



CAPITALS
COALITION

Assuring the capitals:

Building confidence
in natural, social
and human capital
assessments



July 2022

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Executive summary

To transform business models and markets to deliver sustainable economies, understanding the consequences of business on nature and people, previously viewed as ‘externalities’, is now critical. Companies are recognizing that their impacts and dependencies on natural, social, human, and produced capital (the capitals) are the foundation of human wellbeing and economic success, and must inform financial decision making.

Despite the increasing importance of capitals information, conducting assurance (i.e., reducing the risk of material misstatement to a level acceptable to the user) on the capitals, is an evolving field. It needs to mature quickly to keep up with global market and regulatory trends. In the past year, the United States Securities and Exchange Commission (SEC) has moved forward with the development of mandatory climate risk disclosure rules. In parallel, the European Union is actively pursuing climate targets and wider sustainability measures under the European Green Deal and EU Financing Sustainable Growth Action Plan. Both aim to divert capital flows into sustainable investments.

A seismic change is coming for companies who seek to operationalize sustainability commitments, report on performance, and/or have their data assured to build credibility.

This report summarises the steps required to increase decision makers’ confidence in natural, human, and social capitals assessments, presented through the themes of Consolidation, Education and Advocacy.

Consolidation

- ◆ Collaborate with other organizations (e.g., International Organization for Standardization (ISO), International Accreditation Forum (IAF), Social Value International (SVI), British Standards Institution (BSI) etc.) and leverage existing work, such as the Natural Capital Protocol and Social & Human Capital Protocol among others, to develop appropriate subject matter and suitable, assurable criteria for the process of developing capitals assessments.

Education

- ◆ Develop a checklist for preparers of the elements that make for relevant and credible capitals information for decision making. This would include guidance on how to use the results of capitals assessments to inform basic business decisions, what resources are needed, and where they can be sourced.
- ◆ Create supporting guidance and training on how the International Standards on Assurance Engagements (ISAE) 3000 and the International Auditing and Assurance Standards Board Guidance on Assurance of Extended External Reporting Assurance (EER guidance) can be applied to a capitals assessment context.
- ◆ Develop guidance for preparers on how to conduct meaningful and robust capitals assessments with examples and signposts to existing guidance. Preparers without expertise in the subject matter need education on what makes for credible data, so capitals assessments are “CFO check ready.”
- ◆ Prepare guidance and training in partnership with governing bodies, professional practice and quality teams at accounting firms.
- ◆ Build guidance and training for preparers and users (including Boards) on the purpose and importance of assuring capitals assessments.
- ◆ Work closely with the International Accreditation Forum (IAF) to ensure education materials are in conformity to ISO/CASCO standards.



Advocacy

- ◆ Create further awareness about how a capitals assessment links to the business agenda and relates to the wider developments in sustainability, including disclosure and reporting with an emphasis on the importance of robust information.
- ◆ Support the users' demand for high quality assurance and encourage preparers and practitioners to understand the importance of facilitating and arranging high quality assurance. Engage influential market stakeholders to share the importance of capitals assessments and assurance.
- ◆ Advocate for assurance teams to have capitals assessments subject matter experts on their team.
- ◆ Create awareness and encourage practitioners to use and apply ISAE 3000 and EER guidance for capitals assessment assurance activities.

Building trust in capitals assessments through the process of assurance activities is critical to having high quality, useful information. Importantly, assurance of non-financial data on companies' impacts and dependencies across the capitals is core to creating a system of corporate accountability.

The Capitals Coalition will seek to further this agenda in collaboration with its global community. It also encourages others to use these findings and act to build confidence in capitals assessments and help create a world that values the contribution of all the capitals.

Project Approach

The Capitals Coalition convened an Expert Working Group to refine the scope of this project. Following this, desktop research was conducted along with over twenty interviews with subject-matter experts such as assurance providers, capitals assessment preparers and standard setters. Key questions were explored including what barriers and challenges exist for preparers and assurance providers of capitals assessments. The assurance of performance and of management practices were discussed and considered as part of this initiative. They share some common challenges and present unique barriers when applied to capitals assessments (see Section 03).

The results of this inquiry were further discussed at a roundtable in March 2022, with subject-matter experts from relevant fields. The cumulative outcomes of this work are presented in this paper.



01

Business case for assuring capitals assessments

Better decision making requires all the capitals

The urgency to transition to economies that are equitable, nature-positive and carbon neutral is gaining ground with CEOs¹, investors² and policymakers³ as never before. Understanding the consequences of business on nature and people, previously viewed as ‘externalities’, is now critical to transforming business models and markets into sustainable economies. As such, companies are recognizing that all the capitals – natural capital, social capital, human capital and produced (including financial) capitals – must form the foundation of financial decision making to create human wellbeing and economic success.



Our economy, and the industries and businesses that drive it are missing key inputs in their decisions making processes that has lead to the degradation of our ecosystems and social structures upon which our economy depends. “We have grown financial capital in large part through the use, exploitation, and degradation of natural and social capital.”⁴ While we are now seeing and experiencing the impacts of this loss of natural, human, and social capital, it is still not being systematically considered or accounted for by industry or governments in their decision making.

The economy needs to correct its course, and businesses must be part of the solution. Businesses that understand and account for how they impact and depend on natural, human, and social capital will make better informed decisions which in turn will strengthen these forms of value that serve as the foundation for human wellbeing and economic success. Businesses can undertake a capitals assessment which will identify, measure and assess the impacts and dependencies on all the capitals to inform organizational decisions.

What are the capitals and why is important to understand their value?

Capital has traditionally been thought of only as money, or financial capital. However, capital describes any resource or asset that stores or provides value to people.⁵ Natural capital, human capital and social capital work in the same way as traditional capital – if we invest in them, they create value, and if we degrade them, we limit value.

Natural, human, and social capital are the foundation of produced capital - including financial assets - and our economy. Therefore, businesses and the finance sector must understand and account for the value of these types of capital to make better informed financial decisions.

Interest in environmental, social, and governance (ESG) information has grown exponentially over the past decade along with the community of preparers who are conducting assessments on businesses’ natural, social, and human capital impacts and dependencies.

It is important to note the distinction between ESG information (e.g., GHG emissions, water use, health and safety metrics, diversity data etc.) and capitals assessments. As illustrated in Figure 1, capitals assessments assess the change in capitals due to business activities or external factors. Most importantly, capitals assessments allow an organization to understand their contribution (positive or negative) to one or more dimensions of well-being (e.g., changes in disease and flooding incidence from climate change).

¹ The World Economic Forum's 2022 Global Risks report <https://www.weforum.org/global-risks/reports> shows climate action failure, extreme weather and biodiversity loss are the top three most severe risks identified.

² S&P Global highlighted the growing importance of environmental, social and governance issues for corporate boards. Their 2022 ESG trends report <https://www.spglobal.com/esg/insights/key-esg-trends-in-2022> makes clear that along with net zero actions, assessing natural capital and biodiversity risks will rise in importance.

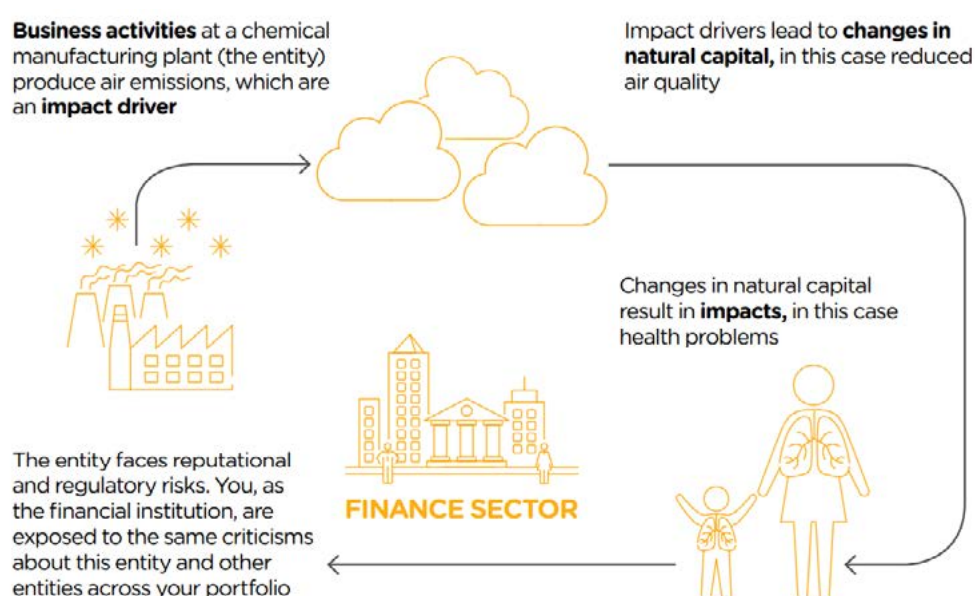
³ The International Sustainability Standards Board released exposure drafts on climate and general sustainability-related financial disclosures in 2022; the US SEC proposed rules require climate disclosures beginning in 2024; the IFRS Foundation and Global Reporting Initiative announced a collaboration agreement in 2022; the European Financial Reporting Advisory Group (EFRAG) are expected to publish exposure drafts for The European Sustainability Reporting Standards (ESRS) in 2022; the EU Legal Affairs Committee (EU Parliament) has adopted its position on the CSRD; The TNFD released the first beta version of its Nature-Related Risk & Opportunity Management and Disclosure Framework in 2022.

⁴ Natural Capital Protocol (2016)

⁵ Natural Capital Protocol (2016)

Figure 1 illustrates how financial entities can have natural capital-related impacts. Shown here is the impact pathway for air pollution, a classic non-product output of industry, typically found in portfolios that include manufacturing businesses. In this example, the supported entity is a business that manufactures industrial chemicals, a process resulting in the emission of certain pollutants (the impact driver). These pollutants lead to a reduction in air quality (the change in natural capital), which may have significant consequences for various groups of people: one example might be health implications for local communities (the impact). These impacts, as well as changes to natural capital, in turn carry reputational and regulatory risks for the financial institution supporting the chemical manufacturer, potentially leading to questions about an institution's investment choices and due diligence.⁶

Figure 1: Example of an impact pathway



⁶ Connecting Finance and Natural Capital: A supplement to the Natural Capital Protocol (2018)
https://capitalscoalition.org/guide_supplement/finance-sector-supplement/

Old challenge, new urgency: the need for credible data

Accounting for natural, human, and social capital is complex. One of the main barriers is that decision makers lack confidence in environmental and social data that measures and values outcomes and impact. Environmental and social data lacks robust quality control processes that financial information benefits from, which limits its credibility, comparability and the decision maker's ability to rely on this information. Controls and quality processes for financial data have had centuries to mature while data related to natural, human, and social capital is playing catch-up⁷.

For investors to inform future decision making on financial capital allocations they need reliable information on the impacts and dependencies of individual entities and/or sectors. Assurance plays a crucial role in the reliability, usefulness and consistency of this information.

“Stakeholders are seeking a basis for confidence”

- Roundtable participant, 2022

Alongside increased interest in ESG data and capitals assessments comes the risk of impact washing or greenwashing, which further underscores the importance of having robust processes and credible input data for capitals assessments. The Sustainable Finance Disclosure Regulation (SFDR) in the EU sets out anti-greenwashing rules which has tightened the definition of what is considered a sustainable investment to limit the amount of greenwashing.⁸

“There is still too much rubbish that is reported under the banner of sustainability and my fear is it could be creating an investment bubble based on wishful thinking, not evidenced claims”

– Roundtable participant, 2022

To stimulate system-level change, accountability to people and the planet must be part of the equation. Organizations that recognize this are conducting activities such as assurance engagements or agreed-upon procedures by an independent party to increase the credibility and reliability of their capitals assessment and input data. This shows their stakeholders that efforts by the organization are genuine, in turn building trust and credibility in the market.

System-level change requires accountability to people and planet

The ultimate accountability for decisions that aim to preserve and enhance natural, social, human and produced capital is to people and planet. However, in today's economies there is no system in place to hold businesses to account for their depletion of the capitals. To whom are businesses accountable? Accountability only works if there are consequences. For example, with financial capital – a component of produced capital – there is the potential for certain companies to be delisted in the face of poor financial audits. A similar accountability loop is needed for human, social, and natural capital.

This paper explores the actions required to increase the confidence in capitals assessments, as a core component of creating a system of accountability for how businesses impact people and the planet. This will encourage private and public sector leaders to make decisions that ensure prosperity across all the capitals. The aim is to create the market and interest in accounting for and assuring capitals, ultimately aligning business interests with the interests of people and the planet.

⁷ Data Use in Natural Capital Assessments: Assessing Challenges and Identifying Solutions: <https://capitalscoalition.org/wp-content/uploads/2019/05/Final-Data-Full-Report.pdf>

⁸ Bloomberg: European ESG Assets Shrank by \$2 Trillion After Greenwash Rules: https://www.bloomberg.com/news/articles/2021-07-18/european-esg-assets-shrank-by-2-trillion-after-greenwash-rules?cmpid=BBD071921_GREENDAILY&utm_medium=email&utm_source=newsletter&utm_term=210719&utm_campaign=greendaily#xj4y7vzkg

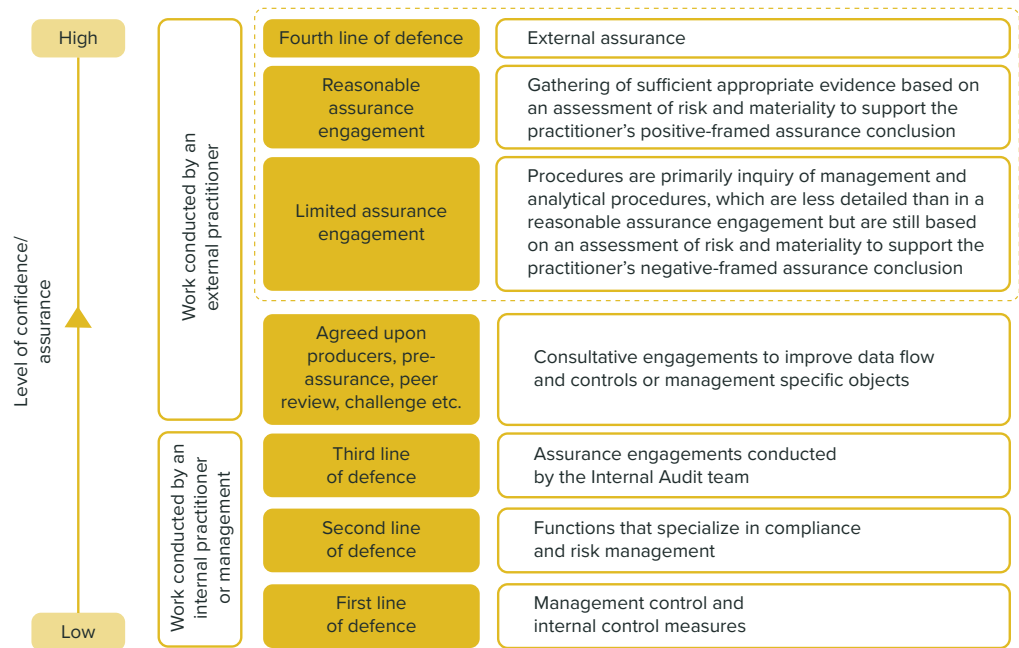
02

Activities that build confidence in capitals assessments

There are many types of confidence-building activities ranging from activities conducted by an organization, when preparing a capitals assessment, to those conducted by external practitioners who are engaged to provide an independent conclusion or opinion. These activities are summarised in Figure 2.



Figure 2: Examples of confidence/assurance building activities⁹



These activities build upon each other to provide users with a greater level of assurance or confidence. For example, an organization is only able to engage in external assurance (e.g., fourth line of defence) once it has established and demonstrated strong internal controls and processes (i.e., first and second lines of defence).

For the purposes of this project we have used the following terms and related definitions that have been adapted from definitions used by the ICAEW (Institute of Chartered Accountants in England and Wales), the Chartered Professional Accountants of Canada (CPA Canada) and the Capitals Coalition:

- ◆ **Capitals assessment:** the identification, measurement and valuation of impacts and dependencies on all the capitals in order to inform organizational decisions
- ◆ **Valuation:** the process of estimating the relative importance, worth or usefulness of the capitals to people (or to a business), in a particular context. Capitals assessment may involve qualitative, quantitative or monetary approaches, or a combination of these
- ◆ **Assurance:** reducing risk of material misstatement to a level acceptable to the user
- ◆ **Practitioner:** the party conducting the assurance activity and/or providing the assurance conclusion
- ◆ **Preparer:** the party preparing the information (e.g., the capitals assessment)
- ◆ **User:** the party relying on the information (i.e., the party using the capitals assessment to inform a decision)
- ◆ **Assurance activity:** activity conducted to reduce the risk of a material misstatement to a level acceptable to the user and that increases the confidence in the subject matter.

Note: the terms preparer, user, and practitioner are representative of individuals or larger cross-functional teams, depending on the organization and the capitals assessment that is being conducted. In larger organizations, preparers may be a team comprised of a member from the operations team and finance team. Likewise, a practitioner from a larger firm may include a team of accountants, capitals assessment experts, biologists and economists.

We recognize that a fundamental challenge is the lack of alignment on definitions, especially related to capitals assessments and assurance. This challenge is discussed in more detail in section 02.

⁹ Definitions sourced from the ICAEW (The Institute of Chartered Accountants in England and Wales) and The Chartered Professional Accountants of Canada (CPA Canada), respectively.

Assurance drawn from the four lines of defence

Building confidence in capitals assessments starts with preparation of the information. For example, it's important to consider how the data was collected, calculated, consolidated and the processes in place to ensure that the data is fit for the purpose for which it was collected. This is where the first two lines of defence can increase credibility of capitals assessment data. ICAEW defines the first two lines of defence as follows:

“First line: the way risks are managed and controlled day to day. Assurance comes directly from those responsible for delivering specific objectives or processes. It may lack independence, but its value is that it comes from those who know the business, culture and day-to-day challenges.

Second line: the way the organisation oversees the control framework so that it operates effectively. The assurance provided is separate from those responsible for delivery, but not independent of the management chain, such as risk and compliance functions.”¹⁰

Having stronger processes and controls around natural, human, and social capital data that feed into capitals assessments improves the overall credibility of the assessment. Further, the risk and compliance functions ensure that the process for developing a capitals assessment is in line with its purpose. As the data and process matures, independent practitioners can be engaged to provide a greater level of assurance over the capitals assessment to further build confidence and credibility in the information. The ICAEW defines the third and fourth level of defence as follows:

“Third line: objective and independent assurance, e.g. internal audit, providing reasonable (not absolute) assurance of the overall effectiveness of governance, risk management and controls. The level and depth of assurance provided will depend on the size and focus of the internal audit function and management’s appetite for internal audit assurance.

Fourth line: assurance from external independent bodies such as the external auditors and other external bodies. External bodies may not have the existing familiarity with the organisation that an internal audit function has, but they can bring a new and valuable perspective. Additionally, their outsider status is clearly visible to third parties, so that they can not only be independent but be seen to be independent.”¹¹

In alignment with the fourth line of defence, organizations can engage third-party practitioners to provide a peer review, agreed-upon procedures, or pre-assurance activities on their capitals assessment. By engaging a third-party practitioner - often a subject-matter expert in capitals assessments - the preparer benefits from the external perspective of the practitioner on the controls, processes, or specific components of a capitals assessment in which management is most interested. This external review by the practitioner lends credibility to the capitals assessment and provides the user with greater confidence in the information.

All four lines of defence reduce the risk of a material misstatement and in turn increase the confidence users have in capitals assessments information.

¹⁰ The Institute of Chartered Accountants in England and Wales - <https://www.icaew.com/technical/audit-and-assurance/assurance/what-is-assurance/assurance-glossary/four-lines-of-defence>

¹¹ The Institute of Chartered Accountants in England and Wales - <https://www.icaew.com/technical/audit-and-assurance/assurance/what-is-assurance/assurance-glossary/four-lines-of-defence>

Making capitals information material creates accountability

To reduce the risk of material misstatement, we need to understand what information is material to a user's decisions. For assurance to drive accountability of decisions that impact people and planet, businesses must view their impacts and dependencies on all the capitals as material. They must be held to account by people who experience impacts and dependencies on capitals. Assurance on capitals is, in effect, for the people experiencing the change in capitals.



Assurance practitioners and frameworks

Assurance activities on capitals assessments can be conducted by subject-matter experts or financial assurance providers with the support of subject-matter experts. There currently is no required certification or designation for assurance providers on this type of information. However, the capabilities of the assurance provider would be assessed by the user and selected based on the users' confidence in the assurance providers' capacity to conduct the assurance activity in a manner that will reduce the risk of material misstatement of the subject-matter to a level acceptable to the user.

“The term assurance is not owned by the accounting profession. Non-accountants also conduct assurance engagements and activities to provide users of that information with greater confidence”

– Roundtable participant, 2022

Many practitioners leverage an assurance framework to conduct their engagements. Table 1 provides examples of commonly used assurance frameworks for capitals assessment data.

Table 1: Examples of commonly used assurance frameworks for capitals assessment data.¹²

Framework	17029:2019 - Conformity assessment — General principles and requirements for validation and verification bodies	AA1000 Assurance Standard	International Standard on Assurance Engagements (ISAE) 3000 and Non- Authoritative Guide on Applying IASE 3000 (Revised) to Sustainability and Other Extended External Reporting (EER) Assurance Engagements	Social Value International (SVI) Report Assurance Process
Objective	To provide confirmation that claims are either plausible with regards to the intended future use (validation) or truthfully stated (verification)	To provide assurance on the nature and extent of adherence to the AA1000 AccountAbility Principles and, where applicable, the quality of publicly disclosed information on sustainability performance	To provide assurance that the information is free from material misstatement with respect to the criteria it against which it is being assessed	To provide assurance among readers of social value and SROI reports that these have been produced in accordance with the SVI Standards for applying the Principles of Social Value
Level of assurance	Independent Practitioner	Independent Practitioner	Accredited Social Value and SROI practitioners	Accredited Social Value and SROI practitioners
Performed by	Independent assurance provider/practitioner	Independent assurance provider/practitioner	Independent assurance provider/practitioner ¹³	Accredited Social Value and SROI practitioners

¹²Adapted from A Discussion Document on Assurance of Social and Environmental Capitals assessments by Social Value UK – Page 8

¹³This ISAE is premised on the basis that:

“(a) The members of the engagement team and the engagement quality control reviewer (for those engagements where one has been appointed) are subject to Parts A and B of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code) related to assurance engagements, or other professional requirements, or requirements in law or regulation, that are at least as demanding; and (Ref: Para. A30–A34)

(b) The practitioner who is performing the engagement is a member of a firm that is subject to ISQC 1,1 or other professional requirements, or requirements in law or regulation, regarding the firm's responsibility for its system of quality control, that are at least as demanding as ISQC 1. (Ref: Para. A61–A66)”

03

Challenges, impacts, and initial solutions

This project engaged and consulted with over twenty subject-matter experts on the main challenges to building confidence in capitals assessments, from both the preparer and practitioner perspective. The top challenges, impacts and proposed solutions are summarised in Figure 3. Note: this list is not exhaustive. Instead, it aims to represent the main challenges and solutions for impact, based on the perspectives of those engaged as part of this initiative.



Figure 3: Top challenges, impacts and potential solutions for building confidence in natural, social, and human capitals assessments

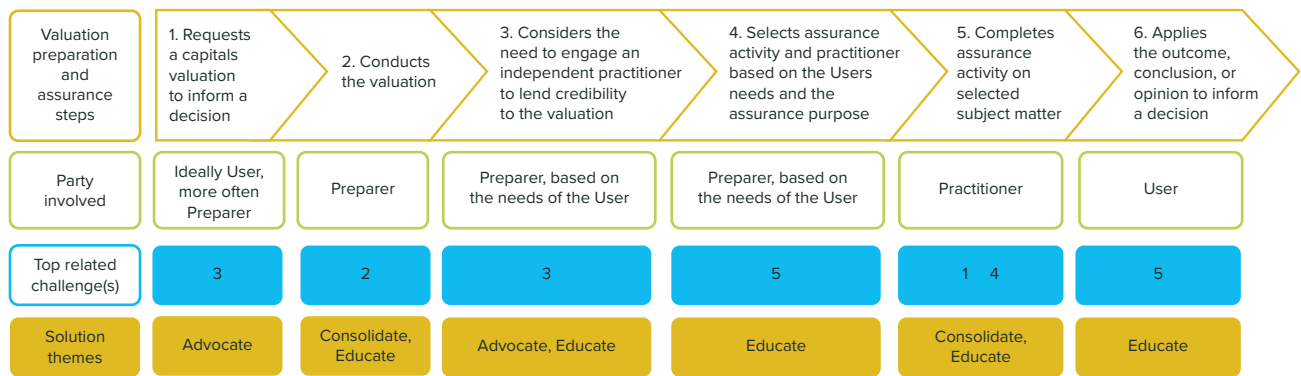
Challenge	Impact	Solution Theme	Example Solution
1. Lack of appropriate subject matter and assurable criteria on the process for conducting a fit-for-purpose valuation	<ul style="list-style-type: none"> Limits the ability to conduct assurance Inconsistent processes are applied 	<div>Consolidate</div> <div>Educate</div>	Collaborate and leverage existing work to develop appropriate subject matter and assurable criteria for the valuations process and related training
2. Preparers have limited knowledge on how to conduct meaningful and robust valuations*	<ul style="list-style-type: none"> Inconsistent processes are applied Limits comparability and credibility of the data 	Educate	Develop guidance for preparers on how to conduct meaningful and robust valuations with examples and signposts to existing guidance
3. Weak market drivers and lack of a regulatory framework for assurable valuations	<ul style="list-style-type: none"> Entities are not incentivised to produce high quality and reliable valuations Limits the maturity of the data and user confidence 	Advocate	Engage influential market stakeholders to share the importance of valuations and assurance
4. Financial auditors lack contextual knowledge on valuations	<ul style="list-style-type: none"> Key questions may be omitted, increases the risk for both the entity seeking assurance and the assurer 	Educate	Develop guidance and training in partnership with governing bodies and professional practice and quality teams
5. Preparers and users lack assurance knowledge	<ul style="list-style-type: none"> Exposes the organisations to reputational risks and potentially limited access to capital or insurance 	Educate	Develop guidance and training for preparers and users (including boards) on the purpose and importance of assuring valuations

*This is applicable to those preparers that do not have a capitals assessment background and have not hired external experts to support them with their capitals assessment development.

To explore the challenges and potential solutions in more detail, Figure 4 outlines the high level steps that are taken by preparers, practitioners, and users in the preparation and the assurance of capitals assessments. As mentioned, building confidence in capitals assessments takes place across the four lines of defence. Therefore, it is important to understand where the challenges exist along this process of preparing and assuring capitals assessments.



Figure 4: High level steps for the preparation and independent assurance of capitals assessments



The following section presents each step in depth, identifying related challenges, potential steps to address the barriers that exist to building the confidence of users in capitals assessments.

Step 1: The user or preparer requests a capitals assessment to inform a decision.

The first step in the preparation of a capitals assessment is the request from the user or preparer for a capitals assessment.

Challenge #3: Weak market drivers and lack of a regulatory framework for assurable capitals assessments

The main barriers identified during this step were weak market drivers and the lack of a regulatory framework for assurable capitals assessments. Influential stakeholders such as investment managers are not openly and consistently requesting capitals assessment information, let alone assured capitals assessments. This is likely due to limited understanding of the importance of the information provided by capitals assessments and a lack of trust in the assurance process. The underlying investors, however, would like credible capitals assessment information but this is not reflected in the fiduciary responsibilities of their agents. As a result, entities are not incentivised to produce high quality and reliable capitals assessments (i.e., with robust controls and processes) that is “investor grade”. This ultimately limits the maturity of the data and user confidence.

“What is being done to embed capitals assessments? We need to talk about incentives before assurance.”

– Roundtable participant, 2022

By way of example, some banks are requiring their funds to be in alignment with the Paris Agreement and to set Net Zero targets. They are requesting organizations to set climate targets and are increasingly requesting that the performance of these targets be assured¹⁴. However, the call for other natural capital information (e.g., biodiversity, nature conservation) and social and human capitals assessments is limited.

¹⁴Reuters: Investors tell Big-4 auditors they risk AGM rebellion over climate accounting: <https://www.reuters.com/business/sustainable-business/investors-tell-big-4-auditors-they-risk-agm-rebellion-over-climate-accounting-2021-11-02/>

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Engage the investor and insurance community through webinars, hosting dialogues, roundtables, or one-on-one interviews to highlight the financial implications of natural, human, and social capital, making it clear this is relevant information for investors and insurers and other market influencers.
- ◆ Engage in advocacy with oversight bodies such as the Securities and Exchange Commission (SEC), European Securities and Market Authority (ESMA), and the Financial Reporting Council (FRC) among others to develop a requirement for assured capitals assessments.
- ◆ Advocate for globally accepted targets for preserving or enhancing the stocks of social, human, and natural capital

Step 2: The preparer conducts the capitals assessment

In this step, the preparer selects or develops a capitals assessment approach, often leveraging existing guidance documents and standards, and prepares the capitals assessment.

Challenge #2: Preparers have limited knowledge on how to conduct meaningful and robust capitals assessments

A barrier that was identified at this step was that some preparers have limited knowledge on how to conduct meaningful and robust capitals assessments that are fit for purpose and include engagement with stakeholders who are impacted. The data that they often use for their capitals assessments is not credible and “CFO-check” ready. In many cases, preparers rely on capitals assessments other organizations and information gathered from databases without adjusting for their local context or checking the credibility of the original source report. This results in capitals assessments that are not fit for purpose nor reliable for decision making. In some cases, inconsistent processes are applied to capitals assessments which decrease the ability to compare information across peers or industries and reduces the credibility of the information for decision making.



Accountability drives action

A system of accountability for a business's impacts on people and planet is needed to drive the uptake of measuring natural, social, human and produced capitals and to ensure they are embedded in management decisions and included in external reporting.

The data provided by capitals assessments will mature with improved process, application of standards and guidelines, integration of controls and quality checks. Preparers should recognize that accounting for value across the capitals is a developing field and that the methodologies are also improving. There is a need for preparers, users, and assurance practitioners to be mindful of this and not to become attached to a particular way of conducting or assuring capitals assessments.

“The more embedded a process is, the harder it is to change it. This was the best way (to conduct a capitals assessment) a few years ago but now it's not (and management) has to be adaptable – the field is evolving.”

– Interviewee, 2022

Related to this challenge is the recognition that there is also a lack of alignment on the definitions related to capitals assessments and assurance. It was a challenge to create alignment during the research. Some interviewees felt that until there is consensus on clear definitions related to capitals assessments and assurance, building confidence in this information will remain a challenge.

“Capitals assessment, validation, assurance, conformity assessment, assurer, auditor, auditing, user, stakeholder... we need alignment on all these definitions and the relations between each other (as a first step)”

– Roundtable participant, 2022

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Consensus building and alignment on the definitions related to capitals assessments and assurance.
- ◆ Develop a guide on the levels of confidence in the input data for capitals assessments.
- ◆ Draft a list of considerations for preparers to cross-reference when developing their capitals assessment and require them to be more transparent in their methods and source data. This may include whether peer-reviewed reports or journal articles were used, how it relates to specific contexts, reasons for use etc.
- ◆ Create a guidance with signposts and references to existing process guidance (e.g., ISO Standards, BSI and SVI standards, the Protocols etc.).
- ◆ Develop a list of examples of what data to collect and what would be relevant for different management decisions.
- ◆ Develop a checklist for preparers with elements to ensure the information provided is relevant and credible information for decision making. This could include what the information is and how the results are used to inform basic business decisions. Preparers need guidance on what makes for credible data in capitals assessments that is “CFO check ready.”



Step 3: The preparer considers the need to engage an independent practitioner to lend credibility to the capitals assessment based on the needs of the user.

In this step management or the user determines that there is a need to engage an independent party, either the Internal Audit team or an external practitioner, to conduct an assurance engagement or review a capitals assessment.

Challenge #3: Weak market drivers and lack of a regulatory framework for assurable capitals assessments

Similar to Step 1, one of main barriers identified was weak market drivers for assurable capitals assessments information. There is limited demand for assurance of capitals assessments and, as a result, organizations are not prioritizing capitals assessments or the assurance of this information for their decision making.

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Engage the investor and insurance community through webinars, hosting dialogues, roundtables, or one-on-one interviews to share the value of assurance and better understand what would help build the trust and confidence in this process and create the conditions to have them publicly advocate for assuring capitals assessments.
- ◆ Write technical op-eds and articles to engage the general public on the importance of credible capitals assessments with a focus of building trust in the accounting and assurance profession.
- ◆ Publish case studies about how shareholder proposals for assurance have influenced businesses e.g., shareholders request the Board to issue an audited report to shareholders on the financial impacts under the International Energy Agency's Net Zero scenario.



Step 4: The preparer and/or user selects the assurance activity and practitioner based on the user's needs and the purpose of the assurance activity.

With any type of assurance activity, particularly for any assurance engagement, the purpose must be clearly defined. In this step the preparer and/or the user selects the assurance activity and practitioner based on the needs of the user and the purpose of the assurance activity.

For assurance engagements, specific criteria must also be met. The International Framework for Assurance Engagements and The Chartered Professional Accountants of Canada have outlined characteristics to define an assurance engagement including:

1. "There are three parties involved: the party preparing the information, the party relying on the information, and the party providing the assurance conclusion.
2. There is appropriate subject matter.
3. There are suitable criteria that the practitioner can apply to evaluate the subject matter. The criteria are available to the intended user(s).
4. The practitioner can obtain the evidence needed to support the assurance conclusion or how the subject matter performs against the criteria.
5. A conclusion is provided by the assurance practitioner in a written letter."¹⁵

Challenge #5: Preparers and users lack assurance knowledge

A top barrier identified is that preparers and users lack knowledge about assurance. This includes a lack of understanding on the purpose of assurance, types of assurance and the associated risks and outcomes of assurance reports and conclusions. Selecting an assurance activity that does not meet the needs of the user or exposes the preparer to reputational risks could lead to limited access to capital or insurance.

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Signpost preparers and users (including Boards) on the different types of confidence-building activities for capitals assessments, their purpose and the value each provides including related risks e.g., expand on The Buyer's Guide to Assurance¹⁶.
- ◆ Develop criteria for practitioners to ensure quality, ethics, and contextual knowledge to guarantee the quality of their work i.e., against a risk and quality assurance framework for non-accountants.

Step 5: The practitioner completes the assurance activity on the selected subject matter.

In this step the practitioner conducts their assurance activity on the selected subject matter based on the purpose defined to meet the user's needs. Within the context of a capitals assessment, assurance activities could be conducted on the content of a capitals assessment or on the process of the capitals assessment. Assuring the content would involve providing a conclusion about whether the value claimed is reasonable or plausible based on the disclosed approach and valuation methodology. Assuring the process would involve providing a conclusion about whether the value reported is representative of the context.

¹⁵International Framework for Assurance Engagements: <https://www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/standards-other-than-cas/publications/understanding-assurance-needs-framework-decision-makers>

¹⁶World Business Council for Sustainable Development https://docs.wbcsd.org/2019/11/WBCSD_ICAEW_A_buyers_guide_to_assurance_on_non-financial_information.pdf



Challenge #1: Lack of assurable criteria on the process for conducting a fit-for-purpose capitals assessment

The lack of assurable criteria, and appropriate subject matter, for the process of conducting a fit-for-purpose capitals assessment across all the capitals and on the integrated nature of the capitals was one of the main barriers identified at this step. This then limits the ability to provide assurance on the process for conducting fit-for-purpose capitals assessments as there is no set criteria nor appropriate subject matter against which to assure.

There are a handful of examples of preparers that have obtained assurance on the content of their capitals assessments e.g., the assurance of Forico's natural capital assessment conducted by KPMG using the Australian Standard on Assurance Engagements ASAE 3000 for the Directors of Forico Pty Ltd¹⁷. The reason the practitioner was able to conduct an assurance engagement on the content was because the preparer clearly disclosed their methodology and calculations related to the capitals assessment, which was sufficient for the practitioner to develop suitable criteria based on the methodology disclosed. However, an important gap remains for assuring the capitals assessment process.

Solutions

The following is the first step that can be taken to address this challenge:

- ◆ Collaborate with other organizations and leverage existing work to develop appropriate subject matter and suitable and assurable criteria for the process of developing capitals assessments. Some of the existing standards and guidelines that can be leveraged include:
 - Natural Capital Protocol
 - Social and Human Capital Protocol
 - ISO 14007:2019 - Environmental management — Guidelines for determining environmental costs and benefits
 - BS 8632 Natural Capital Accounting for Organizations and BS8950 Understanding and enhancing Social Value
 - ISO 14008 Monetary Valuation Of Environmental Impacts And Related Environmental Aspects
 - Social Value International – Standard for applying Principle 3: Value the things that matter and SVI Report Assurance Standard
 - ISO 14071 - ISO/TS 14071:2014 - Environmental management — Life cycle assessment — Critical review processes and reviewer competencies: Additional requirements and guidelines to ISO 14044:2006
- ◆ Work closely with the International Accreditation Forum (IAF) to ensure conformity to ISO/CASCO standards

¹⁷ Forico's 2021 Natural Capital Report: <https://forico.com.au/volumes/images/Natural-Capital-Report-2021.pdf>



Challenge #4: Financial auditors lack the contextual knowledge on capitals assessments

Another challenge identified is that traditional financial auditors lack the contextual knowledge on capitals assessments of natural, human, and social capital. Financial auditors need to be better equipped to ask questions related to the impacts and dependencies on these non-financial capitals. Without this knowledge and broader understanding, important questions may be omitted, which increases the risk for both the preparer and the practitioner.

“Knowledge is one thing –the attitude and mindset (of traditional auditors) needs to change. (We need to) start with understanding the bigger picture”

– Interviewee, 2022

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Advocate for assurance teams to engage capitals assessments subject-matter experts on their engagement team.
- ◆ Work with accounting firms’ professional practice departments or quality teams to integrate an understanding of capitals assessments and sustainability data.
- ◆ Work closely with the International Accreditation Forum (IAF) to ensure conformity to ISO/CASCO standards.
- ◆ Engage accounting governing bodies in a dialogue to determine pathways for the development and deployment of training on human, social and natural capitals assessments for traditional auditors.
- ◆ Develop guidance for traditional auditors on what natural, human, and social capital are and how capitals assessments impact on financial performance and reporting, the assurance implications and how to apply ISAE 3000 more specifically to the subject matter etc.

Step 6: The user applies the assurance activity outcome, conclusion, or opinion to inform a decision.

In the last step following the assurance activity the user receives the outcome, conclusion, or opinion report and applies it to inform their decision.

Challenge #5: Preparers and users lack assurance knowledge

This step highlights the challenge that preparers and users lack assurance knowledge. Users of assurance reports often lack the assurance knowledge to interpret the assurance outcomes, conclusions, or opinion. The results of an assurance activity are then used to inform decisions that are disconnected with the purpose or context of the original assurance activity. This leads to an increased risk for the user as decisions could be made based on information that is not relevant or fit for purpose. Further, there are currently limited consequences to decision makers if they make decisions using data that is not assured or where the risk of material misstatement is too high.

Solutions

The following are first steps that can be taken to address this challenge:

- ◆ Signpost preparers and users (including Boards) on the different types of confidence building activities for capitals assessments, their purpose and the value each provides including related risks¹⁸.



¹⁸ Building on WBCSD and ICAEW's Buyer's Guide to Assurance on Non-Financial Information: https://docs.wbcsd.org/2019/11/WBCSD_ICAEW_A_buyers_guide_to_assurance_on_non-financial_information.pdf

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Next steps to explore

This research summarises the following actions that can, and must, be taken to build confidence in capitals assessments.



Consolidation

- ◆ Collaborate with other organizations (e.g., International Organization for Standardization (ISO), International Accreditation Forum (IAF), Social Value International (SVI), British Standards Institution (BSI) etc.) and leverage existing work, such as the Natural Capital Protocol and Social & Human Capital Protocol among others, to develop appropriate subject matter and suitable, assurable criteria for the process of developing capitals assessments.

Education

- ◆ Develop a checklist for preparers of the elements that make for relevant and credible capitals information for decision making. This would include guidance on how to use the results of capitals assessments to inform basic business decisions, what resources are needed, and where they can be sourced.
- ◆ Create supporting guidance and training on how the International Standards on Assurance Engagements (ISAE) 3000 and the International Auditing and Assurance Standards Board Guidance on Assurance of Extended External Reporting Assurance (EER guidance) can be applied to a capitals assessment context.
- ◆ Develop guidance for preparers on how to conduct meaningful and robust capitals assessments with examples and signposts to existing guidance. Preparers without subject matter expertise need education on what makes for credible data, so capitals assessments are “CFO check ready.”
- ◆ Prepare guidance and training in partnership with governing bodies, professional practice and quality teams at accounting firms.
- ◆ Build guidance and training for preparers and users (including Boards) on the purpose and importance of assuring capitals assessments.
- ◆ Work closely with the International Accreditation Forum (IAF) to ensure education materials are in conformity to ISO/CASCO standards.

Advocacy

- ◆ Create further awareness about how capitals assessment links to the business agenda and relates to the wider developments in sustainability, including disclosure and reporting with an emphasis on the importance of robust information.
- ◆ Support the users’ demand for high quality assurance and encourage preparers and practitioners to understand the importance of facilitating and arranging high quality assurance. Engage influential market stakeholders to share the importance of capitals assessments and assurance.
- ◆ Advocate for assurance teams to have capitals assessments subject-matter experts on their team.
- ◆ Create awareness and encourage practitioners to use and apply ISAE 3000 and EER guidance for capitals assessment assurance activities.

The Capitals Coalition will seek to further this agenda in collaboration with its global community. It also encourages others to use these findings and act to build the confidence in capitals assessments and help create a world that values the contribution of all the capitals.



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Appendix



Glossary of key terms

Capitals Assessment: The identification, measurement and valuation of impacts and dependencies on all the capitals in order to inform organizational decisions

Valuation: The process of estimating the relative importance, worth or usefulness of the capitals to people (or to a business), in a particular context. Capitals assessment may involve qualitative, quantitative or monetary approaches, or a combination of these.¹⁹

Assurance: Reducing risk of material misstatement to a level acceptable to the user.

Practitioner: The party conducting the assurance activity and/or proving the assurance conclusion.

Preparer: The party preparing the information (e.g., the capitals assessment).

User: The party relying on the information (e.g., the party using the capitals assessment to inform a decision.)

Assurance activity: Activity conducted to increase the confidence in the subject matter.

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¹⁹ As defined in the Natural Capital Protocol: https://capitalscoalition.org/capitals-approach/natural-capital-protocol/?fwp_filter_tabs=training_material





The Capitals Coalition is a global collaboration transforming the way decisions are made by including the value provided by nature, people and society. Our ambition is that by 2030 the majority of business, finance and government will include all capitals in their decision-making, and that this will deliver a fairer, more just and more sustainable world.

www.capitalscoalition.org