is on a decision-making context 'that is, in a management accounting rather than an external reporting setting').

This confusion extends to who the primary audience for this guidance is and the processes it will feed into. Clearly setting out the definition of management accounts/accounting and financial accounts/accounting together with the associated processes; gaining clarity on the intended use of this guidance (internal decision-making or external reporting); and who should be applying which sections of this guidance (as noted above, the more technical sections would be better suited to environmental economists than accountants) would greatly help the authors to clarify these points throughout the document.

BALANCING STANDARDISATION AND DECISION-USEFULNESS OF INFORMATION

It is the flexibility of management accounting that allows it to be decision-useful, versus the standardisation of financial accounts that allow for comparable external reporting. We feel that attempts to standardise natural capital accounting would be more appropriate for external reporting (many of these concepts are already tackled in BS8632). Natural capital assessments intended to inform internal decision-making need to allow flexibility of approaches to ensure the information provided is decision useful. At points in the document the guidance recommends a standardisation of approach that is not aligned with the principles of management accounting - to provide decision-useful and actionable information. For example, page 14 'Baselines' states that a pristine baseline must be used (with other scenarios being optional). This requirement limits the decision-usefulness of this information. Returning an area to a pristine state is rarely (if ever) possible, for example in the agriculture sector it would almost always be impossible to determine what the original pristine state was, or to realistically take action to return the land to that state. Therefore, using a baseline that would be actionable will be much more decision-useful, for example, comparing intensive farming to a baseline of organic farming.

The 4 principles of relevance; rigor; replicability; and consistency are useful to carry through this guidance. However, there are instances where these principles conflict with the guidance, for example the principle of relevance is to ensure that you consider the most relevant issues. This conflicts with some of the standardisation that is prescribed here, for example prescribing the impact drivers to be included, and the lack of guidance on the materiality assessment (page 14).

MATERIALITY

Materiality is a concept that is based on professional judgement, and cannot be reduced to a check list. However, this guidance mandates a list of impact drivers to be included in the materiality assessment for the natural capital account. This approach risks users missing other potentially material aspects of natural capital from their account. Further guidance on the process to be followed to balance undertaking a context-specific materiality assessment with fulfilling the requirements to include the stated impact drivers would be useful. At present it seems that the six impact drivers prescribed here are used as the starting point for the assessment, rather than first undertaking a broader materiality assessment and then cross-referencing to these impact drivers (for example, by explaining where any of these six impact drivers have not been found to be material).

Whilst we understand that this guidance is focussing on the Natural Capital Protocol measure and value steps, omission of the materiality assessment is problematic. Please also note the comment

above that decision-useful management accounting information benefits from flexibility over prescriptiveness.

An explanation for why these impact drivers, and not others, have been chosen would also be helpful to clarify this approach and to encourage credibility amongst users.

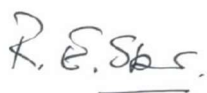
CONFIDENCE IN THE RESULTS

There is a lack of transparency around the methods recommended in this document. This is counter to the approach taken in the Natural Capital Protocol, which sought to build on and harmonise existing methods, providing full references throughout. This means it is not possible to judge the credibility of these approaches, and therefore challenging to build trust (by users and decision-makers) in the recommended approaches. This will also feed into difficulty with any assurance process undertaken on such assessments. We recommend including references to source methods wherever possible.

SMEs

There are likely to be significant implementation challenges for small and medium-sized enterprises (SMEs) using this guidance. SMEs are already struggling for resource to fulfil existing (and upcoming) reporting obligations. Any expansion of this guidance to help these organisations with implementation (for example, sign-posting SME-specific techniques, data, resources) would be very welcome.

Yours sincerely



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