Carbon Guidelines – Who is Responsible?

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Abstract

Climate Change, the biggest threat the world now is facing throws a bigger challenge to the Accounting Standard Setters also. A globally agreed framework on reporting the carbon disclosure in the mainstream financial report is require. With a considerable effort of many drivers to account for carbon emissions, the companies with exposure to high carbon risk definitely needs to report their financial performance to the well informed investors. The governments tightening its control machinery to save the world from facing another 2°C temperature rise, the industrial world is looking for an effective Carbon Guidelines. Who is responsible to set an effective and globally agreeable framework?

Carbon emissions, a sensitive term internationally, which brought heated and sensitive reactions from the world leaders in the recently held summit in Copenhagen, is the biggest threat to our planet earth. The reduction of carbon emission is an urgent need and who is willing to carry the torch to integrate the concern for environment is still vague even after the Copenhagen meet. The blaming tones, protective voices, defensive arguments and self justifications could not prevent the global warming any further, if the focal point from where to trigger the emission control is not identified.

Speaking at the World Business Summit in Copenhagen, Pau Dickinson, Chief Executive of the Carbon Disclosure Project (CDP) said, "as the current economic crisis illustrates the failure to acknowledge risks in the short term can lead to substantial legacies in the long term. Against this background, it is imperative that companies supply their shareholders with appropriate climate change data"[1]

[1] Andrew Dorroughue, "Green annual reporting standards edge closer", Business Green(May 2009)

Global warming is a threat since the century of industrialization and it would be right if the companies start paying back the repair charges. At this point, it is essential to understand that without a standardized method of accounting and reporting for carbon emission, it would rather be difficult to force the companies to begin reducing carbon emissions. As Alan McGill, PriceWaterhouseCoopers (PwC) partner in sustainable development and climate change said, "it took 125 years over which financial accounting rules developed and filled gaps as businesses became more complex, we don't have that sort of time when it comes to climate change. We don't have 100 years to account for carbon".

Companies are employing a variety of different accounting practices for carbon emissions in the absence of clear international guidance on the issue, according to a survey by PwC and the International Emissions Trading Association (IETA)[2]. The exposure given to the problem of climate changes is forcing the corporate world to be committed to find ways and means to emphasize their fairness of reporting regarding the emission efforts but the vacuum in reporting guidelines shifts the responsibility from the corporation to the standard setters.

Having identified the urgency with which the industrial world is to take a constructive step towards disclosing their efforts and expenses in managing carbon emissions, this paper attempts to identify who is expected to set the carbon guidelines so that it could positively influence the carbon reporting pattern of the corporate world. Setting a universal guidance on carbon reporting and getting an accepting nod from all the professional bodies, governments, accounting and audit firms is a huge task and it can get full justice only if the job is done by a very established and well received Board, Forum, Project or Organization. This study identifies some of the well accepted drivers and their efforts towards setting a carbon framework. The feedback for those proposed frameworks are analyzed to derive a better picture of the progress in setting a globally acceptable carbon guideline in the mainstream and other financial reporting. This research paper does not attempt to assess the current carbon reporting patterns of the companies.

A brief overview on what is carbon emission and the intensity of the problem will well explain the need of the hour.

Carbon emission

Carbon emission means polluting carbon substances like carbon dioxide and carbon monoxide released into atmosphere and forming pollutants in the

[2] Lack of consistency in carbon accounting – IETA, PwC, Carbon Finance, 17 May 2007

atmosphere. Global warming is caused by the emission of greenhouse gases, 72% of the totally emitted greenhouse gases is carbon dioxide (CO_2), 18% Methane and 9% nitrous oxide (NO). Carbon dioxide emissions, therefore, are the most important cause of global warming. CO_2 is inevitably created by burning fuels like e.g. oil, natural gas, diesel, organic-diesel, petrol, organic-petrol, ethanol. The emissions of CO_2 have been dramatically increased within the last 50 years and are still increasing by almost 3% each year.[3](Appendix 1)

If we could consider seriously what Intergovernmental Panel on Climate Change (IPCC) warns about global emissions, that the emissions would need to peak and start to decline within about 15-20 years, then the planet earth would have a reasonable chance of avoiding temperature rise of 2°C. By 2050, the world-wide average (CO_2) emission per capita needs to be reduced to 2 tons per year. In the following years, the emissions will need again to be cut by half.

Andrew Dessler, a climate scientist at Texas A&M University, said Atmospheric Infrared Sounder Instrument (AIRS) observations on climate model predictions confirmed that as the climate warms, the atmosphere would become more humid, thus more than doubling the warming effect of increased carbon dioxide. The implication of these studies is that, should greenhouse gas emissions continue on their current course of increase, we are virtually certain to see Earth's climate warm by several degrees Celsius in the next century unless some strong negative feedback mechanism emerges elsewhere in Earth's climate system, said Dessler in a NASA statement[4].

Need for Regulations

In a carbon constrained world, we need to check whether there are appropriate framework to guide to account for carbon emissions and whether there are guidelines for a disclosure pattern to fit for the purpose. Currently, the existing drivers for carbon disclosures are like European Union (EU) Emission Trading Schemes, World Business Council for Sustainable Development (WBCSD), Green House Gas Reporting, Global Reporting Initiative (GRI) and Climate Disclosures Standards Board (CDSB) which is a secretariat to Carbon Disclosure Project(CDP)

There are many examples of good practice in the emerging emissions markets around the world. For example, in New South Wales, Australia, there is a risk

[3] www.wri.org

[4] NASA's carbon emissions data linked to humidity, global warming ,The Sisasat Daily, 17 December 2009

based approach whereby the administration contracts directly with the independent verifiers, requiring them to report on specific elements of the projects in question. In the EU, third party verifiers require accreditation before they can be hired by companies. In the US, detailed standards are established for monitoring and reporting.[5] However, all these highlight good range of national practices of carbon disclosure and assurance but from the multi-national companies' perspective, they cannot fill the gaps of international differences in reporting practices.

Given the situation of danger of global warming, experts have voiced growing concern that businesses are still without a standardized method of accounting for carbon, despite impending policies forcing companies to begin reducing energy emissions. Under globally agreed greenhouse gas (GHG) protocols, there are three types of emissions. Scope 1 emissions occurring within the boundary of a facility from sources. Scope 2 refers to the indirect emissions occurring outside the boundary of a facility whereas Scope 3 includes the emissions occurring as a result of activities outside the boundary of a facility other than electricity. A carbon footprint is a sum of all the three.

Scope 1 emissions are calculated by multiplying the fuel usage by emissions factors which have been set for different types of fuels. Scope 2 emissions are calculated by multiplying the electricity consumed by emissions factors that have been set for the different types of electricity sources and generators. Scope 3, the embodied emissions are determined by using estimates of carbon embedded within goods or services that have been purchased or sold.[6]

All these technicalities of calculation of carbon emissions are explained in detail under Cross Sector Tools, Sector Specific Tools, Additional Guidance Documents and Customized Calculation Tools of GHG. Cross Sector Tools are applicable to many industries and businesses regardless of sector while Sector Specific Tools are meant for specific sectors of industries and businesses. Additional Guidance Documents provide further clarification on reporting and quantification issues whereas Customized Calculation Tools are customized for developing countries. The IPCC Guidelines on Carbon Content factors acts as a basis of assessment of emissions. Despite the guidelines for quantifying the emissions, a principle-based global reporting framework for carbon emissions set by an internationally influential body is the need of the hour.

[5] Building Trust in Emissions Reporting, PricewaterhouseCoopers, February, 2007
[6] KPMG in Australia, July 2009

The compulsion of reducing the temperature by 2°C and the widespread awareness of stakeholders about the climate danger forces a much broader and transparent international reporting regulations on carbon emissions. In that direction, the professional bodies and various governments expect a responsible body to take up the initiative and responsibility to set an internationally acceptable and practicable framework.

The representation of Institute of Chartered Accountants in England and Wales (ICAEW), Accounting for Sustainability and Climate Disclosure Board in Copenhagen[7] documented the benefits of a set of universal standards for disclosure of climate change-related information in mainstream financial reports. It includes reduced complexity and increased clarity that enables businesses and investors to integrate climate change considerations into their strategies and long-term planning. Besides, it brings the benefit of consistent, comparable and reliable disclosures across sectors and geographies and a common language for reporting.

Alan Mc Gill, PwC partner, says that we need an effective reporting system fit for purpose, fit for the 21st century. His main concern is that multinational businesses now have to cope with more than 100 different national policies around the world on how to manage or reduce carbon emissions. And yet there is no standardized accounting method to bring the issue on to company balance sheets.[8]

In the process of identifying the standard setting body for carbon emissions it is essential that it should be internationally influential in convincing about the suitability of its standards. This is a lot debatable as the International Accounting Standards Board (IASB) is widely expected by industries, investors and accounting firms to come up with a standard on sustainability which allows an internationally comparable disclosure on carbon emission.

The role of Carbon Disclosure Project (CDP) cannot be discounted while we look for an universally applicable framework for carbon emissions. CDP acts as a Secretariat to Climate Disclosure Standards Board (CDSB). CDSB does not aim to create a new standard. Through its collaborative approach, CDSB aims to support, harmonise and strengthen existing climate change-related reporting

[7] Representation to the conference of parties on Climate Change(COP15), Copenhagen, 7-18 December, 2009

[8] Rachael Singh, "Cracks appear in carob emissions accounting", Accountancy Age(November, 2009)

initiatives and standards by bringing together and enhancing best practices in the form of a single consistent global framework that can be used for disclosure in mainstream reports.

The CDSB has issued an exposure draft on its proposed Reporting Framework and invited comments thereon by 25 September 2009. According to the Para1.7 of CDP, the framework reflects the characteristics and objectives of mainstream business reporting modes and articulates the demand for information from investors about the way in which climate change affects or is likely to affect a company's current and future financial condition, results of operations and cash flows. The framework is based on financial reporting standards, principles, proposals and discussion papers issued or commissioned by the IASB and their predecessor bodies. Also it is based on the Corporate Accounting and Reporting Standard developed by the World Resources Institute(WRI), the World Business Council for Sustainable Development (WBSCD) and International Standards Organization (ISO14064).

Deloitte[9], in its feedback, expressed confidence in CDSB's Exposure Draft on Reporting Framework by saying that it would assist in standardizing and increasing consistency and comparability of information in this area. At the same time, it pointed out that these disclosures should be evidenced by a cost-benefit analysis similar to that of international standard-setters like IASB.

Accounting for Sustainability[10] mentioned that the CDSB's framework should include references in the Executive Summary to the need for more connected reporting in mainstream financial reports perhaps referencing Connected Reporting Framework (CRF) of the Prince's Accounting for Sustainability Project which provides a model of how to present organizational performance in a connected way.

The American Institute of Certified Public Accountants[11] suggested grounding CDSB's Framework principles in existing and emerging standards, models, frameworks and practices is a sound approach as reliance on the GHG Protocol and others for corporate climate change disclosure, incorporating characteristics of decision-useful information from jointly developed IASB and FASB proposals.

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[9] Deloitte, Responses to CDSB's public consultation, 21 October,2009
[10] Accounting for Sustainability, 25 Septemeber,2009
[11] AICPA, 11 November, 2009

Despite the good feedback, CDSB did not get an endorsement in Copenhagen Summit, where ICEAW president Michael Izza chaired a panel discussion involving representatives from the Big Four and he presented the audience and panel with a potential reporting framework for carbon emissions written by the Climate Disclosure Standards Board, which was open for consultation. The idea of bolting such a standard onto existing international financial reporting standards was floated – but one attendant, PricewaterhouseCoopers sustainability and climate change division partner Alan McGill, believes carbon reporting needs its own framework, and quickly. "Until you get that consistency around measurements, organizations probably won't move as quickly as they could or should do," he said.[12]

The comments on CDSB's framework emphasize the overall need for an appropriate guideline for Carbon emissions to ensure transparency and comparability of carbon reporting. In addition, the question of how effectively carbon disclosure, given the fact that it cannot be a standalone report, related to the financial performance and mainstream financial reports could be made, also arises.

Michael Izza, chief executive of the ICAEW said that a single reporting standard for climate change related disclosure related to financial performance and mainstream financial reports is only the beginning of the process that will promote the provision of more trusted, accurate and reliable information to investors and stakeholders enabling them to make better decisions and drive the scale of behavioral change necessary to achieve a low carbon economy[13]

Climate Wise statement on the United Nations Framework Convention on Climate Change (UNFCCC) Copenhagen negotiations expressed hope that all corporate are committed to action on climate risk analysis, public policy, customer awareness, investment strategies and operational impact and to publicly reporting on progress every year[14]. Andrew Gray, head of environment and social governance research, Goldman Sachs JB Were said that the quality of disclosure among leading companies is increasingly important to help investors understand

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[12] Copenhagen: Emissions standards mooted, Accountancy Age, 20 December 2009
[13] Rachael Sing, "Calls for global standard on carbon reporting grow, Accountancy Age(3 December 2009)
[14] University of Cambridge, Programme for Sustainability Leadership, 22 October, 2009

how climate change may affect companies' operations and ultimately their valuations[15].

At this point, the contribution of IASB is expected to be a great solution provider. As IASB boasts of the effective reach and usage of IFRS throughout the world (Appendix II), it is natural that the Board is expected to set carbon guidelines as well.

Copenhagen was an opportunity for some to call on world leaders to push the IASB into playing a leading role in developing climate disclosure standards for mainstream company reporting as many were of the opinion that a body like the IASB to give those standards the authority of mainstream reporting. Unfortunately, the IASB did not choose to attend Copenhagen as they believed the summit was not an appropriate place to discuss standards owing to the political nature of the negotiations on carbon reduction[16]

The current progress in IASB's efforts towards Emission Trading Schemes could be viewed in a positive light at this point. Emissions trading schemes are designed to achieve a reduction of greenhouse gases through the use of tradable emission permits. The Board and the FASB are conducting a joint project to develop comprehensive guidance on the accounting for emissions trading schemes.

In March 2009, the Board tentatively decided that an entity should recognize emission allowances received free of charge from government as assets. The allowances should initially be measured at fair value. The Board decided tentatively that if an entity receives allowances free of charge from the government, the entity incurs an obligation to reduce its emissions below the level represented by those allowances (ie its cap). The FASB discussed the project in April 2009. The FASB did not reach any conclusions on the accounting questions

[15] Smoke and mirrors, insto, 12 November, 2009
[16] G.Hink & R.Singh, Standards lobby heads for climate summit, Accountancy Age, 3 December 2009

related to initial recognition and measurement of emission allowances received free of charge from governments. The project team plans to bring a comprehensive package of alternative accounting models to the Board in the fourth quarter of 2009.The publication of an Exposure Draft is scheduled for the second quarter of 2010.[17]

There are high expectations of the IASB. Institutes, accounting firms, regulators and investors were all waiting for the IASB to come up with an international accounting standard that would allow them to report on sustainability information in a comparable manner. The problem is that the IASB has been distracted by issues generated by the global recession and the credit crunch. Richard Spencer of the ICAEW said the IASB's position was "understandable" because it "had its hands full". Other observers simply said the board was "overwhelmed" at the moment.[18] Richard added that the biggest problem for the IASB was not just writing a standard, but winning global agreement on it.

Given the situation of global effort towards Climate Change, the effective quick action of IASB is viewed as a great solution provider. The IASB with a track of winning effective adoption of IFRS in many countries, it could definitely win a global agreement on effective carbon disclosure too. The Carbon Guidelines should be mandated by an effective Board who could win a global agreement on it to save the world from further damage to the Ozone layer.

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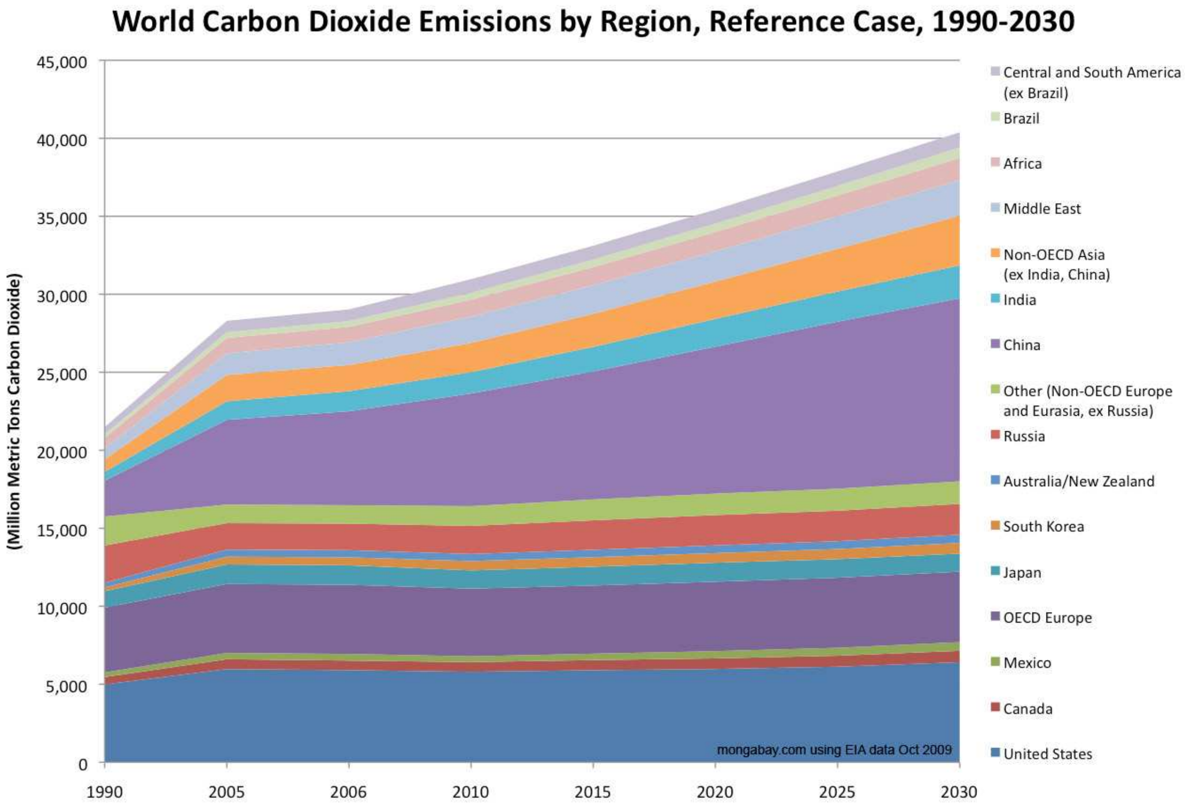

Appendix 2

Source: www.iasb.org

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Shaded grey: Countries seeking convergence to IFRS
Shaded blue: Countries pursuing adoption of IFRS