Carbon management: organisational boundaries

Guidance for public sector organisations

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Contents

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About this document

Resource Efficient Scotland has produced a suite of guidance resources, prepared and written by specialist carbon management consultants, to assist public sector organisations in developing, revising and maintaining their Carbon Management Plans, activities and supporting documentation.

This guidance is currently made up of a series of four inter-related documents, on the following themes:

- Organisational boundaries.
- Setting targets.
- Reporting.
- Governance and accountability.

These documents can each be read on their own, though there are connections between them – for example, the guidance on organisational boundaries has implications for target setting and for reporting (and vice versa). You will find references across the guidance to where more detailed information on particular points may be found in one of the other documents in the series.

Organisational boundaries for carbon reporting

This guidance looks at approaches to setting organisational boundaries for Carbon Management Plans and reporting. Typically, public sector organisations, particularly larger and more complex organisations, will need to be pragmatic in setting their boundaries for carbon management. The guiding principle should be that the boundary you set should capture the majority of your organisation's known emission sources, based on the emissions which are under the organisation's control (even if the control is partial, such as for Scope 3 emissions[1]).

In simple terms, the boundary is essentially a scope limit that determines for your Carbon Management Plan (CMP) what you do and don't report as the carbon impact of your organisation. You need to set a boundary for:

- The line between your own operations and third party operations – this is usually done on the basis of either financial control or operational control.
- If you choose to report the carbon impacts influenced by your organisation, but that occur outside it (Scope 3 emissions in GHG protocol terminology), you need to determine and disclose which of these you are including and why you have to include or exclude any given element.

It is recognised that in a wider sense many organisations will have multiple boundaries for multiple reporting requirements. For example, reporting for the CRC Energy Efficiency Scheme (CRC) (if applicable for your organisation) will have its own boundaries, set by the terms of the CRC; these will be different to the boundaries which can and should be set for your CMP. It is important to appreciate the relationship between different boundaries and why they are not the same, e.g. the CRC boundary, being based on Scope 1 & 2 emissions, can be seen as a subset of the complete CMP boundary.

[1] For more explanation of what constitutes Scope 1, 2 and 3 emissions (terms used throughout this document), please see the guidance document in this series on *Reporting*.

Boundaries should also be amenable to change as you progress through carbon management. For example, if there are elements of your organisation's carbon emissions which you want to be able to include in the future but for which you currently do not have data, it is possible to set boundaries which initially exclude such elements; and then to adjust boundaries at a later date to bring in approximations for that data, using benchmarks or other estimates. The most important aspect of setting boundaries is that decisions must have a clear rationale and there must be documentation which explains where and how the boundary has been set. This needs to communicate both to external and internal stakeholders and also in more detail for internal purposes, so that carbon emissions measurement and target setting can be replicated to the same boundaries in future – and/or with known adjustments to your boundaries.

1 Financial and operational control

The most important concept to be aware of in drawing your scope 1 and 2 reporting boundary is that of **control** – what does your organisation influence? Control can be defined in either financial or operational terms (there is a third approach, using equity share, which is generally not relevant in the public sector).

In most cases, whether an operation falls within the organisational boundary and is therefore reported as scope 1 and 2 does <u>not</u> vary based on whether the financial control or operational control approach is used. The main exception is leased assets (if you lease an asset, such as a building, from a third party, you are likely to have at least some degree of operational control of the asset, though you may well not have financial control over it).

1.1 Financial control

An organisation has **financial control** over an operation or asset if it directly or indirectly has the ability to direct the financial and operating policies of the operation with a view to managing the economic impacts or benefits from the its activities. For example, financial control usually exists if the organisation is largely responsible for the financial performance (and risks) of the operation and its assets. This approach follows the guidance set out in International Financial Reporting Standards (IFRS) and in UK Generally Accepted Accounting Principles (GAAP), such that the economic substance of the relationship takes precedence over the legal ownership. Therefore an organisation may have financial control over an operation even if it has less than a 50 per cent ownership interest in that operation.

Financial control is also used for financial reporting purposes, i.e. if an operation is fully consolidated in the reporting organisation's financial statements then it is likely to fall within the organisational boundary for environmental reporting purposes as well. You can therefore use your organisation's financial accounts as a guide to determining the limits of scope 1 and 2 reporting if you take a financial control approach[2]. It is certainly worth establishing what the boundaries are for your organisation's financial reporting to ensure that carbon reporting boundaries are well aligned to the financial reporting boundaries (although there may some differences in places, which should always be based on sound and documented rationale).

1.2 Operational control

An organisation has **operational control** over an operation if it or one of its subsidiaries has the full authority to introduce and implement operating policies at the operation. Such arrangements commonly arise in the oil and gas industry, where one of the investors in a joint venture or consortium is nominated to operate the joint venture activity on behalf of other investors. See the Defra reporting guidance[3] for more information.

1.3 Choosing whether to use financial or operational control

You will need to make a choice as to whether you use financial or operational control to draw your scope 1 and 2 reporting boundary. Either approach is valid; the key point is to clearly disclose which you have chosen, and stick to it. There are advantages and disadvantages to both:

- An operational control approach best reflects the ability you have to affect GHG emissions from assets and operations.
- A financial control approach aligns better with financial reporting – in general assets and operations are included on an entity's balance sheet if the entity has financial control over them (e.g. it can sell the asset and realise the benefits). Using financial control will mean that your scope 1 and 2 emissions will broadly correspond to the assets and operations on your balance sheet.

Note that, should you choose a financial control approach, it is considered good practice that impacts from entities, assets and operations that are operationally controlled but not financially controlled, are reported as scope 3 emissions, provided that the reporting organisation is able to influence the extent to which GHGs are emitted, or that the reporting organisation is exposed to risk as a result of the operational control. This generally means that if an organisation takes a financial control approach to determining the scope 1 and 2 reporting boundary and therefore does not report leased assets and buildings as scope 1 and 2, it *should* be reporting emissions from those leased assets (rented buildings, for example) under scope 3 (rather than not reporting them at all). This is because organisations have some influence over the GHGs emitted from leased assets such as rented buildings.

Joint operations such as joint ventures or special purpose project vehicles can arise in the public sector. A joint operation is defined as: *a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.* Entities should report either the proportion of the joint operation that they own, or if using operational control they should report all of the impact of the joint operation if they have control; none if they do not have control.

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[2] Associates of privately owned companies are exceptions to this rule as they are represented within the financial statement, but are excluded from the financial control boundary for environmental reporting purposes where they are not under the control of the parent organisation.

[3] https://www.gov.uk/government/publications/environmental-reporting-guidelines-including-mandatory-greenhouse-gas-emissions-reporting-guidance

2 Leases and leased assets

If you own leased assets you should follow the same consolidation approach for including the environmental impacts from the leased assets as you have used for your organisational boundary. So again, if you use financial control, you will include assets under scope 1 and 2 that you let out to third parties, but not assets that you rent yourself (which should be reported as a scope 3 impact).

Ideally, you would determine what type of lease applies to your assets in order to determine the correct treatment – is the lease a finance lease (which gives the lessee (body renting the asset) financial control), or an operating lease (which gives operational control, but not financial control)? However, it is only necessary to do this if you use a financial control approach to determining the scope 1 and 2 reporting boundary; all leases give rise to operational control and therefore if you use this approach, you should always report leased assets as scope 1 and 2, and assets that you rent to third parties as scope 3 (or not at all).

If you use a financial control approach, it is helpful to determine the lease type, but this can be complex without help from a qualified accountant. In general, most buildings are likely to be counted as operating leases (i.e. if you rent a building, it is unlikely that it will appear as an asset in your organisation's balance sheet as it is unlikely the lease will be for a significant proportion of the building's total useful economic life). Therefore, if you use a financial control approach, you should include buildings that you rent to third parties as scope 1 and 2, and buildings that you rent from third parties as scope 3. It is likely that operating leases for assets other than buildings will shortly be disallowed for most financial reporting purposes. See the GHG Protocol's leased assets document[4] for more information.

3 Defining the outer boundary for scope 3 emissions

3.1 From organisational to operational

While your organisational boundary can be said to be a statement of which assets are included for carbon management, your **operational boundary** takes the perspective of what emissions sources are to be included. While the approach discussed above, looking at control of assets and operations, will help you determine how to set the boundaries for your Scope 1 and 2 emissions, your operational boundary is about looking across your Scope 3 emissions.

The GHG protocol allows discretion when choosing which areas of scope 3 emissions to report, so it is important to set and document a policy as to which scope 3 emissions your organisation reports, clearly disclosing this policy. It will also help the users of your CMP and reporting if you clearly define and list data sources.

Example scope 3 impacts are shown in Table 1 below.

We recommend you report as a minimum:

- All scope 1 and 2 emissions.
- Scope 3 emissions from business travel (i.e. all business travel that does not occur in company owned vehicles).
- Scope 3 emissions from waste disposal, since waste is a significant environmental impact.

[4] http://www.ghgprotocol.org/files/ghgp/tools/Appendix_F_Leased_Assets.pdf

- Scope 3 emissions from water use, because this helps to recognise water is a scarce and valuable resource.

Table 1: Common Emissions Sources by Scope 1, 2 and 3

Scope 1	Scope 2	Scope 3
Fuel combustion	Purchased electricity (generation emissions)	Emissions associated with transmission distribution losses of purchased electricity
Fuel used through mileage in company vehicles	Purchased heat	Waste disposal
Process emissions	Purchased steam	Business travel
Fugitive emissions		Transport of products
		Transport for commuting
		Production of purchased materials (supply chain emissions)
		Use of products (supply chain emissions)
		Leased assets, franchises and outsourcing

4 Explaining and disclosing your reporting boundary

It is crucial to explain clearly, for the benefit of the users of your CMP and carbon reporting information, how and where you have drawn the boundaries of your CMP and reporting operations. It is recommended that this is done with:

(a) a diagram to represent the boundaries as they have been drawn. (Figure 1 below shows an example of a boundary diagram); and
(b) a full list of assets and where they fall, within or outside your boundary. This list can be included as an appendix to your CMP and need not necessarily be down to the level of naming every individual asset (e.g. every building or vehicle), more that it should capture the numbers involved of each different asset type.

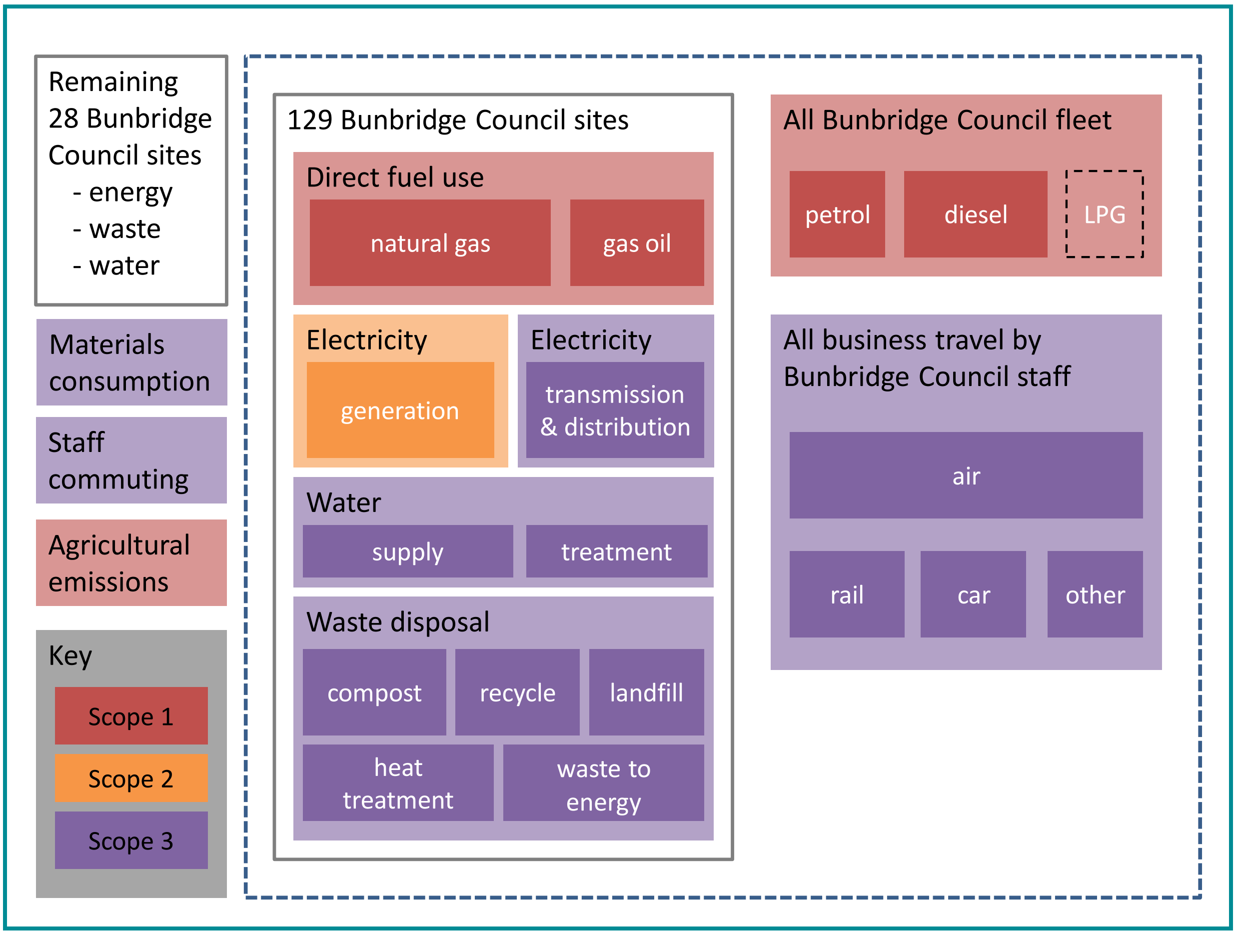
Some key points to help with this are:

- State whether you are using financial or operational control to determine what lies within scope 1 and 2, and what is not reported or is reported as scope 3. All scope 1 and 2 emissions should be included.
- Include a clear inventory of those aspects of scope 3 emissions that are included, preferably with data sources and details of how the data was collected.
- Explain and justify any points where judgement has been used to determine how to report an element of your carbon impact, such as how any shared buildings or jointly owned operations are accounted for.

5 Changes to assets and operations within your boundaries

A common question is how to deal for carbon reporting purposes with changes to your estate and operations. A common example might be the disposal of a building. In general, the principle is that if you are acquiring or disposing of a business area or operational unit to or from a third party, you should restate your carbon emissions baseline if the effect of the change is significant. If, however, you are taking on a new building to expand your own operations, or disposing of a building *without* disposing of a part of your own operations to a third party, then you should not alter your baseline, but instead report the change in emissions. More information on this is given in the separate guidance document in this series on *Reporting*.

Figure 1: Example of boundary diagram



6 Summary – Key steps to defining boundaries

As a summary of the above, the flowcharts in Figure 2 and Figure 3 show the key steps to follow in setting your organisational boundaries using either the operational control approach (Figure 2) or the financial control approach (Figure 3).

Figure 2: Defining boundary using operational control

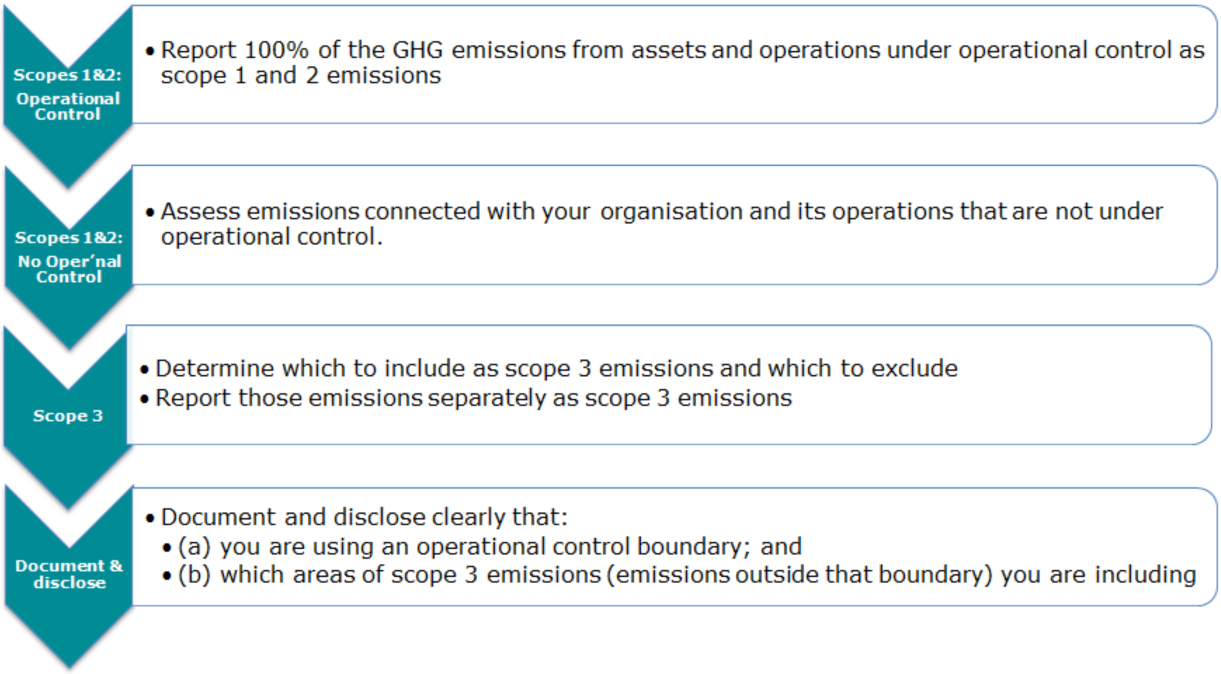


Figure 3: Defining boundary using financial control