

**Scottish Government
Proposals for a Scottish Climate Change Bill Consultation
Institute Members in Scotland (IMS) Group Response**

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INTRODUCTION

1. The Institute Members in Scotland (IMS) welcomes the opportunity to comment on the Consultation for the proposals for a Scottish Climate Change Bill released by the Scottish Government on 29 January 2008.

WHO WE ARE

2. IMS is the dedicated Scottish branch of the Institute of Chartered Accountants England Wales (ICAEW) serving over 1300 members across the private and public sectors in Scotland. IMS aims to represent the views of ICAEW members who work in Scotland for Scottish and international organisations; and to be a communication channel between ICAEW and its members in Scotland.

3. ICAEW operates under a Royal Charter, working in the public interest. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

4. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

SCOPE OF RESPONSE

5. This response focuses on areas where we believe our professional expertise and knowledge can add value to the consultation process and to the development of a Scottish Climate Change Bill. As a result we have not responded to all questions individually in the consultation document, but have included our thoughts on the key sections.

MAJOR POINTS

6. The document clearly sets out the wishes of the Scottish Government to achieve emission reductions nationally, and to set targets that are beyond those set for the UK. It does not detail how these targets will be achieved across the economy. It is important, however, that business is not made to bear more than its fair share of reductions. This is not only because Scotland's business must be allowed to maintain its competitiveness but also the policy and legislative milieu must not discourage inward investment. It is also important the public sector plays a key part in stimulating demand for a low carbon economy.

7. However, we believe that the Bill would benefit from the articulation of an overall long-term strategy in this regard. This would enable business to plan appropriately for the future, especially those sectors that must plan over a very long cycle.

8. The document is unclear on how much detail will be included in the reporting process. Furthermore, there is no consideration of how the reporting will be assured. The generation of information, reporting and assuring and the procedures and processes and necessary skills that underpin them are central to the success of the regime envisaged by the document.

9. A further area of concern is how the framework will minimise the risk of double counting of reductions at European and global scales, given the possible linkages with the European Trading Scheme, Kyoto Protocol's CDM/JI¹ projects and the use of other international credits.

10. Carbon footprinting and target setting at an organisational level is challenging and is thus infinitely more complex at the national level. The challenge and complexities of national carbon accounting should not prevent the advancement of a national framework for carbon accounting and reporting. However, as the evolution of financial accounting and reporting indicates, transparency and independent verification should be a cornerstone of any credible framework.

11. Beyond the possible inclusion of the basket of six GHG, it is unclear from the document how a reporting framework will scope in and out activities which impact the emissions balance sheet. We believe that a transparent framework should link scoped activities to targets and interim budgets; and outline how activities with "off balance sheet" emissions, such as Scottish businesses with operations overseas, international air travel and shipping could affect future carbon targets. The likely inclusion of air transport in the future ETS could lead to "on balance sheet" emissions previously excluded. However, we believe that transparent reporting would reduce such uncertainties for businesses.

12. These are areas in which the accounting profession has particular proficiency and we recommend that you should include accounting within the list of types of expertise in paragraph 7.14. This could be provided by a nomination from the Consultative Committee of Accountancy Bodies, which represents the six chartered bodies of accountants in the United Kingdom and Ireland.

13. The document is limited as to how changes in natural carbon sinks will integrate with the emissions target setting and budgeting. We consider that the framework should be transparent as commented above (10) and if landuse changes are included then accountability for associated emissions should be based on the control approach discussed in paragraphs 19-21.

14. There is a need for continued "joined up" thinking across government at the Scottish and UK level to ensure the Climate Change Bill is integral to the broader Sustainability issues and that other policy areas are congruent and consistent with the targets. A lack of internal consistency across policy areas will send mixed messages which would increase uncertainty for business investment.

¹ Clean Development Mechanism and Joint Implementation.

SPECIFIC POINTS

Targets

Question 1: Should the Scottish Target be based on carbon dioxide only or the basket of six greenhouse gases?

15. We believe that the Scottish Target should include the basket of six greenhouse gases in order:

- i) To provide a balanced portfolio of GHG that can generate opportunities across all sectors of the economy to reduce emissions. Limiting targets to CO₂ will fail to stimulate reductions in sectors that have comparatively high emission levels of the more potent GHG, such as coolants used in the service and food sectors.
- ii) To allow business flexibility to respond to changes in technology that will reduce all six GHG.
- iii) To Improve long term business investment evaluation through taking into account key GHG and thus increase the return of CO₂ e² reduction per £ invested. We consider that setting targets for CO₂ only will limit the “emissions returns” business will generate from their investment.
- iv) To be consistent with international agreements, such as Kyoto Protocol and Post Kyoto.

However, a robust approach is required to measure the basket of six GHG.

Question 2: Should the bill contain provisions to alter which gases are included, for example if the reliability of data for a particular gas improves or if science changes in the future about which gases cause climate change?

16. Notwithstanding our response to question (1), we consider that data reliability should be incorporated into the target setting process and the degree of uncertainty in GHG data should be reported by the Scottish Government. We believe that business risk management and investment appraisal techniques can manage uncertainties, if communicated effectively. For such techniques to be effective requires regular, consistent, assured and transparent dissemination of data and its uncertainties.

17. Where scientific evidence identifies additional GHG, then we believe that the bill should contain provisions to include such GHG. Such provisions need to take into account data reliability, lead time for business succession planning, and appropriate incentives for businesses to adapt to the changes.

² Carbon Dioxide equivalents based on converting other greenhouse gases with known conversion factors into units of Carbon Dioxide.

Question 3: The Scottish Government wishes to ensure that the bill gives sufficient incentives to invest in energy efficiency and renewable electricity. Should targets be based on sources of emissions; end user inventory; or an individual targets for energy efficiency and renewable electricity? Do you have any other suggestions?

18. We believe that a Climate Change Bill needs to encompass all parties in the move towards a low carbon economy; producers and consumers. Therefore organisations should have targets based on the control approach, as suggested by the *GHG Protocol Corporate Accounting and Reporting Standard*.

19. The control approach, consistent with financial accounting, would assign targets based on operational control and influence rather than the manner in which reductions should/could be achieved. This approach ensures that the carbon costs/benefits of an operation are matched to its operational control and financial rewards.

20. The control approach allows a degree of flexibility for organisations to make reductions across a range of measures, which would include low cost behavioural and process change as well as investment in energy efficiency and in renewables. Adopting the control approach enables the organisation to direct action towards areas where it has the ability to deliver cost effective emission reductions; and to benefit from associated costs savings. In a Scottish context it has been estimated that small to medium businesses (SMEs) could reduce CO₂ emissions by 3.3million Tonnes, resulting in cost savings estimated to be £3.6 billion³.

21. Although, we welcome any incentives the Scottish Government would provide to support investment in energy efficiency/renewables, we consider individual targets for investment in energy efficiency and renewables are too restrictive for business decision making.

Question 4: Do you agree that the Bill should allow the means of measuring the target to be changed through secondary legislation to reflect international developments or unforeseen consequences of the Bill?

22. In conjunction to our response in question (1), the Bill should have the means to reflect changes to ensure consistency with international agreements, such as post Kyoto targets and EU targets.

23. However, any changes passed through secondary legislation should be supported by independently substantiated evidence which is reviewed by an independent committee.

Question 5: Should the emissions reduction target take account of the abatement effort by companies under the emissions trading scheme?

24. Although, the cap and trade mechanism is in principle an appropriate measure to stimulate corporate carbon reduction strategies, there are concerns to the extent the scheme should interact with the Scottish emissions reduction programme. These concerns are:

- i) The ETS is for certain industry sectors and thus excludes the wider economy.
- ii) Over-allocation of allowances to companies may generate artificial reduction credits that would unfairly benefit those companies in the ETS compared to those outwith the

³ Response to the Energy Efficiency and Microgeneration Strategy consultation
<http://www.scotland.gov.uk/Resource/Doc/194536/0052252.pdf> (2007).

scheme, especially SMEs in Scotland. In a Scottish context an uncontrolled use of ETS would undermine the credibility of the framework.

- iii) Over-allocation may depress market value of carbon and thus lower the net present value of potential carbon reducing investments.
- iv) Inclusion of ETS credits raises the risk that the Scottish Government's target is undermined by artificial credits that are not linked with underlying resource efficiency improvements.
- v) If ETS credits are to be included as eligible reductions then targets for those participating companies should reflect such benefits.

Question : Do you agree that international credits should be counted towards Scottish targets? Should there be limits on credits counted towards Scottish targets?

25. We agree that credits bought overseas should contribute towards Scotland's emissions reductions. However, this is subject to the limitations implicit in the document: that these should adhere to the principle of 'supplementarity'; that the credits should meet suitable criteria for inclusion – and we believe that these criteria should be put forward by an independent committee on Climate Change; and in written and publicly available form.

26. There is room for a greater degree of sophistication in the consideration of international credits. The concern over using overseas credits stems from a desire that industrialised countries should be seen to be reducing their own emissions and should not exploit and exhaust poorer countries' future ability to achieve cheap reductions of their own. Thus it seems to us that buying credits between industrialised countries, for example within the EU, which would be "international", is less of a concern than between industrialised and developing nations. Notwithstanding our views expressed to question 5, we believe this distinction should be recognised.

27. The inclusion of international credits from the developing world should not be disproportional to domestic reduction targets. This is not only due to the issue of developing countries' future ability to achieve low cost reductions, but also lower emissions will generate a more competitive business sector in Scotland through efficiency gains.

28. Although we do not consider that fixed limits should be included in the bill, a committee should advise the government on the balance between domestic and overseas credits; advice should be made public.

Question 7: Should the Bill allow the level of the 2050 target to be changed through secondary legislation? If so, should this only be allowed on the basis of independent, expert advice, to reflect international developments or unforeseen consequences of the Bill? Should any changes to the target be limited to an increase in the target?

29. In case of upward revision to the 2050 target we consider secondary legislation to be appropriate, if revisions are based on independent expert advice and take into account the uncertainties. We agree that limiting revisions to increases in the target would provide greater certainty to all organizations investing in low carbon technologies.

30. However, if the Bill includes provisions for downward revisions in the 2050 target then these should be through primary legislation to ensure comprehensive informed debate due to the uncertainty this would cause for long term low carbon investment.

31. We believe that criteria for revising the 2050 target should be put forward by an independent Committee on Climate Change in written and publicly available form.

Supporting Framework

Question 8: What factors should be taken into account when setting the level of budgets?

32. We consider that in addition to the factors listed in the document, the following factors should be considered:

- i) Risk of Climate Change to Scottish business, especially tourism and food/agriculture sectors.
- ii) The positive impact on competitiveness by moving towards an efficient and low carbon economy.
- iii) Stimulating and creating new markets for carbon reducing technologies, driving innovation, global business opportunities and industrial symbiosis.
- iv) Changes in societal attitudes and behaviour, especially demand for low carbon products.
- v) The embodied energy/carbon in planned investments as some technologies and infrastructure projects may not be emissions negative until future budget periods.
- vi) Other policy areas that are umbilical with a low carbon economy, such as, green taxation, transport, tourism, waste management.

33. A carbon reduction budget that provides clear signals and certainty to business can lead to a more efficient economy because reducing carbon is effectively reducing waste and costs.

Question 9: How long should interim budget periods be?

34. We think that it is necessary to have more than one budgetary period in place at any one time in order to give business the ability to plan beyond five years. We also support the proposal that budget periods should coincide with other budgetary cycles both international carbon reporting and domestic financial budgets. This will improve transparency of progress and hence limit uncertainty.

35. We consider that there could be potential for more rolling annual budgets in order to give regular and prompt feedback to policy makers and the economy on the progress towards interim budgets.

Question 10: How many years in advance should emissions budget periods be set in order to provide sufficient time to develop infrastructure?

36. We think that a time series 5 year emission budgets to 2050 would indicate to businesses the short, mid and long term emission reduction trajectory. A 5 year interim budget

will enable businesses to build in emission reduction costs into investment appraisals for short-mid capital expenditure. Each interim period would have an associated level of certainty and be revised at the end of each 5 year period. This is important as some investments will impact the emission budgets for 40-50 years.

Question 11: What should be the limit (in terms of absolute quantity or as a percentage of the budget period) on the amount of emissions which the Government can borrow from a following budget period?

37. The concept of “borrowing” credits that have not yet been realised is not one that is immediately appealing. From an accounting standards perspective this is equivalent to benefiting from unrealized gains. Furthermore, the borrowing principle contravenes the explicit objective in the document to give incentives for early action; supported by Stern’s analysis that appropriate early action reduces long-term costs.

38. As the consultation document tacitly acknowledges, the integrity of the system and confidence in the budgetary process and the budgets themselves is vital. If borrowing is to be permitted then we agree that it should be limited to very low amounts, over the short-term, and we believe that it should be according to criteria that a Committee on Climate Change should promulgate early on and should include the principle that borrowing is only permitted in exceptional circumstances and not just because of a general failure to meet budgets. We also agree that the government should seek the advice of a Committee on Climate Change first and we believe that this advice should be made public.

39. Incidentally, we would support the banking of emission reductions to diminish the costs of future reductions and to protect the economy from unexpected upward pressures.

Question 12: Should the Bill include an interim point target? If so, what year (or years) should it be for (2020, 2025, 2030, etc.)? How should the level be chosen?

40. We think that the cumulative target approach would provide greater certainty of the rate of progress towards a 2050 target compared to single point percentage target would place the burden of cumulative shortfalls on later generations; at a higher long term cost to the economy.

Reporting Scrutiny and Framework

Our response to topics covered in Questions 13 to 22 is detailed below.

41. We consider the Scottish Minister should annually report progress towards targets and that the report includes forecast emissions for the remaining years of a particular interim budget period. Forecast emissions would highlight future actions required and hence provide further certainty to business investment planning in the short to mid term.

42. The Minister should report on each significant aspect of Scotland’s carbon balance sheet as well as carbon related issues which are excluded from the targets or “off balance sheet” activities such as carbon sinks. For activities included in the emissions budget, the reporting should include gross gains and losses and not just the net emissions impact. This reporting principle is comparable to financial reporting where related assets and liabilities are presented separately and thus will improve transparency and the framework’s credibility. For instance, the emission gains and losses by using biofuel and the release of GHG from carbon sinks in the construction of windfarms should be reported gross.

43. Annual emissions reports and interim budget reports should be subject to independent assurance by a recognized auditing body under the remit of an independent committee, such as a Committee on Climate Change (refer to paragraph 46).

44. We agree that an independent body such as the one described in the consultation document will be an important addition to the process outlined for reducing the Scotland emissions.

45. We think a Committee on Climate Change should neither cause unnecessary bureaucratic burden or generate inconsistent advice where there are common issues at a UK level. We accept that Scottish carbon reduction programme is likely to differ from a UK wide programme due to economic structure, climatic factors and diverse geography; and thus may require a Scottish advisory committee at a future date. Whichever body has an advisory role we believe that close links should be formed with Scotland Sustainable Development Commission to ensure that advice is considerate with the broader sustainability issues in Scotland and to support greater joined up thinking across Scottish Policy; and the Committee's advice should be made public.

46. However, we are concerned about potential conflicts of interest for the Committee and question how that can be managed. This stems from the fact that the Committee will be giving the government advice, some arising from its own analysis, and will also be tasked with holding the government to account for actions that at least in part will be based on that advice and analysis. This could give rise to a risk of a perceived lack of objectivity and independence of the Committee. One possible solution to this would be for membership of the Committee to be limited to a number of terms. For example members might be permitted to serve for two three-year periods.

Supporting Measures

Our response to topics covered in Questions 23 to 33 is detailed below.

47. We believe the burden and the benefits of delivery emission reductions targets should be shared across the private, public sector as well as NGOs and other organisations. We think that public sector organizations have a duty to the develop procurement policies that account for emission impacts. By the scale of public sector procurement in Scotland, the implementation of low carbon purchase policies would support demand for the private sector to deliver low cost and innovative solutions. The best value guidance should reflect the need for low carbon procurement across the public sector and support low carbon supply chain partnerships in order to drive demand.

48. We consider that a climate change Bill should establish a framework espousing joined-up thinking to ensure measures are compatible with other related legislation, policies and fiscal measures, and vice versa, in order to provide a consistent policy/legislative environment for Scottish Business and inward investors. For instance waste management has significant business cost and GHG impacts, and thus related policy areas should take into account measures to reduce GHG emissions.