PROFESSIONAL ACCOUNTANTS CHANGING BUSINESS FOR THE PLANET

A short guide to natural capital management for **business leaders**

Contents

REPORT SERIES: 1 of 4

About ACCA

ACCA is the Association of Chartered Certified Accountants. We're a thriving global community of 227,000 members and 544,000 future members based in 176 countries that upholds the highest professional and ethical values.

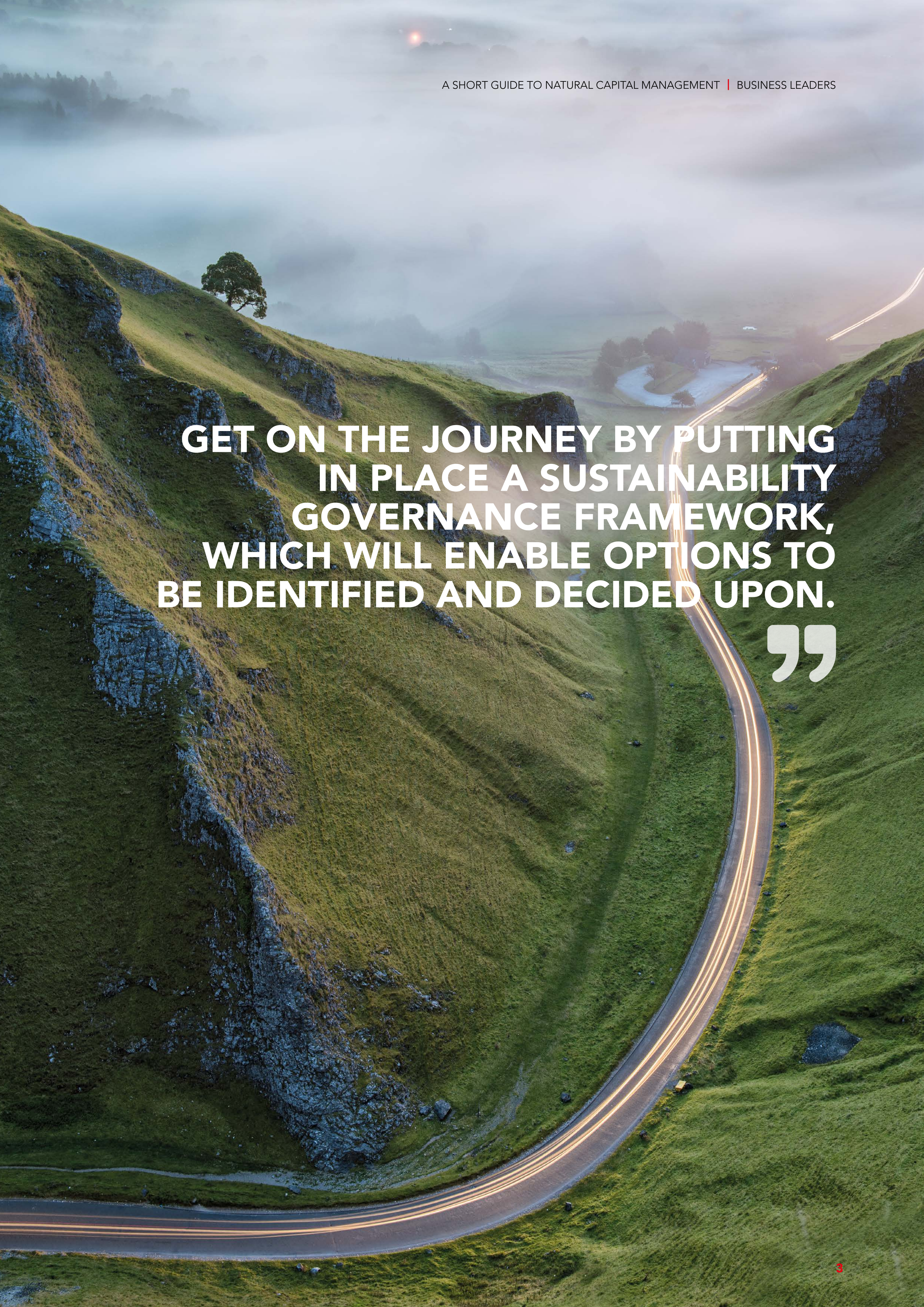
We believe that accountancy is a cornerstone profession of society that supports both public and private sectors. That's why we're committed to the development of a strong global accountancy profession and the many benefits that this brings to society and individuals.

Since 1904 being a force for public good has been embedded in our purpose. And because we're a not-for-profit organisation, we build a sustainable global profession by re-investing our surplus to deliver member value and develop the profession for the next generation.

Through our world leading ACCA Qualification, we offer everyone everywhere the opportunity to experience a rewarding career in accountancy, finance and management. And using our respected research, we lead the profession by answering today's questions and preparing us for tomorrow.

Find out more about us at **www.accaglobal.com**

November 2020



GET ON THE JOURNEY BY PUTTING IN PLACE A SUSTAINABILITY GOVERNANCE FRAMEWORK, WHICH WILL ENABLE OPTIONS TO BE IDENTIFIED AND DECIDED UPON.

1. Introduction

AS A PROFESSIONAL ACCOUNTANT AND LEADER, YOU HAVE THE DIRECT RESPONSIBILITY FOR:

- an organisation's financial well-being
- driving and assessing sustainable value creation.

This means you are leading strategic option selection, financing, risk management and control, and performance reporting.

When natural capital is material to a business, for example, where it is a major resource in the production of goods and services, then a failure to use it well can result in a vicious natural capital and business cycle (see Figure 1.1).

The Reporting Framework of the International Integrated Council (IIRC) identifies six interconnected and interdependent capitals, of which natural capital is one (see the six capitals creating value, Figure 1.2).

A resilient business model is typically one where all material capitals within the value creation model are managed, recognising and balancing the interconnectedness between them, or at the least their connections to financial capital, on which all other capitals are likely to have an impact. When this happens for natural capital then vicious cycles can be averted and virtuous cycles created (see Figure 1.1).

There are a few key steps that professional accountants in leadership roles should follow when developing and implementing a natural capital management strategy.

FIGURE 1.1: 'Vicious' and 'virtuous' business cycles

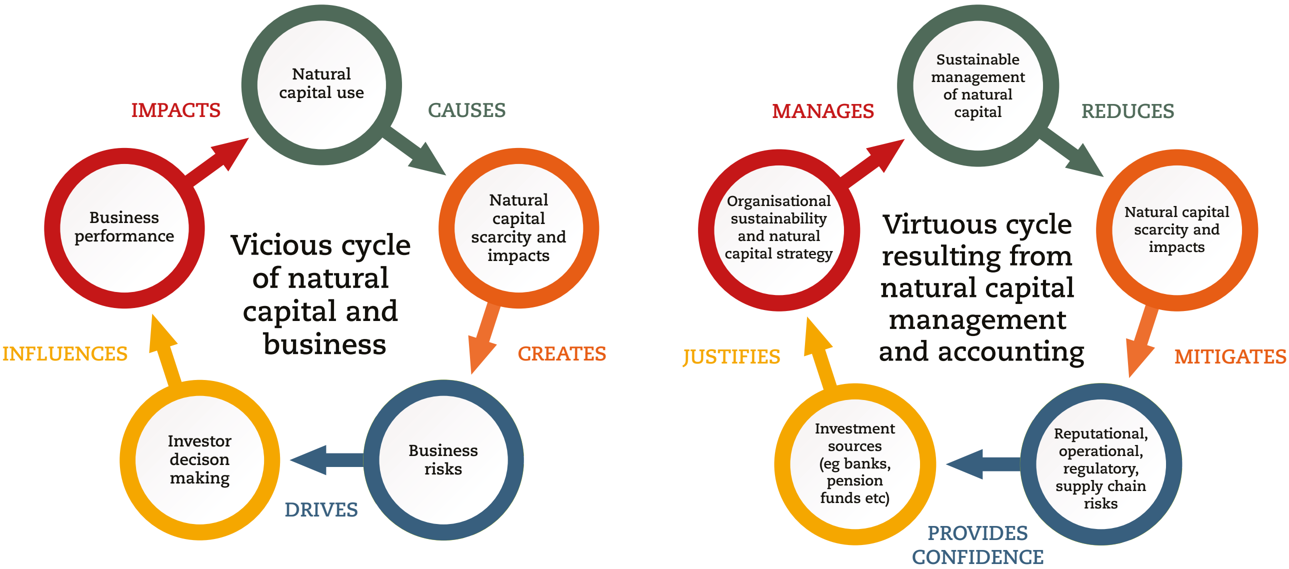
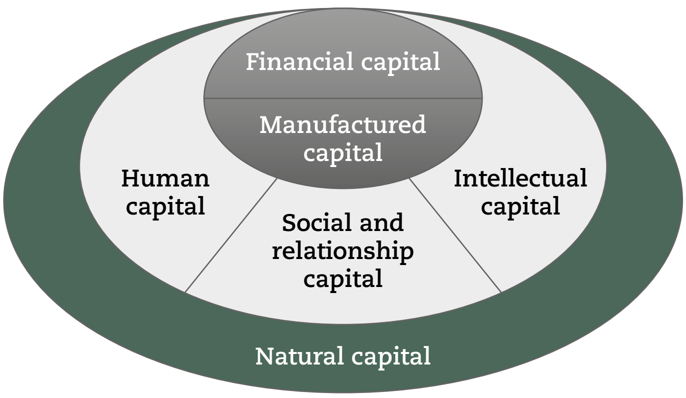


FIGURE 1.2: The six capitals of value creation



This is one of many ways to depict the capitals. Typically, financial and manufactured capitals are the ones organisations most commonly report on. The IIRC takes a broader view by also considering intellectual, social and relationship, and human capitals and natural capital, which provides the environment in which the other capitals sit.

Source: Incite 'Sustainability 2.0: A Guide to Competing in a Changing World'

2. Determining strategic options and deciding your natural capital strategy

DECIDING ON A NATURAL STRATEGY REQUIRES:

1. appreciation of the natural capital dependencies and impacts of your business
2. identification of potential strategic options
3. choosing between your options.

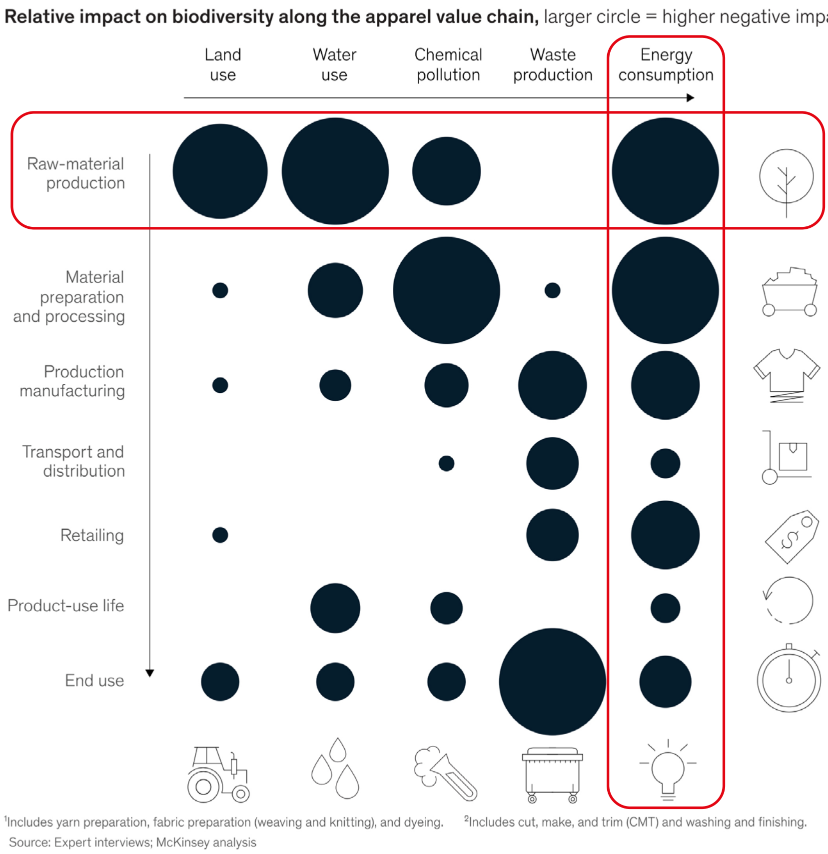
STEP 1: Know your natural capital impacts and dependencies

Deciding any strategy will always start with evaluating the current operating environment and conducting a value chain analysis before moving on to determining options for managing risk or realising opportunity.

This evaluation should consider the following points:

- The **value chain scope**: is it from point of entry to and exit from the business or does it extend to suppliers and customers?
- The **type of dependency or impact**: what does the business need from nature or what impact does business activity have on nature? Dependency will typically be expressed as the input from nature, for example land or water. Impact could be expressed as damaging output, for example emissions to soil or waterways, or the outcome, the actual impact on nature itself, for example biodiversity loss or biological density reduction.
- The extent to which the impact on nature will be considered is referred to as **boundaries**.
  - **Scope 1** – direct impacts owned or controlled by the business, for example, use of land to grow agricultural crops such as wheat for flour.
  - **Scope 2** – indirect impacts from 'utility services' consumed by the business, for example, the emissions from purchased energy used to power the equipment that harvests the wheat.
  - **Scope 3** – all other ancillary impacts arising from the value chain, for example, the emissions and by-products produced by the chemicals company that manufactures pesticides used to protect wheat crops.
- The mechanism for creating **a common scale for measuring impacts**, aiding comparability (see Figure 2.1).

FIGURE 2.1: Worked example for the clothing sector



Source: Granskog et al. (2020)

Value-chain scope: assumed to include suppliers and customers as chain starts with raw materials and ends with disposal (end use)

Types: taken as the three dependencies of land, water and energy and two impacts of chemical pollution and waste production, identified as inputs and outputs respectively.

Boundaries: Assumed to be scope 1 and 2 based on value-chain content and impacts selected. If scope 3 is included, it is likely to be at a more detailed level of analysis

Common scale: The circle sizing creates a common scale, much like a traffic light system. At a glance key problems area are:

- raw material production – land, use of water and energy
- processing – chemicals and energy
- end use – waste.

STEP 2: Determine your options using the 4Rs

Having analysed the natural capital value chain, you will be able to see the risks and opportunities arising, and this knowledge should inform the potential strategic response. A framework, such as the 4Rs of restore, reduce, remove and reimagine success used here, can help generate potential strategic option ideas (see Figure 2.2).

The following steps can be taken to generate potential strategic options.

- Employ the innovative mindset of a 'sustainability trailblazer' (ACCA 2020), thinking holistically and at a macro level, so thinking beyond your own business, towards an industry level, vertically or horizontally from your business.
- Contribute to, or just be aware of, the outputs from business-led natural capital groups and natural capital certification bodies, or lobby to create your own industry special-interest group. This will:
  - improve your natural capital scientific knowledge
  - generate ideas for potential strategic options
  - make feasible your own natural capital options through collaboration opportunities
  - facilitate better policymaking, as policymakers are made aware of macro-level information and common metrics generated by the group, providing insight on progress, challenges and comparative approaches.
- Connect with local stakeholders, for example internally, and the local community, to motivate and generate ideas.

FIGURE 2.2: Definition of the 4Rs

REMOVE: cease the activity, or replace it with alternatives that will achieve the same outcome, for example no longer using plastic packaging, possibly replacing it with recyclable packaging.

REDUCE: lessen negative impact by employing principles of taking only what is necessary or using natural capital that is already damaged.

RESTORE: repair the negative impact, for example by regenerating what has been lost.

REIMAGINE: create innovative transformation to achieve the 3Rs above, or create new value, fundamentally involving a mindset change, for example:

- remove impacts from power generation by using only wind or solar powered energy sources
- reduce impacts through
  - circular economy principles, where waste from your process becomes an asset in another's production
  - generating greater yields from land
- create new value through repurposing business, for example producing geothermal energy from disused oil wells.

A FRAMEWORK, SUCH AS THE 4Rs OF RESTORE, REDUCE, REMOVE AND REIMAGINE SUCCESS USED HERE, CAN HELP GENERATE POTENTIAL STRATEGIC OPTION IDEAS.

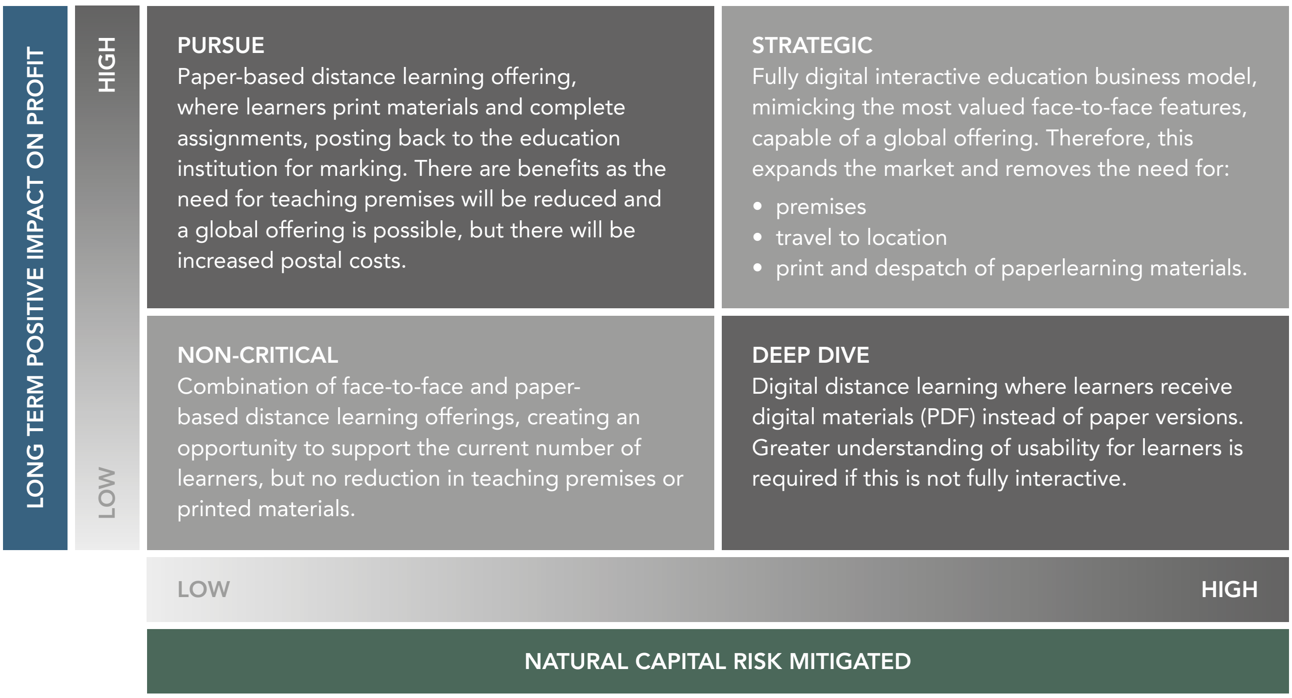
STEP 3: Decide which options to pursue

With the potential strategic options determined, you will need to decide between them by using an integrated thinking matrix (see example in Figure 2.3) supported by a feasibility study and a framework aligning strategy with vision.

- The integrated thinking matrix will enable assessment of the options in relation to the natural capital risk being managed and the impact on long-term financial capital, which forms a proxy measure of the net impact on other material capitals. Your options are allocated to one of four groups.
  - **Non-critical** options are those that do not significantly mitigate natural capital or financial profit. These are only worth pursuing if they achieve other non-monetary benefits.
  - **Pursue** options are those with a positive impact on profit but no worsening of natural capital.
  - **Strategic** options are those where both natural capital risk management is achieved and there is a high financial profit; such options therefore have the best outcome for sustainable value creation.
  - **Deep dive** options are those where natural capital can be managed but the impact on profit may mean that such options are not feasible or there are potentially other unpalatable capital trade-offs, so more investigation is needed.
- Together with the options mapping, decisions relating to each option need to be tested both for feasibility and for alignment with the organisation's vision. This testing should consider:
  - **Purpose** – alignment to the organisation's purpose, vision and objectives
  - **Reputation** – alignment to stakeholders' expectations
  - **Regulation** – compliance with the regulatory environment and available financial support
  - **Operation** – deliverability (factors for this are considered in the next section).

FIGURE 2.3: The natural capital integrated thinking decision matrix, including example

In response to COVID-19 social distancing measures and with the aim of improved management its natural capital dependencies and impacts, an education institution currently delivering face-to-face teaching and providing learners with all materials in paper copy considers four options.



3. Implementing your natural capital management strategy

IMPLEMENTING A NATURAL CAPITAL MANAGEMENT STRATEGY WILL NEED:

- good corporate governance, including governance of information systems
- access to finance, and
- relevant, reliable communication with stakeholders.

STEP 4: Put in place good corporate governance

Implementing a natural capital management strategy is like implementing any other strategy: it requires good governance, which in this case must be tailored for the unique natural capital aspects.

- Enhancing people's capability by
  - encouraging employees with a natural capital interest to share their thoughts, thereby motivating others
  - educating and training staff across the organisation, perhaps drawing on external expertise.
- Putting in place systems and processes to:
  - facilitate integrated thinking, and set clarity on roles and responsibilities, using a responsibility, accountability, communication and information (RACI) system to engage staff and mitigate the risk of group think (see Figure 3.1)
  - create and operate the related organisational structures, for example forums, on workplans and meeting agendas, where natural capital issues are considered in the context relevant to each function
  - engage external stakeholders on natural capital policy and processes, to ensure all are committed to the plan
  - embed technology-enabled information systems to enable natural capital data to be connected to financial information, at the least. This can be a simple system such as spreadsheets connected on a SharePoint to a bespoke information system. Here, both your corporate reporter and performance manager roles will provide insight.

STEP 5: Access green finance

If your strategic option requires external financing, consider seeking green finance initiatives, where there will typically be expectations for returns aligned with those typical of green strategies. Providers of such finance are a great source of education and training.

STEP 6: Communicate

Involving your stakeholders, who have invested in your business in some way, is vital for any strategic change. As a leader you will need to make decisions that are typically those of professional accountants in corporate reporting and assurance.

- Who are the stakeholder groups with whom you will communicate? Are these just financial investors or a wider audience? This will determine the type of information needed, its format and the level of granularity provided. The audience for your reporting will affect how you identify their information needs, and your materiality decisions. In turn, there will be implications for the process used to produce the information.
- What type of engagement will you have?
  - Will natural capital information be integrated within the annual report? Are there requirements you must comply with, for example from certification bodies?
  - How frequently will you engage? Will you align your communications with formal corporate reporting or follow a different schedule?
- Will you seek external assurance? If yes, then what level of assurance will you require: 'reasonable' (the same level as audited financial statements), or 'limited' (commonly termed 'negative assurance')?

FIGURE 3.1: Responsibility, accountability, communication and information (RACI)

R for responsible.
This is the person who undertakes the task, who therefore has the technical expertise.

A for accountable.
This is the person in charge of ensuring that the task is completed on time and/or to the quality expected.

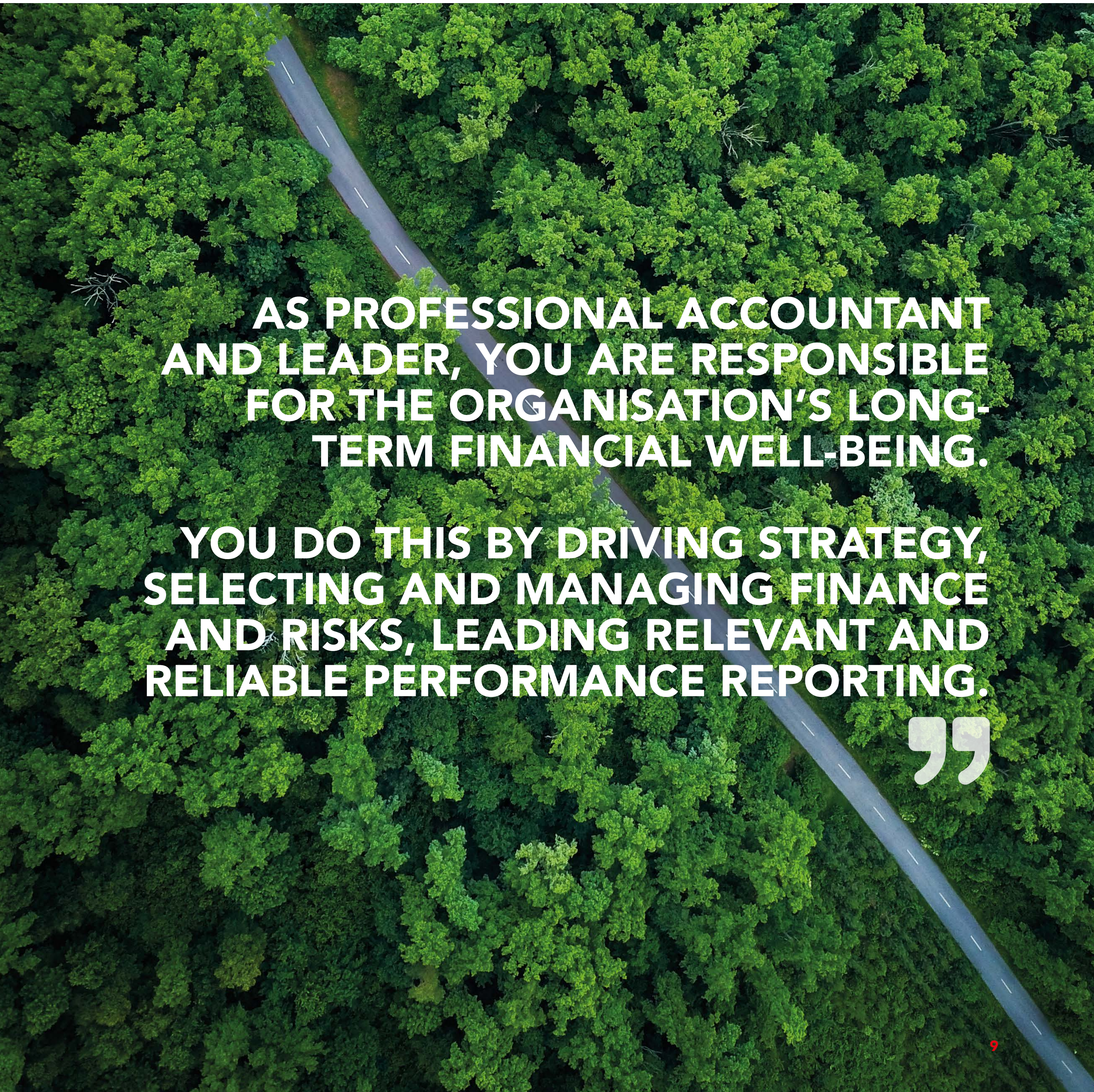
C for consulted.
This is the resource person, who may have the information necessary for shaping the task.

I for informed. This is the person who must be updated regularly as the task is completed, usually because the task relates to fulfilment of their own responsibilities.

References

ACCA (2020), *Future Ready: Accountancy Careers in the 2020s*, <https://www.accaglobal.com/gb/en/professional-insights/pro-accountants-the-future/future_ready_2020s.html>, accessed 9 November 2020.

Granskog, A., Laizet, F., Lobis, M. and Sawers, C. (2020), 'Biodiversity: The Next Frontier in Sustainable Fashion' [website article] <https://www.mckinsey.com/industries/retail/our-insights/biodiversity-the-next-frontier-in-sustainable-fashion>, accessed 9 November 2020.



PI-PACBFTP-LEADERS-SHORT-GUIDE

ACCA The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom / +44 (0)20 7059 5000 / **www.accaglobal.com**