

ALDEERSGATE GROUP

CARBON COSTS: CORPORATE CARBON ACCOUNTING AND REPORTING

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Foreword

Climate change is the single biggest environmental challenge we face. Whilst the changes and costs become ever clearer, we are only just starting to get to grips with what needs to be done. New strategies, initiatives, funds, tools and techniques emerge every day.

Some of the UK's biggest businesses have been addressing what is clearly a major business risk to all sectors. Many have made far-reaching commitments to reduce their emissions. However, these businesses should not be left to go it alone with others carrying on with business as usual.

But how can we tell who is truly committed? Who will gain? Who will lose? And where are the financial risks?

The current lack of rules on the disclosure of carbon dioxide is impeding progress. Without it, those who take action won't reap the full rewards, and those who do nothing cannot be effectively challenged. Without it, Government cannot know whether its carbon targets, and in particular its carbon budgets as proposed in the Climate Change Bill, are being achieved in corporate Britain.

We, the Aldersgate Group, believe that it is vital that carbon accounting and disclosure are clearly defined and comparable measures are used by all large business operating in the UK. A view shared by the World Economic Forum, which recently announced the creation of the Climate Disclosure Standards Board, so that the seven participating partners are consistent in their requests for information from companies.

The purpose of this report is to present the key issues, evidence and proposal for action so that the UK can be at the forefront and reaffirm its leading position in the financial markets in the world.

A handwritten signature in dark ink, appearing to read 'Adrian Wilkes', with a long, sweeping horizontal stroke underneath.

Adrian Wilkes

Chairman, Aldersgate Group

Introduction

The Aldersgate Group believes that high environmental standards, particularly in the use of our natural resources, are essential for our future economic well being and for the competitiveness of the UK economy. Our first report “Green Foundations: Better Regulation and a Healthy Environment for Growth and Jobs”¹, sets out this case.

We therefore welcome the present political consensus on the importance of understanding, measuring and controlling our carbon “footprint”. UK businesses, and the corporate sector in particular, have a vital role in carbon policy; yet few FTSE 350 companies have credible carbon reporting in place, and it is extremely difficult for investors to make sensible comparisons between those that do.

This lack of transparency not only serves to obscure the true contribution of the corporate UK to national or international carbon emissions; it also undermines the comparative advantage that should accrue to companies with good carbon reporting and control. This slows down what needs to be going faster – our transition to a low-carbon economy.

The Aldersgate Group believes that:

- 1 Improving carbon disclosure matters
- 2 The level of current carbon disclosure is too low and what there is, is not comparable
- 3 The lack of a clear definition and protocols is impeding progress
- 4 We need a common reporting standard, which is driven by Government and delivered by business

1 Improving carbon disclosure matters.

“The question we need to ask is whether the current regime of accounting, disclosure and financial regulation are ‘fit for purpose’ for a carbon-constrained world. And if the answer is that it isn’t, then we need to start designing a market regime that will give London a head start in the emerging low carbon economy.”

Nick Robins, Head of Socially Responsible Investment, Henderson Global²

Carbon emissions are now a financially material commodity with an economic and financial value to business, investors and the city. They need to be properly defined, measured, accounted for, audited and reported in the same way as other physical commodities and financial instruments. Too little is understood about the sources of carbon emissions in the economy. Measures introduced to control emissions do not have uniform financial effects on companies even within the same sector.

Companies are coming under investor demands to provide emissions data as part of their investment risk assessment processes. Many companies in Europe and North America now devote considerable resources to respond to those concerns. In many cases, however, where they make detailed quantitative carbon disclosures, those disclosures are often not adequate for investors to make meaningful comparisons.

The absence of comparable, standardised measures means that companies who reduce their carbon emissions are unable to demonstrate their success in relation to their competitors.

Existing drivers for corporate carbon disclosures:

- 1 Compliance with legislation e.g. EU Emission Trading Scheme Directive/ Companies Act 2006
- 2 Compliance with International & UK company reporting standards although currently a weak driver as standards act as little more than recommendations
- 3 Voluntary Measures e.g. World Business Council for Sustainable Development (WBCSD), Green House Gas Reporting campaign, Global Reporting Initiative and Carbon Disclosure Project
- 4 Investor pressure e.g. Institutional Investors Group on Climate Change, Climate Risk Group and Henderson Global Investors^{3&4}

Investors are vulnerable to ‘green wash’, where reporting consists of vague qualitative disclosures about the issue of climate change. The absence of reliable data allows companies that choose not to reduce their dependency on carbon emissions to avoid investor criticism. It also makes it difficult for markets to take account of carbon emissions within asset and liability pricing.

Companies reporting according to a common protocol will be able to demonstrate that they have used the appropriate process to assess risks, define boundaries, measure emissions and report on them in a way that is meaningful, consistent and comparable.

Carbon emissions are increasing in importance, both as a source of cost to companies and as an issue of concern to consumers. Given the global nature of many companies, and the global nature of the climate change problem, emissions disclosures need to display greater conformity.

² “Coming Clean: Revealing the UK’s True Carbon Footprint”, Christian Aid, February 2007

³ How Green is my Portfolio: A Carbon Audit of the Henderson Global Care Income Fund, Henderson Global Investors (Trucost) June 2005

⁴ The Carbon 100: Quantifying the Carbon Emissions, Intensities and Exposures of the FTSE 100, Henderson Global Investors (Trucost) June 2005

2 The level of current carbon disclosure is too low and what there is, is not comparable.

Despite improvements in the number of companies disclosing information on carbon dioxide and climate change, these disclosures are not comparable because of the use of different calculation methods.

A 2004 survey⁵ found only 6.5% of FTSE All Share companies refer to climate change with quantified data in their Annual Reports and Accounts. Only 6% quantify energy use. The follow-up report in 2006 indicated some improvements with 37% of companies making quantified disclosures on climate change or energy use. The disclosures, however, were not comparable.

Five companies in the 2006 report disclosed absolute figures for carbon dioxide (CO₂), waste and water use. They were Emap Plc; Johnson Matthey Plc; Invensys Plc; Scottish Power and Scottish & Southern Energy Plc.

Similar findings emerged from the fourth Carbon Disclosure Project (CDP)⁶ which found only 27% of FTSE 350 companies provided emissions data and only 10% of companies provided data that meets the most basic scope of the Green House Gas Protocol. Further work by Trucost indicated that 60% of the total emissions of the FTSE 350 were not disclosed to the CDP.

Carbon intensity is being used to differentiate investment products. For example, Carbon Counts⁷, a study which ranked UK retail investment funds according to the carbon intensity of their investments, showed that significant carbon savings can be achieved without compromising investment performance. The study required considerable research to standardise incomparable carbon disclosures and employed estimates of emissions in instances where companies did not disclose data.

These research examples clearly illustrate that the perceived value and use of carbon disclosures is currently well in excess of the supply.

5
Environmental Disclosure of the FTSE All-share, Environment Agency (Trucost), 2004

6
CDP Report 2006: FTSE 350, Trucost September 2006

7
Carbon Counts: The Trucost Carbon Footprint Ranking of UK Investment Funds, June 2006

3 The lack of a clear definition and protocols is impeding progress.

“Consistent and comparable disclosure frameworks are important to the incentives shareholders provide corporate managers to deploy capital efficiently”

Richard Samans, Managing Director, World Economic Forum, Davos 2007

There is currently no internationally or UK agreed model for carbon accounting and reporting. The main reporting guidelines and definitions are:

DEFRA CO₂ environmental Key Performance Indicators (KPIs)

In January 2006, DEFRA published best practice guidelines for how UK companies should report environmental impacts including green house gas (GHG) emissions. These guidelines promote a standard calculation method and ensure consistent reporting. The guidance underwent extensive consultation with UK companies, investors and trade associations. It has the support of experts in Defra and the Environment Agency and is consistent with the Global Reporting Initiative CO₂ KPI.

Global Reporting Initiative (GRI) CO₂ measurement KPI

Some companies use the GRI guidance and CO₂ KPI but they tend to be large multi-nationals companies with global operations who are listed on multi-stock exchanges around the world. Take-up of the GRI by private companies and non-listed companies is low.

World Business Council and Sustainable Development (WBCSD)

Green House Gas reporting

The WBCSD has produced guidance on green house gas reporting and some large multi-nationals use it.

Carbon Trust’s Methodology on Carbon Footprint Methodology

The Carbon Trust has produced guidance on how businesses can measure emissions across the product supply chain.

Statutory framework for corporate reporting – how it is not keeping up with demand.

| | |
|----------------------------------|--|
| Company Law | No formal requirement by International or UK company law (existing or proposed) on companies to specifically report on carbon uses and impacts or any carbon finance issues. |
| Company Accounting Standards | No carbon accounting standards set by the UK or International Accounting standards board. |
| Audit standards | No carbon audits standards set by the UK Auditing Practices Board, UK Accounting Standards or the British Standards Institution. |
| Financial regulation/enforcement | No carbon reporting standards set by the Financial Services Authority, Financial Reporting Council or Financial Reporting Advisory Board for private or public bodies. |
| Emissions Trading Scheme | No statutory requirement or fiscal incentives for companies participating in the EU Emissions Trading Scheme to disclose their CO ₂ emissions, their allowances or their value. |

4 We need a common reporting standard, which is driven by Government and delivered by business.

A clear, consistent, comparable definition of carbon disclosure is vital for progress.

High environmental standards are essential for future economic well being and for the competitiveness of the UK economy. The Better Regulation Commission⁸ recently highlighted the need to craft the correct regulatory system to address climate change.

We believe a common reporting standard for quantified carbon accounting and reporting is a vital component of addressing climate change. The measures that we call for below are not a regulatory burden. They represent good business practice, which will deliver financial, reputational and environmental benefits.

We want the Government to:

- 1 Integrate a standard into corporate reporting guidance, specifically in the narrative reporting guidance for the Business Review and in the stock market listing requirements.
- 2 Advocate, adopt and promote the one standard, throughout all departments, presenting clear direction and expectations on business.
- 3 Lead by example by adopting a carbon accounting standard across the whole of Government. The Financial Reporting Advisory Board should incorporate the standard into the Financial Reporting Manual. Government Departments, Agencies and NDPBs will then apply this standard to the preparation of accounts and external auditors can audit against this.
- 4 Task the Financial Services Authority, Financial Reporting Council and each of its operating bodies, specifically the UK Accounting Standards Board and the UK Auditing Practices, to take greater account of the financial materiality of carbon and the Emissions Trading Scheme. These bodies should require greater disclosure in stock market listing documents and in the audited annual reports and accounts of large UK companies.
- 5 Task the Financial Reporting Council to define, in line with other reporting standards, the levels of disclosure for partially-owned subsidiaries, where the UK listed company may only have a degree of influence.
- 6 Once a mandatory standard is in place, ensure companies should be subject to regulatory action for non-disclosure or material misstatement.
- 7 Support the moves by the World Economic Forum (Climate Disclosures Standards Board) and other organisations to work to one standard.

We want all businesses listed on UK Stock Markets to be required to disclose all of the following:

- 1 Absolute total annual emissions (expressed as metric tonnes) of carbon dioxide and other carbon based greenhouse gases such as methane or carbon monoxide for which companies are directly and indirectly responsible. For example, a company may be directly responsible for the combustion of fossil fuels and indirectly responsible, for the 'embedded' greenhouse gas emissions in supplied electricity.
- 2 Relative total annual emissions of the above (expressed as a % of annual company turnover).
- 3 Amount of and financial value (expressed as £m with reference to the traded price of allowances) of their EU ETS CO₂ emission allowances and value of credits for Joint Implementation and Clean Development Mechanism projects.
- 4 An assessment of climate change physical and regulatory risks in terms of the products and services in geographical as well as financial markets in which a company operates.

This information is well within the capacity of companies to manage and report and **does not** require complex tools and techniques.

The disclosures should be in their hard copy statutory annual reports and audited accounts. It should also be available electronically on their company website, in an easily accessible form, for shareholders and potential investors. Supporting information for use by city/carbon analysts and NGOs should also be made available from the company website. For example, an electronic corporate environmental performance report could cover wider environmental issues such as waste and water use reduction strategies.

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Membership of the Aldersgate Group

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Lord Whitty
Royal Society for the Protection of Birds
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SITA UK
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