# BIS Consultation on the Future of Narrative Reporting

# Response by the Institute of Environmental Management and Assessment[1]

## Introduction

1. The Institute of Environmental Management & Assessment (IEMA) is the UK's leading professional body for environment and sustainability practitioners. IEMA has over 15,000 members worldwide and represents professionals working in FTSE 100 companies, public sector organisations, SMEs, consultants and higher education. An independent, not for profit organisation funded by members, our aim is to promote the goal of sustainable development by improved environmental practice and performance.

2. In pursuing our aim, IEMA actively supports the development of knowledge, understanding and capability such that people can make an active contribution to ensuring that environmental issues are properly integrated into decision making and can help to deliver a low carbon and resource efficient economy. IEMA members largely work on a broad range of multi-disciplinary environmental issues, including climate change mitigation and adaptation, resource efficiency and compliance management.

## Overview

3. IEMA welcomes the Government's unequivocal commitment, set out in the Coalition Agreement:

   *"We will reinstate an Operating and Financial Review to ensure that directors' social and environmental duties have to be covered in company reporting, and investigate further ways of improving corporate accountability and transparency[2]."*

4. Corporate accountability requires directors to take responsibility for their company's performance, including environmental performance, and to be transparent in the way that they evaluate risk. Good quality reporting and disclosure is critical to enabling this to happen. Unfortunately, too few companies report on their environmental performance in a way that shareholders can evaluate the long term success of the business and related director performance. In addition, the failure to be transparent about environmental performance also means companies are less well able to demonstrate responsibility to broader society.

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[2] HM Government (May 2010) The Coalition: Our Programme for Government

5. IEMA believes that mandatory environmental reporting has key benefits.

    i. Annual reporting would stimulate companies to improve on their environmental performance and unlock business benefits that they otherwise wouldn't recognise or act on;

    ii. Reporting on the long-term environmental risks and opportunities to the company provides the basis for shareholders to hold directors to account for the long-term success of the company.

6. Mandatory environmental reporting provides a basis for companies being accountable for environmental issues that are material for society and other stakeholder groups, beyond the narrower interests of a company's members. This is an important issue to consider in terms of company reporting.

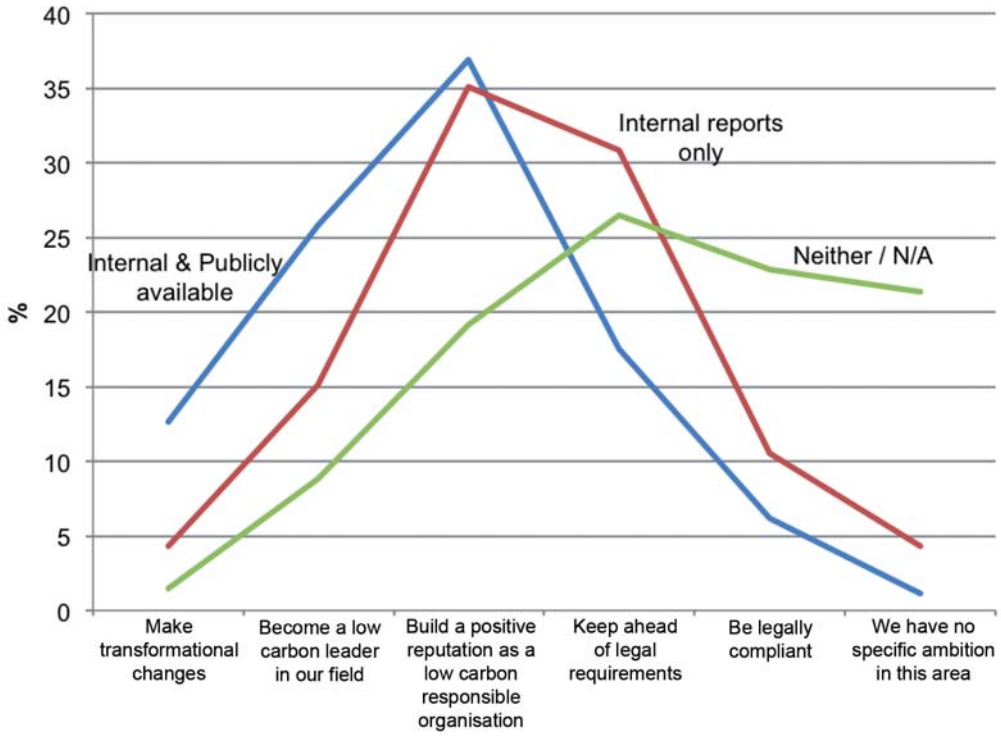
7. The results of a recent survey[3] of 1674 environment and sustainability professionals within IEMA's membership shows the value of reporting. Professionals are clear about the benefits to business:

    *"GHG reporting is viewed by IEMA members as an important enabling tool that helps to build, embed and sustain a strategic organisational approach to carbon and GHG management. Reporting is identified as having a significant role to play in overcoming barriers, including building commitment and support from the board and senior management, unlocking funds and securing investments in low carbon measures and initiatives, and securing the engagement of suppliers."*

8. It is for these reasons that over 80% of IEMA members support reporting on greenhouse gas emissions being a mandatory requirement on companies, as it will make an active contribution to accelerating the transition to a low carbon economy in a way that adds value to business.

9. The graph below, taken from IEMA's report, demonstrates that companies that report on their GHG emissions performance have greater ambition and are more likely to seek to make transformational change to their organisation, compared with those who don't report or only use GHG management information internally. This is important because those organisations that are facing up to the challenge of the transition to a low carbon economy are more likely to be able to adapt their business to minimise risk and maximise opportunity.

[3] IEMA Special Report GHG Management and Reporting, October 2010 www.iema.net/ghgreport




## Value of narrative reporting

**Question 1 - Are company directors providing useful and relevant information on the company's:**

**a. forward-looking strategy and**

**b. principal risks and uncertainties?**

10. Government has highlighted that "climate change is one of the gravest threats we face, and that urgent action at home and abroad is required[4]". Government has also committed to a long term target of 80% reduction in greenhouse gas emissions (GHG) by 2050, against a 1990 baseline – with interim targets established to ensure that the UK remains on course.

11. The move to a low carbon economy and resource efficient economy will require all companies to change the way that they do business in a carbon-constrained world. The changes required will go far beyond the energy sector; no part of the economy will be isolated from the changes. Transformation of the economy will present businesses with risks and opportunities: risks from not adapting business models quickly enough; opportunities for new products and services.

[4] HM Government (May 2010) The Coalition: Our Programme for Government

12. Too few companies are considering the long term changes required to operate in a carbon constrained world. There is a real risk that decisions taken today, without proper consideration of a future low carbon economy, will fail to safeguard the long-term success and competitiveness of companies.

13. In addition, the inevitable changes to the climate that will occur even if the ambitious GHG reduction targets are met, are not being considered or embedded in corporate risk management.

14. Research[5] into reporting under the Companies Act 2006, carried out on behalf of the CORE coalition, provides evidence that there are gaps and omissions in company reporting on environmental risks and uncertainties. The report concluded that:

    *"It may reasonably be expected that companies' $CO_2$ production and their susceptibility to climate change would be widely considered and reported constituting a 'principal risk and uncertainty facing companies' (Section 417 (3) (b)). While this was the single best-reported issue other than economic performance, detailed quantitative information was provided by only 48% of companies. In general it was surprising to find that there were almost no analyses of the sensitivity of the company to climate change or the consequences of adaptation."*

    *"There was also little correlation between the issues reported and the risk to the shareholder, as shown by the relative absence of reporting of climate change risks to the company."*

    **Climate Change Reporting**

15. IEMA believes that there are three key areas in relation to climate change that company directors should be reporting on:

    i. Annual reporting of GHG emissions in line with an agreed reporting standard. Evidence from IEMA's survey shows that the Defra/ DECC guide has rapidly been adopted and this should form the basis of the reporting standard.

    ii. Reporting of risks and business implications from the transition to a low carbon economy. Directors should be reporting on how their business is managing risks and maximising opportunities, set against a national context of the 80% GHG emissions reduction by 2050.

    iii. Reporting on the risks from a changing climate, based on appropriate climate projections (e.g. UK 2009 climate projections).

16. The above points focus on climate change related reporting. These are highlighted partly because climate change is such a serious threat, but also because this has emerged as an area where companies are gaining reporting experience. However, companies should also

[5] CORE Coalition (2010) "The Reporting of Non-Financial Information in Annual Reports by the FTSE100" prepared by Professor Adrian Henriques, Middlesex University.

be reporting on other environmental issues, including potential resource constraints that might limit their future prosperity.

**Question 2 - What are the constraints on companies providing information on these issues?**

17. For the vast majority of companies, environment, GHG emissions and the associated energy use are not a material cost issue to the business – other costs such as staff are significantly higher. The result is that environmental performance and GHG emissions are not issues that reach board level; as a consequence, they don't get reported to shareholders.

18. There is also a general lack of awareness of the strategic implications to companies of the transition to a low carbon and resource efficient economy, which means that the longer term perspective is often ignored.

19. Although climate change is a significant and material issue for broader society, this doesn't necessarily translate into being a material issue for a company's shareholders. This raises issues about accountability to society vs accountability to shareholders…at present the Companies Act focuses director duties on the long terms success for the benefit of shareholders.

**Question 4 - Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?**

20. Based on the above points, IEMA doesn't believe that sufficient information is provided by directors to enable shareholders to challenge them on key risks and strategic direction with regard to environment and business performance.

**Question 7 - Is there scope to reduce or simplify the requirements on which companies report?**

21. IEMA's research on GHG management and reporting[6] shows a wide range of GHG reporting standards and protocols are used to support companies' carbon footprint and reporting activity. IEMA members identified a need for aligned standards and for improved clarity and consistency in approach.

22. The 2009 Defra/DECC "Guidance on how to measure and report your greenhouse gas emissions" has become widely used by practitioners and provides a basis for future mandatory GHG reporting.

[6] IEMA Special Report GHG Management and Reporting, October 2010 www.iema.net/ghgreport

**Business Review**

**Question 9- Looking at an Operating & Financial Review and the existing business review (see Annex D), do you see value in reinstating elements of an OFR and if so what would they be? In particular, would a statutory reporting standard help to improve the quality of reporting?**

23. IEMA members strongly support the introduction of a statutory reporting standard for GHG emissions as this will bring clarity and consistency to reports and also, importantly, help to stimulate internal GHG emissions reduction.

24. An issue regarding the re-introduction of elements of the OFR relates to the competence of auditors to assure any statements about company environmental performance and the management of risk, the relative costs of such assurance, and the extent to which this would make companies less likely to provide comprehensive disclosure information.

**Question 11 - Would more guidance be helpful? If so, what form should this take? For example: best practice example, sample Key Performance Indicators, etc?**

25. IEMA believes that additional guidance would be useful. Most available guidance is focussed on GHG emissions performance reporting; however, there is insufficient information available to support reporting on long term environmental risks and opportunities, and the potential strategic implications to companies from the UK's transition to a low carbon economy and an 80% reduction in GHG emissions by 2050. IEMA would welcome the opportunity to work with BIS to develop appropriate guidance.

**Question 13 - Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?**

26. IEMA does not believe that non-regulatory solutions will provide sufficient stimulus for companies to report on their ongoing environmental performance, nor on the long-term environmental or business risks. The current provisions in the Companies Act regarding the Business Review, with the ambiguity around what is required to be reported (i.e. the caveat "to the extent necessary"), means that reporting is inconsistent, often lacking key information on which shareholders can make informed decisions, and fails to demonstrate that companies are taking their environmental responsibilities seriously.

**Potential Costs**

**Question 15 - If you can provide any information on costs associated either with the existing narrative reporting requirements e.g. preparing your business review or your views on potential costs and benefits in relation to any of the ideas in this consultation, please give details.**

27. As part of IEMA's work on GHG management and reporting, data was collected on the costs of reporting (as being distinct from issues and costs around GHG emissions management). When directly asked, practitioners were very clear about their ability to estimate costs. 77% stated they could not be confident enough to estimate reporting cost with a reasonable level of accuracy (i.e. to within £5,000).

28. However, as a consequence of asking the above question, we have a high degree of confidence in the (albeit limited i.e. 50 respondents) data on reporting costs. Within that data we asked a sub question to ascertain the overall GHG management cost. A majority (over 70%) have costs for GHG reporting (not wider GHG management) of below £10K. We believe that the relatively low cost of reporting represents good value to shareholders.