

Scope 3 greenhouse gas (GHG) emissions – Are they on your radar?

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As demands for credible climate action rise, so do expectations for companies to inventory and address their scope 3 GHG emissions (**scope 3**) – those that are indirect and that occur upstream and downstream in their value chain. Due to the increased attention in this area, directors need to:

- build their own understanding of scope 3;
- understand rapidly rising expectations around measuring, reporting and reducing scope 3;
- understand what it looks like to take credible action; and
- ensure they are providing effective oversight of scope 3.

On average, a company's supply chain produces **11 times**¹ more carbon emissions than its direct emissions, making it a critical component of a company's decarbonisation strategy.

Background – What are Scope 1, 2 and 3 GHG emissions?

The Greenhouse Gas Protocol (**GHG Protocol**)² corporate standard delineates between direct and indirect sources of emissions and defines three different scopes: scope 1, scope 2, and scope 3 to clarify boundaries of control and accountability over the various emissions sources.

1 CDP Global Supply Chain Report 2021: https://cdn.cdp.net/cdp-production/cms/reports/documents/000/006/106/original/CDP_SC_Report_2021.pdf?1644513297

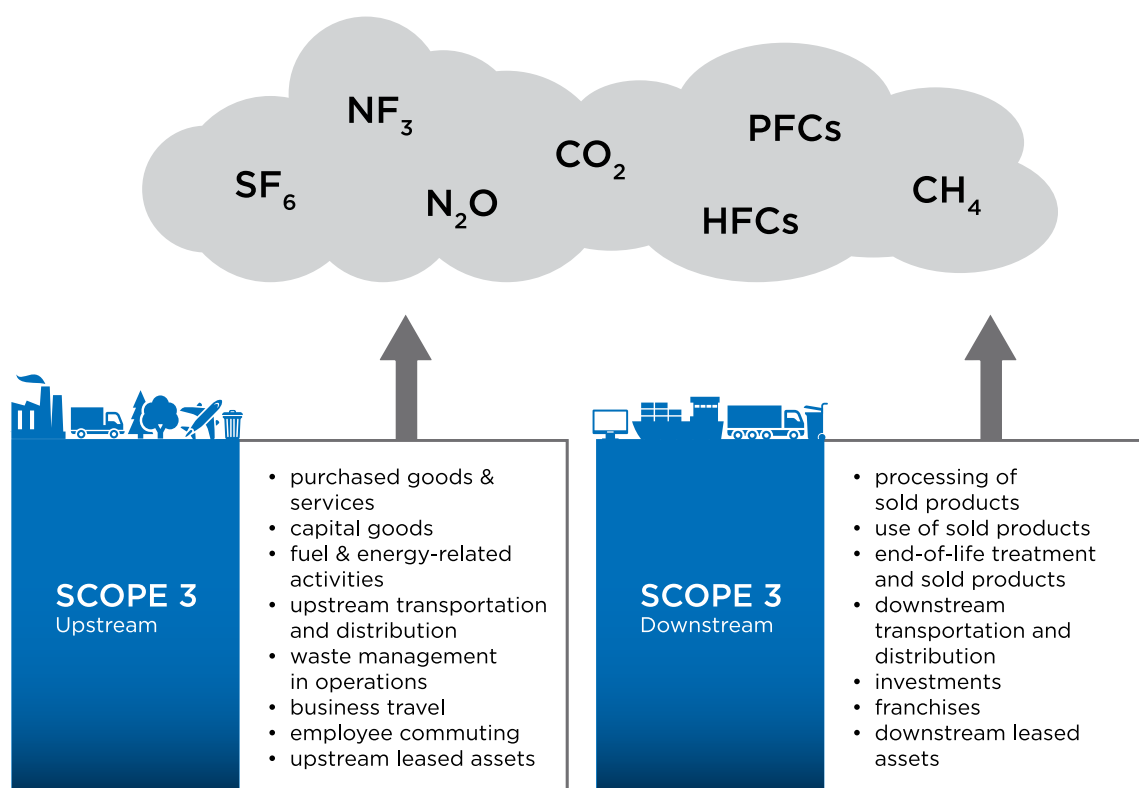
2 The world's most widely used set of GHG accounting and reporting standards (<https://ghgprotocol.org/>)

Scope 1 GHG emissions are the direct GHG emissions from sources that are owned or controlled by your company. This includes emissions from your own production and industrial processes, refrigerants, combustion in boilers or furnaces, and emissions from any company owned vehicles.

Scope 2 GHG emissions are indirect emissions from your purchased or acquired electricity, steam, heating and cooling.

In contrast, scope 3 is a consequence of the activities of a company, but occur from sources not owned or controlled by the company, and which occur upstream or downstream in the value chain. In many sectors, scope 3 makes up the vast majority of a company’s overall carbon emissions inventory and is significantly larger than its scope 1 and 2 emissions combined.³

There are 15 categories of scope 3, divided by upstream emissions, or emissions generated in the course of production of inputs used by an entity in producing its own finished goods; and downstream emissions, or emissions related to the use of the entity’s products, as illustrated below.



The 15 Scope 3 Categories in the GHG Protocol Corporate Standards⁴

For further information on scope 1 and 2 GHG emissions, please refer to [CPA Canada’s Sustainability Reporting Alert: Scope 1 & 2 GHG Emissions](#), and for further information on measuring and disclosing scope 3, please refer to CPA Canada’s [Sustainability Reporting Alert: Scope 3 GHG Emissions](#).

³ CDP (<https://www.cdp.net/en/research/global-reports/engaging-the-chain>); EPA (<https://www.epa.gov/climateleadership/scope-3-inventory-guidance>); Carbon Trust (<https://www.carbontrust.com/resources/briefing-what-are-scope-3-emissions>)

⁴ https://ghgprotocol.org/sites/default/files/standards/Scope3_Calculation_Guidance_0.pdf

Rising expectations for disclosure and credible action

Scope 3 has been pushed into the spotlight. Businesses are under increasing pressure from customers, investors, lenders, insurers, and regulators to measure scope 3, set targets, take credible action to decarbonize their value chain, and disclose their progress. Requirements for scope 3 disclosure are increasingly likely for public companies and pressure on smaller and private firms is mounting.

Committing to certain climate targets may require consideration of scope 3

With corporate net-zero target setting fast gaining momentum, an increasing number of public and private organizations are either setting or committing to set emissions reduction targets aligned with science-based targets. Companies aligning their emissions reduction targets with science-based targets (such as the Science Based Targets initiative [SBTi]) may be required to consider scope 3 in their targets.

In response to growing pressure from value chain partners, investors, lenders and other stakeholders, organizations setting their own emissions reduction targets may also consider including scope 3 in their targets.

Scope 3 targets mean increasing demands from customers

In a world where companies are increasingly attentive to reducing their scope 3 and consumers are more attentive to the impacts of their purchasing decisions, all companies will be under pressure to measure and disclose the carbon footprint of their products or services. Companies that can credibly demonstrate a lower carbon footprint across their value chain will be at a competitive advantage to those that cannot.

Value chain emissions may factor into your cost of capital

As financial institutions and insurers make commitments to decarbonize their assets, financing, and underwriting, emissions data across the value chain may soon factor into the cost of capital. For example, lenders may require borrowers to report emissions data, as they work to understand and reduce their own scope 3. Companies making progress in reducing their value chain emissions may benefit from better rates and access to capital, while those with high emission footprints may face a higher cost of capital.

Scope 3 disclosures are becoming an expectation of credible financial disclosure

Recent efforts towards the consolidation of sustainability reporting disclosure standards have solidified the inevitability of scope 3 disclosure requirements.

The International Sustainability Standards Board (ISSB) and the Canadian Sustainability Standards Board (CSSB)

In 2021, the International Financial Reporting Standards (**IFRS**) Foundation created the ISSB as a sibling board to the International Accounting Standards Board to provide consistent global standards on the disclosures of sustainability information to meet investor needs.

In June 2023, the ISSB issued IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (**IFRS S1**) and IFRS S2 *Climate-related Disclosures* (**IFRS S2**) (collectively, the **Standards**). IFRS S2 requires companies to disclose absolute gross GHG emissions generated during the reporting period, measured in accordance with the GHG Protocol, including scope 1, 2 and 3 GHG emissions.

It is up to individual jurisdictions worldwide to adopt and/or adapt the Standards issued by the ISSB. The Standards are effective for annual reporting periods beginning on or after January 1, 2024, though local jurisdictions may elect a later date in their own endorsement process. Acknowledging the practical concerns of calculating scope 3, IFRS S2 offers one year of relief from providing scope 3 disclosures, to allow reporting entities to understand and map their value chain. An additional transition relief allows companies to use the most recent data available from entities in its value chain even if it does not align with their own reporting period.⁵

In April 2023, the CSSB was established to work with the ISSB to support the uptake of ISSB standards in Canada, highlight key issues for the Canadian context, and facilitate interoperability between ISSB standards and any forthcoming CSSB standards.

Partnership for Carbon Accounting Financials (PCAF)

In the financial sector, the bulk of scope 3 falls within the downstream category related to financed emissions (e.g., emissions arising from the activities of entities that a borrower provides financing to). PCAF is a global partnership of financial institutions that are working together to develop and implement a harmonized approach to assess and disclose the emissions associated with their loans and investments.

The harmonized accounting approach provides financial institutions with the starting point required to set science-based climate targets and align their portfolio with the Paris Climate Agreement. PCAF enables transparency and accountability and has developed an open-source global GHG accounting standard for financial institutions, the [Global GHG Accounting and Reporting Standard for the Financial Industry](#).

Regulatory pressure for scope 3 disclosure is likely to follow

Several regulators have signaled their intent to move towards mandatory scope 3 disclosures. The Canadian Securities Administrators (**CSA**) and US Securities and Exchange Commission (**SEC**) are both in the process of articulating reporting requirements for climate-related financial disclosures. In both cases, current signs point to required scope 3 disclosures for certain companies, along with provisions for a transition period as companies improve their understanding and ability to disclose.

⁵ <https://www.ifrs.org/news-and-events/news/2022/12/issb-announces-guidance-and-reliefs-to-support-scope-3-ghg-emiss/>

In July 2023, the CSA indicated that it is working to adopt disclosure standards based on ISSB standards, which could make scope 3 and other sustainability information required for at least some public companies in Canada. The CSA is also engaging and collaborating with the CSSB with respect to the ISSB standards.

In addition, the European Union issued its Corporate Sustainability Reporting Directive in October 2023 with an effective date of January 1, 2024 for entities within scope. As a result, companies in scope will be required to disclose their absolute gross scope 3, subject to materiality and other reliefs/exemptions.

Taking credible action on scope 3

To understand and address scope 3 your company should:



Image source: Embedding Project

- undertake a scope 3 inventory to identify categories of scope 3 and where in the value chain these occur;
- develop a robust data management system;
- set scope 3 targets (and optionally, seek validation of those targets from a third party);
- develop a strategy to support your value chain partners' efforts to decarbonize;
- verify your data and data processes and disclose your progress; and
- adapt your strategy to keep driving down value chain emissions.

You can find more information about how to measure and manage scope 3 in CPA Canada's [Climate impacts of value chains: Tackling Scope 3 GHG emissions](#).

What directors should know about this process

Get started early – ramping up on scope 3 takes time

Given the multi-year timeframe for a company to gather credible scope 3 data, set credible targets, and implement reliable processes and systems, companies should be preparing now for a future of scope 3 disclosure.

Compliance with scope 3 GHG emissions disclosure requirements will require additional resources

Companies should be prepared for additional compliance costs related to scope 3. Gathering, compiling and analyzing data; software integration; and assurance may all require significant training, staff time and resources.

Scope 3 data collection and management is still evolving

Data access and quality are often a significant challenge. Your value chain partners may be very early in their own journeys of accounting for their emissions and/or you may lack control or influence, especially as you get further up or down your value chain.

The methods of measurement related to scope 3 are also much less mature than the measurement of scope 1 and 2 GHG emissions – at this point, there is still considerable variation in the methods and assumptions employed. As a result, it is common to experience considerable diversity in your data sources and their underlying assumptions.

Estimates and emissions factors only get you so far

While estimates and approximations provide useful information to users, ideally, you will get to the point where you gather primary data – which is GHG emissions data directly from suppliers or customers. At early stages, often this data is unavailable and most companies begin by making estimates using proxy data based on published emission factors (using the mass or volume of goods and/or the spend-based method).

This lack of primary data has implications for the future. When your scope 3 inventory relies heavily on estimates and averages, you are unable to accurately pinpoint the emissions hotspots in your own value chain. It also becomes difficult to demonstrate emissions reductions (i.e., shifting to lower carbon suppliers will not have a direct effect on scope 3 emissions if primary data is not used). Unless you can gather better data, especially for the activities with the highest emissions in your value chain, you will need the whole product class or industry to shift for your company's scope 3 emissions to come down.

The GHG Protocol provides different methods to measure and calculate your emissions based on your data availability (details are outlined in the [Technical Guidance for Calculating Scope 3 GHG Emissions](#)).

Setting credible scope 3 targets

As scope 3 may be the most significant scope within an organization's GHG inventory, you may be facing pressure to set credible and ambitious emissions reduction targets that include scope 3. Organizations can set their own targets, generally related to net-zero or carbon neutrality, or may choose to set targets that are aligned with science-based targets. The difference being that science-based targets aim to align with the scale of reductions required to keep global temperature increases in line with the Paris Agreement goals. Companies setting their own emissions reduction targets have more flexibility in their targets and methods, but should be cautioned against any public statements that may be perceived as greenwashing.

Many companies are choosing to commit to a science-based target. Committing to targets under a specific initiative or guideline may restrict the use of carbon credits in your reduction plan, and will likely include more stipulations on the target itself and the mechanisms used to reduce GHG emissions. The initiative may also require validation of the targets. The primary initiative for setting science-based targets is the SBTi, which is a partnership between the CDP (formerly known as the Carbon Disclosure Project – a recognized global platform for measuring, reducing and reporting climate emissions), the World Resources Institute, the World Wide Fund for Nature and the United Nations Global Compact. The SBTi defines and promotes best practices in emissions reductions and net-zero targets in line with climate science. Under SBTi, companies committing to science-based climate targets whose scope 3 is more than 40 per cent of total emissions are required to consider and set emission reduction targets related to their total scope 3. Determining how to set your target and whether to use an independent initiative such as SBTi will depend on your company's specific circumstances and sector or industry. For example, the SBTi is currently unable to accept commitments or validate targets for companies in the oil and gas or fossil fuel sectors.

The SBTi provides guidance on how to set scope 3 GHG emission targets in its [Getting Started Guide](#) and also provides [sector-specific guidance and requirements](#). You can also find more information about setting scope 3 targets in CPA Canada's [Climate impacts of value chains: Tackling Scope 3 GHG emissions](#).

Collaborating with your value chain partners to support decarbonization

To be successful in decarbonizing your value chain, your company will need to move beyond the traditional procurement approach of placing demands on suppliers enforced through contract conditions. While these can be initial levers for action, they often unduly push the burden onto your value chain partners. Instead of simply mandating action, ask how your business can collaborate with value chain partners, including by offering support and bringing tangible resources to the table.

Collaboration is often the only path forward with the speed and energy needed to support rapid decarbonization throughout the economy. As you consider your company's strategy, it may be helpful to apply these four key sets of actions:

PROMPT: Help partners to understand why action on decarbonization is urgent and begin to gather the data that both sides need.

INFLUENCE: Encourage and support value chain partners to set credible emissions reduction targets, reinforce expectations through solicitation and contracting language, and engage in advocacy and lobbying to help create the conditions for your value chain partners to be successful.

SUPPORT: Provide training and technical support, help to convene and connect communities of practice to support learning, and help partners to access the resources they need.

INVEST: Provide tangible resources, offer incentives, support research and development, and make financial investments.

Image source: Embedding Project

Preparing for scope 3 assurance

Momentum is building for verification and assurance on GHG emissions data, including on scope 3. Generally, the terminology used in carbon accounting refers to “verification” as the process of evaluating a statement of historical data (such as a GHG inventory), whereas “assurance” refers to the outcome of the verification process (i.e., a statement of limited/reasonable assurance).

Given that many companies will need to disclose their GHG emissions as part of their general-purpose financial reports – and may be relying on the data to make financial decisions, make product sustainability claims, or to calculate executive compensation – assurance over the information becomes crucial. Without credible, independent assurance, scope 3 reporting can result in significant reputational, financial and legal risks.

External verification of scope 3 data involves evaluating a statement of historical data and information to determine if the statement is materially correct. Verification can provide a certain level of assurance (e.g., limited or reasonable) that emissions data is prepared in all material respects, in accordance with the relevant standards under which the data is reported.

Although assurance (limited or reasonable) over GHG emissions data is not yet required in Canada from a regulatory body (for example, as assurance over annual financial statements is required by securities law for public companies), there may be instances where an entity would seek assurance over GHG emissions data as a result of investor or other stakeholder needs, or for internal strategic purposes. There are currently general assurance standards in Canada that can be applied to sustainability information and an assurance standard over GHG emissions statements. In addition, responding to investor and other stakeholder needs, the Auditing and Assurance Standards Boards, both internationally and in Canada, have recently published a proposed sustainability assurance standard that supports the consistent performance of quality sustainability assurance engagements.

Directors are encouraged to keep abreast of developments in this area, as assurance over GHG emissions data and other sustainability information may be required in due course.

How to prepare

Be sure that critical controls are in place for scope 3 data and consider engaging a practitioner with relevant experience in the key standards or frameworks, including the GHG Protocol. Make sure that all parties within the value chain from which you are obtaining information are transparent in their methodologies so that you can make comparisons from year to year. In the early stages, your board's audit committee may need to seek guidance on how to effectively oversee scope 3 data.

The release of IFRS S2 will create pressure for more comprehensive and transparent scope 3 disclosures and the scrutiny of those disclosures will also inevitably rise over the coming years.

Many companies are already engaging in voluntary scope 3 disclosures in their sustainability reports and through the [CDP](#).

Credible governance and oversight of scope 3

Directors play a crucial role in supporting the effective governance and oversight of scope 3 reductions. When it comes to scope 3, here are some key questions that directors and senior executives can ask:

Understanding the pressure to provide scope 3 data

- Are investors or other stakeholders demanding (or likely to demand) that we provide scope 3 data?
- Are we (or will we be) subject to disclosure requirements that will require us to report on scope 3?

The strategic implications of scope 3

- What are the strategic implications of scope 3 GHG emissions for our business and our value chain? For example, could the procurement process, or not acting on scope 3 reductions hinder access to capital or increase the cost of capital?
- How could our scope 3 reduction efforts change our cost structure, price of products and services, and return on investment?

Understanding our scope 3 and hotspots

- Do our executive team and board have a sufficient understanding of scope 3 and the implications for our business?
- Have we undertaken a baseline inventory of our scope 3?
- What hotspots or priority activities and/or suppliers or customers does the baseline inventory reveal?

- How much confidence do we have in our scope 3 inventory and the hotspots identified within it? (Is the baseline largely estimated based on emissions factors and to what extent are we gathering data directly from suppliers and customers?)
- What are some of the key limitations in the baseline inventory? What efforts and resources would be required to improve our understanding?

Scope 3 target setting

- Have we set (or do we plan to set) a scope 3 target? Are we committing to scope 3 reductions and/or to engaging value chain partners?
- Are our targets consistent with limiting global warming to 1.5°C?
- Do our targets align with a science-based climate target? Will we pursue validation by a target initiative?

Scope 3 GHG emissions data management and assurance

- Do we have the expertise, processes and systems we need to manage scope 3 effectively? Do we need to hire for the required skills or engage a 3rd party consultant for assistance?
- Is the data credible – can it withstand verification and assurance?
- Are we engaging in verification and assurance of our scope 3 data, processes and disclosures?
- What do we need to do to improve the quality of our scope 3 data collection?
- How can we build a scalable, secure (and ideally, automated) emissions data system across our value chain?

Confidence in our strategy to deliver on our scope 3 commitments

- Have we developed a credible strategy to meet our scope 3 targets?
- Have we allocated the resources and capital to deliver on our commitments?
- How can we accelerate our scope 3 activities to more quickly meet our decarbonization targets?

Scope 3 disclosure

- Are we reporting or preparing to report in line with the GHG Protocol, CDP, SBTi and the evolving disclosure requirements of the ISSB and others?
- Have we articulated a credible position, goals, and strategy that investors, customers, partners, and employees clearly understand?

Additional resources

Scope 3 resources:

- Embedding Project's [A Guide: Getting Started on Scope 3](#) – comprehensive overview of the fundamentals of scope 3
- CPA Canada's [Tackling Scope 3 GHG Emissions Management Accounting Guidelines](#) – how to measure and manage scope 3
- CPA Canada's [Sustainability Reporting Alert: Scope 3 GHG Emissions – scope 3](#) reporting requirements under IFRS S2
- Embedding Project's [free goals database](#) – for examples of leading scope 3 goals in a range of industries

For additional guidance on climate risk and climate risk oversight:

- CPA Canada's [Climate risk: Is it on your radar?](#)
- Embedding Project's guide on [Climate Change and Climate Risk Oversight: A Guide for Corporate Leaders and Directors](#).

For support articulating a credible public position consult the Embedding Project's guides on [Developing Position Statements on Sustainability Issues](#) and [Emerging Trends and Best Practice in Climate Position Statements](#) and their free [position statement database](#).

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