



# Governance and Management

CLIMATE CHANGE BRIEFING PAPER

## Climate change briefing papers for ACCA members

Increasingly, ACCA members need to understand how the climate change crisis will affect businesses. This impact can be felt throughout an organisation as a consequence of changing taxation, carbon trading, new reporting requirements, different management needs, formulating adaptation policies, or changes required in governance.

The ACCA climate change briefing papers provide readers with the information needed to assess the changing environment ahead. ACCA has worked with several well-established partners in the relevant field to develop their content.

ACCA climate change briefing papers include the following titles:

1. adaptation
2. governance and management
3. investment
4. mitigation
5. taxation.

[www.accaglobal.com/climatechange](http://www.accaglobal.com/climatechange)

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## Climate change: the science and economics – a recap

Climate change is now widely recognised as one of the most significant challenges facing the global economy. The projected impacts on the environment and society are unprecedented. Climate change is undoubtedly a critical theme for today's (and tomorrow's) companies and their accountants.

By now the science and economics of climate change will be familiar to most. In 2007, the pre-eminent scientific authority on climate change, the Intergovernmental Panel on Climate Change (IPCC), published its Fourth Assessment report. This concluded that warming of the climate system is taking place. The IPCC is more than 95% certain that most of the observed increases in globally averaged temperatures since the mid-20th century are due to increases in anthropogenic greenhouse gas (GHG) concentrations. Temperature increases of 1.8–4°C are predicted with associated sea level rises of 28–43 cm. Environmental impacts include increased flood risk, declining crop yields, species extinctions and extreme weather patterns.

The economic imperative for action is also strong. The 2006 *Stern Review: The Economics of Climate Change* concluded that in a Business-As-Usual (BAU) scenario a 2–3°C rise in temperature could reduce global economic output (as measured by GDP) by 3%. Using the results from formal economic models, the Review estimates that if no action is taken, the overall costs and risks of climate change will be equivalent to losing at least 5% of global GDP each year, now and forever. In contrast, the costs of action – reducing greenhouse gas emissions to avoid the worst impacts of climate change – can be limited to around 1% of global GDP each year. Stern concluded that the benefits of strong, early action on climate change outweigh the costs.

## The importance of governance – managing key risks and opportunities

Climate change has the potential to affect shareholder value significantly, especially in the medium to long term. Investors need to understand the risks to their investments as well as the role they should play in the wider policy debate.

For companies and their investors, climate change presents a number of risks and opportunities.

### **Regulatory challenges**

National and international policy frameworks for reducing GHG emissions are making it imperative to reduce operational emissions. The UN Framework Convention on Climate Change (UNFCCC) Kyoto Protocol entered into force in 2005 with a GHG target for Annex 1 countries of 5.2% below 1990 levels by 2008–12. The outcomes of the 2009 meeting in Copenhagen may bring about a number of changes in national and international legislation. Existing and emerging product standards (such as the EU Directive on the Energy Performance of Buildings), environmental taxes and compliance costs now need to be factored into companies' operational costs.

### **Changing market dynamics**

Higher and fluctuating energy costs will have a significant negative impact, in particular for energy-intensive industries. Conversely, changing consumer attitudes and demand patterns will open up opportunities for new technology, products and markets.

### **Changing weather patterns**

The physical risks of climate change include damage to assets as a result of flooding and extreme weather events.

### **Reputational risk**

Customer, employee, investor and societal perceptions are increasingly affecting brand value.

The governance and management of climate change is a critical issue for companies. Where robust and transparent sustainability and climate change governance practices are embedded into corporate strategy, companies are more likely to be able to manage the risks and maximise the opportunities presented by climate change.

## Snapshot of climate change governance

In the run-up to the United Nations Climate Change Conference in Copenhagen, the global responsible investment research specialist, EIRIS, examined the response to climate change of 300 of the world's largest companies, as listed on the FTSE All World Index, and the progress they have made over the last 12 months in responding to the related challenges.

This research reveals that just over one-third are failing to address the risks they face from climate change, although the quality of companies' response to climate change has improved overall.

To produce a profile of the climate change impact of a company, EIRIS have classified companies into over 50 sectors, on the basis of their business activities. Each sector is defined as having very high, high, medium or low impact, on the basis of its direct and indirect emissions, which are considered alongside other factors, such as the sector's projected growth, beneficial impact, allocation of emissions across the value chain, and contribution to climate change solutions.

**Figure 1: Climate change impact by percentage market cap of global 300 (2009)**

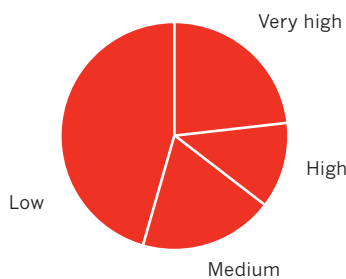
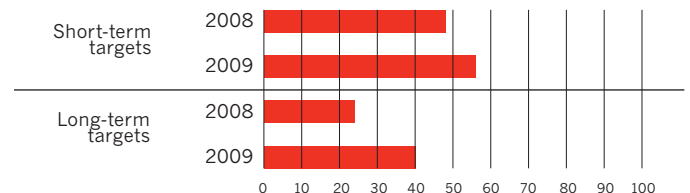


Figure 1 illustrates over one-third (35.6%) of companies in the global 300 are classified as having a high or very high impact for climate change.

Analysis of those companies classified as having high or very high impact for climate change indicates that 99% have a corporate-wide climate change commitment (in comparison with 84% in 2008). This can be explained by a number of drivers that have emerged, including the increasing activity of investors. Almost three-quarters (73% compared with 61% last year) have referenced the wider policy context in the form of international targets, regulations or the scientific imperative. This is good news, but only 21% (14% in 2008) of companies have confirmed this commitment by linking board or senior management remuneration to GHG emission reductions or equivalent climate change strategies.

**Figure 2: Strategy performance of companies having high or very high impact for climate change**



Targets are an important indicator of both corporate climate change strategy and a company's commitment to achieving GHG emissions reductions. Over half (55%, increased from 48% in 2008) of analysed companies with high or very high climate change impacts have a short-term (less than five years) management target, either publicly stated or internal. The proportion of companies disclosing a publicly stated long-term (at least five years) strategic target has increased to 40%, from one-quarter in 2008. Although the increasing use of short-term targets is good news for investors seeking companies that are actively managing their GHG emissions, the lack of long-term targets is a concern and may reflect uncertainty about the future policy framework and longer-term caps on GHG emissions, including the outcome of the UN Climate Change Conference in Copenhagen. Although a number of countries are publicising national GHG emissions targets, many companies are awaiting the outcome of Copenhagen as a signal for long-term reduction targets.

Impressively, the proportion of companies in the global 300 assessed as having no or limited disclosure on climate change has reduced to less than 12% (from 29.4% in 2008). Over four-fifths (85%) of companies with very high or high impact disclose either absolute or normalised data (up from 81% in 2008). Impressively, 91% of companies with very high or high impact disclose absolute carbon dioxide (CO<sub>2</sub>) or GHG emissions data (up from 73% in 2008) and 79% of such companies (up from 70% in 2008) disclose normalised data. Over three-quarters of these companies (83%, up from 38% in 2008) disclose an indication of scope of data or methodology used and almost half of this information (48% up from 36% in 2008) was verified by an external party.

This is an impressive improvement in the proportion of companies disclosing data and an encouraging trend in terms of disclosure of scope or verification of data. Nonetheless, more does not necessarily equal better. A lack of clarity and comparability of quantitative data persists and can compromise investment decisions based solely on the disclosure of such data. Initiatives such as the Carbon Disclosure Project (CDP) have made a significant contribution to the amount of data disclosed. EIRIS analysis shows that over one-quarter (26%, up from 18% in 2008) of companies with very high or high impact are providing a quantified assessment of the financial, regulatory or physical risks or opportunities posed by climate change. This is in large part driven by the inclusion of this question in the CDP questionnaire.

Disclosure in the area of climate change will increase as a result of investor, regulatory and wider stakeholder pressure. The launch of the CDSB (Climate Disclosure Standards Board) framework for the inclusion of climate change data in mainstream reports will support the efforts of companies to disclose further information on their performance on climate change issues. The framework clarifies which climate change data should be reported and provides guidelines designed to streamline disclosure procedures.

## The role of accountants

**Accountants play a key role in the accurate reporting of information that enables companies and their investors to make effective business decisions. As sustainability accounting and reporting of greenhouse gas emissions develop and become more robust, accountants will play an increasing role in climate change governance and management.**

In July 2009 FEE (Federation of European Accountants) put forward a policy statement articulating the areas where accountants could contribute. These included:

- evaluating the returns of low-carbon investment proposals
- developing organisation-relevant carbon and greenhouse gas (GHG) key performance indicators (KPIs) and related measurement protocols
- advising employers and clients about how emissions trading regimes operate and developing related response strategies
- providing improved disclosure of information on organisations' carbon and GHG emissions and climate change risks through the annual report and accounts
- auditing and assuring carbon and GHG disclosures
- advising employers and clients as to the best courses to take in adapting to climate change, including the probable investment costs and returns from such investments
- generally quantifying and profiling the financial consequences of climate change.

Given the importance of climate change and the probable impact of it on future long-term corporate financial performance, it is increasingly seen as investors' fiduciary responsibility to integrate consideration of climate change into their investment strategies, as outlined in the UN Environment Programme Finance Initiative (UNEP FI) *Fiduciary II* report. Following the recent global financial crisis and growing evidence of the significant physical effects of climate change, the outcome of the Copenhagen Conference will set the direction for a financial and policy framework for future climate change investment for governments, corporations and investors, with longer-term implications for the way accountants operate in the future.



## About EIRIS

EIRIS is a leading global provider of independent research into the social, environmental governance and ethical performance of companies. EIRIS, a UK-based organisation with offices in the US and France together with its international research partners, has a wealth of experience in the field of responsible investment research. EIRIS provides comprehensive research on around 3,000 companies in Europe, North America and the Asia Pacific region. EIRIS is already retained by 100 institutional clients including pension and retail fund managers, banks, private client brokers, charities and religious institutions across Europe, North America, Australia and Asia. EIRIS has developed a comprehensive suite of products to help investors assess their portfolios and design investment strategies in response to the challenge of a carbon-constrained economy.

[www.eiris.org](http://www.eiris.org)

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