CAPITALS COALITION

Conceptual Framework for Sustainability Reporting

2022

Towards a Conceptual Framework for Sustainability Reporting

Using the structure and logic of the Conceptual Framework for Financial Reporting in determining useful information but starting with the intention of reporting on sustainability.

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This paper is supported by an appendix that sets out what the Conceptual Framework for social and human and natural captial reporting could look like and examples of measurement bases.

To read the appendix , please click here.

Appendix A

The Conceptual Framework for Social, Human and Natural Capital Reporting

Appendix B

The Conceptual Framework for Financial Reporting (CFFR) sets out the fundamental concepts for financial reporting. It helps to ensure that accounting standards provide useful information for investors, lenders and other creditors. Financial reporting has been through various attempts to consolidate and standardize its approach to reach the current state of the International Financial Reporting Standards (IFRS) but perhaps the most significant point of consolidation was the articulation of a Conceptual Framework. As reporting is not a scientific endeavor, the principles that underpin reporting are not fixed but represent choices and norms. Perhaps the most important recent change is the decision of the IFRS to establish the International Sustainability Standards Board (ISSB) to sit alongside the International Accounting Standards Board (IASB).

The purpose of this paper is to stimulate discussion and contribute to the development of these standards by, as far as possible, applying the logic and structure that the CFFR uses in determining useful information to sustainability. This approach should show points of commonality as well as highlighting the main differences.

The CFFR focuses on financial capital and physical capital within the boundaries of the reporting entity. As both are incorporated into what is commonly referred to as produced capital, this report focuses on the missing capitals of natural, social, and human capital (see Diagram 1). Natural, social, and human capital are important concepts and form the foundation of human wellbeing and economic success but are missing from the CFFR. By understanding the sustainability context and how organizations impact and depend on all the capitals, they can make holistic decisions that create value for nature, people and society alongside businesses and the economy. A capitals approach moves beyond considering only how we impact on the capitals to also highlighting how we depend on them. This shift in mindset contextualizes our relationships with the capitals and helps to illustrate a clear business case for their protection and investment in their health and resilience.

Diagram 1: The Capitals

Natural capital	Social capital	Human capital	Produced capital
The stock of renewable and non-renewable natural resources that combine to yield a flow of benefits to people.	The networks together with shared norms, values and understanding that facilitate cooperation within and among groups.	The knowledge, skills, competencies and attributes embodied in individuals that contribute to improve performance and wellbeing.	The human-made goods and financial assets that are used to produce goods and services consumed by society.

The Capitals Coalition and its predecessor bodies have done a considerable amount of work and standardization in this area, as set out in the Natural Capital Protocol and the Social & Human Capital Protocol and associated guidance, tools, and resources. The Capitals Coalition is currently combining these into one integrated capitals protocol and developing the links between decision making and disclosure. This discussion paper, which builds on earlier work on the disclosure of impacts on capitals in financial statements, is also expected to inform that process.

This paper intends to address these missing capitals and set out what an interim Conceptual Framework for Sustainability Reporting (CFSR) could look like. The CFFR has been developed over several years and is informed by the existing IASB standards. The approach to determining useful information, covering the concepts of relevance and faithful representation, and allowing for inevitable uncertainty, is well established. A CFSR could follow the same scope, logic, and structure as the CFFR with the same approach applied to other capitals. A CFSR could have the same scope as the CFFR, covering the reporting of past management decisions. A management commentary, if provided, would include information on the effect of external factors on an enterprise's performance and the entity's own future strategy and would also, but separately, be useful to investors.

Appendix A sets out an interim CFSR based closely on the CFFR. Each section highlights the main issues that arose in using the CFFR and highlights the reasons why this is an interim position. In a continuum between a world where resource allocation decisions are primarily based on expected financial returns to one where they would be based on sustainability returns (all the capitals), we have had to make a judgement of how far to go. We have erred on the side of maintaining the structure and language of the CFFR in order to generate discussion between financial and sustainability accountants.

The main point of difference is the purpose behind the decisions. The CFFR clearly states who the primary users are, the decision being made, and the purpose behind that decision. The primary users of financial reports are current and potential investors, providers of loan finance and suppliers, making decisions to provide economic resources, in the expectation of financial returns. In this interim CFSR, the primary users would remain current and potential investors, providers and loan finance and suppliers, still making decisions to provide economic resources but now in the expectation of returns to social, human, and natural capital. The structure of the CFFR addresses the same issues that would be addressed in a CFSR and, critically, users will need a combination of information on all the capitals that have been used by the entity as well as managers' performance in making decisions to create returns to those capitals.

By focusing on an interim step, but using the logic and structure of the CFFR, it is possible to:

- provide a contribution to the work of the ISSB and disclosure of information on social and environmental topics;
- highlight the consistency between the Capital Coalitions Protocols and the CFFR; and
- show the relevance and importance of building on the approach to useful information that has been established by the IFRS in the CFFR.

The idea of returns to capitals has been used for comparability with the CFFR. The language that is commonly used and is used in the Capital Coalition's Protocols is of 'impacts and dependencies on the capitals', or in other words, changes to those capitals that have been caused by the decisions of the managers of an entity. 'Financial' in the CFFR has been replaced in the interim CFSR with 'Natural, Social and Human Capital' and 'economic' has been replaced with 'social and environmental'. This increases comparability with the CFFR but should also be seen as an interim position since the use of 'economic' would need to change in a fully integrated CFSR.

Useful information will provide a measure (using the language of the CFFR) of impacts and dependencies so that users can properly evaluate the performance of the business and the prospects of its business model. It will show how any trade-offs have been made between capitals, building on existing guidance in the Principles of Integrated Capitals Assessments, and how capital is being maintained. Public policy is required to set limits on thresholds and allocations and the extent to which trade-offs can be made. In the absence of those policies, businesses will need to report those trade-offs and reference other scientific and social norms as a context.

Sustainability, capitals, impact and well-being

There is increasing convergence in the concepts that underpin the language of sustainability, capitals, impact, and well-being. There is also a growing recognition that the purpose of human activity is to increase the well-being of current and future generations, and therefore the well-being of people and planet, or equally to contribute to sustainability, assessed by accounting for impacts on all capitals. Examples include the UNDP SDG Impact Standards, OECD's work on well-being, work on the Future of the Corporation at Said Business School, the BSI PAS 808 on purpose-driven organisations and in ISO 37000 on governance of organisations.

Conclusions

The most important result of this paper is that much of what is set out in the CFFR could be replicated in an interim CFSR, especially in the earlier sections. The logic behind what would be useful information for the existing primary users remains the same. Nonetheless there are important differences in how this would be created and the level at which it would be disclosed. Further work would be required to finalize an interim CFSR especially in relation to the elements of reporting in Section 4 and to maintenance of the capitals in Section 8. The main changes that were needed to be made to the CFFR to create an interim CFSR, primarily resulting from the change in purpose, are:

- a potentially lower threshold for existence, outcome, and measurement uncertainty for disclosure, including for the concept of measurement in the CFFR which relates to impact valuation in sustainability and impact accounting;
- the removal of the requirement that an obligation cannot be practically avoided replaced with recognizing that ethical and responsible business practices may require the creation of an obligation irrespective of any practical ability to avoid the obligation;
- the replacement of the concept of control with the concept of responsibility to recognize positive and negative changes to capitals which are not controlled, building on the attribution hierarchy in the Principles of Integrated Capitals Assessments;
- clarification of the use of language, as measurement in the CFFR refers to the common unit of money whereas measurement in the Capitals Coalition's Protocols refers to the change in a capital and valuation of the relative importance of such changes; and,
- the addition of the measurement of change in natural, social and human capital although the valuation of change can follow existing approaches in the CFFR but with a higher level of uncertainty.

Subsequent integration of the CFFR and the interim CFRS would start by recognizing that existing and potential investors are in fact all people, who have an interest in both their expectations of financial returns and returns to natural, social and human capital, in other words in both their individual wellbeing as well as the consequences for the well-being of others. We believe that this restated purpose represents the information needs of the maximum number of these users. Integration would also mean the existing audit framework would be applied, building on the IAASB guidance on Extended External Reporting.

Next steps

The purpose of this paper is to promote discussion and to contribute to the development of sustainability accounting and reporting.

Issues for a future CFSR

Decisions to provide economic resources:
The decision to provide economic resources in the CFFR hinges on the concept of control, i.e., the decision to provide resources controlled by the primary user. This does not account for the use of those resources on which the entity's business model depends, but which are not controlled by a primary user. In relation to returns on capitals, any use of resources which are not controlled by those providing resources would be accounted for in the calculation of returns. However, decisions would be more effective if the decision to provide resources had already considered all those resources on which an entity depends for the generation of returns, whether financial or returns to natural, human and social capital. This interim CFSR therefore considers dependencies in the calculation of returns and in the calculation of capital used but not in the decision to provide economic resources. The change required would be for primary users to make decisions to provide resources, recognising both resources they control, those that are owned in common and those that are being taken from others, either unpaid or underpaid and considering the limits imposed by planetary and social thresholds.

Primary users:
Although the users of a CFSR would be all those with an interest in returns to all the capitals which is wider than the primary users in the CFFR, it is possible to argue that the current and future population of the world are already primary users since:

- **The current and future population of the world are either current investors or potential investors. The CFFR may have intended potential investors to only cover those investors that control economic resources, but everyone has the potential to control economic resources especially if the overarching public interest behind the CFFR is met;**
- **Whilst investors recognise external investors and suppliers as people that provide resources in the expectation of financial returns (or payments for supplies), employees are also investors as they invest time for a financial return; and**
- **The purpose of financial returns is not the financial returns per se, it is the potential for an increase in well-being that investors expect from those returns. Financial returns are a proxy for well-being. If investors provide resources in expectation of a potential increase in well-being, then current and potential customers are also investors since they make purchases in the expectation of a potential increase in well-being.**

Relationship between capitals:
Finally, a CFSR would have to address the relationships between the capitals and recognise a hierarchy across capitals. Financial capital and financial returns are a means to an end. The purpose of generating financial returns is to enable changes in other capitals. This would mean that the information generated by standards developed under the CFFR would be an input to a CFSR and not the other way around. Even if this were to be recognised and accepted, the implications for the detail within the CFFR and this interim CFSR would require more work.

Nonetheless this could be achieved by integrating the purpose in the CFFR and the interim CFSR which would become the provision of resources in the expectation of financial, natural, social and human capital returns.

To read the Appendix in full, please click here.

CAPITALS COALITION

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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 governmnet will include all capitals in their decision-making, and that this will deliver a fairer, more just and more sustainable world.

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