

JOSEPH AAMIDOR LOOKS AT HOW SOFTWARE IS BECOMING ESSENTIAL FOR CARBON RISK MANAGEMENT

A changing climate

Identifying the person in charge of enterprise greenhouse gas (GHG) management is a good indicator of whether or not the organisation views it as a strategic issue. At present, many companies have tasked carbon management to an environment, health and safety (EHS) or sustainability office, which allows the most knowledgeable environmental professionals within the organisation to address climate change, but doesn't attract the attention of the most influential parts of the business.

This status quo is changing quickly because carbon management is more than responsible environmental stewardship. It's a risk management imperative that has a direct impact on an enterprise's bottom line.

Thus, the responsibility for enterprise carbon management has started and will continue to move to the desks of chief financial officers and directors of risk management, making GHG mitigation and adaptation a central part of company operations, instead of just a marketing exercise to external stakeholders or simply a reporting task to governments. As managing carbon becomes a key responsibility for finance and risk management professionals – who traditionally do not have accountability over this domain – they should be aware of some of the reasons why this shift is occurring. They include:

- *A maturing regulatory environment:* A higher level of understanding and concern among legislators and the general public continues to drive many countries and their subtending jurisdictions to pass laws and policies that require entities to measure, report and, in some cases, reduce their emissions. Just as regulation to address environmental concerns, such as air and water

Box 1. US EPA's MRR

The US Environmental Protection Agency's (EPA's) Mandatory Reporting Rule (MRR) has a number of entry points for entities subject to report. Certain carbon-intensive industries are required to provide annual reports on their emissions, regardless of the quantity of carbon emitted. A second group of industries need to report if their emissions exceed 25,000 tonnes of carbon dioxide equivalent a year. There are separate guidelines for certain stationary combustion facilities and suppliers of fossil fuels and industrial greenhouse gases. Enterprises are required to submit the first report for 2010 emissions by the end of March 2011. The EPA has not yet released details on data submission, but it will use a web-based system to receive reports.

quality – through the Clean Air and Clean Water Acts – led applicable entities in the US to make significant investments to ensure compliance and reduce the risk of litigation, climate regulation will do the same for GHG emissions. In the US, the Environmental Protection Agency's (EPA's) mandatory reporting rule is just the tip of the iceberg that should be interpreted as a wake-up call to enterprises that have not begun to actively manage their carbon emissions (see box 1).

- *A proliferation of cap-and-trade programmes worldwide:* Several large developed economies have implemented or are considering market-based programmes to reduce carbon emissions. One driver was the UN's Kyoto protocol, which highlighted emissions trading as one strategy to reduce GHGs. The EU emissions trading scheme (ETS) is the most well-known cap-and-trade system and recently a similar scheme has been proposed on Capitol Hill (see pages 10–15). Companies subject to an ETS rely on auditable tracking of emissions and the ability to perform scenario and what-if analyses for investment in new infrastructure, initiatives and programmes. Enterprises also need to reduce the time

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and effort it takes to manage their allowances portfolio and understand the impacts of such a scheme on their bottom line.

- *Shareholder demands:* The sole responsibility of a business is to create value for its shareholders and anything preventing this is a material risk – subject to disclosure. Climate change risks and the impact they have on the valuation of companies is of increasing interest to shareholders. This issue gets less publicity than carbon regulation, but it is driven by the growth of socially responsible investing (SRI) and was recently addressed by the US Securities and Exchange Commission (see box 2). It's likely that the number of lawsuits related to the lack of carbon risk disclosure by public companies will continue to climb.
- *Infancy of green standards:* Some green standards, such as Energy Star in the US, have established themselves as the leader in a given product category or type of impact, but for most environmental issues, there are a number of competing protocols that enterprises can choose



to follow. Eventually, there will be a single standard in each area of environmental impact, currently, however, companies either can pick the standard that makes them look the greenest or find a relatively ‘soft’ protocol to cover up their poor performance – so-called greenwashing. These protocols are important to companies because they influence purchasing decisions, leading to sales and profit. Companies should look forward to a time when they have more clarity on the right standard to use for each product or service, but they should also prepare for dramatic shifts in participation guidelines and reporting requirements that will occur as standards mature.

- *Emergence of private initiatives:* Private companies with market influence are requiring suppliers to improve their sustainability or risk losing lucrative deals. Retail giant Walmart’s sustainable product index seeks to become a central source of information on the impacts of products by demanding more sustainability-related information from suppliers. Walmart also founded the Sustainability Consortium with other retailers and private companies to establish more support for its product sustainability plans. Companies that sell goods to Walmart or other consortium participants have found that the financial risk of ignoring the requirements is far greater than investing to adhere to the data submission guidelines.

All these trends will challenge enterprises to improve their ability to identify, measure, report and reduce their GHG emissions, which can be done most efficiently with the deployment of robust management systems. Companies

that make the investment in such software will realise a number of monetary benefits:

- *Resource cost savings:* Companies that reduce their emissions also reduce their energy costs and software can enable them to better understand the financial benefits of such efforts;
- *Significantly reduced administrative burden:* Adherence to new and existing regulations and standards can be streamlined by using systems that can aggregate activity data from multiple sites and facilities, create automated tests to ensure data integrity and reliability and automatically generate forms and reports for required submission;
- *Energy security:* As traditional energy resources become scarce, more expensive to produce, less politically viable and subject to more stringent regulation, enterprises will need to analyse the costs and benefits of using new sources of energy before making the capital investments;
- *Profitable participation in carbon markets:* Companies subject to market-based carbon schemes should make their participation as successful as possible by using systems to manage the purchase and sale of credits; and
- *Efficiencies throughout the enterprise:* Simply measuring performance on a regular basis and disseminating it leads to improvements. Entities that use systems to monitor and report energy and emissions data can easily provide the same information to employees, which will encourage them to reduce consumption. Collecting and tracking more granular data with software leads to bigger improvements and cost savings.

The demands placed on companies in this new age of carbon consciousness are significant risks and daunting operational and management challenges that should concern the highest levels of executive leadership. But the organisations that elevate these issues accordingly, and invest in robust management systems, will be able to turn these risks into competitive advantages that lead to growth and profit in the future. ●

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Box 2. SEC guidance

The Security and Exchange Commission’s (SEC’s) interpretive guidance on disclosure related to business or legal developments regarding climate change helps companies include climate change in existing disclosure requirements, specifically under four areas of disclosure that must be included in quarterly and annual submissions. They are: the impact of regulation and legislation; the impact of international treaties, accords and agreements; the indirect consequences of regulation and business trends, which could include increasing or decreasing demand for goods based on the amount of emissions generated; and the physical impacts of climate change.