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Carbon Tracker Initiative

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For more information about Carbon Tracker, visit www.carbontracker.org

The World has Changed – Reporting Must Too (page 4)

Q1. (a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

Yes. We see that the current valuation of companies is based on assumptions which are not transparent and do not appear to move with the times. Our particular focus is on extractive companies in relation to climate change. The Head of the UNFCCC, Christina Figueres has noted that she believes climate change is not being factored into the valuation of fossil fuel companies.[1]

We would like to see the assumptions underlying the value of realising revenues from assets explained. For example which energy demand or greenhouse gas emissions scenarios are used to underpin the valuation. The UK Actuarial society has published an article exploring what this might mean for asset valuation.[2]

This would also go towards explaining the CAPEX strategy. For example if you are an oil company with 10-15 years of proven reserves at current production levels, what is the justification for spending $25 billion on finding more oil? Does this assume no limit on carbon emissions and heading for 4 degrees of warming? If so what does 4 degrees of warming mean for its business in terms of water availability or melted permafrost?

At present the business model is just perpetuated without investors questioning whether the cash being generated should be used for something else. Providing more information on this can only help to engage shareholders to become more active owners.

It is therefore not only new companies and sectors with intangible assets that need to explain their value-creation process. The changing context means that the more traditional companies need to explain how they are adapting to (for example) a low carbon future.

Materiality should indeed be a primary driver. This is why we have focused on reserves for the extractives sector. The ability to convert these reserves into both carbon dioxide and revenues is material to the future viability of the business. This is a forward-looking material issue. This is what these companies should report on, rather than whether they turned out the lights in their offices to reduce their scope 1 annual greenhouse gas emissions in the previous year.

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[1] http://www.guardian.co.uk/environment/2011/oct/10/climate-change-cost-companies-worth?INTCMP=SRCH

[2] http://www.theactuary.com/actuary/feature/2103923/stranded-assets

(b) Do you agree that this action should be international in scope? Why/why not?

International requirements should be the ultimate goal. This would give a level playing field and simplify requirements for international companies with multiple listings. It may be that individual jurisdictions decide to act sooner and demonstrate / test what is possible / useful in the meantime.

Towards Integrated Reporting (page 6)

Q2. Do you agree with the definition of Integrated Reporting on page 6? Why/why not?

Yes. At present there is a disconnect between policy statements on issues such as climate change, and investment and strategy decisions. It is also not clear what timeframe the company is applying to its decision-making, with some decisions appearing to be driven by short-term performance rather than long-term sustainability. The fundamental contradiction between the current approach of the financial markets and political positioning on climate change was highlighted in an opinion piece published by the Financial Times.[3]

Different stakeholders are seen to have different needs at present. Traditionally investors are expected to look at short-term financial performance whilst NGOs might consider long-term environmental and social performance. Integrated reporting can help bring these interests together so that investors look longer term and NGOs consider the links to financial performance. There are systemic factors in the investment chain that contribute to the short-termism currently observed in the market which will also need to be overcome.

One report is part of the solution, however it needs to be integrated in a meaningful way. Otherwise there will continue to be not links between policy statements on one page and financial information on the next page.

An International Integrated Reporting Framework (page 8)

Q3. Do you support the development of an International Integrated Reporting Framework? Why/why not?

Yes – because large investors have global portfolios and want to be able to compare across geographies. Companies themselves are also international and transcend traditional political boundaries.

Q4. (a) Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not?

Yes – the most significant impacts will then be covered, and the development costs will be borne by those that can most afford it.

(b) Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector and not-for-profit organizations?

Once the Integrated model is more developed by its application to larger companies, other organisations can then adopt it as appropriate.

Business Model and Value Creation (page 10)

Q5. Are: (a) the organization’s business model; and (b) its ability to create and sustain value in the short, medium and long term, appropriate as central themes for the future direction of reporting? Why/why not?

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[3] http://www.ft.com/cms/s/0/52f2709c-20f0-11e1-8a43-00144feabdc0.html#ixzz1g1WNryuV

The timeframe is definitely a critical factor. More information on the future is certainly needed to bring in the changing context and how companies are going to respond to that. Bringing in clear timeframes will create a process behind the reporting to make companies consider the longer term options compared to short-term issues. Linking this to remuneration will also be important as the incentives for performance will partly determine the time horizon that is applied to decision-making. The integrated report should demonstrate how long-term incentives are being effective.

Q6. Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

To some degree, but as many of them are externalities it is not always practical to make a link to value. However it could be useful in trying to demonstrate the social purpose of an organisation – e.g. what do banks contribute to society. Having limits on the types of capital available is also a useful aspect. For example will the physical impact climate change limit the amount of water available or will carbon regulation limit the amount of carbon that can be released into the atmosphere. Bringing these concepts together to get a balance will make stronger links and show how the different types of capital might impact each other. We use the concept of a carbon budget (as calculated by the Potsdam Institute) in our work to convey the importance of cumulative emissions over time for climate change, as opposed to just annual emissions levels.[4]

We would however caution attempts to convert one capital into another, especially by putting a financial price on other types of resources. This risks commoditising everything, when there may be other factors which cannot be valued which should be taken into account, e.g. when a particular species has reached endangered status or if a community's human rights are being breached.

As this concept of multiple capitals is not widely accepted or applied currently it would need to be clearly defined and explained so that directors understood their disclosure duties. Otherwise there is a risk that a material issue would be omitted because it did not fit under a traditional definition of 'capital' that was being applied.

Guiding Principles (page 13)

Q7. Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that should be added? Why/why not?

Yes. Up to this point the document priorities the needs of investors. Does this mean that responsiveness to other stakeholders is a subject matter as far as it is of concern to investors rather than something to be delivered by the integrated report? Greater clarity needs to be provided in order to manage expectations – NGOs have limited capacity to engage in every corporate report and those that do would expect to see something reflecting their engagement, rather than something just aimed at investors.

Responding to stakeholders could mean a range of things. It raises questions such as who selects them, who assesses whether the company has responded in a

[4] http://www.nature.com/nature/journal/v458/n7242/full/nature08017.html

meaningful way. There is a big difference between a panel of friendly NGOs the company has self-selected and interviews with known critics of the company.

Content Elements (page 14)

Q8. Do the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report – are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added? Why/why not?

Yes. As long as the balance between past and future is right. Putting in a separate section on future outlook should prompt the greater forward-looking disclosure that is required.

What Will Integrated Reporting Mean for Me? (Reporting organizations – page 21, Investors – page 22, Policy-makers, regulators and standard-setters – page 23, Other perspectives – page 24)

Q9. From your perspective:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

(c) Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis (from the perspective of investors)? Why/why not?

We think there are still relationships and behaviours that maintain the status quo. Some of these will need to be addressed if reporting is to change. For example the relationship between large companies and their accountancy firm is one that has long been questioned with regard to independence. Having a fresh pair of eyes that has no potential to be compromised due to concerns over maintaining a client relationship may be critical to speeding up change.

Financial regulators have so far been reluctant to make significant changes following the financial crisis. Whilst it could be argued the opportunity still exists to improve the regulation of large companies, regulators need to be active and open to change. On the positive side, listings requirements and guidance change all the time without requiring primarily legislation, which could facilitate the process.

It is noted that some issues may receive less coverage as they are not material but will still be very important to some stakeholders. This should be part of the process of determining materiality, but will also present a genuine indication of how the issue is viewed in the company. Getting this sense of what is actually important for the company is part of the value of this approach over the current rather flabby reports which list everything to tick the boxes of SRI surveys

Future Direction (page 25)

Q10. (a) Do you agree that the actions listed in the Discussion Paper should be the next steps undertaken by the IIRC? Why/why not? Are there other significant actions that should be added?

We think examples are very useful to show companies in different sectors what their new integrated reports might look like, and give them something to respond to. We would be very interested in producing a sample report for the oil and gas sector for example, giving options of what might presented. This might also give stakeholders a chance to input at an early stage without having to review each individual report.

(b) What priority should be afforded to each action? Why?

We think getting some integrated reports out as soon as possible is key to show what can be done.

Given the time it will take to amend and harmonise reporting requirements this should also be prioritised.

Q11. Do you have any other comments that you would like the IIRC to consider?

We would like to see an integrated report which shows how the business model is adapting to future climate change scenarios.

For example for a fossil fuel extraction company, we would want to see the following questions addressed:

- What are the assumptions in booking reserves as assets in terms of future restrictions on greenhouse gas emissions?
- What patterns of energy demand and future prices are assumed – e.g. IEA scenarios
- How many degrees of global warming is the business model based on?
- What is the justification for ongoing capital expenditure on replacing reserves with more hydrocarbons that are incompatible with natural capital limits?
- What would be the physical impact on the business of the climate change scenario the business model is based on?

We present this as a challenge to create a meaningful integrated report and would be happy to contribute on this area.