

The CBI's recommendations on carbon reporting

August 2009



Introduction

Many large companies now invest considerable resources in acquiring, analysing and reporting their greenhouse gas (GHG) emissions. Yet, the reality is that corporate reporting is of far less value than it could and should be to investors and other stakeholders as a consequence of inconsistencies in the scope of reporting, the narrowness of the scope of reporting and inconsistencies in the application of reporting protocols and emission estimation techniques.¹ This affects all parties: investors seeking to assess the financial implications of climate change for the companies in which they invest, stakeholders wishing to understand companies' GHG emissions performance, and companies trying to differentiate between suppliers or partners on the basis of environmental performance. Perhaps most significantly, problems in reporting could reflect weaknesses in companies' analysis of their GHG emissions: there is a real risk that companies themselves are making the wrong decisions in terms of where they deploy their capital and focus management attention.

The need to standardise corporate GHG emissions reporting is recognised as a policy priority in the UK. The UK Climate Change

Act 2008 requires the Government to publish guidance on the measurement or calculation of GHG emissions, to carry out a review in 2010 to evaluate the contribution that reporting on GHG emissions is making to the achievement of its climate change objectives, and to introduce regulations requiring the mandatory reporting of GHG emissions information by April 2012 (or submit a report to Parliament explaining why this has not happened). In June 2009, the UK Department of Energy and Climate Change (DECC) and the Department for Environment, Food and Rural Affairs (Defra) issued a consultation document, 'Draft Guidance on How to Measure and Report your Greenhouse Gas Emissions', setting out broad principles on how companies should measure and report on their GHG emissions.²

The CBI Carbon Reporting Working Group

In summer 2008, the CBI established its Carbon Reporting Working Group. Chaired by Rory Sullivan, Head of Responsible Investment at Insight, the Group included representatives from a range of companies including Ernst & Young, Kingfisher, Lloyds Banking Group, Aviva, Linklaters, Tesco, Shell International Limited, Corus UK Limited, PriceWaterhouseCoopers and BT.

The Working Group's objective was to produce proposals for how businesses might measure their carbon emissions, based on the best of existing corporate reporting frameworks. These proposals – which were contained in a report, 'All Together Now', published by the CBI in June 2009 – were based on:

- the participants' experience with GHG reporting;
- a review and comparison of voluntary and mandatory GHG reporting protocols and standards from around the world, and;
- discussions with key organisations involved in this area, such as the Climate Disclosure Standards Board, The Carbon Trust and Defra.³

CBI's Technical Proposals

The Working Group's starting premise was that any reporting requirements should be based on the World Resources Institute/World Business Council for Sustainable Development's Greenhouse Gas Protocol, as this is the most widely used and globally recognised reporting standard for the measurement and disclosure of GHG emissions. However, the Working Group recognised that the GHG Protocol leaves

many choices – in particular, in relation to the boundaries and scope of reporting – open and therefore, proposed refining how the GHG Protocol is applied by companies in measuring and disclosing their emissions.

Establishing boundaries

In relation to boundaries, the GHG Protocol permits three approaches, the equity approach (where the entity reports only its ‘share’ of emissions of subsidiaries and joint ventures), the operational control approach (where the entity reports 100% of the emissions for the subsidiaries where it has the ability to introduce and implement operating policies, irrespective of its economic interest in the subsidiaries) or the financial control approach (where the control is defined as entities consolidated for financial reporting by the entity).

The Working Group proposed that companies follow the financial control method for GHG reporting, for a number of reasons. First, it aligns GHG emissions reporting with financial reporting and also addresses one of the key challenges in reporting – reconciling emissions in joint ventures (as the treatment of joint ventures is well established for financial reporting). Second, it allows the development of relative indicators by comparing GHG emissions against financial results (such as turnover) prepared on a similar basis. Third, it focuses attention on where the company derives the economic benefits and/or bears the risks of exposure to the emissions produced. The principle is that company management should be responsible for seeking to reduce emissions in all activities that they are financially responsible for, even if they are not directly responsible for day-to-day operation of the plant or facility.

Scope of reporting

In terms of the scope of reporting, the Working Group proposed that companies report on emissions they are directly responsible for – i.e. from heating, company-owned vehicles, industrial processes and refrigerants – as well as from each company’s electricity consumption (i.e. emissions corresponding to ‘Scope 1’ and ‘Scope 2’ in the GHG

Box 1: Scope 3a and 3b emissions

Scope 3a	Scope 3b
Business travel (non company-owned vehicles)	Distribution beyond point of sale
Outsourced or subcontracted business processes (e.g. IT services, customer support etc)	Employee commute
Contractors, e.g. for property construction and/or maintenance	Raw material life to point of purchase, including fossil fuels extraction, production and transport
Emissions from waste in landfill and transport of waste	Emissions generated through use of products
Assets under operating lease	Emissions generated at end of product life, particularly product disposal

Protocol). The group believed that focusing on Scope 1 and 2 emissions represented a sensible focus, as the boundaries for these emissions are clearly defined, the information sources relatively easily available and many of the emission factors needed are currently provided by government.

The Working Group noted that Scope 3 emissions (i.e. those emissions occurring as a consequence of a business’s activities, but that are not directly owned or controlled by that business) currently represent advanced practice in emissions reporting. While some leading companies have begun to report emissions in this category, particularly in parts that are more easily understood (e.g. employee business travel in non company-owned vehicles), these emissions remain costly and challenging for many businesses to report as comprehensive methodologies and conversion factors have not yet been established. The Working Group argued that policy-makers should encourage progress by supporting further research on these emissions within Scope 3 to establish robust and consistent measurement techniques, methodologies and the necessary conversion factors. In this context, the Working Group suggested that Scope 3 emissions could usefully be divided into Scope 3a and Scope 3b (as in Box 1). Scope 3a emissions represent those that are still challenging to measure

but where most progress has been made in establishing relevant measurement techniques and methodologies. Emissions within Scope 3b are significantly more complex to measure, with much less progress having been made in establishing robust and cost-effective means of data collection.

Accuracy and materiality

The Working Group was of the view that it is premature to define a formal ‘accuracy’ or ‘materiality’ threshold for reporting. For example, while a relatively small omission from the company’s total emissions volume may not be significant compared with the total emissions volume, if this omission causes the information presented to indicate the company had reduced emissions in the period reported when in fact it had not, the omission could be considered material. At the other end of the scale, companies with small absolute GHG emissions footprints could find that numerical thresholds could add an unnecessary reporting burden, as a relatively large percentage change in their emissions (even though this may represent a very small change in absolute emissions), may trigger a series of recalculations in reported emissions without producing significant overall benefit to the organisation or any users of its GHG emissions data.

Despite these concerns, the Working Group recognised the need for companies to adopt a consistent and transparent approach to decision-making in their GHG reports, and for them to explain their decisions as an integral part of the reporting process. It therefore proposed following the principles established in financial reporting (i.e. embedding the practice of 'define and explain' rather than establishing single numerical thresholds for decisions over materiality), and also recommended that companies provide sufficient narrative information to explain the approach they have taken (assumptions, calculation methodology, views on the uncertainties in their emissions estimates) as an integral part of their reporting.

More generally, the group argued that companies should provide narrative and supplementary information to put their emissions information into context. This not only includes information on how emissions data have been calculated (e.g. assumptions, inclusions/exclusions) but also information that enables the emissions to be put into context (e.g. a description of the business and its activities, emission reduction targets where these have been established, trends in emissions over time).

Comparing the proposals of the CBI and DECC/Defra

Overall, there is strong alignment between the CBI Working Group's proposals and those that have been proposed by DECC/Defra. DECC/Defra have proposed that financial control is the preferred way of defining organisational boundaries, that companies should report on their Scope 1 and 2 emissions, and that companies should provide information on how they have calculated their emissions as well as wider information on the business, its targets and trends in its GHG emissions.

However, there are also a number of differences where further work is required. These primarily relate to specific technical issues and to the manner in which a

mandatory GHG emissions reporting requirement would be implemented.⁴

The first issue is who exactly will be required to report. The Working Group suggested that mandatory requirements should be applied to those companies covered by the EU Emissions Trading Scheme (EU ETS) and the Carbon Reduction Commitment (CRC), on the grounds that these companies will already have the data and systems required to report on their emissions. Others have argued that a much wider number of firms, including most SMEs, should be required to report on their emissions. This is obviously an issue that will be the subject of much discussion over the coming months. The decision reached has important resource implications as the greater the number of companies that need to report, the greater the need for government support in terms of the provision of reporting tools and other business support.

The number of firms that are required to report will also have implications for the type and level of verification that is required. Verification is an integral part of the reporting requirements for firms covered by the EU ETS (where the entire emissions inventory is required to be verified) and the CRC (where the verification is focused on a selection of participants). However, the Working Group argued that, given many firms' emissions will be relatively small and that many technical issues and uncertainties are yet to be resolved, mandatory verification or assurance would not be a proportionate approach to encouraging data accuracy and transparency within a national reporting framework such as that envisaged in the Climate Change Act. The Working Group therefore argued that businesses should internally verify the accuracy and robustness of their reported emissions and have a clear and transparent quality control process in place to demonstrate the robustness of the verification process. The working group noted that this is likely to be an ongoing discussion and recommended that any future reviews of the effectiveness of

mandatory reporting in the UK should include an assessment of the merits of business self-verification of emissions.

The working group highlighted transport as an area where companies face real technical challenges in reporting. The reasons include the difficulties in gathering robust data on fuel types, vehicle models, average speeds and activity levels, the limitations in government conversion factors for transport, and the difficulty in assigning and calculating carbon emissions from 'multi-user' transport solutions, where either a single transport provider or a network of transport providers may all have a role in moving products between countries and within countries for a customer using a variety of modes of transport.

Finally, the working group highlighted the potentially serious issue of inconsistency between reporting requirements. There are two dimensions to this. First, a number of existing mandatory reporting requirements, such as the Carbon Reporting Commitment, are potentially in conflict with the GHG Protocol. Potential areas of difference include the way in which company boundaries are defined, the conversion factors used to calculate emissions data, the treatment of subsidiaries and joint ventures and the threshold set for recalculating the base reporting year. Second, companies may face multiple reporting requirements because they operate in different countries. The working group highlighted the importance of the UK Government leading international discussions on a common approach to measurement and disclosure of GHGs.

Next Steps

Insight is encouraged by the very significant progress that has been made towards the introduction of mandatory GHG reporting in the UK and see the proposals from the CBI working group and from DECC/Defra as representing a critical step forward in addressing some of the key issues in reporting around consistency and comparability. The proposals also present a pathway – including identifying the key policy challenges – for the UK

Government to implement mandatory reporting.

We intend to play an active role in these discussions, as we see standardised GHG emissions reporting as an essential building block in moving towards a low carbon economy. In the short term, we will encourage businesses to work with DECC/Defra to address the technical and policy issues outlined above. Once DECC/Defra conclude their consultation and issue their final guidelines, we will encourage companies to adopt these guidelines and to provide feedback on their experience with using them.

¹ The limitations in the quality of corporate reporting on climate change have been a recurring theme of much of our climate change-related research and engagement. see, for example, our reports “ Taking the Temperature: Assessing the Performance of Large UK and European Companies in Responding to Climate Change” (2008), “Climate Change Disclosure Standards and Initiatives: Have they Added Value for Investors?” (2006), and “The Climate Change Disclosures of European Electricity Utilities” (2006).

² <http://www.defra.gov.uk/corporate/consult/greenhouse-gas/draft-guidance.pdf>

³ (<http://climatechange.cbi.org.uk/uploaded/All%20together%20now%20-%20a%20common%20business%20approach%20for%20greenhouse%20gas%20emissions%20reporting.pdf>)

⁴ It is important to note that the DECC/Defra guidelines relate to voluntary GHG emissions reporting and, as a consequence, do not address some of the key institutional issues that would need to be addressed in a mandatory reporting regime.

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