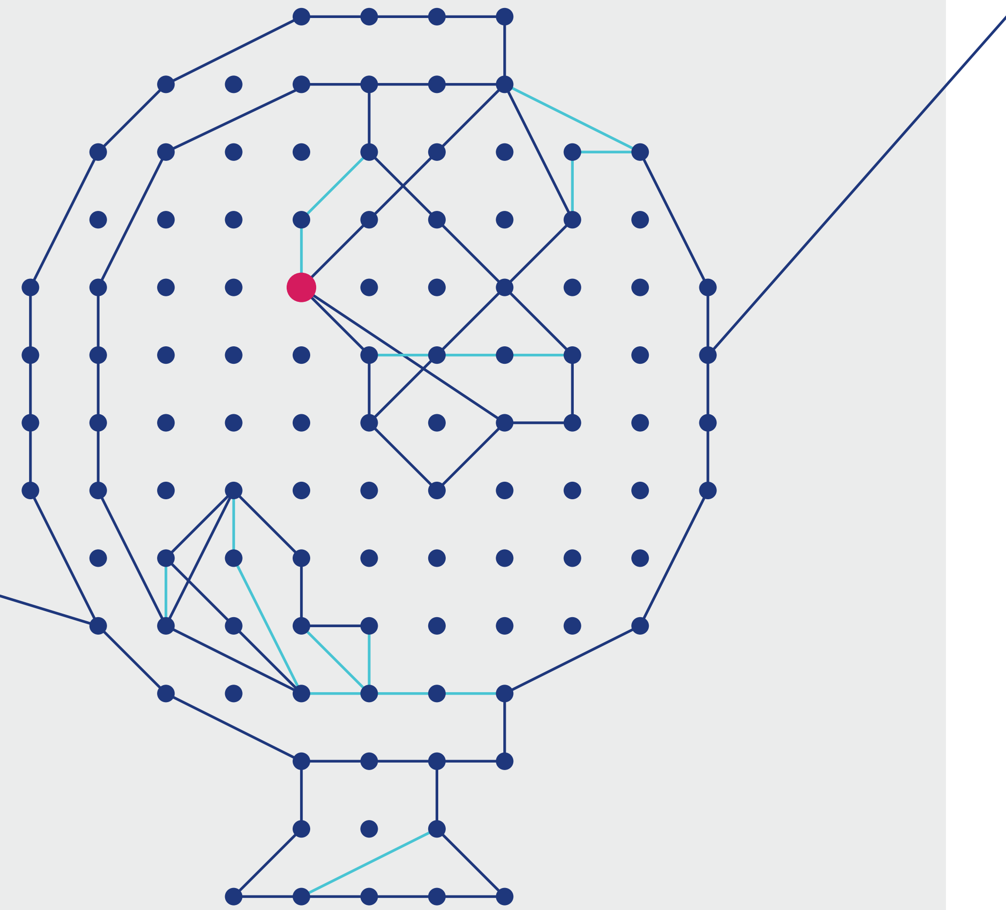
Climate Disclosure Standards Board

Comply or explain

A review of FTSE 350 companies' environmental reporting and greenhouse gas emission disclosures in annual reports



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www.cdsb.net/FTSE350

About CDSB

CDSB is an international consortium of business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

We do this by offering companies a framework for reporting environmental information with the same rigour as financial information. In turn this helps them to provide investors with decision-useful environmental information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials.

Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. Collectively, we aim to contribute to more sustainable economic, social and environmental systems.

Acknowledgements

CDSB is appreciative of the support and advice provided by **Timotius Kasim**, Doctoral Candidate, Saïd Business School and **Professor Richard Barker**, Professor of Accounting, Saïd Business School, University of Oxford. CDSB also gratefully acknowledges the valuable contributions of **David Cooke**, Lawyer, Company and Financial, ClientEarth and **Dr Jarlath Molloy**, Technical Working Group Member, CDSB.

Contents

Chapter 1

Executive summary

There is increasing pressure on companies to provide information about their environmental impacts and dependencies. This reflects the view that those charged with the governance and management of organisations are stewards not just of investors' financial capital, but also of natural capital, with a responsibility to report how that stewardship is being exercised. From a relatively narrow "shareholder value" perspective, the environmental risks to sustainable economic value creation are becoming increasingly clear. From a broader social perspective, the cumulative impact on our climate and on our natural resources is a matter of enormous consequence and urgency.

Relatively speaking, environmental reporting practice remains in its infancy and there is much to learn. Drawing information from one of the world's leading capital markets, this report reviews the disclosure of environmental information in FTSE 350 companies' annual reports following the implementation of the UK Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013[1] ("the Regulations"). The report also provides some sector analysis and uses examples to illustrate current practice. The aim is to inform companies, regulators and governments of current reporting practices and their implications for the implementation of the EU Non-Financial Reporting Directive[2] ("the NFR Directive"), as well as for the further development of corporate reporting.

Here we identify some key issues that emerge from the report. The issues are summarised in the form of eight statements. The first four represent observations about corporate reporting practice and the other statements propose steps that could be taken by regulators to enhance the enabling environment for disclosure. The statements are intended to provoke discussion and reflection on the contents of the report.

What is best practice in corporate environmental reporting?

1. Strengthen the relationship between environmental matters and overall corporate strategy, performance and prospects. Applying the concept of connectivity helps to show a holistic picture of the factors that affect the organisation's ability to create value over time, including the interrelatedness and dependencies between them. A key finding of this report is that although environmental factors feature as principal business risks, those risks are not always reflected in the key performance indicators used by management to monitor the company's progress. By sector, environmental matters are identified as a principal risk by 38% of discretionary, 73% of energy, 54% of industrial and 37% of IT companies. However, they are represented in KPIs in 29%, 20%, 39% and 21% of companies in each of these respective sectors. Companies also struggle to communicate how environmental matters will affect the future development, performance and position of their business.

2. Consider the characteristics and purpose of performance indicators. Strategies and targets that inform a company's assessment of its performance are, by definition, unique to each company. Accordingly, this report finds that a wide range of KPIs are used to monitor and report on performance. Notwithstanding the legitimate variation in performance targets, the consistency and comparability of disclosures could be enhanced through the development of performance indicators with common characteristics that still link to the objective of disclosure and the circumstances of the organisation. The common characteristics that could be applied to KPIs in order to encourage conformity include ensuring that they are:

    a. connected with financial information;

    b. consistent over successive periods and with internal indicators;

    c. focused on material matters;

    d. presented with qualitative information to provide context; and

    e. consistent with accepted industry benchmarks.

[1] United Kingdom. The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. (SI 1970). Available from: http://www.legislation.gov.uk/ukdsi/2013/9780111540169/contents

[2] For more information see: http://ec.europa.eu/finance/accounting/non-financial_reporting/index_en.htm

3. Environmental reporting is more than emissions reporting. Leading companies are considering risks and opportunities associated with waste, biodiversity, air pollutants, water security and soft commodities. Some are considering natural capital impacts and dependencies, applying measurement and valuation, and bringing new ideas and information into strategic planning and operational decision-making.
4. Scope 3 is not beyond scope. The environmental impact of any given business does not stop at the legal boundary of the entity, but runs instead throughout the value chain. Reporting on Scope 3 can help readers to understand the actions a company has taken to minimise its environmental impacts. While Scope 3 is difficult to measure, it is nevertheless striking how few companies disclosed their Scope 3 GHG emissions – 26% of the overall sample.

How can regulators enhance the enabling environment for disclosure?

1. Build on emerging practice. There is a clear overlap between the UK Strategic Report requirements and the International Integrated Reporting (<IR>) Framework, both of which require companies to report their strategy, business model, risks and key performance indicators. Regulators can further enhance the quality of reporting by agreeing shared definitions of terms (such as business model) that are common to both types of reporting and referencing guidance that supports compliance with both the UK Strategic Report requirements and Integrated Reporting. For example, the International Financial Reporting Standards Practice Statement on Management Commentary provides international guidance on content reported for both Strategic and Integrated Reporting purposes, therefore encouraging reporting on the same content to develop consistently across different jurisdictions.
2. Balance flexibility, consistency and comparability. While different businesses have different stories to tell, communication is enhanced by storytelling taking place within a common, shared framework. This report reveals considerable variation in reporting practice within and between sectors that is not wholly explained by the unique nature of businesses. Further guidance that describes the expectations of reporting companies might go some way towards supporting greater consistency, comparability and connectivity in reporting practice.
3. Establish and strengthen some mandatory reporting requirements. Whether reporting requirements should be mandatory or voluntary depends upon the type of information in question. Where information is measurable, objective, auditable, capable of standardisation across companies and widely used for decision-making, the case for the mandatory reporting of material activities is strong. For example, reporting standards for Scope 1 and 2 GHG emissions give users reassurance that information is complete, consistent and comparable. At the same time companies benefit from clear definitions of what information should be captured and how it should be presented and disclosed.
4. Understand the international landscape and opportunities for alignment. The UK Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 provide a clear structure and platform for the implementation of the EU Non-Financial Reporting Directive. This report shows that from a regulatory perspective the UK is well positioned to lead the development of non-financial reporting and the implementation of this Directive.

Chapter 2

Introduction

Background

Consistent, comparable and comprehensive information is essential for communicating business performance, informing investor engagement and decision-making. The business risks and opportunities associated with corporate impacts and dependencies on the environment are becoming more widely understood and accepted. As such, the reporting and disclosure of corporate environmental performance has become established as an essential component of good corporate governance and business practice. Reflecting this trend, a growing number of mandatory and voluntary government schemes have emerged which, together with non-governmental initiatives, require or encourage business to measure and report environmental information such as GHG emissions. In the UK, the Regulations provide legislative infrastructure for corporate reporting of environmental information.

The Regulations came into effect on 1st October 2013. Quoted companies, as defined by the Companies Act 2006[3], are required to report GHG emissions in the directors' report. Various other information in relation to environmental matters should be covered in the strategic report and should include, where appropriate, the use of key performance indicators (KPIs).

In order to assist companies in complying with the parts of the Regulations that relate to environmental matters, the Defra Environmental Reporting Guidelines[4] ("Defra's Guidelines") were released in June 2013, to help businesses measure and report their environmental impacts and GHG emissions. The Financial Reporting Council ("the FRC") has also issued Guidance on the Strategic Report ("FRC's Guidance") for directors with responsibility to prepare a strategic report[5].

The UK is not alone in introducing statutory requirements for the disclosure of environmental and other non-financial information. A growing number of national policy makers are introducing comparable laws, such as Grenelle II in France and the Danish Financial Statements Act. These also require companies to disclose environmental information in the mainstream report and connect information about environmental performance with their overall corporate strategy, performance and prospects. Across the world, corporate environmental and climate change-related reporting requirements are being introduced through various policy and legislative routes, including specific laws on GHG reporting or wider environmental, climate change, sustainability, corporate social responsibility, governance and company laws[6,7]. These emerging practices are indicative of the trend towards mainstreaming climate change and environmental matters in business reporting, decision-making and investment practices.

[3] Defined in section 385(2) of the Companies Act 2006 as a company that is UK incorporated and whose equity share capital is listed on the Main Market of the London Stock Exchange UK or in an EEA State, or admitted to trading on the New York Stock Exchange or Nasdaq.

[4] UK Department of Environment, Food and Rural Affairs (2013) Environmental Reporting Guidelines: Including mandatory greenhouse gas emissions reporting guidance. Available from: https://www.gov.uk/government/publications/environmental-reporting-guidelines-including-mandatory-greenhouse-gas-emissions-reporting-guidance

[5] Financial Reporting Council (2014) Guidance on the Strategic Report. Available from: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf

[6] World Resources Institute (2015) Guide for Designing Mandatory Greenhouse Gas Reporting Programs. Available from: http://www.wri.org/publication/guide-designing-mandatory-greenhouse-gas-reporting-programs

[7] Global Reporting Initiative (2013) Carrots and Sticks: Sustainability reporting policies worldwide – today's best practice, tomorrow's trends. Available from: https://www.globalreporting.org/resourcelibrary/Carrots-and-Sticks.pdf

Chapter 3

Methodology

Requirements

The report reviews disclosures against criteria, expressed as questions and statements that represent the requirements of the Regulations. It focuses on specific requirements in the Regulations to disclose information about "environmental matters" in the strategic report and to report GHG emissions in the directors' report. The report also examines whether more general requirements in relation to the strategic report, such as to describe the principal risks and uncertainties facing the business, have been applied to environmental matters.

Sample

This report reviews the way in which FTSE 350 companies have responded to the requirements of the Regulations. As a sub-set of quoted companies, the FTSE 350 was chosen as a representative sample comprising the 350 largest companies by market capitalisation that are listed on the London Stock Exchange. 49 companies listed on the FTSE 350 have been excluded from this review because they are not "UK incorporated" and therefore outside the scope of the Regulations. The sample includes 301 companies.

Information source and reporting periods

This report examines the annual reports of the sample companies for the first financial year after the implementation of the Regulations, covering year ends from 1 December 2013 to 30 November 2014. The collected data underwent a review and verification process by colleagues at Saïd Business School, Oxford University. This process helped to ensure accuracy, validity, as well as a true and fair representation of the information collected.

Questions

The report reviews company responses to the requirements of the Regulations by reference to a series of questions and statements that reflect the reporting requirements and aspects of Defra's Guidelines. These are categorised and assigned a code referring to the relevant chapter, section, subsection and clause pertaining to that question. The questions and statements are as follows:

Strategic Report (SR)

Principal risks and uncertainties

P2 4A 414C (2) (b) Does the description of the principal risks and uncertainties facing the company include environmental matters?

KPIs

P2 4A 414C (4) (b) Does the SR include, where appropriate, analysis of environmental information using KPIs?

P2 4A 414C (5) What KPIs are used?

Future development

P2 4A 414C (7) (a/b) Does the SR include environmental matters in the main trends and factors likely to affect the future development, performance and position of the company's business?

Business impact on the environment

P2 4A 414C (7) (b) (i) Does the SR include information about the impact of the company's business on the environment?

Environmental policies

P2 4A 414C (7) (b) Does the SR include information about any policies of the company in relation to environmental matters? Does the SR include information about the effectiveness of those policies? If the SR does not contain information mentioned in (b), does it state which of those kinds of information it does not contain?

Directors' Report (DR)

GHG emissions

P7 15 (2) Total annual emissions of GHG (CO_2e) for which company is responsible;

P7 15 (2) (a, b) GHG emissions from fuel combustion and operation of any facility (CO_2e) Scope 1;

P7 15 (3) Total annual emissions of GHG from purchase of electricity, heat, steam or cooling for company's own use (CO_2e) Scope 2;

P7 15 (4) Where it is not feasible for the company to obtain some or all of information required by 15 (2) & (3), does company state what is missing and why? What is missing? Why is it missing?

Disclosure

P7 16 Are the methodologies used for responding to questions 15 (2) and (3) listed? What methodologies were used?

P7 17 What GHG intensity metrics are stated? What units of measure are used to normalise emissions?

P17 18 Are previous years' results for 15 (2) and (3) and 17 disclosed?

P17 19 If the DR reporting period is different to information disclosed in 15 (2) and (3), is it stated?

Data handling

Wherever possible, the exact wording of the annual report under review was captured during the initial data collection. This provided a diverse data set, which limited comparative analysis. In order to facilitate analysis, some data was categorised and regularised, particularly for the analysis of the following questions:

- P7 15 (4) "Where it is not practical for the company to obtain some or all of information required by 15 (2) & (3), does the company state what is missing and why? What is missing? Why is it missing?"
- P7 17 "What GHG intensity metrics are stated? What units of measure are used to normalise emissions?"

Sector review

The review analyses current practice on a sector-by-sector basis for sectors within the sample that include 15 or more companies. Sectors with fewer than 15 companies are not included in the sector review and comparisons. Using this threshold, sector analysis was undertaken for Consumer Discretionary, Consumer Staples, Energy, Financial, Industrials and Materials. All UK quoted companies and sectors in the FTSE 350 sample are included in the overall analysis.

Table 1 Sector proportions of the FTSE 350 sample

Sector	Number	Working Number
Consumer Discretionary	65	58
Consumer Staples	20	19
Energy	18	15
Financial	108	90
Health Care	13	11
Industrials	62	54
Information Technology	21	20
Materials	29	22
Telecommunication services	6	5
Utilities	8	7
Total	**350**	**301**

Chapter 4

Summary

Principal risks	41% of companies consider environmental risks in their analysis of the principal risks to their company.
KPIs	27% of companies make use of environmental KPIs. Of those that do, the majority use one of four main categories of KPIs based on: GHG emissions, energy, water or waste management (Figure 1).
Future development	42% of companies identify environmental matters when considering the future development, performance or position of their company.
Environmental policies	87% of companies disclosed environmental policies, 78% disclosed their policies and provided an indication of the effectiveness of those policies.
Environmental impacts	90% of companies disclosed information regarding the environmental impacts of their business operations (Figure 2). Of the 10% that did not, 70% provided an explanation as to why that information was omitted.
GHG emissions	The Regulations require the disclosure of total annual GHG emissions (CO_2e) for which a company is responsible. 90% of companies disclosed their total annual GHG emissions. 77% of companies disclosed the breakdown of both Scope 1 and 2 GHG emissions. 41% of companies disclosed omitted emission sources and explained the reasons for omission. Of the companies who explained omissions, the majority (44%) cited materiality as the main reason for omission (Figure 3). The sources of GHG emissions omitted by companies varied widely. Figure 4 shows the range of general categories of information omitted.
Scope 3	Reporting of Scope 3 emissions is not required by the Regulations, however, approximately 26% of companies still reported these emission sources.
Emissions intensity	96% of companies that disclosed emissions also reported a ratio using a normalising factor. 15% of companies reported more than one intensity metric.
Boundary	71% of companies that disclosed emissions stated the organisational boundary used in order to collect and report GHG emissions. Figure 5 shows the organisational boundaries selected by companies. The majority of companies used one of three definitions of organisational boundary, but for 19% of disclosures the organisational boundary definition was unclear.
Reporting cycle	11% of companies used a different reporting period for environmental information than for financial information.
Assurance	23% of companies sought and reported independent assurance for their GHG emissions and further environmental information.

Figure 1 All sectors: KPIs used

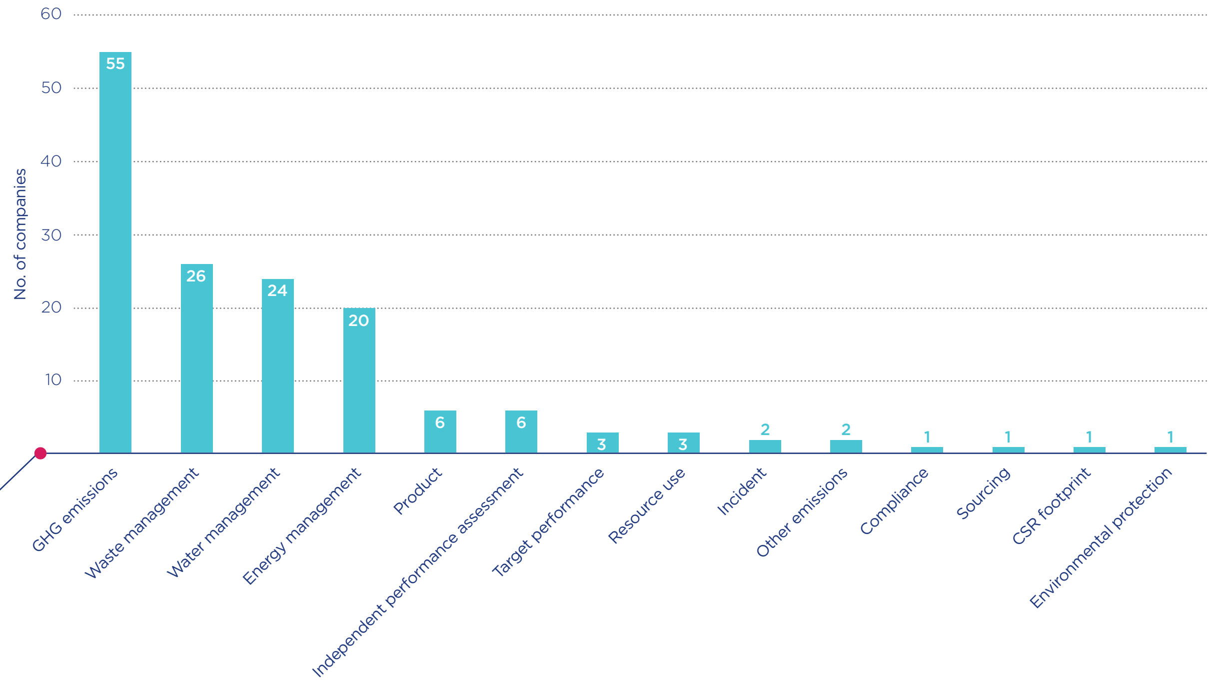
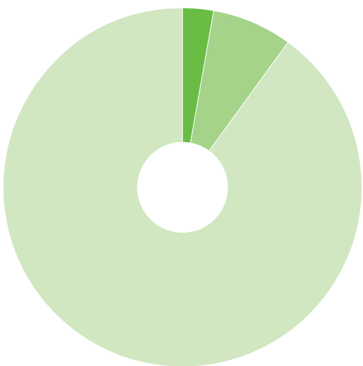
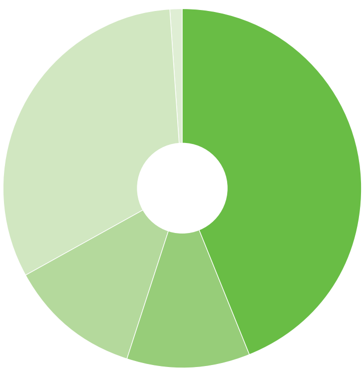


Figure 2 All sectors: environmental impact



3%	Do not account for missing information about environmental impacts
7%	Do account for missing information about environmental impacts
90%	Include relevant information about environmental impacts

Figure 3 All sectors: frequency of explanations for omissions in GHG emissions data



44%	Materiality
11%	Availability
12%	Measurability
32%	Outside boundary
1%	Measurability and materiality

Figure 4 All sectors: omitted GHG information

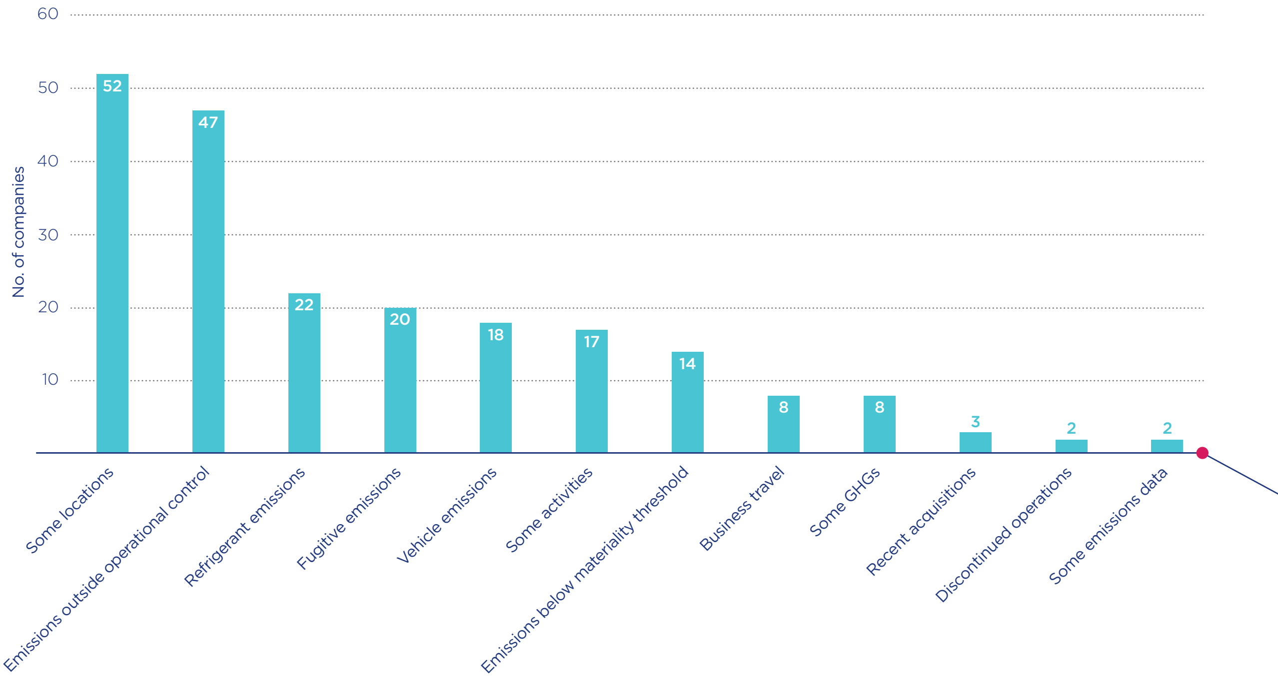
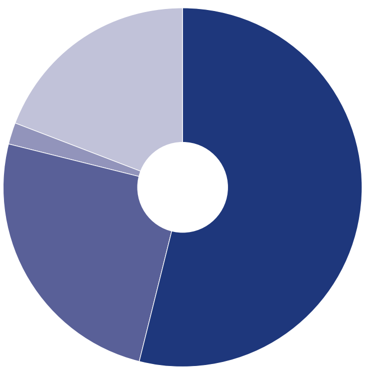


Figure 5 All sectors: boundaries used



- 54% Operational
- 25% Financial
- 2% Equity share
- 19% Unclear

Chapter 5

Detailed review

Principal risks and uncertainties

P2 4A 414C (2) (b) Does the description of the principal risks and uncertainties facing the company include environmental matters?

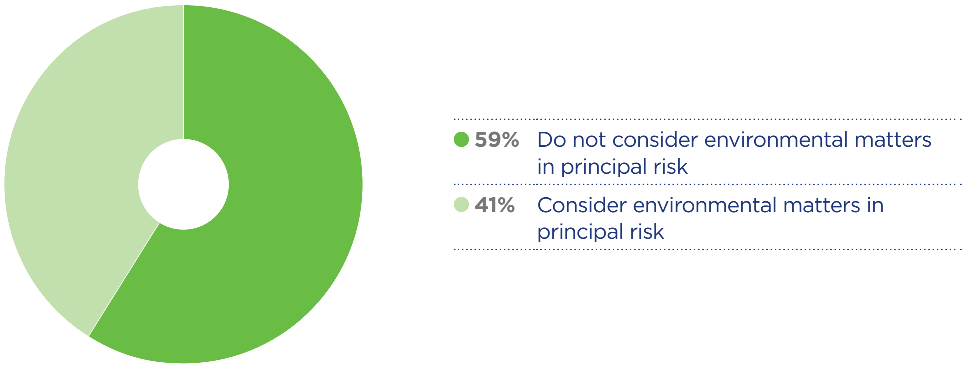
Summary

The strategic report must contain: "a description of the principal risks and uncertainties facing the company" consistent with the size and complexity of the business, and with the aim of contributing towards a fair review of the company's business in terms of development, performance and position over the course of the financial year.

Results

- 41% of companies considered environmental matters in their principal risks (Figure 6).

Figure 6 All sectors: principal risk



What types of environmental risks are reported?

Companies identify a range of environmental risks. Common themes, however, included:

- Loss of reputational capital resulting from poor environmental management, product stewardship responsibility, impacts management and/or regulatory compliance;
- Monetary fines or legal liabilities as a result of regulatory non-compliance;
- Direct negative impacts as a result of environmental risks e.g. damage to property, assets and/or infrastructure as a result of extreme weather events; and
- Indirect negative impacts resulting from environmental risks e.g. increase in commodity prices and resource constraints as a result of environmental risk throughout the value chain.

Sector overview

- Companies in the Materials sector most often included environmental matters in their principal risks (91%). Significant proportions of Industrial (54%), and Energy (73%) companies also identified environmental principal risks;
- 81% of companies in the Financial sector did not consider environment matters amongst their principal risks.

Table 2 Sector breakdown: principal risk

Sector	% include environmental matters in principal risks
Consumer Discretionary	38
Consumer Staples	42
Energy	73
Financial	19
Industrials	54
Information Technology	37
Materials	91

Example

Pennon Group PLC provided a visual representation of the company's risks and mitigation strategies, together with an indication of the direction of change experienced or anticipated in relation to each risk. Environmental risks are included in their principal risks.

Operating performance

Risk	Mitigation	Change
Extreme weather and climate change can place pressure on the company's water resources and networks.	Despite recent extreme weather, service to customers has been maintained and the business continues to be well placed to manage such situations. Key mitigation is having detailed contingency plans, sufficient emergency resources and a capital programme that supports ongoing efforts to manage these risks. In the longer term, the impact of climate change is being considered. The company has plans in place and will adapt the way it conducts its business to respond effectively to the anticipated hotter, drier summers and wetter winters.	↔
Poor service provided to customers. South West Water could incur a financial penalty under Ofwat's Service Incentive Mechanism (SIM) for below average customer service performance.	The company has delivered further improvements in customer service resulting in its best ever SIM score and South West Water's best ever score in the last quarter of 2013/14. While South West Water's performance continues to improve, a financial penalty would be incurred by the company under Ofwat's SIM for a below average customer service performance.	↔
Non-compliance or occurrence of avoidable health and safety incident.	There are rigorous health and safety policies and procedures in place across South West Water. Senior management and Executive Director visits are undertaken during the year across a number of the company's sites and a behavioural safety programme launched in 2012 badged 'TAP' has continued to be publicised.	↑

Key				Risk Level
Increased during year	↑	↑	↑	**Low**
Unchanged during the year	↔	↔	↔	**Medium**
Reduced during the year	↓	↓	↓	**High**

The colouring (red, amber, green) is our estimate of the inherent risk level to the Group after mitigation. It is important to note that risks are difficult to estimate with accuracy and therefore may be more or less significant than indicated.

Discussion

Environmental risks are difficult to assess as they come in many forms: direct and indirect, current and future, physical, reputational and regulatory. The process and decisions involved in prioritising and disclosing principal risks are complex. They are specific to the context and operations of a business and dependent on management's judgement about the implications of omission or misstatement.

Guidance is mixed around the extent to which companies should report on environmental risks. General reporting guidance from government, regulators or industry associations tends to encourage shortlists of principal risks accompanied by quantitative information[8] and to discourage inclusion of narrative information that is not material to shareholders or otherwise required by law or regulation. This is intended to reduce "clutter"[9] that diminishes disclosure utility and efficiency.

By contrast, Defra's Guidelines advise companies to "include an evaluation of climate risks in your company's overall assessment of business risk" and encourage explanations about the relationship between reported environmental matters and overall corporate strategy, performance and prospects. This is consistent with guidance by the Institute of Chartered Accountants in England and Wales, which also highlights the importance of integrating information on risk with other disclosures, as well as the importance of thinking beyond the annual reporting cycle.

KPIs

P2 4A 414C (4) (b) Does the SR include, where appropriate, analysis using KPIs with information relating to environmental matters?

P2 4A 414C (5) What KPIs are used?

Summary

Companies must provide, where appropriate, "analysis using other key performance indicators including information relating to environmental matters and employee matters" in order to provide an accurate "understanding of the development, performance or position of the company's business".

This analysis is confined to a review of the key performance indicators reported as measures to assess performance, management's focus, and alignment with the interests and contribution to shareholder value. The analysis does not take account of key performance indicators reported outside the strategic management focused parts of the annual report, for example in the sustainability or corporate social responsibility sections of an annual report. The analysis focuses on environmental indicators of strategic management performance as a company identifies its vision, strategy, business model and measures its strategic performance.

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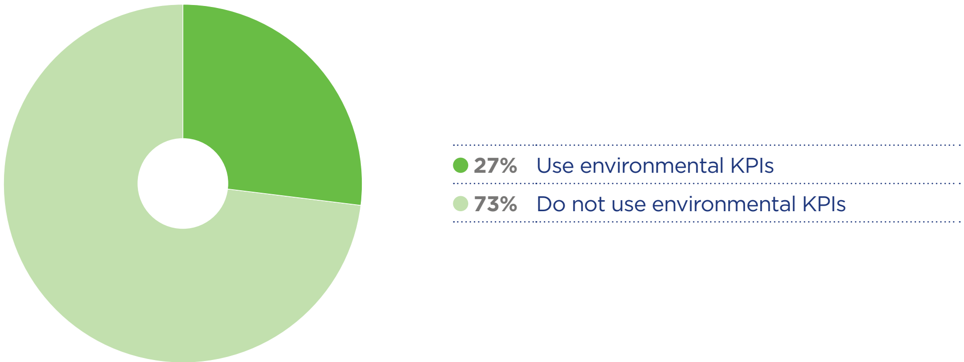
[8] Institute of Chartered Accountants in England and Wales (2011) Reporting Business Risks: Meeting Expectations. Available from: http://www.icaew.com/~/media/corporate/files/technical/financial%20reporting/information%20for%20better%20markets/ifbm/rbr%20final.ashx

[9] Financial Reporting Council (2014) Guidance on the Strategic Report, pp 38. Available from: https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf

Results

- 27% of companies reported environmental KPIs (Figure 7);

Figure 7 All sectors: use of environmental KPIs



- Most of that 27% report four main categories of KPIs: GHG emissions (68%), energy (25%), water (30%) or waste (32%) management.

Sector overview

- 7% of companies in the Financial sector reported environmental KPIs;
- 20% of companies in the Energy sector reported environmental KPIs;
- 82% of companies in the Materials sector reported environmental KPIs;
- GHG emissions, energy management, waste management and water management-based KPIs were most popular across all the sectors;
- 14 different general categories of KPI were identified (Figure 1).

Table 3 Sector breakdown: use of environmental KPIs

Sector	% include environmental matters in principal risks
Consumer Discretionary	29
Consumer Staples	32
Energy	20
Financial	7
Industrials	39
Information Technology	21
Materials	82

Example

DS Smith reported only one environmental KPI, which is shown alongside other strategically important KPIs. Their disclosure also clearly states targets and tracks performance against those for the previous two years.

To lead the way in recycling

Return on average capital employed (ROACE)

1 Restated for IAS 19 (Revised 2011).
2 Pro forma for SCA Packaging acquisition.

Target

12-15%

Definition

Earnings before interest, tax, amortisation and exceptional items as a percentage of average capital employed over the 12 month period.

Why is it a KPI?

ROACE is our key measure of financial success and sustainability. With a cost of capital of c. 9.5 %, our target of 12–15% throughout the economic cycle is above this. See page XX for further explanation.

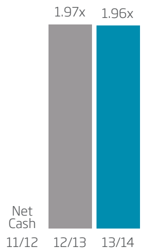
Performance

This year we have sustained our focus on ROACE which has benefited both from synergies driving our profitability, but also continued reductions in our working capital, which liberates capital to be used elsewhere in the business.

Link to our Values

Be challenging
Be trusted
Be tenacious

Net debt/EBITDA



Target

< 2.0x

Definition

Net debt at the period end, over earnings before interest, tax, depreciation, amortisation and exceptional items for the preceding 12 month period.

Why is it a KPI?

Net debt/EBITDA is a key measure of balance sheet strength and financial stability.

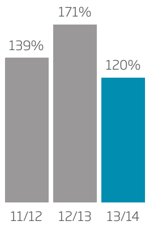
Performance

Our net debt/EBITDA ratio is in our target range.

Link to our Values

Be challenging
Be tenacious

Cash conversion



Target

> 120%

Definition

Free cash flow before tax, net interest, growth capex, pension payments and exceptional cash flows as a percentage of earnings before interest, tax, amortisation and exceptional items.

Why is it a KPI?

We focus on cash conversion because this ensures we are able to sustain our progressive dividend policy.

Performance

Cash conversion remains our target reflecting further year-on-year improvement in working capital.

Link to our Values

Be challenging
Be tenacious

CO_2 emissions

Target

20%

reduction over the 10 years to 2020

Definition

Total CO_2 emissions per tonne of production (ktonnes).

Why is it a KPI?

We actively play our part in the drive to reduce CO_2 emissions through investment in energy and material efficiency projects.

Performance

Increased production volumes and even greater efficiency in our processes per unit of energy input has resulted in a reduction in our intensity ratio of CO_2 per tonne of production. This trend has also been aided by investments in fuel switching and combined heat and power technology increasing the energy yield per tonne of CO_2 emitted.

Link to our Values

Be caring
Be tenacious
Be challenging

Discussion

There is a disconnect between the companies that report environmental impacts of their business (90%) and companies that report KPIs (27%) associated with environmental performance. This disconnect is at variance with Defra's Guidelines, which recommends that companies should report "at least 3 KPIs associated with their key environmental impacts". Defra's Guidelines define environmental KPIs as "quantifiable measures that reflect the environmental performance of an organisation in the context of achieving its wider goals and objectives and highlight the importance of 'key' measures i.e. those most important to an understanding of an organisation".

Defra's Guidelines' emphasis on connecting KPIs to the organisation's wider goals and objectives is consistent with the <IR> Framework which also encourages companies to include information on the critical elements of strategy, business model, risks and associated KPIs. However, while the <IR> Framework, Defra's Guidelines' and the FRC's Guidance promote the importance of connectivity or linkage, it is clear from our analysis that companies often struggle with the challenge of finding and presenting a clear, coherent and connected picture of their business, particularly with regard to linking strategy with relevant KPIs.

Though the Regulations require companies to measure, calculate and report their GHG emissions in tonnes of CO_2 equivalent figures (tCO_2e), some companies chose to use KPIs referencing only CO_2 emissions. Reporting CO_2 emissions provides only a partial disclosure of total GHG emissions and raises uncertainties as to the consistency and integrity of reported information. Some companies may, however, have made a mistake in the unit used and noted their emissions simply in terms of tonnes of CO_2 rather than as tCO_2e.

Fourteen general categories of KPIs were identified in the review, including independent performance assessments, emissions, waste and water management. There was also evidence of significant variation in metrics and normalisation factors. For example, KPIs relating to water management included water consumption (millions of cubic metres per £m sales), water withdrawal (mega litres used in processes), water usage (metrics applicable to business units of global entities including subsidiaries) and water efficiency/intensity (litres water/ packaged product).

The variation in choice, design and applicability of KPIs suggests that companies face dilemmas in determining which measures best reflect and communicate their environmental performance. Although some variation is to be expected as performance indicators are by definition specific to company-determined targets, the reason for the extent of variation within sectors is less obvious.

At the very least, KPIs should be connected with financial information, consistent over successive periods and with internal indicators, focused on material matters, presented with qualitative information to provide context and consistent with accepted industry benchmarks[10]. Companies could look to standards developed through due process, including industry and national standards. For example, companies could look to the work of Sustainability Accounting Standards Board (SASB) who have developed sustainability accounting metrics, and technical protocols that provide guidance on definitions, scope, compilation, and presentation to make sure that they account for performance on material issues in a consistent, comparable, and auditable way.

Future development

P2 4A 414C (7) (a/b) Does the SR include environmental matters in the main trends and factors likely to affect the future development, performance and position of the company's business?

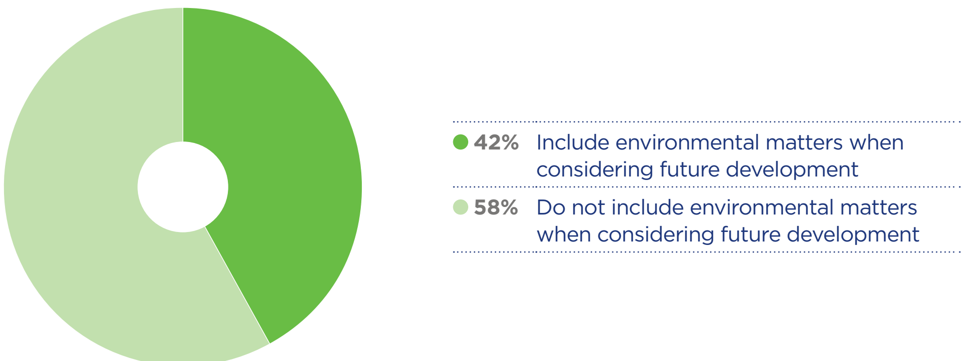
Summary

Quoted companies should "report to the extent necessary for an understanding of the development, performance or position of the company's business... the main trends and factors likely to affect the future development, performance and position of the company's business".

Results

- 42% of companies consider environmental matters amongst the main trends and factors that may affect their future development (Figure 8).

Figure 8 All sectors: future development



[10] International Integrated Reporting Council (2013) Integrated Reporting Framework. Available from: www.theiirc.org/international-ir-framework

Sector overview

- 82% of companies in the Materials sector reported environmental matters amongst the main trends and factors likely to affect their future development (Table 5);
- 26% of companies in the Information Technology and 20% of the Financial sector considered the environment as an important factor that may affect future development.

Table 4 Sector breakdown: future development

Sector	% of companies that consider environmental matters amongst main trends and factors likely to affect future development
Consumer Discretionary	41
Consumer Staples	53
Energy	67
Financial	20
Industrials	54
Information Technology	26
Materials	82

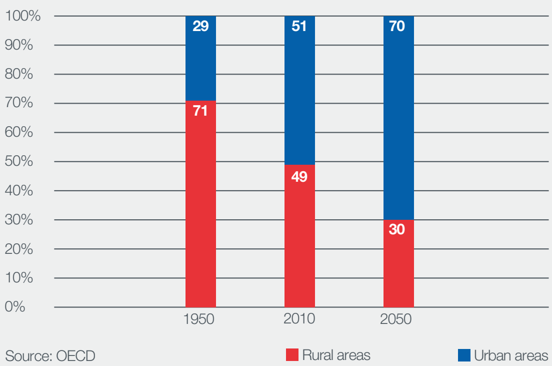
Example

National Express integrated environmental matters into discussions regarding material factors that may have an impact on the company's future position and performance.

Urbanisation

Our services benefit from increasing urbanisation around the world, in particular driving demand for bus operations. Existing towns and cities are expanding, in addition to the creation of new centres of population. Often this is accompanied by significant investment in infrastructure. This in turn requires additional transportation services, both within and between locations, so our bus, coach and rail operations are increasingly in demand.

Share of global population living in cities %



Source: OECD

Modal shift

Modal shift is the move by individuals from one form of transport to another. For National Express, the relevant move is from the private car to bus, coach and rail travel. The biggest reason for this is an increase in the cost of motoring, such as rising fuel and insurance prices, although other factors such as environmental concerns and congestion can also be important. In Spain, we have seen additional support for demand in long distance coach services as air travel has either become more expensive or capacity has reduced.

Environment and congestion

Bus, coach and rail services are significantly more environmentally friendly forms of transport than the private car or air travel, reducing both the level of carbon emissions per person travelling and travel congestion. Society as a whole and individuals are becoming increasingly concerned about the effect of emissions on the environment and are explicitly choosing public transport as an alternative.

Discussion

The FRC's Guidance states that the strategic report is expected to provide shareholders with a holistic and meaningful picture of an entity's business model, strategy, development, performance, position and future prospects. It also asks report preparers to "ensure that relevant information that meets the needs of shareholders is presented in the strategic report".

However, despite 42% of companies acknowledging that environmental matters might affect their future development, few of those companies go on to provide any meaningful analysis or forecasts of how, to what extent or when environmental matters might impact development. It might be that the guidance is too general for preparers to determine whether they satisfy the purpose of the strategic report. Furthermore, as the FRC's Guidance states, "the purpose and required content of the strategic report does not differ significantly from that of the business review which it replaces". It is therefore difficult for companies to discern what adaptations and alterations they should make to existing reporting practices in order to align with the new regulations.

Connectivity of reporting

Our analysis highlighted a disparity between the number of companies that list environmental matters as a principal risk, as a factor that could affect future development, and those that use KPIs to communicate performance (Table 5). Only 16% of companies report on all three. Such a disconnected and fragmented approach to reporting may not provide a clear picture of the company's efforts and plans regarding environmental risks and opportunities, both present and future. Similarly, without the use of relevant KPIs to demonstrate a company's performance, the narrative discussions of environmental matters amongst principal risks or development only provide a partial and limited picture to the reader. Connected and complete disclosures, however, provide valuable information and serve the decision-making needs of users.

Table 5: Companies that identify environmental matters in different analyses

Companies that identify environmental matters:	% of sample
as one of their principal risks	41
as one of their principal risks and amongst the main trends and factors that might have an impact on the future development of their company	29
as one of their principal risks and use KPIs to monitor environmental performance	18
as one of their principal risks and amongst the main trends and factors that might have an impact on the future development of their company and use KPIs to monitor environmental performance	16

Business impact on the environment

P2 4A 414C (7) (b) (i) Does the SR include information about the impact of the company's business on the environment?

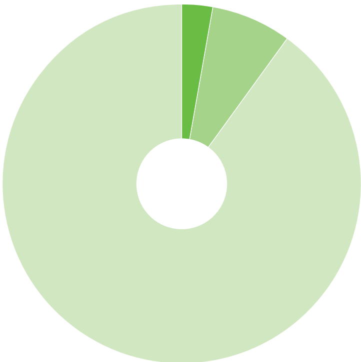
Summary

Quoted companies are required to report information regarding the impact of their business on the environment to the extent that is necessary to give an understanding of the development, performance or position of the company's business.

Results

- Commonly reported impacts include:
  - GHG emissions;
  - Other emissions;
  - Waste;
- 90% of companies disclosed information about the environmental impacts of their operations;
- Of the 10% that did not include information on the environmental impacts of their operations, only 30% did not provide an explanation for the omission (Figure 9).

Figure 9 All sectors: impact on the environment



- **3%** Do not account for missing data/info about environmental impacts
- **7%** Do account for missing data/info about environmental impacts
- **90%** Include relevant data/info about environmental impacts

Sector overview

- 100% of the companies in the Consumer Discretionary, Consumer Staples, Energy and Materials sectors disclosed information about the environmental impacts of their operations;
- Three sectors included companies that omitted some information and failed to explain that omission: Financial (6%), Industrials (2%) and Information technology (5%); and
- 71% of companies in the Financial sector disclosed information about the environmental impacts of their operations.

Table 6 Sector breakdown: impact on the environment

Sector	% of companies that disclosed relevant information about environmental impacts	% of companies that accounted for omissions of information about environmental impacts	% of companies that did not account for omissions of information about environmental impacts
Consumer Discretionary	100	–	–
Consumer Staples	100	–	–
Energy	100	–	–
Financial	71	23	6
Industrials	98	–	2
Information Technology	95	–	5
Materials	100	–	–

Example

Antofagasta provided a detailed breakdown for each of their main environmental impacts, including water, GHG emissions, waste and biodiversity. They provide information related to actual impacts, why they occur, how they may affect the company's business, and the policies and measures undertaken by the company to address these impacts and improve on associated performance.

Water

Continental water is already a scarce resource in many parts of Chile while increasing demand, non-sustainable practices and climate change are a continuing threat. Mining activities can affect the availability of water through water extraction and/or impacting water quality.

Why it matters

– Water scarcity is an environmental challenge, a highly material social issue for communities, as well as a cost issue.

Performance

Although copper production increased, water consumption decreased from 45,482 to 44,666 ('000s of m^3) due to the mining division's focus on improving water efficiency.

45%

Sea water as a percentage of total water consumption.

In focus

Pioneering the use of sea water

Antofagasta Minerals has pioneered the use of sea water with two operations using non-desalinated sea water and a third (Antucoya) about to do the same. It is also installing an innovative highly water-efficient thickened tailing deposition system at Esperanza.

Making better use of water

To address the issue of water scarcity, Antofagasta Minerals has implemented innovative solutions, pioneering the use of non-desalinated sea water and more water-efficient thickened tailings deposit technology. The Company monitors the quality of water in its area of influence and minimises its use of natural high-quality water. Water reuse rates as high as 85% are achieved at some operations.

All sites have water management plans, which include regular monitoring and detailed water accounting records. These are based on the Water Accounting Framework methodology developed by the Sustainable Minerals Institute of Queensland University and the Minerals Council of Australia.

The Company has participated in the CDP Water Disclosure Project ("WDP") since 2010, publishing its information on water use in accordance with the WDP and the Global Reporting Initiative. In 2013 Group-wide water consumption was 44.7 million cubic metres, of which 45% was sea water and the remaining 55% was low-quality continental water.

Los Pelambres has been taking actions to prepare for the potential impact of continued below-average precipitation on its water supply. Initiatives include: the improvement of water capture and transport infrastructure, research on reducing evaporation loss from the tailings dams and the feasibility of recovering more water from them, a detailed review of the operation's water balance and data collection methods and the identification of where water loss occurs and potential solutions. The Company also works with the communities to help them use water more efficiently, having financed the improvement of the local irrigation systems and lining the water channels, among other initiatives.

For the water division, maintaining water quality and pressure, as well as reducing water losses from leaks is an ongoing priority. Aguas Antofagasta is proud to be the first Latin American company to supply desalinated potable sea water. Since 2011 the Company has been certified to ISO 22000, the highest water quality standard.

The transport division operates two wastewater treatment plants at its facilities to ensure that its discharges comply with legal requirements.

Discussion

The most common impacts disclosed in the annual reports of FTSE 350 companies relate to waste, water and energy. However, some businesses are beginning to identify their natural capital impacts and dependencies, apply innovative valuation methodologies (such as environmental profit and loss accounting) and bring new ideas and information into strategic planning, operational decision-making and capital allocation. 90% of the companies reviewed disclose information regarding their main environmental impacts and, of the remaining 10%, 70% provide an explanation of omission. The explanations given for omissions include: having no (or a limited number of) employees and having no properties or activities outside of investments, and therefore no or insignificant direct environmental impacts. 3% of companies omitted environmental information with no explanation.

For some companies the main sources of environmental impact are indirect in the upstream or downstream supply chain and outside the control or ownership of the company. Defra's Guidelines encourage companies to report all impacts that are considered material. Collecting quantitative information on indirect impacts can be challenging. However, Defra's Guidelines state that where accurate quantitative information regarding a company's environmental impacts is unavailable, companies may provide a narrative description together with an explanation about the missing information.

GlaxoSmithKline for example have begun to explore impacts and dependencies across their supply chain identifying that suppliers use an estimated 1,200 million m^3 of water. They have collaborated with TERI, an NGO in India, to develop a diagnostic water impact tool, and in 2014, they used this to identify opportunities for 10 of their largest suppliers to reduce their water impacts. Rolls Royce identify risks in their supply chain related to hazardous substances and describe collaborative efforts through active participation in the International Aerospace Environment Group to mitigate those risks, through new standards, substitution and phase out programmes, across the aerospace supply chain. Tate and Lyle also highlight the importance of diligence across the supply chain identifying beyond their operations a focus on their agricultural raw material and ingredient supply chain, the transportation of products, and product packaging. They are working on sustainable agricultural sourcing across 30 raw materials/ingredients.

Environmental policies

P2 4A 414C (7) (b) Does the SR include information about any policies of the company in relation to environmental matters? Does the SR include information about the effectiveness of those policies? If the SR does not contain information mentioned in (b) (i) does it state which of those kinds of information it does not contain?

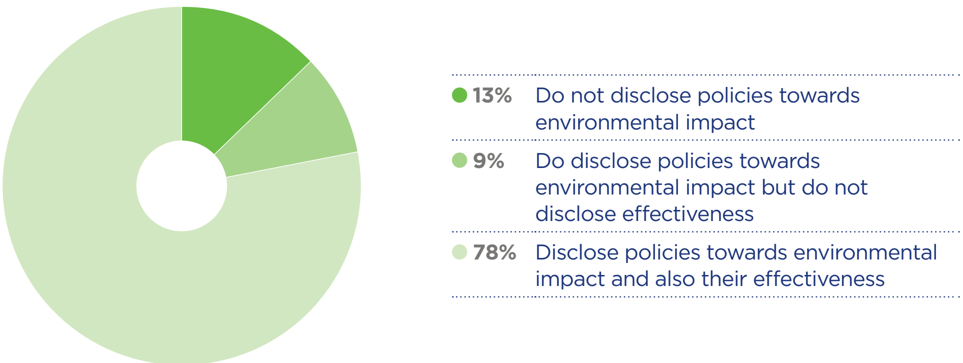
Summary

Quoted companies are required to report information about their environmental policies, as well as the effectiveness of those policies.

Results

- 87% of companies disclosed their policies in relation to environmental matters;
- 78% disclosed policies and monitored the effectiveness of those policies (Figure 10).

Figure 10 All sectors: environmental policies



Sector overview

- 34% of companies in the Financial sector did not disclose any environmental policies. 16% disclosed environmental policies but did not include information about their effectiveness;
- 91% of Consumer Discretionary companies and 100% of Consumer Staple companies disclosed environmental policies and their effectiveness; and
- 100% of companies in the Energy sector disclosed their environmental policies with 80% also reporting the effectiveness of those policies.

Table 7 Sector breakdown: environmental policies

Sector	% of companies that disclosed environmental policies and also their effectiveness	% of companies that disclosed environmental policies but not their effectiveness	% of companies that did not disclose environmental policies
Consumer Discretionary	91	5	4
Consumer Staples	100	–	–
Energy	80	20	–
Financial	50	16	34
Industrials	94	4	2
Information Technology	84	16	–
Materials	90	5	5

Example

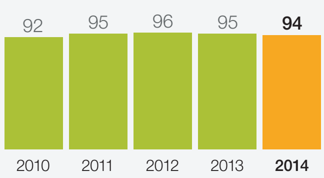
Barratt Developments provided an overview of their targets, and performance against those targets, in a business strategy summary. Environmental matters were identified alongside financial and non-financial targets. Barratt Developments also cross-referenced to the relevant area of their report that provided further details on the environmental policies they have implemented in order to achieve these targets. This referencing also ensures enhanced readability and navigability of the strategic report.

Safeguarding the environment

- Minimising the environmental impact of our operations and supply chain while increasing the energy and resource efficiency of our homes
- Seeking to enhance habitats, biodiversity and local environments across all of our developments

Target:
- Adopt an industry-leading role in influencing policy and developing innovative solutions to meet Zero Carbon Homes challenge
- 100% FSC/PEFC timber compliance by 31 December 2013
- Continue to achieve at least a 95% diversion of waste from landfill

Construction waste segregated on site for recycling
%



Total waste generation per legal completion
tonnes

- Continue towards requirements of Zero Carbon homes from 2016. 5,544 of our completions met Code for Sustainable Homes Level 3 or above
- Built 63% of our homes on brownfield sites in the year
- Published an Ecology and Biodiversity Policy in the year and entered into a unique national partnership with the RSPB
- Achieved 100% FSC/PEFC timber compliance by 31 December 2013

Safeguarding the environment

Our key areas of focus to help safeguard the environment are:

- Increasing the energy efficiency of the homes we build
- Seeking to enhance habitats, biodiversity and local environments across our developments
- Minimising our environmental impact

Increasing the energy efficiency of the homes we build

We are committed to delivering energy efficient homes that are both economically and environmentally sustainable, providing real benefits to our customers and the community. During the year, we have continued to develop the sustainability features of our homes and developments. We also continue to invest in research and development, to enable us to achieve the requirements of zero carbon homes from 2016. Our strategy for delivery remains 'Fabric First', minimising the need for complicated renewable technologies. 5,544 (2013: 4,277) of our completions during the year met Code for Sustainable Homes Level 3 or above.

During the year we have worked closely with our supply chain to deliver our solution to Part L of the Building Regulations in an efficient way whilst maximising the benefits to our customers through reduced energy bills. We have also installed water saving features in 67% (2013: 60%) of our homes during the year, which significantly reduce water consumption compared with older properties.

Enhancing habitats, biodiversity and local environments across our developments

During the year we built 63% (2013: 66%) of our homes on brownfield sites. Across our developments we seek where possible to protect existing environments or restore or create new biodiverse habitats. During the year within our developments, 611 (2013: 556) hectares of open space were created and 866,819 (2013: 310,923) trees or shrubs were planted or retained. We published an Ecology and Biodiversity Policy during the year, and made a commitment to produce biodiversity action plans on all new developments. We have now entered into a unique national partnership in our sector with the RSPB to develop a programme to improve practices in this area.

Minimising our environmental impact

We seek to minimise the environmental impact of our operations by using resources efficiently and reducing waste and carbon in our construction processes.

We segregate waste for recycling as standard across our sites and have achieved a recycling rate of 94% (2013: 95%) for the year. We narrowly missed our recycling target of 95% for the year and will continue to focus our efforts on identifying ways to ensure that we eliminate and reduce waste in FY15.

We generated 6.39 tonnes (2013: 6.25 tonnes) of waste per legal completion in the year, this is an increase of 2.2% compared to 2013, and we will re-focus our efforts on improving resource efficiency.

Discussion

The Regulations require companies to disclose information regarding environmental policies and provide an indication of the effectiveness of those policies. Across all sectors, the majority of companies meet these requirements of the legislation. With the exception of Financial, the disclosure of both policies and effectiveness is greater than 80% in all sectors.

34% of businesses from the Financial sector did not disclose information on their environmental policies, the highest percentage across all sectors. However, many Financial companies reported having little or no impact on the environment (i.e. no employees, no owned nor leased properties and no direct operations outside investments), and would therefore not provide information related to environmental policies. 66% of Financial sector companies did disclose their policies, 50% disclosed both their policies and effectiveness. Some financial companies provided information on how and to what extent environmental matters were involved in their investment decisions and policies as part of their disclosure.

In order to raise disclosure quality and demonstrate the commitment of investors acting in the best long-term interests of beneficiaries, there should be greater clarity and improved definition of the expectations and requirements for financial institutions to disclose their policies relating to environmental matters. One such initiative that will help provide clarity is the Portfolio Carbon Initiative[11], which will develop a series of resources to guide financial institutions towards greater climate performance and away from the risks attached to carbon-intensive assets.

In order to provide harmonised and meaningful emissions disclosure, financial institutions need accounting guidance on how to measure and report emissions from their financial assets. Financial institutions also need guidance on how to identify, assess, and manage carbon asset risks in their lending and investing portfolios. CDSB has considered the role of reporting carbon asset risks in mainstream reports and proposed both amendments to existing legislation and new requirements to reporting standards and practices. The proposed changes encourage companies to account for and report in a way that enables investors and other users of mainstream corporate reports to identify, assess and respond to carbon asset risks[12].

[11] The Greenhouse Gas Protocol's Portfolio Carbon Initiative http://www.ghgprotocol.org/Portfolio_Carbon_Initiative

[12] Climate Disclosure Standards Board (2014) Proposals for Reporting Carbon Asset Stranding Risks. Available from: http://www.cdsb.net/what-we-do/reporting-guidance/reporting-carbon-asset-stranding-risks

Fiduciary duty

Signatories to the Statement on fiduciary duty & climate change disclosure[13], convened by CDSB with the support of UNEP Finance Initiative, commit to producing and using climate change information in mainstream corporate reports. Signatories make this commitment out of a sense of fiduciary and social responsibility, in order to support the efficient allocation of capital. They believe shareholders and beneficiaries have an inherent interest in the completeness and comparability of climate-related information available in annual and other mainstream corporate reports. Signatories include companies (such as L'Oreal, Philips and Unilever), investors (including Storebrand, CalSTRS and Calvert) and investor groups (including the Investor Network on Climate Risk and the PRI Initiative).

Institutional investors have a duty to act in the best long-term interests of beneficiaries[14]. A number of investor initiatives are promoting and embedding responsible investment practices, including the United Nations-supported Principles for Responsible Investment (PRI), the Institutional Investors Group on Climate Change and Sustainable Investment and Finance Association. The PRI Initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Signatories, consistent with their fiduciary responsibilities and the purpose of public disclosure, commit to the following:

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest
- Principle 6: We will each report on our activities and progress towards implementing the Principles

GHG emissions

P7 15 (2) Total annual emissions of GHG (CO_2e) for which the company is responsible

P7 15 (2) (a, b) GHG emissions from fuel combustion and operation of any facility and/or business units (CO_2e) [Scope 1]

P7 15 (3) Total annual emissions of GHG from purchase of electricity, heat, steam or cooling for companies' own use (CO_2e) [Scope 2]

P7 15 (4) Where it is not feasible for the company to obtain some or all of information required by 15 (2) & (3), does company state what is missing and why? What is missing? Why is it missing?

Summary

Quoted companies must "state the annual quantity of emissions in tonnes of carbon dioxide equivalent from activities for which that company is responsible". This includes emissions resulting from the combustion of fuel, the operation of any facility and "the purchase of electricity, heat, steam or cooling by the company for its own use".

[13] Climate Disclosure Standards Board (2015) Statement on fiduciary duty & climate change disclosure. Available at: http://www.cdsb.net/fiduciary

[14] UN Global Compact, UNEP Finance Initiative, UN supported Principles for Responsible Investment, UNEP Inquiry (2015) Fiduciary duty in the 21st century. Available at: http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf

Results

- 90% of companies disclosed their total annual GHG emissions for which they are responsible;
- 79% of companies disclosed the breakdown of Scope 1 and 2 GHG emissions;
- 26% of companies disclosed their Scope 3 emissions;
- 12 categories of omitted GHG emission sources were identified including: business travel, discontinued operations, fugitive emissions, recent acquisitions, refrigerant emissions, some activities, some GHGs;
- "Materiality" was the most common explanation given for missing information (identified by 44% of companies), followed by "information being beyond the company's chosen reporting boundary" (identified by 33% of companies);
- 31 companies omitted all GHG emissions, 26 of these provided a reason for that omission:
  - two cited the availability of information;
  - four reported that they had no material emissions on which to report;
  - two reported that it was impractical for them to measure their GHG emissions at present; and
  - 18 cited that their emissions fell outside their chosen operational boundary for reporting;
- five companies did not report any emissions-related information, or provide an explanation why the information required was missing.

Sector overview

- 97% of Consumer Discretionary companies disclosed annual GHG emissions for which they were responsible. 38% disclosed omissions and provided explanations;
- 71% of Financial companies disclosed GHG emissions for which they are responsible. 51% disclosed omissions and provide explanations;
- 100% of Industrial companies disclosed GHG emissions for which they are responsible. Only 4% offer no information on, or explanation for any omissions;
- 100% of Energy companies disclosed GHG emissions for which they are responsible but only 67% provide a detailed breakdown of emissions from the combustion of fuel and the operation of any facility, and purchase of electricity, heat, steam or cooling. 27% do not provide an explanation for omissions.

Table 8 Sector breakdown: GHG emissions

Sector	% of companies that disclosed GHG emissions for which they are responsible	% of companies that disclosed Scope 1 and 2 GHG emissions breakdown	% of companies that disclosed GHG emission information omissions and offer explanations	% of companies that disclosed omissions but do not provide an explanation
Consumer Discretionary	97	90	38	2
Consumer Staples	95	89	37	5
Energy	100	67	20	27
Financial	71	61	51	6
Industrials	100	91	46	6
Information Technology	100	74	53	0
Materials	100	77	32	14

Example

First Group PLC displayed a complete and clear GHG emissions disclosure. They included Scope 1, 2 and 3 emissions. The group provided a clear and concise summary with accompanying narrative, including information on methodology, omissions, organisational boundary and reporting period.

Greenhouse gas emissions

Tonnes of carbon dioxide equivalent – CO_2(e)	2014	2013	2012
Scope 1*	**2,477,381**	2,536,389	2,588,285
Scope 2*	**344,076**	368,956	361,281
Scope 3	**3,862**	3,401	3,542
Out of scope	**11,439**	11,444	11,969
Total tonnes of CO_2(e)	**2,836,758**	2,920,190	2,965,077
Tonnes of CO_2(e) per £1m revenue	**422**	423	444

Scope 1 – direct emissions from fuel usage by our vehicles, both owned and leased, and from gas used in our buildings

Scope 2 – indirect emissions from electricity used in our buildings and to power our electric rail fleet

Scope 3 – other indirect emissions from business travel by air

Out of scope – from burning biofuels in our vehicles from our UK Bus division, reported in line with DEFRA reporting guidelines

* The 2014 Scope 1 and 2 CO_2(e) data included in this table has been independently verified by Carbon Credentials Energy Services Ltd and is covered by an assurance report which is available in full on our website. Verification activities were performed in accordance with ISO 14064-3:2006.

Our reporting follows the GHG Protocol Corporate Accounting and Reporting Standard, applying the financial control approach to our organisational reporting boundary with a materiality threshold set at 5%. We have reported all material emission sources using the following emission factors:

- DEFRA/DECC UK Government conversion factors for GHG Company Reporting 2013
- World Resources Institute (2008) GHG Protocol tool for Mobile Combustion, Version 2.2
- Environmental Protection Agency – Emission Factors for GHG Inventories

The reporting period is defined as 1 April to 31 March, in line with the Company's financial year. However, emissions from energy consumption within buildings in our North American operations are reported by calendar year due to availability of consumption data. In addition, Scope 2 emissions from electricity consumption in North America were calculated using CO and not CO_2(e) due to limited conversion factors being available. Fugitive emissions from air conditioning equipment have been excluded this year but we are taking steps to measure and report on this next year. A full list of exclusions can be found in our 2014 Corporate Responsibility Report.

The Company's baseline year is 2010/11. The same baseline year is also used in FirstGroup's climate change strategy, which contains the Group's carbon reduction strategy and targets for 2015/16.

Discussion

90% of companies disclosed their total annual GHG emissions for which they are responsible. There are however some disparate practices in detailed accounting and reporting practices, such as the identification and categorisation of emissions-releasing activities. While a significant majority of companies provided a disclosure of GHG emissions for which their company is responsible, only 79% of companies disclosed both Scope 1 and 2 GHG emissions. Only 67% of companies in the Energy sector provided this detail. Other sectors provided this breakdown: 90% of Consumer Discretionary and 91% of Industrial companies for example.

Defra's Guidelines state that GHG disclosures should include supporting explanations, provide details of any specific exclusions of emissions from Scopes 1, 2 and 3 (including an estimation of the percentage they represent) and explain the reason for any exclusions. Defra's Guidelines also states that, where information is incomplete or has been prepared under conditions of uncertainty, companies should identify and clearly explain the nature and degree of omissions, errors or uncertainty. These descriptions are an important part of companies faithfully representing information and ensuring disclosures are complete, neutral and free from error. Disclosures are complete if they include all information that is necessary for an understanding of the matters that they represent, and do not exclude details that could cause information to be false or misleading to users.

According to the Regulations and Defra's Guidelines, companies are required to quantify and report on all sources of environmental impact within their defined reporting boundary, disclosing and justifying any specific exclusions or omissions. Eighteen companies identified that the responsibility for GHG emissions fell outside their organisational boundary, describing their relationship to other organisations and attributed responsibility to other entities. Forty-two companies identified boundary reasons for omitting some emissions (i.e. emissions were known but fall outside the corporate boundary).

In some cases it may be appropriate to disclose environmental information outside an organisation's reporting boundary. This may occur for a variety of reasons such as, exposure to material risk, opportunity or financial impact. The CDSB Framework recommends that the organisational boundary used for environmental reporting purposes is as far as possible the same as (or capable of reconciliation to) the boundary used for the mainstream report[15], in order to promote comparability and consistency of reporting. The CDSB Framework also recommends that information attributable to entities, facilities, business units or activities outside the organisation's mainstream reporting boundary should be clearly distinguished from information about entities and activities within the boundary. This approach is consistent with the IIRC and SASB approaches identifying that non-financial results should be prepared according to or should be capable of reconciliation with financial information prepared according to financial consolidation rules[16].

Disclosure

P7 16 Are the methodologies stated for 15 (2) and (3)? What methodologies were used?

P7 17 What GHG intensity metrics are stated? What units of measure are used to normalise emissions?

P17 18 From year 2 onwards, are previous year's results for 15 (2) and (3) and 17 disclosed?

P17 19 If DR reporting period is different to information disclosed in 15 (2) and (3), is it stated?

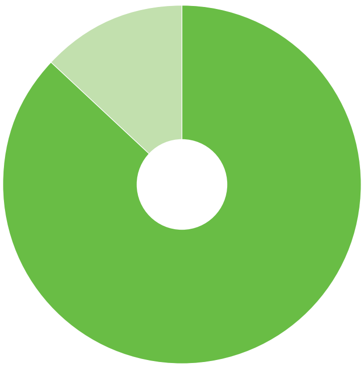
Summary

Quoted companies are required to "state the methodologies used" to calculate their GHG emissions disclosure. They must also state "at least one ratio which expresses the quoted company's annual emissions in relation to a quantifiable factor associated with the company's activities". If it is not the company's first year reporting such information, it must also report the previous year's GHG emissions. Lastly, the company must also state whether or not the "period for which it is reporting information required by paragraph 15 (2) and (3) is different to the period in respect of which the directors' report is prepared".

Results

- 87% of the companies reviewed that had disclosed their GHG emissions also disclosed their methodology (Figure 11);

Figure 11 All sectors: methodology



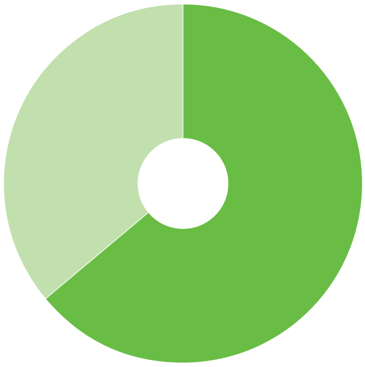
87%	Disclose methodology
13%	Do not disclose methodology

[15] Climate Disclosure Standards Board (2015) CDSB Framework for Reporting Environmental Information and Natural Capital. Available at: http://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital

[16] Climate Disclosure Standards Board (2014) Proposals for boundary setting in mainstream reports. Available at: http://www.cdsb.net/what-we-do/reporting-guidance/boundary-setting-mainstream-reports

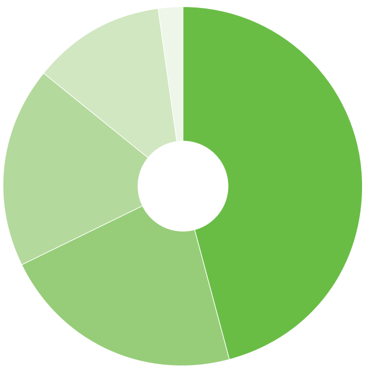
- 36% of companies did not state which emissions factors were used to calculate their emissions in terms of tCO_2e (Figure 12);

Figure 12 All sectors: emissions factors



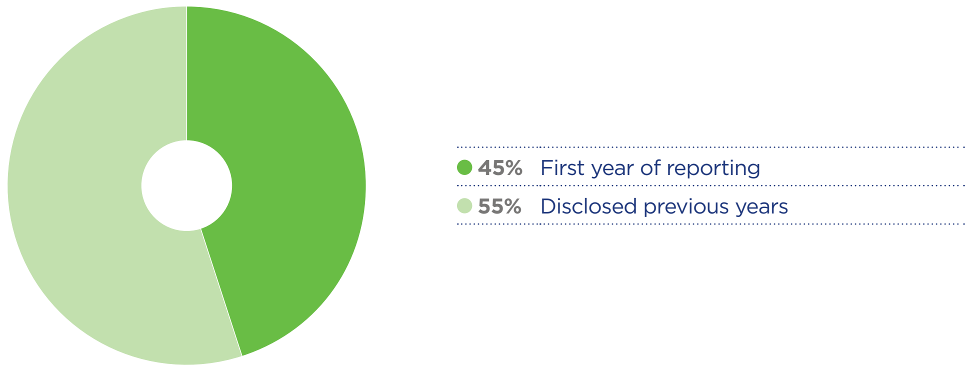
- 95% of disclosing companies provided at least one emissions ratio associated with their company's activities;
- Five distinct categories of emissions ratios were reported:
  - 46% Turnover/revenue (e.g. tCO_2e per £m revenue tCO_2e per £Turnover, tCO_2e per £m net income after administrative costs);
  - 22% Employee (e.g. tCO_2e per FTE, emissions per staff member, tCO_2e per 1,000 hours worked);
  - 18% Product (e.g. Kg of tCO_2e per tonne of laundry shipped, tCO_2e per home completed, kg $kgCO_2e$/barrel produced);
  - 12% Area (e.g. tCO_2e per m^2 per 1000 sq. ft. of sales floor); and
  - 2% Customer (e.g. tCO_2e per thousand customers, $kgCO_2e$/Occupancy).

Figure 13 All sectors: emission intensity metric



- 45% of disclosing companies did not disclose the previous year's GHG emission results;
- 55% of the companies disclosed information from the previous year as well as from the current year.

Figure 14 All sectors: first year of reporting



- 23% of companies disclosed that they independently assured their GHG emissions disclosure.

Sector overview

- 91% of companies in the Industrials sector disclosed their methodologies, 57% of them disclosed the relevant emission factors;
- 91% of companies in the Consumer Discretionary sector disclosed methodology, 79% disclosed the relevant emission factors;
- In the Industrials sector 4 categories of emissions ratios were used: Turnover/revenue (68%), Employee (19%), Product (7%), Customer (5%);
- In the Financial sector 5 categories of emissions ratios were used: Turnover/revenue (26%), Employee (46%), Product (4%), Area (21%), Customer (3%).

Table 9 Sector breakdown: disclosure

Sector	% disclose methodology used	% disclose emissions factors used	% first year of reporting	% have emissions assurance
Consumer Discretionary	91	79	46	16
Consumer Staples	89	50	33	44
Energy	80	40	53	0
Financial	81	70	47	28
Industrials	91	57	43	31
Information Technology	89	61	56	22
Materials	77	50	36	14

Example

Pennon Group provided all the requested information in a clear and concise table-narrative combination. The company also provided its Scope 3 emissions and other relevant emissions sources, such as biogenic emissions outside its scope breakdown. To improve disclosure, the Group could specifically indicate whether GHG emissions are omitted and why, and further information could be provided on the level of independent audit and verification.

Pennon Group Plc greenhouse gas emissions

	2013/14	2012/13
Scope 1	1,223,568	1,200,591
Scope 2	143,478	143,528
Scope 3	60,080	57,493
Total gross emissions	1,427,126	1,401,613
Carbon offsets	0	0
Netted off renewable electricity export to grid up to total amount of electricity purchased and consumed by organisation	(143,478)	(143,528)
Total annual net emissions	1,283,648	1,258,084
Biogenic emissions outside of scopes	936,133	957,425
Intensity measure: tCO_2e (gross Scope 1 + 2)/£100,000 revenue	103 tCO_2e/£100,000 revenue	112 tCO_2e/£100,000 revenue

Scope 1 (Direct emissions) Activities owned or controlled by our organisation that release emissions straight into the atmosphere, for example the combustion of fuels in company owned and controlled stationary equipment and transportation, emissions from site based processes and site based fugitive emissions.

Scope 2 (Indirect emissions) Emissions released into the atmosphere associated with our consumption of purchased electricity, heat, steam and cooling. These are indirect emissions that are a consequence of our activities but which occur at sources we do not own or control.

Scope 3 (Other indirect emissions) Emissions that are a consequence of our actions, which occur at sources which we do not own or control and which are not classed as Scope 2 emissions.

Notes

Change in emissions

Our GHG emissions increased between 2012/13 and 2013/14 largely as a result of additional fugitive emissions from our landfills. However our emissions intensity measure of tCO2e/£100,000 revenue decreased as a result of our revenue increasing at a faster rate than our emissions.

In order to maintain emissions comparability between reporting years we have taken the decision to rebase our historical emissions following a recent change in the Government's methodology for calculating the emissions conversion factors associated with imported electricity usage. The Government's modification has resulted in an approximate 7% reduction in emissions from imported electricity (Scope 2 emissions) compared with the previous methodology and this has been significant enough to prompt us to rebase our 2012/13 reportable emissions.

Our second methodological change is to remove biogenic emissions from our Scope 1 emissions and report them separately so that they are no longer included within our total gross and net emissions. This accords with the latest Government guidance on reporting emissions reductions such as those emissions that have their origins in biological matter.

Methodology and approach

We have followed the Government's environmental reporting guidelines for mandatory greenhouse gas emissions reporting published by DEFRA in June 2013. In calculating our emissions we have used the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard (revised edition) and the web-based conversion factors provided by DEFRA.

Organisational boundary

The emissions listed here cover the Pennon Group of companies using the financial control approach.

Operational scopes

We have measured our Scope 1, 2 and some Scope 3 emissions where information is available.

Intensity measurement

We have chosen an intensity measure of Scope 1 and 2 gross emissions in tCO_2e per £100,000 revenue.

External assurance statement

Our greenhouse gas emissions data has been independently audited and verified for accuracy, completeness and consistency by an external assurance assessor.

Carbon offsets

We do not purchase any carbon offsets, instead we rely on self-generated renewable energy to reduce our overall emissions.

Green tariffs/renewable energy export

We do not purchase green tariff electricity; instead we can reduce our net emissions by exporting our self-generated renewable energy to other users.

Discussion

Consistent disclosure of information is essential for an accurate and meaningful understanding of operational performance and related environmental management improvements. Companies are required not only to disclose information for the current financial year, but also to disclose information year-on-year from the second year of reporting. Although our review covered the first year of reporting, 55% of the companies reviewed provided year-on-year disclosure. This may be attributable to the established reporting practices of many companies using GHG accounting methodologies such as the GHG Protocol Corporate Standard and ISO 14064-1.

The Regulations require companies to normalise at least their total Scope 1 and 2 emissions using an intensity ratio. Intensity ratios should be relevant to the business and meaningful to users of this information. Although some common categories were identified across all companies, a range of normalisation factors were identified within and between sectors. For example, within the Financial sector, intensity metrics used by insurance companies included both tCO_2e/employee and net tonnes of emissions/£million of net written premiums. Similarly, within the trucking sub-industry, intensity metrics included tCO_2e/£million Revenue and tCO_2e/passenger journey. This variation raises questions about the comparability of reported information. In some sectors and industries however, common metrics and ratios were evident. For example within the Consumer Staples, Discretionary and Retail sectors and sub-industries most companies identify ratios that relate to either their retail space (e.g. tCO_2e/'000 sq. ft.) or revenue (e.g. tCO_2e per £million of revenue).

For 11% of companies, the period for which environmental information was reported, did not match the period used for the directors' report. For the other 89% of companies either no statement was provided regarding the alignment of reporting period or they identified the non-financial reporting period as aligned with the financial. Where GHG emission information is provided on an annual basis for the same period covered by the directors' report, it is made available to decision-makers on a timely and useful basis.

The proportion of companies providing information related to the methodology used for the preparation and disclosure of GHG emissions information was variable across different sectors. However overall, more than 75% of companies in all sectors provided this information. Across all sectors, 23% fewer companies disclosed their emissions factors, when compared to other methodological information. Emission factors are essential in the calculation process that normalises emissions of GHGs to a carbon dioxide equivalent value. Defra's Guidelines highlight that companies should use consistent methodologies to allow for meaningful comparisons of environmental impact over time, and that companies should document any changes to the data, methods, or any other relevant factors. Therefore, methodological information should be disclosed as part of a complete and transparent disclosure.

Only 23% of companies reported that their emissions disclosure had been independently assured. Assurance processes and engagements can improve the quality of the reported information, reinforce credibility among stakeholders and improve reporting processes by reducing information risk. Generally, the financial auditor is required to read information presented in addition to the audited financial statements and to identify any significant inconsistencies between the two. The auditor also has to verify any observed significant misstatements of fact in those disclosures and ensure that the statements conform to local regulations. However, the purpose of the consistency check is not to provide assurance on the information published. Further, a financial statements audit is generally not suited to reach conclusions on specific and discrete disclosures such as environmental information. The consistency check does not therefore represent assurance of environmental information and is not comparable to assurance activities carried out under ISAE 3000 and ISAE 3410. CDSB encourages organisations to engage with assurance providers to agree an appropriate assurance approach. Assurance engagements conducted according to existing standards such as International Standards on Assurance Engagements (ISAE) 3000, 3410, or similar national standards are suited to provide assurance on environmental information.

Chapter 6

Conclusions

Lessons learnt

The majority of companies in our sample meet the requirements of the Regulations, either by disclosing all the requested information or by explaining any omissions in the information reported. Our findings suggest that companies are less likely to report on environmental matters where the requirement to report depends on whether the information is relevant and/or material. This might be attributable to the dilemmas that companies face in seeking to limit "clutter" in their reports even where Defra's Guidelines and stakeholder pressure encourage reporting of environmental information. There are opportunities for companies to develop reporting practice through considering the characteristics and purpose of performance indicators, the risks and opportunities associated with environmental matters beyond GHG emissions, and strengthening the relationship between environmental matters and overall corporate strategy, performance and prospects.

The variations in reporting practice suggest that further work is needed to send clear signals to companies about what and how to report on environmental matters. The evidence outlined in this study shows that mandatory requirements to report objective, auditable, decision-useful, standardised material activities can be effective. It is however important that regulators and government acknowledge the challenges and difficulties companies face in responding to multiple policies and schemes, whose messages and interactions may be unclear. Regulators should therefore seek to build on emerging practice look to align and support the development of corporate reporting. A holistic review of all influences on corporate reporting behaviour is likely to reveal opportunities for regulators to encourage greater consistency, comparability and connectivity of information through more specific requirements. This will serve policy objectives, reporting companies and users of information alike.

Future work

One of the main conclusions from this report is therefore that a similar review should be undertaken for successive reporting periods to understand developments and opportunities for the development of environmental reporting. Doing so, particularly in tandem with a holistic review of reporting practice, would provide further insight into changing corporate reporting practices and the implementation and interpretation of legislation. Further work could also begin to explore the relationship between the disclosures provided by companies in their sustainability reports, CDP responses and other reporting schemes to further understand the value of mandatory disclosure and explore the content provided through the different formats.

Opportunities

The CDSB Framework for reporting environmental information and natural capital

Companies looking to develop their reporting practice to reflect integrated management and facilitate informed and sustainable decision-making should look to appropriate guidance and frameworks that can enable a more cohesive and efficient approach. The CDSB Framework sets out an approach for reporting environmental information and natural capital in mainstream reports, such as the annual report, or integrated report. It is designed to help organisations prepare and present environmental information in mainstream reports for the benefit of investors. The CDSB Framework helps companies to provide clear, concise and consistent information to investors, connecting their environmental performance to its overall strategy, performance and prospects. It encourages standardisation of environmental information reporting, as it builds on the most widely used reporting approaches, such as CDP, GRI, SASB, IFRS and <IR>. The CDSB Framework also supports compliance with current and emerging regulatory requirements for environmental reporting (e.g. the EU NFR Directive).

The CDSB Framework provides guiding principles and reporting requirements. The guiding principles are designed to ensure that environmental information in mainstream reports is useful to investors, is correct, complete and supports assurance activities. The guiding principles help to ensure determining, preparing and presenting environmental information is done in accordance with the reporting requirements. The reporting requirements set out the type of environmental information that should be reported. They are based on reporting standards already used by companies, and CDSB's input where there were gaps in these existing standards. The reporting requirements relate to the organisation's environmental policies and strategy, risks and opportunities and governance thereof; the organisation's environmental results and performance; management's future outlook regarding environmental results, performance and impacts; and the way in which environmental information is prepared and reported.

EU Non-financial Reporting Directive ("EU NFR Directive")

The Regulations provide a clear structure and platform for the implementation of the NFR Directive. Many of the environmental requirements of the NFR Directive are already addressed, in the Regulations. Both the Regulations and NFR Directive identify policies, impacts, material risks and opportunities, and performance using KPIs. Both use the wording "environmental matters", and the NFR Directive explicitly states GHG emissions are part of environmental matters: "where undertakings are required to prepare a non-financial statement, that statement should contain, as regards environmental matters, details of the current and foreseeable impacts of the undertaking's operations on the environment, and, as appropriate, on health and safety, the use of renewable and/or non-renewable energy, greenhouse gas emissions, water use and air pollution". This also supports the case for keeping and reviewing responses to the Regulations for the foreseeable future.

Leadership

The combination of clear and consistent Regulations, the innovation in corporate reporting practice and keen investor demand for information makes for an evolving reporting landscape, but one that is motivated by the desire for a resilient and sustainable future. This report shows that from a regulatory and business perspective, whilst there are opportunities for improving reporting practice, the UK is well positioned to implement the NFR Directive and to show leadership in the international development of non-financial reporting practices.

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