TheCityUK

TheCityUK response to call for evidence on Scope 3 emissions in the UK reporting landscape

About TheCityUK

TheCityUK is the industry-led body representing UK-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK, across Europe and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes over 12% of the UK's total economic output and employs nearly 2.5 million people, with two thirds of these jobs outside London, across the country's regions and nations. It is the UK's largest net exporting industry and generates a trade surplus exceeding that of all other net exporting industries combined. It is also the largest taxpayer and makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business, and protect and manage risk.

Executive Summary

- The development of a global baseline for sustainability-related disclosures is crucial to creating an international framework for the measurement and management of sustainability risks and opportunities. The International Sustainability Standards Board's (ISSB) standards provide the opportunity to develop this global baseline.
- TheCityUK endorses the approach to Scope 3 reporting in IFRS S2, and the integration of Scope 3 reporting into the UK reporting framework as articulated by the ISSB.
- We broadly support the ISSB's approach to materiality, whereby a company is required to disclose Scope 3 emissions that are financially material.
- As the most widely used accounting platform for corporate greenhouse gas (GHG) reporting, the use of the GHG Protocol for the purpose of Scope 3 reporting within IFRS S2 will enable globally comparable and consistent reporting.
- Accurately accounting for and reporting Scope 3 emissions can help drive greater climate resilience and will enable companies to understand their emission impact across the value chain.
- There are significant challenges to Scope 3 reporting, in particular the limited availability and quality of data. The UK's Scope 3 reporting framework must allow for reporting to improve over time as capacity and capability develops.
- Accounting for and tracking Scope 3 emissions is a significant and complex undertaking. It will be a financial and resource intensive exercise.
- Scope 3 reporting will be a particular challenge for small and medium enterprises (SMEs) in the supply chain, who have limited capability and resource.
- Proportionality considerations should be factored into the UK's Scope 3 reporting framework to allow companies time to adjust and build capability.
- Government should provide a clear roadmap for the introduction of mandatory Scope 3 reporting in the UK, including a breakdown of how this will apply across different types of companies.

Scope 3 GHG reporting

Scope 3 reporting within IFRS S2

TheCityUK welcomed the acknowledgement from government in the 2023 updated Green Finance Strategy of the importance of international harmonisation on sustainability-related disclosures, and the commitment to set up a framework to assess the suitability of the ISSB standards for adoption in the UK. The development of a global baseline for sustainability-related disclosures is crucial to creating an international framework for the measurement and management of sustainability risks and opportunities and ensuring the effective functioning of capital markets. The ISSB standards will allow for the standardisation of sustainability-related disclosures on a single, global baseline. This will create greater harmonisation, consistency, and comparability across jurisdictions. It will also reduce the risk of fragmentation and regulatory arbitrage and lower the cost of compliance.

We endorse the integration of Scope 3 reporting in the UK as articulated within IFRS S2 and broadly support the ISSB's approach to materiality. The ISSB's focus on financial materiality will require a company to disclose material information on Scope 3 emissions that could be reasonably expected to affect its prospects. The definition used by the ISSB is aligned with the IFRS Accounting Standards and the US Securities and Exchange Commission (SEC). It will also provide useful information for investors and lenders. We would welcome guidance on which type of Scope 3 emissions should be regarded as material.

We consider that the UK has an important role to play in shaping coherent sustainability and climate-related disclosures across jurisdictions. It is crucial that the UK integrates all aspects of the ISSB standards into our domestic reporting and disclosure frameworks to avoid setting a precedent that a piecemeal approach can be taken to the adoption of ISSB standards. The government must advocate for as much consistency and standardisation as possible to ensure international interoperability. This is particularly important for companies and investors operating across multiple jurisdictions.

The GHG Protocol

IFRS S2 requires that Scope 1, Scope 2, and Scope 3 GHG emissions should be measured in accordance with the GHG Protocol.[1] The ISSB has used the Taskforce on Climate-related Financial Disclosures (TCFD) framework as the basis for IFRS S2. The TCFD requires organisations to report GHG emissions in line with the GHG Protocol methodology, to allow for aggregation and comparability across organisations and jurisdictions.[2]

Given that the GHG Protocol has already been integrated within IFRS S2 and the TCFD, and that the GHG Protocol Corporate Accounting and Reporting Standard provides the accounting platform for the majority of corporate GHG reporting programmes globally, we endorse use

[1] https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/

[2] https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/

of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2.[3] Many companies are already calculating Scope 3 emissions in accordance with the GHG Protocol and it is recognised to be a comprehensive global standardised framework to measure GHG emissions. Using the GHG Protocol will therefore enable the UK to deliver globally comparable and consistent reporting that is useful for investors and users of accounts both in the UK and internationally.

TheCityUK recognises that some concerns have been raised over the GHG Protocol's Corporate Value Chain (Scope 3) Standard.[4] In particular, the lack of a standardised methodology and that some practical questions are left unanswered.[5] Nevertheless, the GHG Protocol remains the most widely adopted accounting standard and it has been integrated into the ISSB standards and the TCFD recommendations.

Furthermore, while there is a role for the government to play in defining the reporting framework for Scope 3 emissions in the UK, Scope 3 emissions are fundamentally an international issue. Data and supply chains will be international and reporting entities in the UK will be reliant on international companies in their value chain to provide adequate data for them to assess risk. Therefore, the UK should not seek to take an approach that differs from other jurisdictions.

Costs and benefits of Scope 3 reporting

Costs of Scope 3 reporting

Accounting for and tracking Scope 3 emissions is a significant and complex undertaking for companies. The collection and reporting of data can be financially and resource intensive. Calculating emissions along the value chain will require companies to have staff with technical expertise in carbon measurement. This may require companies to move staff and hire or retain additional staff. Companies will also need to establish new organisational structures, data management plans and data quality processes. Some companies may have to outsource to, or partner with, third parties to upskill their staff and estimate, calculate, and extrapolate Scope 3 data to meet reporting requirements.

The SEC estimates that the first-year cost of complying with its proposed rule on climate-related disclosures – which incorporates Scope 3 reporting – will be $640,000 for large companies, dropping to $530,000 in later years.[6,7] A survey by Environmental Resource Management (ERM) of current average annual issuer costs arrived at a similar figure to the

[3] https://ghgprotocol.org/corporate-standard
[4] https://ghgprotocol.org/corporate-value-chain-scope-3-standard
[5] https://www.unravelcarbon.com/blog/companies-struggle-scope-3-measurement
[6] https://www.thomsonreuters.com/en-us/posts/esg/sec-climate-rules/
[7] https://www.bloomberg.com/professional/blog/sec-pressured-from-all-sides-as-climate-rule-awaits-finalization/

SEC's estimate after the first year of implementation. GHG analysis and/or disclosure was identified to be the largest cost category, with an average annual cost of $237,000.[8]

Challenges for SMEs

Scope 3 reporting will be a particularly costly and burdensome undertaking for SMEs, both in terms of their own reporting and in supplying data to companies in their supply chain. Large corporates who are implementing their own Scope 3 strategies will seek data from SMEs (and others in their supply chain). Banks are also dependent on data from SMEs, given their significant exposure to SMEs as customers. Leading international frameworks such as the TCFD, the Partnership for Carbon Accounting Financials (PCAF), and the Science-Based Targets initiative (SBTi) tend to focus more on large companies than small ones. Likewise, disclosure platforms and reporting frameworks such as the Global Reporting Initiative (GRI) and the CDP are also designed for large companies.

The tools that are currently available to support reporting under the Streamlined Energy and Carbon Reporting Regulation (SECR) are not appropriate for SMEs. Many of these tools are burdensome and are dependent upon information that SMEs do not have easy access to. As a result, the burden of data collection and input partially sits with SMEs in the supply chain. With limited resources and capability, it is challenging for SMEs to allocate sufficient resource to reporting their emissions. It is therefore important that any Scope 3 guidance is straightforward, proportionate, and provides specific actions that SMEs could take.

Benefits of Scope 3 reporting

While there are notable costs and challenges to reporting Scope 3 emissions, we recognise that it is a challenge that must be tackled to address climate-related risks and opportunities.

Accurately accounting for and reporting Scope 3 emissions can help drive greater climate resilience across a company and their suppliers. A survey by ERM on climate-related disclosures identified that both companies and investors recognise the benefits of disclosing climate-related activities. Respondents identified that disclosures could enable better performance in meeting sustainability, climate, and ESG targets and result in better access to data capable of improving corporate strategy.[9]

Reporting on Scope 3 emissions could enable a company to identify climate hotspots and build greater awareness of their supply chain. This will better position the company to mitigate future climate-related risks and identify opportunities to decarbonise. Additionally, through developing a full corporate emissions inventory across Scope 1, Scope 2 and Scope 3 emissions, a company will build a more complete picture of their emissions impact. The

[8] https://www.erm.com/news/survey-reveals-costs-and-benefits-of-climate-related-disclosure-for-companies-and-investors/

[9] https://www.erm.com/news/survey-reveals-costs-and-benefits-of-climate-related-disclosure-for-companies-and-investors/

company could then direct attention to the areas where operational changes would have the most notable abatement impact.

Understanding Scope 3 emissions is critical to enabling a company to assess the transition risks of climate change more broadly. This is because Scope 3 emissions give a sense of the overall risk and are an essential piece of the puzzle. Scope 3 reporting generates valuable data for companies to manage their transition risk and holds potential to unlock business opportunities, through the identification of areas for improved resource efficiency and reduced operational costs. The process of Scope 3 reporting could also better position a company to manage their climate-related risks and opportunities by directing capital towards lower carbon activities.

TheCityUK recognises that there are benefits from Scope 3 reporting and it is a necessary exercise to enable companies to make meaningful progress towards climate mitigation. However, we also recognise that there is currently limited data to quantify such benefits. This makes it challenging to accurately evaluate the benefits against the costs, and the overall value of Scope 3 emissions reporting for a company in the long-term. Considering this, and that companies will incur upfront costs to produce Scope 3 reporting, the government must seek to keep reporting costs as low as possible. Ensuring consistency with other jurisdictions will help significantly with this. The government's approach to Scope 3 reporting should be guided by the principle of a single, global baseline of sustainability-related disclosures and avoid variation from the ISSB standards. This will improve the flow of information across borders and reduce the burden and cost of compliance for firms operating in multiple jurisdictions.

Challenges to Scope 3 emissions reporting

Data availability

Producing consistent Scope 3 data for corporate GHG reporting faces several challenges. The greatest challenge is the limited availability and quality of data from suppliers and other value chain partners. As outlined above, many supply chains include SMEs. For example, a material percentage of each financial institution's loan book will be to SMEs. Data on SME emissions is therefore essential to understand and achieve net zero.

The financial and related professional services industry is making great strides in improving Scope 3 data through the development of new methodologies and models. Nevertheless, data availability remains a hurdle. Many organisations struggle to collect relevant and sufficiently granular primary data from suppliers.

Sourcing standardised, timely and accurate data is another challenge. There are significant data gaps in the availability of company-reported data, especially in the energy sector. These gaps are most pronounced when considering a company's Scope 3 emissions. These gaps lead to reliance on estimations and average emissions factors (which represent the average GHG emission rate of a specific source). This reduces accuracy due to the large variation and uncertainty in the data. While the uncertainty associated with emission factors varies across sources, it is not unusual for the range of uncertainty for industry average factors to be over +/- 50% and +/- 100-150% for spend factors.[10]

Reliance on value chain partners introduces additional challenges in terms of lack of influence on the data collection and transparency in partners' processes and methodologies. Engaging suppliers to collect data can be resource-intensive, and supplier fragmentation and lack of cooperation can exacerbate the difficulties.

Defining the boundaries of Scope 3 emissions is another complex aspect, with variations between companies and industries in determining which emissions sources to include and how far upstream and downstream to extend the value chain. Methodological challenges such as the absence of standardised approaches and the use of different mechanisms to collect data contribute to inconsistent reporting. This further hinders meaningful comparisons across sectors. Even when companies report data, the format and metric of choice can vary considerably:

- There can be large differences in the data provided by different vendors of the same company, driven by differences in methodology used in calculating emissions data. This can lead to inaccurate estimates.
- Vendors often have to estimate Scope 3 emissions data, which may be inaccurate. For example, a vendor may choose to provide a revenue-based Scope 3 emissions estimate, which increases in line with the company's revenues over a given period, rather than measuring the actual changes in the company's emissions.
- Where no data is available, industry often resorts to fallback methodologies using assumptions, which may lead to inaccurate data.
- The lag in third-party disclosure of climate-related data continues to be a challenge, as it can significantly lag typical financial reporting information and disclosures.

Useful data sources

Perseus is a programme run by non-for-profit initiatives Bankers for NetZero (who convene the UK Country Chapter of the Net Zero Baking Alliance) and Icebreaker One, designed to offer a whole-of-market solution for rapidly scalable, low-effort, low-friction sustainability reporting. It aims to unlock access to capital by automating GHG reporting for every SME in the UK. Building on the principles of Open Banking, Perseus creates the rules and processes that make automated reporting possible, making it easier to implement reporting standards. In turn, these rules will enable a host of other products and services, like emissions calculators, databases, and reporting software. It will improve the quality and durability of the data reported. This means that financial institutions and corporates can access reliable and standardised energy data from the SMEs in their supply chains or portfolios. Perseus focuses on automating access to assurable energy data to support the reporting of Scope 3 Category 15 emissions.

[10] https://www.unravelcarbon.com/blog/companies-struggle-scope-3-measurement

The government recognised Perseus in its 2023 updated Green Finance Strategy as a crucial part of the decarbonisation architecture required to ensure the UK reaches its emissions reduction targets. In 2023, Perseus has focused on co-design and the creation of a demonstrator for COP28.

Proportionality considerations

Companies will have differing experiences and capabilities in terms of Scope 3 reporting. It will take time for many companies to adjust to Scope 3 reporting requirements and develop the necessary capacity and capabilities. Proportionality considerations should therefore be factored into the UK's Scope 3 reporting framework.

We welcome the inclusion in IFRS S2 of a temporary relief period for the disclosure of Scope 3 emissions. However, this may still not provide sufficient time for companies to embed the necessary capabilities, and for some of the current challenges and barriers to be resolved. While the accuracy of Scope 3 reporting will improve over the long-term as data availability improves, in the short term the quality of data reporting will vary significantly. The UK's reporting framework must allow for reporting to improve over time as capacity and capability develops. A few potential solutions to address this include:

- Offering a targeted and time-limited relief, or phase-in period for reporting on Scope 3 emissions among asset classes where industry guidance is not yet in place.
- Including a comply or explain provision to help firms adhere to reporting requirements in a flexible manner for a time-limited period.
- Allowing flexible reporting timelines for value chain GHG emissions in accordance with IFRS S2 paragraph 29(a)-B19. The ISSB grant entities permission to use information for reporting periods that are different from their own reporting period if the entities in its value chain have misaligned reporting periods. The reporting flexibility set out under this provision is critical for firms disclosing Scope 3 emissions and should be adopted as part of any UK sustainability-related disclosure requirements.
- The government could also look to the SEC's proposed rule to enhance and standardise climate-related disclosures.[11] The proposed rule staggers compliance with Scope 3 reporting, providing time for companies to consider their approach, and includes a safe harbour provision with respect to liability for Scope 3 emissions disclosed.

Different companies will have different abilities in terms of reporting, and many companies will need substantial time to prepare and implement systems to meet new Scope 3 reporting requirements. It is therefore important that the government provides a clear roadmap with timelines for the introduction of Scope 3 reporting in the UK, including a breakdown of how this will apply across different types of companies.

[11] https://www.sec.gov/news/press-release/2022-46