Funding the Future

Why financial accounting for Scope 3 emissions is essen...

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I have written quite often about my ideas on sustainable cost accounting now. A fair number of comments have come in on it. Many, admittedly, because of their tone and abusive nature look to simply be trolling. Most have the feel of climate change denial around them. But three issues persist.

One is the claim that I am double counting by requiring that a company account for its Scope 3 climate change emissions.

The second suggests that companies are not, in any event, responsible for these emissions.

The third is that I am not accounting for climate change because I am not requiring that carbon be priced.

The last is for another blog. I will deal with the first two here.

The standard on greenhouse gas emission measurement is set by the Greenhouse Gas Protocol Standard. I have some issues with this standard (some noted below), but let's accept it for now. They say:

The GHG Protocol Corporate Standard classifies a company's GHG emissions into three 'scopes'.

Scope 1 emissions are direct emissions from owned or controlled sources.

Scope 2 emissions are indirect emissions from the generation of purchased energy.

Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

That's it. I am accused of being brief in what I say in my suggested standard. They manage to be much more sparse. But the suggestions are enough: standards are meant to be guidance.

As they also say:

Most of the largest companies in the world now account and report on the emissions from their direct operations (scopes 1 and 2).

The claim made by many commentators that this is not possible is, then, not true: it is happening.

Scope 3 is harder to measure, of course. It requires that the emissions in the products an entity buys for use and the emissions that their use gives rise to when sold (including those in the eventual process of disposing of them as waste) all be taken into account. I am told by a PLC I discussed this with recently (because despite claims made, I have researched this issue) that the range of answers this can give rise to are wide, partly and even precisely because how you define use and what part of the overall emissions of the user the company making the supply is responsible for can give rise to many different answers. But this does not mean Scope 3 cannot be measured. What it does mean is that the protocols around measurement need refining. That will, I suggest, inevitably happen. As too, in due course, will the standards around auditing these figures be developed because that is always the way. That current variation is really nothing very surprising then. Nor does it mean answering these questions is something I need do: the process of doing so is already very clearly well underway whatever I might do.

So then, is this Scope 3 reporting double counting? I have to admit I find this question rather bizarre. It's like saying that because one company has recorded a transaction in which two entities are necessarily involved then the other should not. But of course, they should: accounting requires it. What it does not require is that both account for it as the same thing. So if it is a sale in one it is a purchase in the other. That's how accounting works. And so too is it with Scope 3. If a company treats the emissions arising from its sale as a Scope 3 customer chain output another company can treat it as a Scope 3 supplier chain input. That's what should happen. It's not double counting. I'd rather they became Scope 3 and 4 to avoid the complication of being called the same thing, but this is not an issue. If both are called Scope 3 for now, both must be counted.

And nor is this in any way an issue creating conflict for sustainable cost accounting. Sustainable cost accounting is about micro accounting issues i.e. it's about information about which the decision making entity itself has to decide. The fact that it makes an externality an internal issue is beside the point. That is the intention of sustainable cost accounting. What SCA does is recognise that the full cost of a company's activity has not been accounted for to date and now it has to be, and it does so by estimating the cost of eliminating that externality. And since Scope 3 emissions are an externality the company creates they have to be covered by sustainable cost accounting, as a matter of fact or the requirement to decide is not recognised.

And, as a matter of fact an entity that really wants to be net carbon neutral has to consider what the carbon emissions in its supply chain are, and how it can impact them e.g. by changing its own buying behaviour or product design to mitigate their impact. And it has to also make decisions on whether it wants to sell products with high greenhouse gas emissions inherent in them and decide how it might help its customers to mitigate or eliminate those emissions, again by product redesign, providing longer product life, improving recyclability and so on. To pretend that these are not issues the company should not think about is absurd. Of course it should do so. And if they are within its scope then necessarily they must be within the scope of sustainable cost accounting.

In addition, in a great many cases (but not all, I know) the purchaser of the product sold and which will have to be accounted for is the end consumer. Since they will never report their Scope 3 emissions if their supplier does not then no one ever will. The risk of not reporting Scope 3 is, then, under and not over-reporting, but this is not real issue of concern; that is that the company has to make decisions on Scope 3 and so it must report on them: the logic is as simple as that.

But to turn to the second point it is also rather more than that. To say that a company is not responsible for its Scope 3 emissions is just wrong. That's like saying a company is not responsible for the goods it sells and their impact. We know that they are. For example, companies are responsible for selling goods of merchantable quality. And they are responsible for making sure their products cause no harm. We know that liability to not cause harm can extend to those who also never actually acquired their products. Issues around products such as faulty drugs and asbestos, as well as smoking, have clearly proved this. So to pretend that Scope 3 emissions have nothing to do with a company is just wrong. And that is precisely why a company must report them and how they intend to mitigate them because as a matter of fact they are responsible for the goods that they sell either alone, or as a potential party to a group action, with others. So the argument that they are neither material or do not need to be reported is just wrong.

I am sure some will always disagree with these views. In time I am also quite sure society will consider those who think Scope 3 to be irrelevant now to be wrong. That's the way these things always progress. Scope 3 is a company reporting issue, and in due course no one will doubt the fact. It's just a rearguard who pretend otherwise now.