



Comments on South African Discussion Paper for Integrated Reporting.

Background.

The [Carbon tracker Initiative](#) is looking at climate change risk in a new way. It is focused on the fossil fuel reserves held by publically listed companies and the way they are valued and assessed by markets. We want to change the way companies are brought to market by investment banks; the way they are valued; what disclosures the regulators and UK listings authority require in documents; how new public offerings (IPO's) and listed businesses report on the carbon stored up in their reserves; and the way investors assess systemic climate change risk in their portfolios.

Mandatory & Material

Firstly we would like to endorse the approach being proposed in South Africa and agree that a fundamental shift is needed in how companies account for their actions. In particular, we believe that voluntary measures have run their course and it is time for mandatory requirements to be introduced to deliver the information on material environmental and social risks that should be factored in by all investors considering a company.

Meaningful data

It is clear that there is currently a disconnect between sustainability reporting and investment decisions. BP's Gulf of Mexico incident demonstrates that even where evidence of a poor safety record in the US is available to all, the company did not pay sufficient attention to the issue, and neither did shareholders. In order to do put these issues on the table it is essential that stock exchanges require listed companies to provide meaningful data.

Forward-looking

Climate change is clearly a strategic risk for investors, and the uncertainty around the policy frameworks, the precise extent of impacts and the timeframe for action has only added to the potential risk. Research by Mercer into the impact of different policy response scenarios on behalf of the world's largest pension funds demonstrates the need to integrate the impact of climate change policy on asset allocation decisions at the portfolio level. We support the objective to create more forward-looking indicators, which have a clear connection to value – either value at risk or the potential to create value.

Boundary-setting

There have been significant developments in greenhouse gas reporting standards which have enabled more accurate monitoring of carbon emissions around the world. For certain purposes it is obviously useful to attribute responsibility for emissions in a consistent manner to avoid double-counting. E.g. Applying scope 1,2 & 3 definitions as defined by the Greenhouse Gas Protocol. However in the context of corporate disclosure, we believe not including scope 3 emissions can lead to the most material emissions not being considered as they are related to the product use phase. For example the fossil fuel extraction companies do not typically put figures on the emissions associated with product use. (Although we note that in the past both BP and Shell have reported this and Rio Tinto provided an estimate last year for products sold in that year.)



It is clear that the market for a company's product is essential to its ongoing ability to derive revenues from its assets and remain a viable entity. We would therefore stress the importance of boundaries being determined by materiality, rather than a uniform approach. It may be possible to provide guidance by sector about where the material issues lie, although it could also be argued that effective regulation requiring directors to identify and report on material risks should produce a suitable response.

Uncertainty and time horizons

In applying more forward looking analysis, there will inevitably be greater element of uncertainty. It should be recognised that there are different types of uncertainty. For example an electricity company will face regulatory uncertainty about the exact requirements of future climate change legislation and could also face technology uncertainty about whether it will deliver carbon capture and storage systems in a decade's time. Both of these issues demonstrate that companies need to be looking further ahead at factors which could influence their performance over the next decade, rather than just profits over the next quarter. Uncertainty should not be used as an excuse for inaction and on the contrary, companies should demonstrate how they are adapting to change and actively managing a response.

A test for integrated reporting

We propose the following as a test of the integrated reporting framework and hope that companies and regulators rise to the challenge.

Companies which extract coal, oil and gas rely on their reserves and the ability to extract them economically and get them to a market to inform their share price. Reserves and their replacement are therefore critical to the valuation of a company and form a fundamental indicator in financial reporting. Integrated reporting should bring this information together with climate change risk to review the value placed on reserves.

At a global level, the coal, oil and gas reserves held by listed companies are enough to take us beyond 2 degrees of global warming, (with state and private assets taking us even further). The UN process agreed in Cancun that governments will work to limit global warming to 2 degrees. Therefore we cannot afford to burn all the reserves and release all the emissions. This suggests that there should be increasing differentiation between reserves as to which ones are more likely to be burnt. Relevant factors include the local climate change policy context, access to water, community opposition, and energy alternatives. This raises questions such as:

- When accountants review the value placed on reserves and the discount model applied, are they factoring in this systemic climate change risk?
- Do accountants have sufficient information to distinguish between reserves rather than assume a standard value for a tonne of coal or a barrel of oil?
- Does the stock exchange regulator know what concentration of reserves are on its exchange and therefore how exposed related indices are to potential revaluation of reserves?

We believe a properly functioning market with a progressive regulator should be providing this information for investors and analysts to factor into decision-making. We look forward to seeing this marriage of reserves and climate change risk in integrated reports.