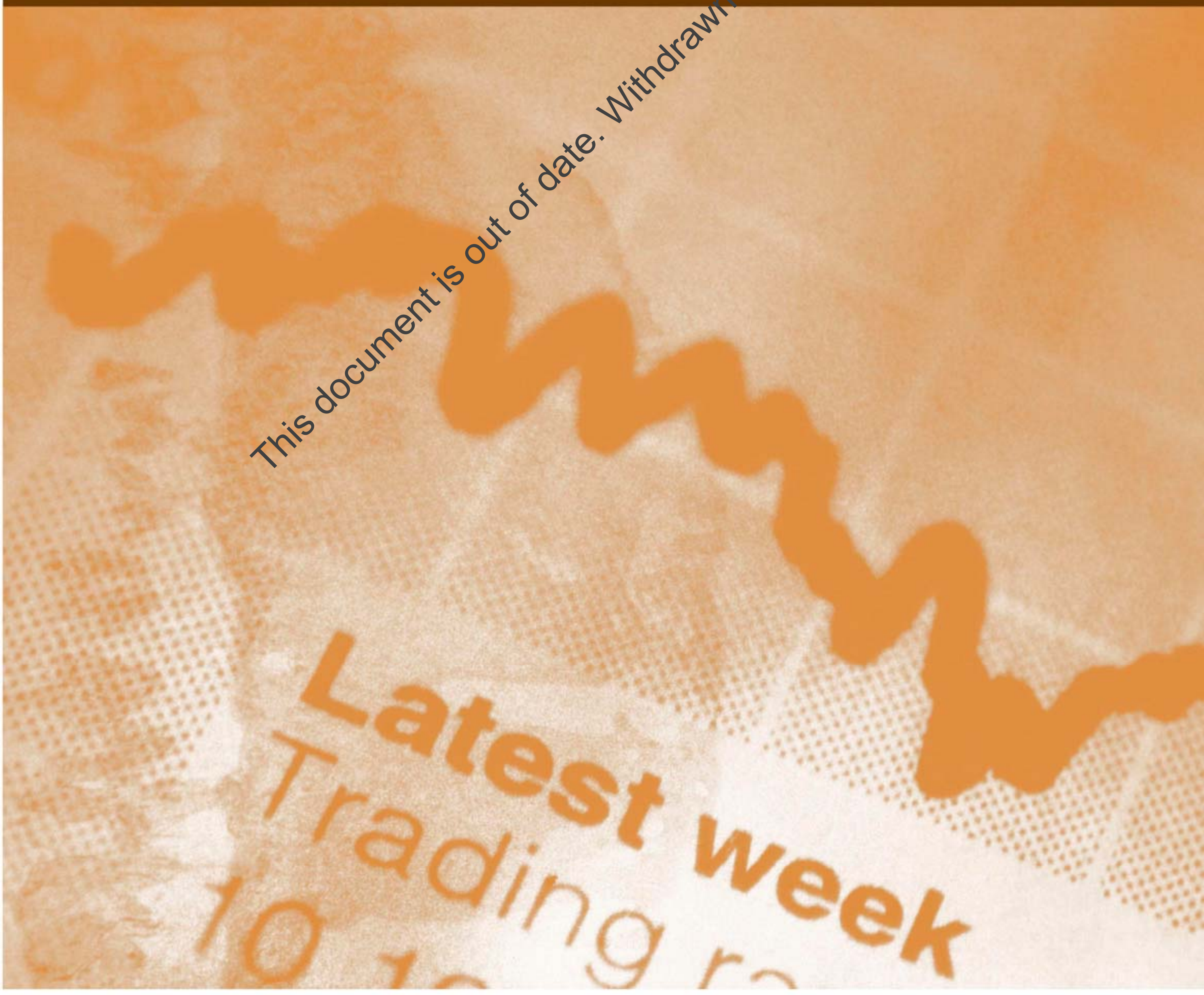
Environmental disclosures summary

Key findings of the third major review of environmental reporting in the annual report & accounts of the FTSE All-Share companies



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Foreword

In 2003 the Government asked the Environment Agency to assess environmental disclosures in the statutory annual report and accounts of FTSE All-Share companies listed on the London Stock Exchange. The aim being to establish a 2004 baseline before the new Companies Act became law in 2006 and to repeat the assessment using the same methodology in 2006 and again in 2009.

Over this period new mandatory disclosure frameworks do appear to be driving more qualitative disclosures but there is scope for further improvement in quantitative disclosures to help customers, shareholders, and financial investors make better informed decisions.

99% of FTSE listed companies made qualitative environmental disclosures with 89% on waste management, 79% on pollution, 62% on climate change, 61% on environmental management systems, 57% on energy, and 57% bio-diversity and land use.

67% of FTSE listed companies made quantified disclosures on three key performance indicators, with 62% on energy use and climate change, 41% on waste and 25% on water. Around 57% were in the business review section and 36% in the externally audited sections of the annual reports. But only 22% on energy use and climate change, 12% on waste, and 10% on water were in accordance with government guidance. There were few disclosures on environmental incidents, spending, trading, taxes, penalties or fines.

Within this report there are some examples of good practice in environmental disclosure, and we have also published detailed guidance “Environmental Issues and Financial Reporting” with the Institute of Chartered Accountants in England and Wales.

Overview of findings

More FTSE All-Share companies are providing environmental information in their statutory annual reports and accounts. However, the information provided varies between companies, and more standardised information would be useful to help decision taking for their customers, shareholders, investors and other stakeholders.

This summary provides highlights of our report *Environmental disclosures*, which assesses environmental reporting in 2009-2010 by over 450 companies listed in the FTSE All-Share. Under the Companies Act 2006, listed companies are required to include environmental matters in Business Reviews as part of their statutory annual reports and accounts where relevant. The study shows how the level and quality of environmental reporting has changed since our previous reviews in 2004 and 2006.

Key findings include:

- **99% of companies made some reference to an environmental topic in their 2009-2010 annual reports.** However, many of these references are still at a very basic level.

- **67% of FTSE All-Share companies are reporting quantitatively on their environmental impacts.** A marked increase on the 42% which did this in 2006.

- **36% of the environmental disclosures were made in audited sections of the annual report and accounts.** With 57% discussed in Business Reviews, and 40% in Operating Financial Reviews (OFRs).

- **Quantitative disclosures follow Government guidelines most frequently for climate change and energy use (22%).** But only 12% reported on waste and 10% reported on water use in line with the latest Government guidance.

- **The biggest percentage increase in environmental topics discussed between 2006 and 2009-2010 was for environmental management systems (EMS),** up from 33% to 61%.

- **Discussion of pollution, biodiversity/land use, and environmental procurement increased significantly on 2006 levels** out of the other key environmental topics examined. **57% of companies now refer to biodiversity or land use, and 33% made a reference to environmental procurement.**

- **Over two-thirds of FTSE All-Share companies report quantitatively on at least one of three environmental key performance indicators (KPIs) that are relevant to most businesses - carbon dioxide emissions, water use and waste.** But only 25% provide quantitative figures in line with government guidance.

Figure 1: Key statistics on environmental topics and frequency of environmental disclosures in statutory annual reports and accounts

	2004	2006	2009-2010
Number of companies analysed	506	537	458
Percentage of FTSE All-Share companies with an environmental disclosure	89	98	99
Percentage of FTSE Small Cap companies with an environmental disclosure	80	97	98
Percentage of FTSE All-Share companies:			
With environmental disclosures in audited sections of their annual report and accounts	10	35	36
with quantitative environmental reporting on one or more of the three core KPIs (climate change / energy use, water or waste)	27	42	67
reporting quantified figures on climate change or energy use (carbon)	N/A	29	62
reporting quantified figures on water	N/A	12	25
reporting quantified figures on waste	N/A	27	41

What environmental matters are companies reporting?

Reporting has improved since legal requirements to report significant environmental impacts came into force under the EU Accounts Modernisation Directive (2003/51/EC) in 2005.[1] The Directive's requirements for large companies to report on environmental issues in a Business Review as part of their annual reports and accounts where relevant are implemented under the Companies Act 2006. If the Business Review does not contain such information, it must explain why not.

57% of environment-related keywords appeared in Business Reviews included in annual reports, up from 21% in 2006.

This study shows that 90% of companies included a Business Review and 7% included an Operating and Financial Review (OFR) in their annual reports. 40% of the keywords examined were discussed in OFRs. 88% of environmental issues examined featured in Corporate Social Responsibility (CSR) sections.

A stock market listed company must ensure that its Business Review includes information about environmental matters, including its impact on the environment, where necessary for an understanding of the development, performance or position of its business. Clear

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0051:EN:NOT

identification of environmental risks and opportunities are important for the success of most companies.

Reporting on environmental incidents such as accidents and spillages tripled from 1% in 2004 to 3% in 2009-2010 but is still very low.

Risk management can include managing the risk of breaching pollution controls. Since 2006, the percentage of companies reporting on compliance has increased to 55%. Companies risk losing their licence to operate if they breach environmental permitting conditions. Rather surprisingly between 2006 and 2009-2010, the percentage of companies discussing their licence to operate fell from 6% to 1%.

Companies also face financial penalties or litigation if they do not comply with permit conditions. Around 20% of FTSE All-Share companies mentioned fines and/or penalties in their 2009-2010 annual reports. Provisions and liabilities such as environmental expenditure were only reported on by 9% of companies although this is a slight increase on 2004 levels. Environmental taxes, such as carbon tax were only reported by 1% of companies.

Many of the FTSE All-Share companies discuss legislation that affects or might affect their financial performance, including references to the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme by 22%. From July 2011 the CRC will require some 5,000 organisations to report emissions from energy use to the Environment Agency. Emerging mandatory requirements for environmental disclosure, as well as voluntary reporting frameworks, could inform environmental disclosures in Business Reviews.

The biggest increase in reporting between 2006 and 2009 was for the environmental management system (EMS) topic.

Companies can support compliance with environmental regulations by implementing a certified EMS,[2] which provides a structured framework for managing significant environmental impacts and improving environmental performance. 61% an EMS, up from 33% in 2006.

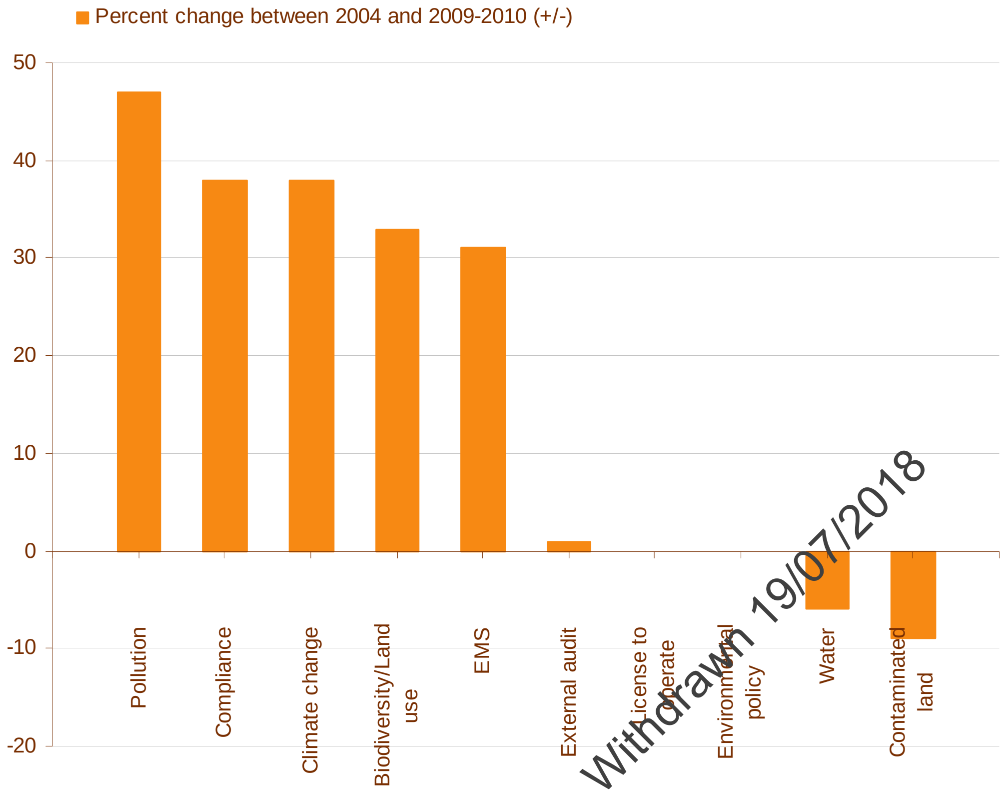
An organisation can use an EMS to help put its environmental policy into practice.[3] Environmental policies were discussed by 38% of companies, up from 37% in 2006.

Many more companies reported on pollution (up from 56% in 2006 to 79% in 2009-2010). In contrast, only 45% of companies discussed sustainability or corporate social responsibility, down from 57% in 2006.

References to environmental procurement rose from 10% in 2004 to 33% in 2009-2010. This suggests that companies are more aware of both risks and opportunities from a growing focus on reducing indirect environmental impacts from supply chains.[4]

[2] www.environment-agency.gov.uk/research/library/position/110118.aspx
[3] www.iema.net/readingroom/all_documents?aid=283
[4] www.environment-agency.gov.uk/business/topics/performance/32352.aspx

Figure 1: Keyword topics with biggest changes in discussion levels by companies



Reporting on impacts

More companies discussed environmental impacts in their annual reports in 2009-2010. Between 2006 and 2009-2010, the increase in discussion was greatest for biodiversity/land use and climate change, followed by energy and waste management. These topics also featured most frequently in 2009. Resource efficiency has also risen up the business agenda.

Between 2004 and 2009-2010, references to climate change increased from 24% to 62%, while discussion of energy rose from 28% to 57%. This could reflect growing awareness of energy and climate-related business risks and opportunities. Between 2006 and 2009-2010, the technology sector had the greatest increase in discussion of climate change (up from 14% to 38%). Since 2004, references to energy increased most among health care companies (up from 8% to 40%). Apart from the energy and carbon-intensive utilities sector, industrials are now most likely to discuss energy use, while basic materials, oil and gas and consumer goods companies are most likely to mention climate change.

24% of companies discussed water in 2009, down from 43% in 2006. This decline is partly due to changes in the constituent companies of the index, as well as less discussion of water in the financials, consumer goods and health care industries. Only the technology and utilities sectors had an increase in water references since 2006. In 2009-2010, 19% of technology companies discussed water, compared with almost 90% of utilities and 62% of basic materials firms.

Companies that use water abstracted from source or supplied by water utilities more efficiently could be better prepared for climate change impacts. Reducing water use can also contribute to lowering carbon dioxide emissions from supply chains. Companies need to monitor their water use in relation to local water availability, water quality, competition for resources and industrial growth.[5]

89% of the 458 companies analysed discussed waste management in 2009-2010, up from 76% in 2004. The biggest increases were among health care, utilities and oil and gas companies. Waste has remained the most discussed topic since 2004. Discussion rates were highest among utilities (100%) and lowest among oil and gas companies (75%). Although 85% of basic materials companies discussed waste in 2009, this is down from 95% in 2006.

An increase in discussion of waste among technology companies may be partly due to the introduction of the Waste Electrical and Electronic Equipment Directive in 2007. Most companies could reduce waste and increase reuse and recycling to improve resource efficiency, with potential cost savings. The incentive to use resources more efficiently will increase.

Quantitative reporting

Management of energy, carbon dioxide emissions, water and waste can affect company performance. Companies that measure their environmental impacts are better placed to manage them. They can utilise data on resource use, pollution and waste to identify opportunities to reduce impacts, improve processes, reduce costs and support regulatory compliance. Quantitative information makes it easier to compare corporate environmental and financial performance.

The requirement for a Business Review is designed to improve company reporting on environmental matters. Since the previous study, reporting requirements have been expanded and Business Reviews should now include, 'where appropriate, analysis using key performance indicators including information relating to environmental matters'. *Environmental Key Performance Indicators: Reporting Guidelines for UK Business* (2006) from the Department for Environment, Food and Rural Affairs[6] recommends quantitative reporting on environmental key performance indicators (KPIs) relevant to business activities. Companies can use the guidance to select environmental KPIs to report on in their Business Reviews.

Reporting of quantitative information on one of the three core environmental KPIs in accordance with Government guidelines by FTSE All-Share companies **rose from 15% in 2006 to 28% in 2009.** The number of FTSE All-Share companies providing either general quantification, data that could be derived, or disclosures that meet Government guidelines increased by 59% between 2006 and 2009-2010 (see Figure 2).

The number of companies not quantifying any data has fallen among companies of all sizes. However, one-third of FTSE All-Share companies still do not report quantitatively, down from 58% in 2006.

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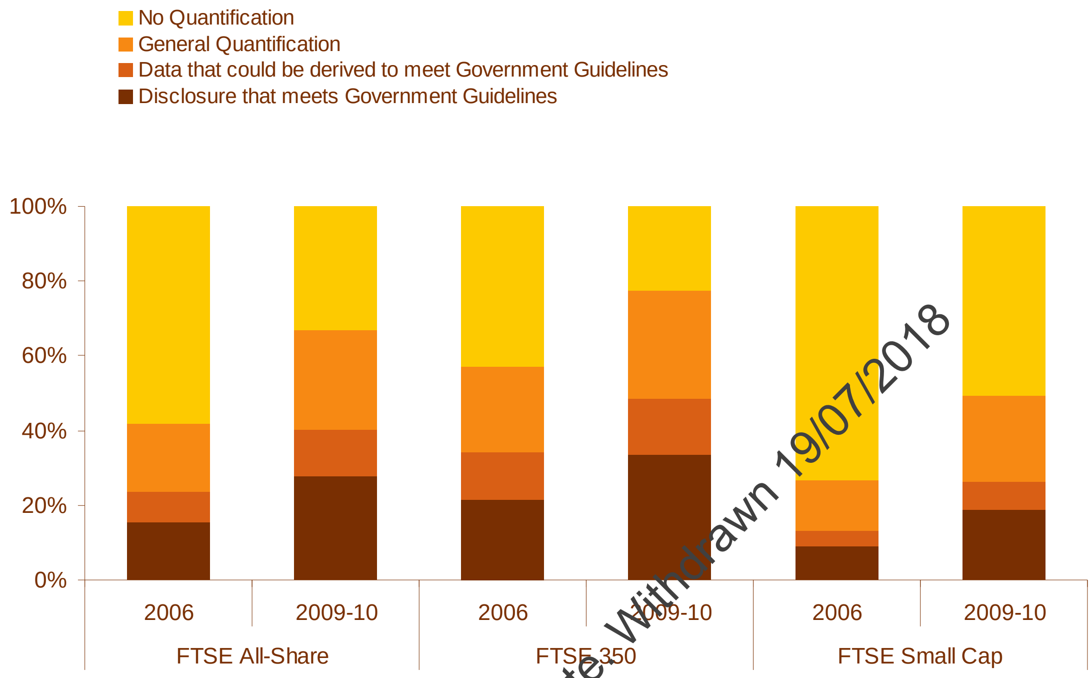
[5] www.wbcsd.org/Plugins/DocSearch/details.asp?DocTypeId=251&ObjectId=MzgzMTY
[6] Environmental Key Performance Indicators: Reporting Guidelines for UK Business, available at www.defra.gov.uk/environment/business/reporting/index.htm

Over one-quarter of FTSE All-Share companies provided general quantification, such as data normalised without an aggregating factor available, or percentage changes in environmental impacts.

Figure 2: Quantitative reporting by companies of different sizes

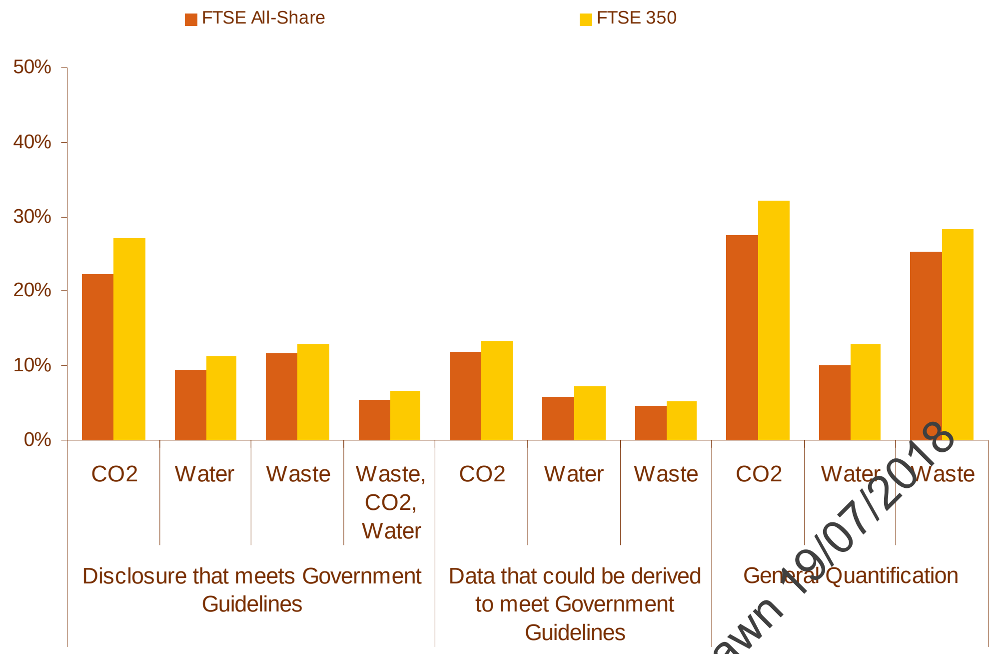


More FTSE 350 companies reported data in line with Government guidance (34%) than those disclosing general quantitative information (29%). More companies are therefore providing absolute data on the environmental impacts of their entire business operations.

A further 15% provided data that could be derived to meet the guidelines. For instance, some companies provided data that were for part of their operations or only on energy consumption. Comparable quantitative disclosures also increased among FTSE Small Cap companies.

The percentage of FTSE All-Share companies reporting in line with Government guidelines on the three KPIs carbon, water and waste has doubled to 6% (see Figure 3). 34% of FTSE 350 companies disclosed carbon, water or waste data in line with Government guidelines, compared with 22% in 2006. 77% provided some quantification on at least one of the core KPIs as recommended in the guidance, up from 57% in 2006.

Figure 3: Disclosure of quantitative data – FTSE All-Share vs. FTSE 350 in 2009-2010



The number of companies reporting CO_2 emissions in line with Government guidance has risen by 90% among FTSE All-Share companies since 2006. Reporting levels have increased from 18% to 28% among FTSE 350 firms.

Several business groups support the introduction of mandatory public carbon reporting. Under the UK Climate Change Act 2008, the Government must introduce mandatory carbon reporting rules by 6 April 2012 or explain why it has not done so. Meanwhile, companies can use voluntary guidance issued by Defra in 2009 – *Guidance on how to measure and report your greenhouse gas emissions* – to disclose GHG emissions in Business Reviews.[7] The guidance states that quoted companies 'will want to consider if they wish to include' emissions data and supporting explanations in their Business Reviews. The carbon reporting guidelines recommend that all organisations publicly report their total annual GHG emissions in tonnes of CO_2e in line with financial accounting.

Defra's environmental reporting guidelines also recommend that companies report on volumes of water abstracted as well as supplied water, usually measured through automatic meter readings or bills. Fewer companies are generally quantifying water data. Levels of quantitative reporting on water use in line with Government guidelines increased among FTSE All-Share companies, but remain low at 10%.

Comparable data on waste were provided by 12% of FTSE All-Share companies. Government guidelines advise companies to report waste in metric tonnes a year, breaking down waste materials into type.

[7] www.defra.gov.uk/environment/business/reporting/pdf/ghg-guidance.pdf

Progress and next steps

Environmental disclosures among FTSE All-Share companies has improved since 2006. More companies are discussing environmental topics and quantified disclosures on environmental KPIs are more frequent and robust. This suggests that statutory reporting frameworks and voluntary guidance have helped improve the standard of environmental disclosure.

Many companies are already disclosing clear information on their environmental impacts and leading by example. Those companies that are seeking to improve their level of disclosure should look at the examples of the leaders in their sector, many of which are included in this report.

The growing financial materiality of environmental impacts such as energy, carbon dioxide emissions, water use and waste is driving demand for more focused and useful environmental disclosure. Statutory reporting standards are being strengthened to provide shareholders with access to better information. Investors and other business stakeholders need data on environmental performance to understand how a company is positioned for related risks and opportunities.

UK company law and guidance on environmental disclosures aim to help companies provide relevant, comparable and reliable information. To support this, government is pushing for greater disclosure of quantified data on environmental impacts. Companies need to measure impacts in order to effectively manage and reduce them. Using metrics in line with accepted standards can enable better environmental management. Quantified measurement of environmental performance could help identify opportunities to achieve cost savings, productivity gains, regulatory compliance, business continuity and greater competitiveness.

More companies could follow Government guidelines on how to collect and report data cost effectively. Most businesses would benefit from measuring up to five environmental KPIs. Based on this survey more progress could be made by companies taking some of the following actions:

- disclosure of absolute quantities of energy and water use, greenhouse gas emissions and waste in annual reports and accounts;
- companies providing data on any other environmental KPIs which might affect the development, performance or position of the business;
- companies could report figures for entire global operations in line with financial accounting;
- companies may chose to provide supporting information on related policies and their effectiveness;
- choosing to report gross GHG emissions from operations over which the company has financial control in tonnes of CO_2e;
- providing information on direct use of oil, coal and renewable energy such as wind or solar power in standardised metrics such as joules;
- reporting quantities of water in absolute cubic metres using data from automatic meter readings or water bills for supplied water, or using pumping data for abstracted water. Sectors could also outline policies on water use, highlighting variances in water related pressures;
- companies could report absolute tonnes of waste by disposal route, for example volumes of landfill and recycled waste.

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