CPA CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Climate impacts of value chains: Tackling Scope 3 GHG emissions

by Sarah Keyes

What is the issue?
Global attention on climate change has never been greater. In 2021, in anticipation of COP 26 in Glasgow, global governments and businesses reaffirmed their commitment to achieving the Paris Agreement target to limit global warming to 1.5 degrees by mid-century. To achieve this, widely accepted science suggests that global greenhouse gas (GHG) emissions must reach net zero by 2050. This must include an organization's Scope 1, 2 and 3 GHG emissions.

Increasingly, organizations must measure, monitor, manage and report on their Scope 3 GHG emissions, which are the GHG emissions from their upstream and downstream value chain activities. In October 2022, the International Sustainability Standards Board (ISSB) announced its landmark decision to make Scope 3 reporting mandatory. North American regulators, including the Canadian Securities Administrators (CSA) and the Securities Exchange Commission (SEC), have also tabled proposed mandatory climate-related disclosure rules that consider Scope 3 emissions reporting.

Why is the issue important?
Increased attention on companies' Scope 3 GHG emissions by the global capital markets (e.g., investors, insurers, lenders, ratings agencies and regulators) and broader company stakeholders (e.g., employees, customers, communities) will require organizations to measure, monitor, manage and report on their Scope 3 GHG emissions to investors and other stakeholders. Organizations can no longer commit to net zero targets that include only Scope 1 and 2 GHG emissions. Increasingly, an organization's ability to reduce its Scope 3 GHG emissions is an essential component to a credible climate change strategy – particularly if an organization has set a target of net zero by 2050.

What can be done?
Organizations need to develop baseline inventories and accounting systems to measure and monitor their Scope 3 GHG emissions. Once a baseline is established, organizations can evaluate actions to reduce their Scope 3 GHG emissions, such as engaging with suppliers to reduce their carbon emissions or supporting customers' end-use of products to reduce their downstream emissions. Organizations must be prepared to transparently report on their progress toward reducing Scope 3 GHG emissions in support of net zero ambitions. This is a journey of progress, not perfection, as methodologies for accounting for Scope 3 GHG emissions are still under development globally.

Who is this guideline for and how can it be applied?
This guideline is intended for CPAs working in industry (i.e., operational, management accounting and reporting roles), CPAs and business professionals in leadership roles, and boards of directors. This guideline provides practical industry guidance for CPAs to establish measurement systems for Scope 3 GHG emissions and a framework to develop an implementation plan to achieve reductions across their value chain activities. CPAs will learn how to utilize their skills and competencies to identify, plan, implement, assess performance and respond to stakeholder expectations on Scope 3.

MANAGEMENT ACCOUNTING GUIDELINE

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Overview

This management accounting guideline (MAG) was developed as a practical guidance document to help CPAs understand the importance of Scope 3 carbon emissions, as part of an overall approach to GHG management within an organization. Several other resources available on the CPA website are recommended as pre-reading to this MAG. These include *A Primer for CPAs on Greenhouse Gas (GHG) Emissions Management Systems* and *How CPAs Can Help Organizations Adapt to Climate Change*. In addition, CPA Canada has developed the MAG *GHG Emissions Management: Linking GHG Emissions Management to Corporate Strategy, Risk and Performance* and an accompanying case study. Together, these resources provide additional background to support CPAs in their role in helping to manage and mitigate GHG emissions.

How Scope 3 GHG emissions could impact your business

Climate change has become a mainstream issue, and companies today can no longer ignore concerns coming from different stakeholders, including investors, customers and employees. Canadians' and global societal views have shifted significantly during the COVID-19 pandemic, which has put a spotlight on addressing climate change. An IPSOS survey from July 2021 found that half of Canadians (49 per cent) say recent extreme weather events such as wildfires and floods make addressing climate change more urgent. Investors want to inform their investment decisions and are increasingly questioning how companies are managing the financial impacts of climate-related risks and opportunities. Stakeholders such as customers and employees want to be associated with responsible companies who are doing the right thing and creating additional value through more innovative and carbon-efficient products and services.

Carbon emissions reporting is new for corporate issuers, and disclosures have mostly focused on Scope 1 and 2 emissions, with limited consideration for Scope 3. In comparison to Scope 1 and 2, Scope 3 emissions can be the most difficult to understand, measure and control, as they represent the indirect emissions in a company's value chain. Despite this challenge, Scope 3 emissions (all 15 categories) must be properly assessed and included into the overall GHG emission assessment and reduction strategy, given they represent a significant proportion of an organization's overall emissions (in most cases) and provide an organization with a full view of its climate-related risks and opportunities. For investors to have this holistic view, companies must consider Scope 1, 2 and 3 in their reporting. Moreover, the push to set science-based net zero targets, as well as proposed regulations in Canada, is a significant driver for increased pressure for Scope 3 disclosures. Reporting GHG emissions – inclusive of a proper Scope 3 assessment – is the only way that a company can responsibly assess and mitigate its full climate impact.

When it comes to carbon reporting, organizations that maintain the status quo and do not appropriately assess Scope 3 emissions will face long-term implications as the global economy transitions to net zero by 2050. This could include, but is not limited to, loss of access to capital, increasing costs of capital and insurance, inability to attract and retain strong talent (particularly, younger generations who seek to work with organizations aligning

with their values), lost opportunities for efficiencies and improvements in relationships with key stakeholders.

Conversely, organizations that proactively begin to tackle measuring and reducing Scope 3 GHG emissions will be well positioned to thrive as the policy and legal, market, technology and reputational risk landscape evolves over time in response to climate change. Businesses undergoing an assessment of Scope 3 emissions can help identify new market opportunities and ways to engage and improve relationships with key suppliers and customers.

Mini case study: Lululemon Athletica

Lululemon Athletica (a Canadian company) established a climate change strategy that includes its Scope 3 GHG emissions. Lululemon had its GHG emissions targets validated by the Science-Based Targets Initiative (SBTi), which illustrates their credibility, given this is global best practice for climate change targets.

Lululemon is focused on four key pillars to implement its climate change strategy and reduce its Scope 3 GHG emissions:

- sourcing renewable electricity in operations through a combination of renewable energy credits (RECs) and a virtual Power Purchase Agreement (PPA) in North America
- engaging with manufacturing partners for energy efficiency and renewable energy progress
- sourcing more sustainable raw materials and fibers, including recycled and renewable content polyester and nylon
- reducing carbon emissions in inbound logistics

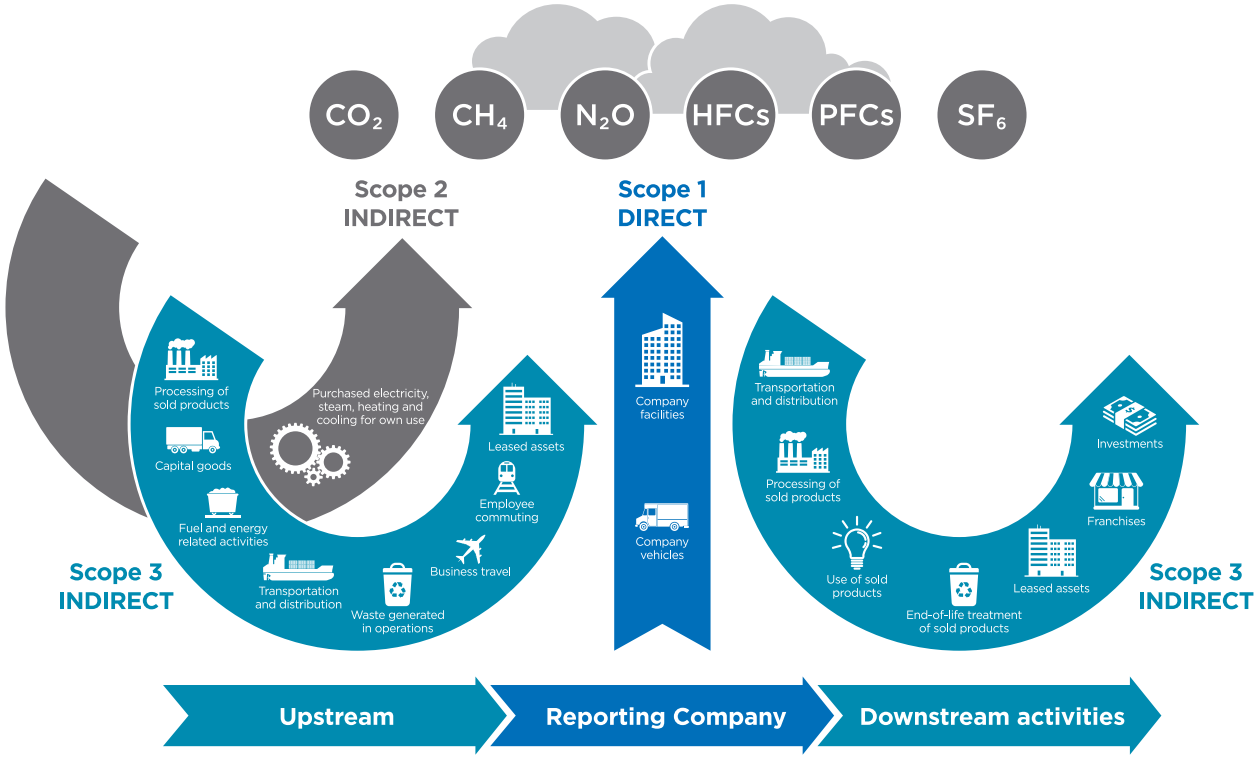
Introduction to measuring Scope 3 GHG emissions

Scope 3 emissions can be challenging for organizations to understand and measure. However, if a company is deeply committed to assessing all its climate-related risk and opportunities, it must properly address its Scope 3 emissions.

Scope 1, 2 and 3 GHG emissions can be measured and defined using The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (GHG Protocol). The standard classifies a company's direct and indirect GHG emissions into three "scopes," defined as Scope 1 emissions (i.e., direct emissions from owned or controlled sources), Scope 2 emissions (i.e., indirect emissions from the generation of purchased energy consumed by the reporting company) and Scope 3 emissions (i.e., all other indirect emissions that occur in a company's value chain). The GHG Protocol is not the only standard available to measure GHG emissions; however, it is the most widely used accounting standard referenced in many regulations, standards and frameworks.

Figure 1 (according to the GHG Protocol) is a clear illustration of the three scopes of carbon reporting and the way they relate across a company's operations and value chain. Note that Scope 3 emissions are defined using 15 categories upstream and downstream of the company's direct operations. Depending on the organization's value chain, not every Scope 3 category will have material emissions. The Scope 3 categories will be further discussed in the five-step process outlined below. Upstream emissions generally result from the production of goods and services that an organization uses. In the case of a manufacturer, these emissions occur in the life cycle of a material/product up to the point of sale by the producer. Whereas downstream emissions are those resulting from the use or end-of-life phases of the goods and services. Examples of this would include the use phase of a product (e.g., dishwasher) or, in the case of financial services companies, carbon emissions resulting from financing other companies' operations (e.g., lending to or investing in an oil and gas company).

FIGURE 1: DEFINING SCOPE 1, 2 AND 3 GHG EMISSIONS



On the continuum of environmental disclosures, GHG emissions reporting is new. Early reporters often focus on Scope 1 and 2 emissions, with limited or partial Scope 3 reporting, usually focusing on the most basic categories such as Category 6 (Business Travel) or Category 7 (Employee Commuting). GHG emissions reporting and prioritization of Scopes 1 and 2 tends to occur because measuring and reporting Scope 3 emissions can be complicated, difficult and often unreliable. Although this may be true, stakeholder expectations are changing, and science-based and net zero target-setting (inclusive of Scope 3) has rapidly moved to the mainstream with board-level commitments, forcing companies to take a more serious approach to Scope 3.

For an emissions reduction target to be "science-based," it must align with the latest climate science deemed necessary to meet the goals of the Paris Agreement – limiting global warming to well below 2°C above pre-industrial levels and pursuing efforts to limit warming to 1.5°C. Most importantly, science-based targets must cover Scopes 1, 2 and 3 emissions if Scopex3 accounts for more than 40 per cent of the combined Scope 1, 2 and 3 emissions. This 40 per cent threshold is significant, considering most companies have their largest GHG emissions in Scope 3.

According to the CDP – a not-for-profit organization that runs global disclosure systems for companies and cities – supply chain emissions are, on average, 11.4 times higher than operational emissions (Scopes 1 and 2), which equates to approximately 92 per cent of an organization's total GHG emissions (Source: *CDP 2020 Global Supply Chain Report*, February 4, 2022).

These statistics magnify the fact that organizations must properly define and measure their Scope 3 emissions to have credible emissions reduction goals or commitments. There are large reputational implications for organizations that neither understand the impacts of their value chain activities nor address Scope 3 with rigour and transparency. Science-based targets help establish this rigour when formally validated by the SBTi. Organizations can also align their science-based target to net zero and set a near-term target and long-term science-based target with zero emissions by 2050. Companies reporting full scope carbon emissions (Scopes 1, 2, 3) with a verified science-based net zero target are not commonplace for Canadian issuers, but this is sure to grow. Currently in Canada, over 125 companies have set net zero targets, and 17 of these companies had their targets verified under the SBTi. This list can be viewed on the Canadian Business for Social Responsibility (CBSR) net zero leaderboard (SBTi) (Source: CBSR – Canada's Net Zero Leaderboard).

Another factor driving Scope 3 GHG emissions reporting is the 2022 proposed Canadian Securities Administrators (CSA) regulations, which, if passed into law, would require corporate issuers to publicly disclose a range of practices related to climate change and emissions reporting. The CSA proposed regulations will ask Canadian issuers to disclose Scope 1, 2 and 3 GHG emissions in regulatory filings, but the exact requirement is still undecided for each scope. The U.S. Securities and Exchange Commission (SEC) also released similar but more stringent proposed regulations. This MAG is focused on the Canadian context; however, it is important to note that changes in U.S. regulations will also have implications for Canadian issuers with operations in both countries. Publicly traded companies will need to monitor the development of these regulations, and many are proactively preparing.

Another important shift in reporting is the development of international standards through the 2022 draft release of the International Sustainability Standards Board's (ISSB) Climate-related Disclosures Standards. The proposed standard states that Scope 3 should be included as an important part of a company's emissions reporting and is being closely monitored by companies all over the world. The inclusion of Scope 3 emissions reporting in science-based and net zero targets, securities regulations and standards is driving more robust disclosures of Scope 3 emissions as an integral part of the full scope of GHG inventory reporting for an organization.

Scope 3 emissions are critical to understanding the full extent of a company's opportunities and carbon-related risks. Although there is imminent pressure for publicly listed companies to measure and report Scope 3 emissions, it is important for all types of organizations – including private, not-for-profit and government – to consider their Scope 3 impact as part of an overall approach to emissions reduction and management. Regardless of whether the organization is forced to disclose through regulation or chooses to disclose, the consideration of Scope 3 emissions provides a holistic view of a company's value chain impacts, risks and opportunities that would otherwise be lacking if only Scope 1 and 2 were evaluated. As part of the five-step process outlined below, we discuss how Scope 3 assessments can inform a company about its value chain risks and opportunities and how organizations can benefit from a value chain approach, which can lead to stronger relationships with stakeholders such as customers and suppliers.

Figure 4 below outlines some of the opportunities and challenges associated with measuring, managing and reporting on an organization's Scope 3 GHG emissions.

FIGURE 4: OPPORTUNITIES AND CHALLENGES WITH SCOPE 3 GHG EMISSIONS

Linking "RAISE" to Scope 3 GHG emissions management

In times of change, building a sustainable enterprise requires a progressive mindset. To help meet this challenge, CPA Canada developed a philosophy called RAISE, which helps CPAs reflect on and assess their own proficiencies while guiding their organization to assess its level of resilience, adaptability and capacity to innovate in response to change. The concepts of resilience, adaptability and innovation as defined in **Figure 2** are not new; rather, they provide an integrated approach to strategic decision-making that prioritizes long-term sustainability. By weaving a **RAISE** approach into day-to-day analysis, planning and implementation, CPAs and organizations can foster transformational change.

FIGURE 2: RAISE

***R**esilient* is the ability of an organization to mitigate risk and quickly recover ("adapt") from constant turmoil and disruptions while maintaining continuous business operations and safeguarding people, assets and overall brand equity. [**Resilient = Protect + Recover**]

***A**daptive* is the ability of a CPA and organization to maintain a high degree of flexibility and to change or adjust in almost real time by altering routines and practices in response to either/both internal and external changes. [**Adaptive = Learn + Respond**]

***I**nnovative* is the ability of a CPA and organization to translate fresh, novel or revolutionary concepts into reality for success and sustained value (as they create new markets). Innovation is synonymous with risk-taking and challenging the status quo by being disruptive and transformational – an area that many fail to adequately explore or execute upon. [**Innovative = Transform + Reframe**]

The management of Scope 3 GHG emissions poses a new challenge to businesses because it requires management of climate-related risks and opportunities that are outside of direct operational control. Addressing Scope 3 GHG emissions requires a new mindset of adaptability, resilience and innovation for businesses to move toward true sustainability that acknowledges our planetary boundaries and aligns with best available climate science.

CPAs have the skills and competencies to help their organizations with measuring and managing Scope 3 GHG emissions and with linking these processes to existing corporate strategy, risk, performance measurement and management, and reporting. When integrated with **RAISE**, a business and accounting professional can maintain their position as a trusted business advisor of the 21st century and also create additional value by becoming an integral part of operating a sustainable business.

How CPAs add value to Scope 3 GHG emissions management

For CPAs wondering how they fit into the overall "picture" of Scope 3 emissions management, it's important to recognize that CPAs can lead the way in establishing robust internal systems to measure and reduce Scope 3 GHG emissions. CPAs can leverage their skills and competencies to establish internal controls over data collection and reporting, identify appropriate metrics to monitor and measure performance over time, and assist with internal and external engagement and reporting to key stakeholders (e.g., board of directors, investors, employees, customers, communities).

In addition, CPAs in senior roles can directly influence business decisions about allocating resources to effectively manage risk or to drive innovation and meaningful action. Carbon accounting is new and unchartered territory for all organizations. CPAs at all levels within a company can play a pivotal part in helping their organization on the journey of climate reporting along with a mindset of resilience, adaptability and innovation.

By including Scope 3 in the overall GHG emissions management approach, the organization will get a full picture of their entire direct and indirect emissions, which can lead to better identification of any associated risks and opportunities. This fulsome picture can then be integrated with the RAISE philosophy – resulting in a more adaptive, resilient and sustainable enterprise.

Five-Step process for measuring, managing and reporting of Scope 3 GHG emissions

Step 1

Motivate action for addressing Scope 3 GHG emissions

Managing emissions is key to a successful company, not only being the right thing to do from an environmental standpoint but also providing many business benefits. GHG emissions management, particularly when it comes to Scope 3, may seem daunting at first. So it's important to have the mindset of progress over time, not immediate perfection. The first step in addressing Scope 3 emissions is understanding the business goals and outcomes from undertaking such an assessment. Discussing this with key stakeholders from across the organization will help gain buy-in and mutual understanding and can help identify key personnel for involvement with the Scope 3 assessment, including data collection or external value chain engagement.

Accounting for Sustainability (A4S) Essential Guide to Incentivizing Action Along the Value Chain

This framework provides guidance for mapping an organization's value chain to identify sustainability risks and opportunities within it, including GHG emissions. This guide can be used as a complementary resource to this guidance to incentivize action to reduce GHG emissions across the value chain.

Some of the business goals related to developing a Scope 3 inventory may include the following:

- identifying and understanding risks and opportunities associated with value chain emissions
- responding to customer requests for GHG emissions data and information
- engaging value chain partners in GHG management
- enhancing corporate reputation through improved reporting and disclosures

Risk management is a key function for any organization, and a lack of Scope 3 GHG management across the value chain can pose risks and liabilities to companies – particularly if the organization operates in a sector where Scope 3 represents the vast majority of total emissions (e.g., oil and gas). GHG-related exposures in the value chain can range from unstable resource and energy costs to resource scarcity to environmental regulations to changing consumer preferences to scrutiny from investors to reputational risk.

Below are five Scope 3 risk factors and reasons why managing GHG emissions from all value chain activities is good for strategic business planning and risk management.

Mini case study: Manulife

As a long-term investor and asset manager, Manulife understands the significant risks and opportunities associated with climate change. In its climate change statement, Manulife Financial explicitly identifies potential transition risks, including climate litigation, regulation and technology change, alongside physical risks related to extreme weather and mortality. The company acknowledges that [*f*]*ailure to adequately prepare for the potential realities of climate change may have a negative impact on [our] financial position and/or our ability to operate*.

Manulife is net zero in its operations, and aims to be net zero in its investments by 2050. The company has committed to the SBTi, reporting on Scope 1, 2 and 3 emissions.

FIGURE 4 : RISKS AND THEIR POTENTIAL IMPACTS RELATED TO SCOPE 3

Risk category	Examples of potential impacts
Regulatory	Changes in GHG emissions-related laws or regulations can affect a company's suppliers and customers, depending on the region in which they are located.
Supply chain costs and reliability	Suppliers affected by rising energy or emissions-related costs can pass higher prices to customers, and physical events can cause supply chain business interruption risk (e.g., flooding).
Product and technology	Company may lose market share due to increased demand for competitor products with lower emissions.
Litigation	GHG-related lawsuits can be directed at the company or an entity in the value chain.
Reputation	Negative media coverage or customer backlash against a company and its value chain activities may take place, based on GHG management practices or emissions.

Conversely, by not doing a full GHG inventory that includes Scope 3, companies can miss out on the many opportunities and benefits. Figure 5 below outlines the main Scope 3 opportunities and reasons why managing GHG emissions from corporate and value chain activities is beneficial.

FIGURE 5: OPPORTUNITIES AND THEIR POTENTIAL IMPACTS RELATED TO SCOPE 3

Risk Category	Examples of Potential Impacts
Efficiency	Reducing GHG emissions in the value chain can result in decreased costs and increased profitability/efficiency.
Innovation	GHG management provides new incentives to drive innovation in supply chain management and product design.
Sales and customer loyalty	Consumer demand is increasing for low-emissions goods and services.
Stakeholder relations	Improving engagement with value chain partners, suppliers and customers demonstrates enhanced trust and transparency to all stakeholders.
Differentiation	Engaging the value chain and improving reputation amongst competitors demonstrate leadership.

Organizations who assess the risks and opportunities associated with Scope 3 emissions management and define their business goals will develop a clearer understanding of why a Scope 3 assessment is a business imperative that requires action. The risks and opportunities contribute to increasing collaboration and engaging value chain partners in GHG management and can also provide indirect and direct financial benefit.

Step 2

Develop a baseline

Now that the organization has established a vision and the necessity for measuring Scope 3 GHG emissions, the next step is to develop a baseline inventory of Scope 3 GHG emissions. Before a company can measure its baseline, it must choose a consolidation approach. The GHG Corporate

Standard outlines that either an equity share or control approach must be disclosed as part of reporting – **this is further described in the GHG Emissions Management MAG**. The consolidation approach will determine whether some activities or operations will be excluded from Scope 1 and 2 and instead will be included in Scope 3. This process is called setting the Scope 3 boundary and is a critical step to ensure that major activities are captured in the Scope 3 inventory to avoid double counting, as the categories are designed to be mutually exclusive for an organizational inventory.

One way to assist with setting a Scope 3 boundary is to undertake a mapping exercise of all the value chain activities. The GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard outlines 15 Scope 3 categories from all value chain activities, and they are described here in **Figure 6** (as established by the GHG Protocol).

FIGURE 6: SCOPE 3 EMISSIONS CATEGORIES

Upstream or downstream	*Scope 3 category*
Upstream scope 3 emissions	1. Purchased goods and services 2. Capital goods 3. Fuel- and energy-related activities (not included in scope 1 or scope 2) 4. Upstream transportation and distribution 5. Waste generated in operations 6. Business travel 7. Employee commuting 8. Upstream leased assets
Downstream scope 3 emissions	9. Downstream transportation and distribution 10. Processing of sold products 11. Use of sold products 12. End-of-life treatment of sold products 13. Downstream leased assets 14. Franchises 15. Investments

To facilitate mapping, the GHG protocol has a free Scope 3 evaluator, which performs a high-level sector-based screening across all 15 upstream and downstream categories. This tool allows users to develop an initial rough approximation of their full Scope 3 footprint regardless of their organization type and size. These initial estimates will help identify GHG emission "hotspots," categories with minimal emissions and even categories that are not applicable and can be excluded. If a particular Scope 3 category is not relevant or has emissions that are insignificant, the reporting company can exclude it, but the reasons should be justified and disclosed. Initial mapping and screening can help the organization identify action areas, perform initial reporting or disclosure of their inventory, or use the information to plan efforts to produce a more accurate inventory of emissions. Building a Scope 3 emissions inventory

takes time and resources, but starting this process can provide insights about where to focus efforts along the value chain.

At some point after the initial mapping and screening, the organization will want to develop a more robust baseline of Scope 3 emissions to measure progress and to set goals and targets. This will require more specific calculation methods with a focus on priority categories identified in the screening. Most Scope 3 categories have multiple calculation methods, and the GHG Protocol Technical Guidance for Calculating Scope 3 Emissions provides detailed information to guide users to the most appropriate method. To calculate emissions, the company will need to collect both primary and secondary data. Primary data includes data from specific activities within a company's value chain – for example, asking suppliers/customers for their emissions data directly. Secondary data is from a source that is indirect from specific activities in a company's value chain and uses industry averages and other data proxies in calculations. Scope 3 emissions calculations tend to have a higher reliance on secondary data compared to Scope 1 and 2.

Depending on the size of the organization, data collection will likely require the cooperation of many employees across the organization, as well as external stakeholders across the value chain. This represents an opportunity for CPAs to lead cross-functional teams. The type of data collected will determine who needs to be involved. Expense data and the purchasing ledger are particularly important data sources when seeking activity data for Scope 3 categories. Financial spend data is used to estimate GHG emissions for many categories that involve third-party expenses, including purchased goods and services, capital goods, business travel, transportation and distribution. For example, many companies will use the spend-based method to calculate Scope 3 Category 1 emissions for purchased goods and services. In this case, the data source for spend would be the finance and accounting department, in which CPAs will likely be involved.

Once the **data has been collected and estimated, the company can establish a baseline year** for Scope 3 emissions reporting. The baseline year is an important benchmark for year-over-year comparisons for tracking performance and setting a target for emissions reduction. The baseline year should be the earliest year with reliable Scope 3 data for as many categories that apply. Once the baseline is calculated, the company can decide on appropriate goals, targets and reduction strategies as described in Steps 3 and 4.

In general, when developing a GHG inventory, CPAs should apply five main accounting principles: Relevance, Completeness, Consistency, Transparency and Accuracy. Every CPA should be familiar with these concepts through their professional training and education. Although these principles are straightforward in concept, the nature of Scope 3 calculations creates challenges because Scope 3 data can be difficult to collect and measure, which causes reliance on assumptions and data proxies. As previously stated, it's important to ensure that a company maintain clear boundaries when setting Scope 3 emissions to avoid double counting within the company's full GHG inventory of Scope 1, 2 and 3, as well as within the 15 Scope 3 categories.

Step 3

Set targets

Using the baseline year calculations, an organization can begin to set targets for emissions reduction. The screening and mapping process described in Step 2 will have identified key priority categories for reduction efforts, and performance can be tracked over time by setting a target against those reduction efforts.

Approaches to setting Scope 3 emissions reduction targets will vary company to company; however, in general, target-setting will need to consider the following:

1. Which Scope 3 categories will be included (i.e., priority categories)?
2. Will the goal or target include Scope 1, 2 and 3, or will it focus on Scope 3 only (either as a single target for Scope 3 emissions or separate targets for individual Scope 3 categories)?
3. Will the goal or target be absolute (e.g., reduction in overall emissions) or intensity target (e.g., emissions/revenue reduction) or both?
4. When is the completion date for the target (e.g., 2030)?
5. What is the numerical target (e.g., 30 per cent reduction)?
6. Will the target include the use of offsets or credits?

Verified science-based targets and net zero targets are the most reputable approaches for organizations wanting to set a more formal target

Guidance on setting science-based targets

For the Scope 3 priority categories, organization can submit an emissions-reduction target through the SBTi. This requires a Scope 3 screening and target when Scope 3 emissions account for more than 40 per cent of total emissions. The target can be based on overall Scope 3 emissions, or it can be category specific. However, companies must set one or more targets that collectively cover(s) at least two-thirds of Scope 3 emissions for a near-term target of 5–10 years (near-term science-based target). An example of a single category target could be as follows: Reducing absolute Scope 3 emissions from purchased goods and services by 50 per cent by 2025 from a 2020 baseline year. For multiple Scope 3 categories, a company could set the following science-based target: from a 2015 baseline year and by 2030, reducing Scope 3 GHG emissions by 30 per cent from purchased goods and services, upstream transportation and distribution, and waste generated in operations per ton of product produced.

Another Scope 3 target approach accepted by the SBTi is Supplier/Customer Engagement Targets for value chain partners. The target needs to consider what percentage of emissions from relevant upstream or downstream categories is covered by the engagement target, or if that information is not available, what percentage of annual procurement spend is covered by the target. For example, an organization may develop a Category 1 purchased goods and services target of having 80 per cent of its top suppliers by spend commit to

achieving a science-based target (for their Scopes 1 and 2 at a minimum) within the next five years.

Science-based targets can also be net zero targets with the aim to achieve zero emissions or become carbon neutral by a certain date and can include offsets to reach "zero." In 2021, nearly 35 per cent of the global market capitalization had set and committed science-based targets. (Source: SBTi). The net zero standard requires companies to set both near-term and long-term science-based targets, halving emissions by 2030 and producing close to zero emissions by 2050, neutralising any residual emissions that are not possible to eliminate. This standard covers a company's entire value chain emissions, including those produced by their own processes (Scope 1), purchased electricity and heat (Scope 2), and generated by suppliers and end users (Scope 3). In 2022, the SBTi adjusted its Scope 3 boundary for longer-term targets (by 2050) as part of the SBTi net zero target validation (long-term science-based target). The company must set one or more targets that collectively cover(s) at least 90 per cent of Scope 3 emissions for a long-term target by 2050.

Target-setting will involve senior management and board review, and approval along with a clear action plan for how the target(s) will be achieved over defined time frames. The action plan must have a formal process of inventory and accounting systems to measure, monitor, manage and report against the targets, with frequent communications and regular updates.

Mini case study: CN Rail

In 2021, CN Rail became the first North American railroad company to commit to net zero in line with a 1.5-degree scenario, signing the Business Initiative for 1.5 degrees led by the SBTi and UN Global Compact.

Comprising approximately 30 per cent of CN's carbon footprint, Scope 3 reduction targets include the following:

- GHG emissions from fuel- and energy-related activities by 40 per cent per million gross ton miles by 2030 from a 2019 baseline year
- achieving a 32 per cent progress toward its target by 2021

A detailed overview is provided in the company's *2021 Data Supplement GRI and SASB Index*.

Step 4

Develop an action plan

With an established baseline and target(s), an organization can begin to develop a multi-year action plan to achieve the goal of reducing emissions over time. Certain Scope 3 categories will be high priority for emissions reduction, and other categories will be immaterial and not require any action. Setting action plans for emissions reduction highly depends on the Scope 3 category of focus and will require custom strategies and tactics involving internal and external stakeholders.

CPAs in senior roles can directly influence business decisions about allocating resources and developing accountability frameworks to effectively manage risk or drive innovation and meaningful action. CPAs should consider the following when involved in developing an action plan for Scope 3 GHG emissions reduction:

- **Resources** – How much time, money and personnel will be needed?
- **Capacity** – Is there enough internal capacity, or will external support be required?
- **Feasibility** – Are the action plans realistic, and can they be implemented?
- **Timeline** – Is the timeline realistic for the proposed action?

The action plan must have a formal process of developing an inventory and establishing accounting systems to measure, monitor, manage and report against the targets, with frequent communications and regular updates. The delineation between the 15 categories of Scope 3 GHG emissions in the GHG Protocol are by design, intended to provide companies with a systematic framework to measure, manage and reduce emissions across the value chain.

Tracking key metrics and emissions reduction activities requires a proper system of monitoring and evaluation. Data monitoring is based on the premise that Scope 3 emissions calculations (whether actual or estimated) are documented and repeatable, so that emissions performance can be regularly tracked and compared against the baseline. Evaluations will allow for an assessment of the action plan to determine whether adjustments or improvements need to be made to support progress toward the objectives and goals.

Consistent and regular monitoring of any Scope 3 emissions reduction efforts will help ensure progress is made toward any goals or targets; however, companies should consider recalculating baseline year emissions when changes to the organization could cause significant impacts to the inventory. These changes could include structural changes in the reporting organization (e.g., mergers, acquisitions, divestments, outsourcing and insourcing), changes in calculation methodologies (e.g., improvements in data accuracy, or discovery of significant errors) or changes in the categories or activities included in the Scope 3 inventory.

Companies should also use an iterative approach to improve the accuracy of its Scope 3 inventory by collecting more granular and accurate data for emissions hotspots over time. Using the same example of purchased goods and services, in the first year, a company may start using a spend-based approach to calculating carbon emissions for their material suppliers in this category. Over time, as the company engages their suppliers to report, the quality of

the data can be improved by gathering more supplier-specific data. This may require a reset of the baseline, but better data will result in only more accurate measuring and tracking of performance over time.

Figure 7 provides guidance on how to establish each component of the action plan.

FIGURE 7: GUIDANCE ON ACTION PLAN

Action plan component	Guidance
Statement of the Scope 3 GHG Reduction Target	Use the target(s) determined in Step 3 as the foundation of the organizational action plan.
Assessment of emissions reduction opportunities	Identify top strategies for emissions reduction for each priority Scope 3 category with a consideration of timelines and involvement of key internal and external stakeholders.
List of priority actions	Determine which actions should be highest priority, based on categories with the largest emissions reduction.
List of key performance indicators for measuring and managing	Determine key metrics for internal reporting (to leadership and boards), and external reporting aligned to standards and frameworks such as Sustainability Accounting Standards Board (SASB) or the Task Force on Climate-related Financial Disclosures (TCFD).
Evaluations and adjustments	Companies should consider recalculating baseline year emissions when changes to the organization could cause significant impacts to the inventory. Companies should use an iterative approach to improve the accuracy of its Scope 3 inventory by collecting more granular and accurate data for emissions hotspots over time.

Mini case study: Sobeys

Sobeys' approach to climate action includes targeting net zero for Scope 1 and 2 emissions by 2040 and Scope 3 emissions by 2050, while setting near-term targets for 2030.

Its near-term Scope 3 GHG emissions targets are as follows:

- 28 per cent reduction by 2030 in emissions from fuel sold
- 62 per cent of Sobeys' and Empire's suppliers, by spend, to set science-based reduction targets on their Scope 1 and 2 emissions by 2027

As a retailer, much of Sobeys' environmental, social and corporate governance (ESG) exposure lies within its supply chain. Sobeys' supplier engagement strategy is focused on partnering with suppliers and providing them with resources and reporting tools to help set GHG reduction targets.

Step 5

Report to stakeholders

Organizations managing Scope 3 GHG emissions will benefit from enhanced risk management and communications across internal stakeholders, but reporting externally to a public audience has different drivers and benefits. For a decision tree on how to determine whether reporting is required, refer to GHG Emissions Management: Linking GHG Emissions Management to Corporate Strategy, Risk and Performance (Step 5A).

ISSB includes Scope 3 reporting in global accounting standards

In October 2022, the International Sustainability Standards Board (ISSB) announced its landmark decision to make Scope 3 reporting mandatory. North American regulators, including the Canadian Securities Administrators (CSA) and the U.S. Securities and Exchange Commission (SEC), have also tabled proposed mandatory climate-related disclosure rules that consider Scope 3 emissions reporting.

Scope 3 GHG emissions management is a journey and over time can result in an organization's enhancing its corporate reputation through emissions mitigation and improved reporting and disclosures. Increasingly, companies are receiving requests from customers and suppliers to report on their own emissions. In addition, informing customers and suppliers about a company's approach to emissions management enables them to play an active role in Scope 3 emissions reduction activities. For example, a company can approach a supplier to support its Scope 3 reduction targets and gather input to help design a more efficient product as part of the use phase of a product. In addition, a company can use GHG emissions as a competitive differentiator with prospective customers if they are aligned in their emissions strategies.

The reporting of Scope 3 emissions is evolving quickly, and transparency is increasing as more companies set net zero and science-based targets. Investors want to be informed about a company's management of Scope 3 as part of the overall narrative of how the company identifies risks and opportunities and demonstrates performance over time. As discussed earlier, the CSA is proposing reporting requirements for publicly traded companies in Canada, and Scope 3 requirements are not yet finalized as of the time of this writing. For investor-focused reporting, many companies will align their Scope 3 emissions to industry-specific SASB standards, the TCFD and the CDP, using the methodologies in the GHG Scope 3 Protocol. Companies aligning to the TCFD will eventually be expected to include Scope 3 emissions to provide a transparent view of all emissions they produce, giving investors a clear picture of the corporate's commitment to net zero and decarbonisation progress. As described in Step 2, in the interim, it is important to disclose details for why a particular Scope 3 category is not relevant or has emissions that are insignificant. It is acceptable for the reporting company to exclude a Scope 3 category, but reasons should be justified and disclosed.

As with Scope 1 and 2, Scope 3 GHG reporting can be externally assured by a third party, which involves a review of planning and scoping (e.g., determining risks, material misstatements), identifying emission sources, gathering evidence, performing analytics, evaluating results and reporting conclusions. Assurance provides a level of confidence that the inventory results

and report are complete, accurate, consistent, transparent, relevant and without material misstatements. CPAs can be integral to the assurance process as part of an internal audit function to help manage the external third-party assurance process or to perform third-party audits of Scope 3 emissions for clients.

Mini case study: TELUS

In June 2021, TELUS became the first Canadian telecom company to set GHG emissions reduction targets for Scope 1, 2 and 3 emissions, approved by the SBTi.

Its Scope 3 GHG emissions targets are defined as follows:

- reducing absolute Scope 3 GHG emissions from business travel and employee commuting by 46 per cent from 2019 to 2030
- reducing Scope 3 GHG emissions from purchased goods and services, capital goods and use of sold products by 75 per cent per million dollars of revenue within the same time frame

In its 2021 Sustainability and ESG Report, TELUS reported on its progress in relation to these targets for the first time, already surpassing its travel/commuting target at 92 per cent (largely due to COVID) with incremental improvement in relation to supply chain (at five per cent per million dollars).

Roles for CPAs in the five-step process

Scope 3 emissions management can provide CPAs with an opportunity to be directly involved with core strategy, risk management and performance activities. Scope 3 emissions management can be incredibly challenging. CPAs have expertise in internal and external reporting, including the underlying processes and controls to help ensure accurate, reliable and timely information. Scope 3 emissions calculations also highly depend on third-party spend data, which gives CPAs additional opportunity to be involved in data collection and reporting. CPAs involved in company finances are the first line of sight when it comes to expenses and third-party expenditures and will have insights to the type of third-party spend that is resulting in Scope 3 emissions and can play an integral role.

Figure 8 provides a summary of detailed roles for CPAs in leadership positions across all organizational levels and functions.

FIGURE 8: HOW CPAS CAN SUPPORT THE FIVE-STEP PROCESS

Roles for CPAs	Step 1: Motivate action for addressing Scope 3 GHG emissions	Step 2: Develop a baseline	Step 3: Set targets	Step 4: Develop an action plan	Step 5: Report to stakeholders
CPAs in leadership positions	**Examples:** • ensuring senior leadership and board are educated about Scope 3 GHG emissions management, its importance, and the benefits • ensuring Scope 3 is integrated into overall GHG emissions strategy, risk management and decision-making with a proper assessment (Over time, this includes across all 15 categories.) • supporting setting GHG emissions reduction targets inclusive of Scope 3 (required for science-based targets if over 40 per cent of total emissions are in Scope 3) • monitoring progress toward achievement of Scope 3 targets, and providing effective oversight of Scope 3 emissions management activities				
Roles for CPAs at all levels	**Examples:** • supporting the business case (risks, opportunities) and goals for addressing Scope 3 emissions	**Examples:** • supporting category-specific data collection and calculations – especially, for spend-based methodologies • supporting the development of a GHG emissions reduction target inclusive of total Scope 3 or category-specific	**Examples:** • supporting action plans by ensuring dedicated resources are allocated for implementation • establishing KPIs for measuring progress against actions identified	**Examples:** • supporting internal processes and controls for Scope 3 reporting • developing internal reports for monitoring progress against KPIs in the action plan to evaluate success	**Examples:** • developing internal and external disclosures of Scope 3 GHG emissions – especially, those based on spend-related calculations • conducting internal audit on Scope 3 GHG emissions from within the reporting company • providing third-party assurance on organizations' Scope 3 GHG emissions

Summary

Organizations must be prepared to transparently report on their progress toward reducing Scope 3 GHG emissions in support of net zero ambitions. They will continue to face pressure to measure, manage and report on their Scope 3 GHG emissions over time. As a starting point, companies need to establish a Scope 3 GHG emissions baseline and evaluate actions to reduce their Scope 3 GHG emissions, such as engaging with suppliers to reduce their upstream GHG emissions or supporting customers' end-use of products to reduce their downstream GHG emissions.

CPAs have a critical role to play in supporting their organizations' efforts to measure, monitor and report on Scope 3 GHG emissions. Scope 3 GHG emissions will increasingly fall under the purview of the finance and accounting function within organizations regardless of where a CPA may be working – within industry or as a provider of assurance services to clients. This represents a growing opportunity for the profession to act in the public interest while supporting Canadian organizations' competitiveness on the global stage as the world economy transitions to net zero by 2050.

Resources

CPA Canada publications

CPA Canada. (2022) A closer look at the GHG Protocol

CPA Canada. (2021) Canada's transition to net zero: Meeting 2050

CPA Canada. (2020) Climate risk: Is it on your radar?

CPA Canada. (2019) Disclosing the impact of climate change: A process for assessing materiality

About the author

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With a decade of diverse experience as a thought leader, consultant and auditor, Sarah is a recognized voice on the financial impacts of environmental, social and governance (ESG) issues for the Canadian business community. She is a speaker, author and facilitator on the impacts of climate change risks and opportunities on governance, strategy, risk management and performance.

Sarah is a principal at ESG Global Advisors, a new consulting firm created to help bridge the gap between companies and shareholders on ESG issues. Prior to this role, Sarah was a principal at CPA Canada where she produced research, thought leadership and practical guidance for companies to integrate climate change considerations into business strategy, risk management, governance and reporting.

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