ACCOUNTANCY FUTURES

The carbon we're not counting

ACCOUNTING FOR SCOPE 3 CARBON EMISSIONS

FIVE MINUTES ON...

Delivering value in the low-carbon economy

The question of carbon emissions – how we manage, measure and hopefully reduce them – is central to the issues of climate change and global warming. The accountancy profession is gradually recognising that, if not already at the tipping point beyond which irreversible climate change will occur, then we are very nearly at that point, with inevitable costs for business and society. There is a major part for the profession to play in developing strategies and solutions in response to the carbon challenge.

Our report highlights that businesses can't evaluate the nature, extent and value of greenhouse gas emission-associated risks and opportunities until high-quality information is available. And this means an investment in credible and complete carbon accounting.

Credible information on Scope 1 and Scope 2 emissions allow a company to better understand what is happening inside its fences. But more significant is the carbon many businesses aren't counting. Scope 3 emissions look across the full value chain. Measuring Scope 3 emissions provides the information needed to understand climate-related risks and opportunities upstream and downstream from operations, beyond operational boundaries and

Delivering value from carbon

Everyone agrees that we need to reduce greenhouse gas emissions. However, there is less agreement on how we achieve these reductions and the lack of coordinated public policy is symptomatic.

The UN Framework Convention on Climate Change (UNFCCC), whose role is to coordinate public policy on climate change internationally, has had limited success. Each year the UNFCCC convenes a conference of the parties (COP – all of the countries who have signed the UN climate change convention) to develop and agree on the policies and actions needed to combat climate change.

At the 15th annual conference of the parties held in Copenhagen in December 2009, the parties once again failed to negotiate a binding policy agreement – against a background of increasing urgency and high expectations. COP 16, held a year later in Cancun, Mexico, in late 2010 did not break the public policy log jam.

In this policy vacuum, the role of business and markets are becoming increasingly important. Given the lack of coherent public policy signals, a key element of this leadership will be finding ways to deliver carbon reductions that also deliver value within the context of the marketplace.

Finding these value drivers is not easy. It takes good information, innovative critical analysis and the ability to think outside of the 'business as usual' paradigm. It also requires looking at emissions across the full value chain.

To find and deliver value by reducing carbon, companies need to take a long-term view. And they need to look at an increasingly broadening range of GHG risks and opportunities

A better understanding of the risks and opportunities (including cost, taxation, regulation and revenue) associated with GHG emissions needs to be brought into the investment appraisal process to enable the development of strategies that will create value for organisations and their stakeholders.

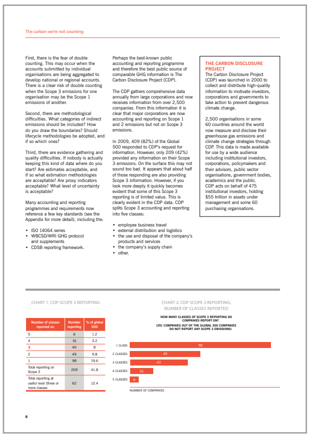
in the products and services developed and sold.

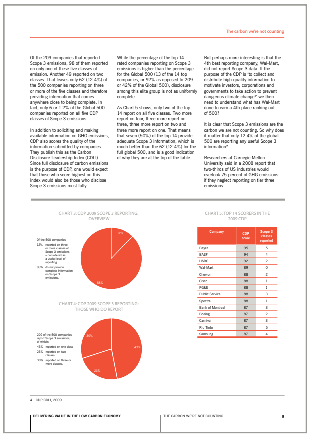
Unfortunately, none of the many regulatory or voluntary accounting and reporting programmes require Scope 3 accounting and reporting. At best they make it optional and the reasons for this are understandable. There is the fear of double counting when the Scope 3 emissions for one organisation may be the Scope 1 emissions of another. There are also methodological difficulties and evidence gathering and quality issues are also a challenge.

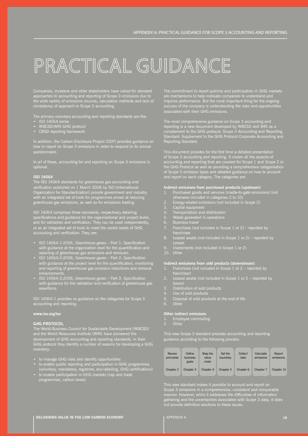
In reality, in 2009, 82% of the Global 500 responded to the Carbon Disclosure Project's request for information. Forty-two percent provided information on their Scope 3 emissions. On the surface this may not sound too bad. But as our findings reveal, if you look more deeply it quickly becomes evident that some of this Scope 3 reporting is of limited value. The fact that only six of the Global 500 companies reported on all five of the CDP's Scope 3 emissions classes indicates that the field is wide open. There is lots of opportunity for market-leading innovation.

Joining the low-carbon economy doesn't happen by chance. It happens only when you have the right information to make the right decisions. Scope 3 is really about innovation and the future. It is about business remodelling rather than improved efficiency. It is not about doing what you do better, it is about understanding what and how to do things differently. Scope 1 and Scope 2 are about better. Scope 3 is about different. We need Scope 3 reporting if we are going to get beyond the efficiency drive to business remodelling.

Helen Brand
Chief executive, ACCA







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'Those companies today that do measure and report their Scope 3 emissions tend to pick which activities to include in a piecemeal way (eg air travel but not employee commute), based on the ease of data capture, relevance to brand, or degree of control. This means that, despite the advancements in carbon disclosure, investors and others are forced to compare apples to oranges. While the numerator may look comparable, the hidden denominator (or boundary) varies drastically between companies.' Emma Stewart, Environmental Leader, 26 February 2009

Perhaps the best-known public accounting and reporting programme and therefore the best public source of comparable GHG information is The Carbon Disclosure Project (CDP).

The CDP gathers comprehensive data annually from large corporations and now receives information from over 2,500 companies. From this information it is clear that major corporations are now accounting and reporting on Scope 1 and 2 emissions but not on Scope 3 emissions.

In 2009, 409 (82%) of the Global 500 responded to CDP's request for information. However, only 209 (42%) provided any information on their Scope 3 emissions. However, if you look more deeply it quickly becomes evident that some of this Scope 3 reporting is of limited value.

And here there is a role for accountants. Accountants do not simply produce reliable information and report on it. They must also analyse and understand the importance of that information so that it is included in strategic and operational decision making.

GHG emissions types

SCOPE 1: DIRECT GHG EMISSIONS
Direct GHG emissions occur from sources that are owned or controlled by the company.

SCOPE 2: ELECTRICITY INDIRECT GHG EMISSIONS
GHG emissions from the generation of purchased electricity consumed by the company. Purchased electricity is defined as electricity that is purchased or otherwise brought into the organisational boundary of the company. Scope 2 emissions physically occur at the facility where electricity is generated.

SCOPE 3: OTHER INDIRECT GHG EMISSIONS
All other indirect emissions. Scope 3 emissions are a consequence of the activities of the company, but occur from sources not owned or controlled by the company.

For the full report: www.accaglobal.com/af

Scope 3 approaches

The Control Approach

The Control Approach focuses on the middle part of the value chain and therefore focuses on looking for ways to improve operational efficiency. Improved efficiency is a necessary condition for achieving the progress we need to make against climate change.

Many companies – like ExxonMobil – continue to focus primarily on looking for greater operational efficiencies and technological fixes within their fences. This is necessary, but is it sufficient?

ExxonMobil does not report Scope 3 emissions. Its position is that Scope 3 reporting should be a conditional question. Exxon is very good at what it does. It has systematically worked to improve efficiency and environmental performance throughout its facilities worldwide.

ExxonMobil also recognises that risks to society and ecosystems could be significant. They do accept that any approach to meeting the world's growing energy needs will incorporate strategies to address the risk of climate change. They recognise that there are two things that need to be done: to stabilise emissions at a level that will reduce the risk of severe climate change, and to invest in adaptation strategies – those strategies that will allow us to respond effectively to climate changes.

The Influence Approach

Scope 3 emissions look at emissions across the full value chain – upstream and downstream. This can be a daunting and potentially expensive task. So it is natural to ask: 'where can I get the best leverage, quickly?' For many companies this means looking upstream at the supply chain where, because of financially based business relations, they have significant influence.

Choosing to focus upstream has an unquestionable multiplier effect. This is especially important when the task ahead of us is so great and the need to go to scale so urgent. Wal-Mart for example has more than 100,000 suppliers. The immediate impact of influencing the actions of this many other companies can be enormous.

Although Wal-Mart has not reported on its Scope 3 emissions it has qualified this. It states that it recognises the importance of supply chain carbon management and has been engaging its suppliers on sustainability since 2005.

Wal-Mart recognises the significance of Scope 3 emissions. It has studied them in some detail but does not yet feel it is in a position to report credible data. It is, however, willing to state an estimate of the scale of the emissions. This is very important because this information has begun to influence the decisions it makes.

The Engaged Approach

Looking upstream and using influence where it exists is better than only looking at operations and those things you can control, but it is still only part of the picture. A company that seeks to fully understand its impact will begin to engage downstream. This is where significant innovation and new opportunity begins to appear.

Focusing upstream on your suppliers can simply be a process of transferring operational efficiencies from your factory to your suppliers' factories. But when you begin to look more closely at how products are used, how long they are used for, what energy and other resources are required for their continued use, how they are disposed of and the impact of the materials they contain at the time of disposal, you begin to get a truer and fuller picture of the impact of your organisation and its products and services.

Bayer is right at the top of the CD Leaders' Index. This successful company has reported on all CDP areas of Scope 3 emissions and has built the reduction of carbon emissions into the very core of its business strategy. Bayer goes well beyond risk identification and mitigation. Its strategy is built on climate-related opportunities. It knows what the numbers are and has a sound foundation for innovation and strategic decision making.

Recommendations

We need Scope 3 reporting if we are going to get beyond the efficiency drive to business remodelling.

For governments and standards setters
Governments, intergovernmental agencies and other standards and policy setters should consider making Scope 3 mandatory. Standards setters and others who contribute to public policy should consider making Scope 3 reporting mandatory rather than voluntary as it currently is in most schemes.

For business
Business should begin to account for and report on Scope 3 emissions. Scope 3 information and analysis should begin to be included in strategy development and in operational decisions and actions. Scope 3 information and analysis should begin to be brought into the investment appraisal process.

Practical guidance

Companies, investors and other stakeholders have called for standard approaches to accounting and reporting of Scope 3 emissions due to the wide variety of emissions sources, calculation methods and lack of consistency of approach in Scope 3 accounting.

The primary voluntary accounting and reporting standards are the:

- ISO 14064 series – www.iso.org/iso
- WBCSD/WRI GHG protocol – http://www.ghgprotocol.org
- CBSD reporting framework – www.cdsb-global.org.

In addition, the Carbon Disclosure Project (CDP) provides guidance on how to report on Scope 3 emissions in order to respond to its annual questionnaire.

In all of these, accounting for and reporting on Scope 3 emissions is optional.

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 147,000 members and 424,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.