Intelligence MEMOS

From: Peter van Dijk

To: Canadians Concerned about Recognition of Natural Assets

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Re: **WHY PUBLIC SECTOR ENTITIES MUST BE ALLOWED TO INCLUDE NATURAL ASSETS IN FINANCIAL STATEMENTS**

Canada's wealth of natural capital – forests, wetlands, rivers, lakes and grasslands – deliver critical benefits to support our economy and our society.

Despite their value, these natural assets only turn up in the financial statements of public sector entities in Canada when they are purchased or capital was spent to repair or restore them.

This dramatically understates the actual value of these assets, which are predominantly owned by governments across Canada. Consequently, any decrease in the value of these assets – which could be very large – is not reflected in the financial statements.

Without knowing the costs of damage to these assets or the benefits of enhancing them, they are not consistently factored into economic decision-making. This favours the pursuit of short-term monetary gains that degrade natural assets over the long-term economic and social benefits they provide.

The degradation of natural assets represents a material risk to the long-term economic stability of Canada and the world. This is highlighted in many recent studies, including the World Economic Forum's New Nature Economy Series and the UK government's landmark Dasgupta Review. Valuing and appropriately managing natural assets also underpins Environmental, Social and Governance (ESG) performance and is critical to achieving the United Nations' Sustainable Development Goals.

In addition to maintaining biodiversity, the effective management of natural assets also addresses climate change on two fronts. First, restoration or expansion of natural assets increases carbon sequestration and storage, reducing greenhouse gases in the atmosphere. Second, natural assets contribute to climate change adaptation by reducing physical climate risks – wetlands restoration, expansion and creation reducing flood risks, is but one example.

Recognizing the importance of natural assets, financial institutions, regulators, and corporations established a working group in September 2020 to bring together a Taskforce on Nature-related Financial Disclosures (TNFD), similar to the established Taskforce on Climate-related Financial Disclosures (TCFD). In last month's Federal Budget, the government indicated Canada would join the TNFD.

There are already moves in several countries to adopt natural capital accounting systems. For example, in the UK, the Office for National Statistics (ONS) compiles natural capital accounts annually, in line with the guidelines recommended by the United Nations Statistical Commission's recently adopted ecosystem accounting protocols.

The private sector has already started incorporating natural capital considerations into investment decision-making. Detailing engagement priorities for 2021, BlackRock, the world's largest asset manager, stated: "All companies rely on natural capital in some way and, as the world transitions to a low-carbon economy, we ask companies to demonstrate how they are minimizing their negative impacts on, and ideally enhancing the stock of, the natural capital on which their long-term financial performance depends." Institutional investors are also looking for investment opportunities to increase natural capital as part of their sustainable finance initiatives, as exemplified by HSBC Pollination Climate Assessment Management's launch of specific natural capital funds.

However, as mentioned, most natural assets in Canada are owned by governments and other entities in the public sector. It, therefore, matters how governments value, manage, protect, and restore their natural assets on behalf of Canadians. The good news is that forward-thinking local governments in Canada are increasingly valuing and incorporating natural assets – in addition to built assets – into long-term asset management planning. While progress is made in the planning and management of these assets, their recognition in the financial statements of public sector entities is expressly excluded under the current standards issued by the Public Sector Accounting Board (PSAB) of CPA Canada.

PSAB is an independent organization entrusted with the authority to set accounting standards for public sector entities in Canada. PSAB's conceptual framework currently prohibits the inclusion of "natural resources and Crown lands that have not been purchased." This means that public sector entities that have valued their natural assets are actively prevented from including these assets in their financial statements.

PSAB is currently holding formal consultations on proposed changes to its conceptual framework. But the proposals do not include removing the prohibition. They do acknowledge the importance of these assets and recommends that the PSAB carry out further research and consultation on whether this exclusion is appropriate.

The PSAB should remove this outdated prohibition altogether, considering the importance of natural assets for our economy and our society and the availability of generally accepted valuation methodologies for natural assets. It should also give guidance for those entities that want to proceed with disclosure and a timeline for when new standards will be developed.

The urgency to address this issue now is significant because leaving these assets outside the accounting framework leaves them hidden when they are at their greatest risk. The timing for paving the way for more full and timely recognition of the value of natural assets in our financial reporting frameworks is now.

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