Sage's submission to the Department for Energy Security and Net Zero's Call for Evidence

Overview
Sage welcomes the opportunity from the Department for Energy Security and Net Zero to provide evidence to this Call for Evidence on Scope 3 reporting, particularly in reviewing the benefits, costs and practicalities of Scope 3 emission reporting in the UK. Sage believes that small and medium sized enterprises (SMEs) need to be able to easily report their footprint in a full and complete way. Sage urges the Government to include all businesses in Scope 3 reporting and develop SME specific reporting standards to make it easy and simple for SMEs to report. 65% of SMEs describe the current reporting standards as complex, and whilst 83% of SMEs have stated that sustainability is important to their business, just 7.7% of SMEs are currently undertaking sustainability reporting[1]. The UK will not be able to reach net zero if SMEs are not included in the reporting requirements as they account for a significant proportion of business emissions.

Currently, SMEs face considerable challenges in reporting effectively such as a lack of skills and capacity. However, the current challenges can be overcome through the use of digitalisation and automation which help to simplify the process. For example, carbon accounting solutions, like Sage Earth, can help SMEs more easily measure, report, and reduce their environmental impact. Sage is working towards identifying more ways to simplify reporting for SMEs, which includes building data infrastructure to support SMEs, promoting the use of digital technologies for sustainability reporting and providing clear rules to easily determine material topics and metrics for reporting. These solutions are detailed in our new report, Path for Growth: Making Sustainability Reporting Work for SMEs.

We have included some of our initial thinking in this area via responses to select questions in the Call for Evidence. We would welcome further engagement with the Department on any points you wish to raise directly with Sage or our industry partners.

About Sage
Sage exists to knock down barriers so everyone can thrive, starting with the millions of small and mid-sized businesses served by us, our partners, and accountants. Customers trust our finance, HR and payroll software to make work and money flow. By digitising business processes and relationships with customers, suppliers and employees, banks and governments, our digital network connects SMBs, removing friction and delivering insights. Knocking down barriers also means we use our time, digital tech and expertise to tackle digital inequality, economic inequality and the climate crisis.

Question 4: What role does Scope 3 emissions reporting currently play in your organisation? If your organisation does report its Scope 3 emissions, which Scope 3 emissions categories are you currently reporting on and why? Is this on a voluntary or mandatory basis? Please state whether you have done so in the past and, if you no longer report Scope 3 data, why.

Sage has a set a voluntary Science-based Targets for emissions reduction, which has been validated by the Science Based Targets initiative (SBTi). As part of this commitment, we are reporting on all material Scope 3 categories including: Scope 3.1, 3.2, 3.3, 3.4, 3.5, 3.6, 3.7, 3.11, and 3.15. Sage excludes the following categories because:

- We do not have any leased assets and therefore have no requirement for 3.8 and 3.13.

[1] Sage Path for Growth: Making Sustainability Reporting Work for SMEs, November 2023

- We do not operate a franchise business model that meets the criteria of 3.14.
- We are a digital business therefore 3.9 and 3.10 are not within our boundary.
- We only have a small amount of transportation and distribution, which is reported under 3.4.

Question 5: Do you agree or disagree with the ISSB's assessment of the value of Scope 3 information?

Sage agrees with the ISSB's assessment of the value of Scope 3 reporting and the assessment of the two main barriers to reporting – the availability and quality of data. However, there are emerging frameworks (such as the Partnership for Carbon Transparency (PACT) and the UKRI Professional & Financial Services Data Access Demonstrators) that aim to address these challenges. In addition, Sage is collaborating with stakeholders to develop innovative solutions to address these issues via an improved taxonomy, categorisation, and emission intensity factor database or library.

Sage recently completed evidence-based research, *Path for growth: Making sustainability reporting work for SMEs*, on ESG reporting and found that most SMEs find it hard to measure and track their sustainability reporting based on the following reasons:

- The number and type of data requests being asked of an SME are not proportionate.
- The current sustainability terminology is not simple enough for SMEs to understand. It is important to clearly define and simplify the terms, topics, and metrics across the reporting landscape for SMEs.

As a result of the above, Sage believes that large companies should report on Scope 3 under ISSB and to support SMEs in their supply chains with this there needs to be a simplified SME reporting standard within the ISSB framework. Bringing SMEs along this journey is crucial as small business account for half of total business emissions which themselves make up around half of total emissions. By not including SME Scope 3 emissions, by default around one fifth of all emissions would be excluded[2]. It would, therefore, be very difficult for the UK Government to meet its legal commitments under the Climate Change Act if SME Scope 3 emissions are not measured.

While Sage acknowledges that there is a risk that current data availability and quality challenges might result in lower-quality disclosures, we believe this will only be an issue to begin with. Once all businesses start reporting Scope 3, this will lead to improved data quality and availability (based on increased datasets).

Therefore, considering the value of Scope 3 in generating further information and driving emissions reduction, the Government must not delay the start date for companies with >250 employees but in the meantime should simplify reporting for SMEs with a common reporting standard. Ultimately, a lower-quality Scope 3 disclosure will still generate more actions to reduce emissions than no Scope 3 reporting.

More specifically, Scope 1 and 2 emissions typically amount to approximately 15% of a total footprint, and Scope 2 emissions reporting is often incomplete as it tends to be calculated using the market-based calculation methodology. This methodology does not provide a true reflection of the GHG emissions associated with the consumption of electricity. Scope 2 emissions only reflect actual

[2] Sage, The Climate Impact of SMEs: Evidence from the UK and South Africa, November 2022

emissions if a location-based methodology is used. Finally, restricting reporting to Scope 1 and 2 is predicated on the idea that Scope 3 reporting is too difficult. However, as mentioned, reporting without Scope 3 would be of little value and Sage, and other organisations, are already providing carbon accounting solutions that make Scope 3 reporting easy.

Question 6: What is your view on the approach to Scope 3 reporting contained within IFRS S2? Please consider the ISSB's approach to materiality in your answer.

Sage agrees with the approach, with the exception of the delayed introduction of Scope 3 reporting. To support SMEs in supply chains we need to:

- Drive early adoption of voluntary standards by SMEs.
- Accelerate sustainability action by focusing SMEs' reporting efforts and providing practical guidance beyond commitments.
- Support progress towards global sustainability goals by increasing accuracy and comparability in reported sustainability data.

SMEs have limited resources and expertise to report in line with current reporting standards and therefore, SME specific reporting standards are required. Our research also found that current Scope 3 reporting frameworks are too complex and inconsistent, making compliance for SMEs even more difficult. Additionally, we found that SMEs currently find it difficult to collect and analyse data appropriately. As a result, it is our view that large companies should report on Scope 3 under ISSB and to support SMEs in their supply chains with this there needs to be a simplified SME reporting standard within the ISSB framework.

Question 7: What is your view on the use of the GHG Protocol for the purposes of Scope 3 reporting within IFRS S2? Will this lead to comparable and consistent reporting that is useful for investors and users of accounts?

Sage agrees with the use of the GHG Protocol. Sage recognises that the Protocol is, in some areas, outdated and does not reflect the current situation. However, it is the backbone of all existing reporting and calculations and therefore it would be counter-productive to introduce a new protocol for reporting. Furthermore, the GHG Protocol is undergoing several reviews and consultations to update the guidance. If the GHG Protocol is not followed this would lead to an increase in administration costs as businesses will need to re-train and, potentially, restructure their entire internal reporting frameworks.

Therefore, using the GHG Protocol for the purposes of Scope 3 reporting would lead to comparable and consistent reporting that is also useful for investors and users of accounts. For example, Partnership for Carbon Accounting Financials (PCAF) is based on GHG Protocol, as are all existing verification and reporting systems.

Question 8: Would using the ISSB's approach to Scope 3 reporting have knock-on consequences for your organisation that the Government should be aware of? For instance, you may wish to consider the interaction between IFRS S2 and any EU regulations, or other energy/emissions reporting requirements that your organisation may be impacted by.

Sage does not believe the ISSB's approach to Scope 3 reporting will have any knock-on consequences that are worth noting.

Question 9: Is there any additional emissions or energy-consumption related data that is not required within IFRS S2 that you believe is valuable for investors, users of accounts and other stakeholders?

We do not believe so.

Question 10: What further guidance and support might be needed for your organisation, and organisations in your value chain, to report Scope 3 information in accordance with IFRS S2?

Question 23: What could the Government do to reduce the costs or increase the benefits of reporting for smaller businesses in the supply chains of entities that report on Scope 3?

We have grouped our response to questions 10 and 23. As a large organisation, Sage has the resources to report on Scope 3. However, for smaller organisations in our value chain, the Government could support SMEs by delivering a series of key proposals. The sustainability landscape is complex and overwhelming for many SMEs, who are constrained by lack of time, funding, and resources. Sage's recommended standard setters include:

- **Proportionality:** Ensuring the number and type of data requests being made of an SME are proportionate. All requests need to be realistic for a business with limited resources to comply with.
- **Consistency:** Establishing consistent sustainability terminology. It is important to clearly define and simplify key terms, topics and metrics across the reporting landscape.
- **Materiality:** Providing clear rules to easily determine material topics and metrics for SMEs to prioritise the most relevant and essential topics, so that SMEs with limited capacity can focus their data collection, processing, and reporting efforts on what matters most.
- **Convergence:** Continuing the ensure that there is convergence across standards and greater clarity on how the requirements of one standard meets the requirements of selected other standards.
- **Accessibility:** Ensuring standards are user-friendly and easy to understand. Reporting requirements should be accompanied by supporting visuals and examples. Accessible standards paired with industry led digital solutions will be key to efficient reporting.
- **Accuracy:** Prioritising data accuracy in reporting guidance. There is a critical need to guide SMEs on how to report "actual" sustainability data on their performance rather than relying on proxies and sector averages.

How, if at all, do you expect to use the Scope 3 information that could be disclosed by businesses in accordance with IFRS S2?

Sage intends to use the Scope 3 information to:

- Inform procurement of our goods and services.
- Inform the reporting of our downstream Scope 3 activities.
- Allow us to increase the number of Scope 3 categories we report on.

- Improve the data availability of our carbon accounting platform, thereby, improving overall data quality within the supply chain (more datapoints will increase the granularity of footprints and improve the quality in the 'system').

Question 13: If you are a user of annual reports, which of the Scope 3 GHG emissions categories do you most value information on and why?

It is important that reporting of Scope 3 is full and complete so that that the footprint is complete. For example, it should include all Categories in all Scopes, or at least a statement that any category for which there is no emissions data does not apply. Provided a footprint is complete, it is of value, whereas an incomplete footprint is of little value as there is no way to tell the significance of the missing categories.

Question 15: What are your views on the overall costs and benefits of Scope 3 reporting? Please be as specific as possible.

Sage's recent report highlighted that SMEs are concerned about the upfront costs of reporting and directly attribute these costs to the complexity of the current reporting standards. This complexity means that extra outlays are required for upskilling, collecting data, and developing and implementing a reporting system. Costs are also linked with reallocating, or hiring staff, purchasing technology solutions, and engaging with third-party vendors. This indicates that there is a need to simplify reporting standards and tailor them to the needs of SMEs.

The key reporting challenges leading to increased upfront costs include:

- **Complexity of reporting standards**. Reporting standards can be complex and difficult to understand. SMEs are navigating a wide range of inconsistent and technically challenging data requests from multiple stakeholders. They are trying to determine what topics are relevant and applicable to their business. 65% of SMEs state current reporting standards are too complex and that they would be more likely to engage if standards were tailored and simplified.
- **Lack of capability or knowledge.** The vast majority of SMEs lack sustainability specialists within their organisation. This means they may struggle to understand or respond accurately to requests for data.
- **High volume of data requests and lack of capacity.** SMEs are often restricted in their capacity and capability because of their size, meaning they can lack the internal resources necessary to meet data demands. They often lack the tools and resources needed to collect the large quantities of sustainability data required to meet requirements and to develop and implement a reporting system.

Sage has also found that there is a clear need to build more automated tools and infrastructure to support SMEs in their sustainability reporting. SMEs need more affordable and user-friendly tools to help them to collect and report on their data.

Question 16: What benefits could Scope 3 reporting bring to your organisation? Please be as precise as possible when explaining the basis of any benefits you provide.

Scope 3 reporting is essential for Sage to enable us to track our emissions against our Science-based target. Without it we cannot prioritise our carbon reduction activities and reach Net Zero. The same applies to SMEs. Our report also found that Scope 3 reporting can create numerous opportunities for SMEs, such as:

- Improved access to finance and investment
- Improved access to customer supply chains
- Increased eligibility and preference in public sector contracts
- Enhanced innovation and competitiveness
- Reduced operational costs and risks
- Attracting and retaining top talent

Question 17: What costs could Scope 3 reporting bring to your organisation? Where possible, please give a breakdown of each element of cost. Please be as precise as possible when explaining the basis of any costings you provide. If you do currently produce Scope 3 data voluntarily under SECR, please explain the costs you have incurred and how they have changed over time.

Sage has a group-wide integrated sustainability monitoring and reporting function, gathering emissions data from key suppliers, employee transport, waste etc. (covering all GHG Protocol Scope 3 Categories).

Question 18: How are you approaching the issues around data availability in relation to Scope 3 reporting? Are you aware of any useful data sources, reporting tools, or resources (such as emissions factors) to help UK organisations report their Scope 3 emissions, and how are you tackling them?

Where there is an issue with data availability, Sage uses a spend-based approach to calculating and reporting our Scope 3 emissions. If primary data is available, we use the relevant primary GHG conversion factors (e.g., DESNZ GHG conversion factors sheet). Where primary data is not available, we use third-party spend-based emission intensity factors. Similarly, Sage has developed automated carbon accounting solutions to help SMEs address issues around data availability.

In our experience, primary data from our value chain is limited. The main reason for it being limited is because a significant proportion of our value chain does not measure/record the relevant datapoints required for us to calculate our Scope 3 emissions. Sage's recent report highlights that this is also an issue for SMEs. In particular, our report found that there is a critical need for SMEs to report 'actual' sustainability data, rather than relying on proxies and sector averages. Their ability to provide more accurate information to key stakeholders will contribute to increased transparency on sustainability data. As a result, Sage recommends that any new guidance reflects the current state of limited primary data, emphasises the need for using primary data, and encourages organisations to develop collaborations with their value chain to obtain more primary data.

Question 19: What are, or do you anticipate being, the greatest barriers to producing consistent Scope 3 data?

Sage believes that the greatest barriers to producing consistent Scope 3 data are:

- Ensuring data quality (e.g., ensuring that base data is from reconciled and trusted sources such as accounts and smart meters, and that reporting companies must report accurately and honestly);

- Consistent taxonomy of Emission Intensity Factor (EIF) (different calculation methodologies use different emissions intensity factors, resulting in discrepancies in emissions estimation; a single, consistent source of EIFs would help to resolve this);
- Having EIFs at a more granular level that is linked to the taxonomy, i.e., more categories (the range and detail of currently available EIFs is low, so that reporting organisations are forced to choose the nearest approximation, which is often a poor representation of the actual spend or activity).
- Improving/changing accounting systems and their categorisations so they are linked to the EIF taxonomy and categories (accounting systems have been set up only for financial accounting; they are a useful source of information for automated carbon accounting, but this could be improved if they were also adapted for this purpose).
- Currently, due to the limited availability of primary data, most supply chain emissions reporting is done using generic EIFs (i.e., "a laptop" rather than "this specific laptop model from this manufacturer." This makes the process easier, but it only generates a rough estimate of the relative importance of emissions categories (e.g., supply chain vs. commuting), it does not inform businesses about how to reduce emissions. Using generic EIFs, a business can only reduce supply chain emissions (which are almost always the largest single category) by reducing spend. To reduce emissions, businesses need to know the difference in emissions associated with purchasing a specific product or buying a service from a specific merchant. The current lack of a common protocol for reporting company- and product-level EIFs automatically is a fundamental brake on the effectiveness of emissions reporting. As a result, Scope 3 emissions reporting will only be improved if the availability of primary data is significantly improved. Therefore, a key focus of any new guidance should be on measuring, recording and reporting primary data. This will significantly aid Scope 3 emissions reporting, reducing the perceived burden of the task, and improving the usability of the outputs in relation to overall supply chain emissions reduction.

Sage is involved with several work packages that look to address the issues with consistent Scope 3 data. In particular, we are a member of the Partnership for Carbon Transparency (PACT) which has developed a framework for developing high quality product carbon footprints. Product carbon footprints comprise a significant proportion of Scope 3 emissions, and having a consistent and agreed framework for how the data associated with these is handled will significantly improve Scope 3 data quality and make it more consistent in its format.

Question 21: What impact could an increase in Scope 3 reporting by a larger reporting entity have on your organisation?

It will not have an impact on Sage, but it will impact the SMEs we represent. Our recent report showed that an increase in Scope 3 reporting by larger entities may lead to more complexity and confusion for SMEs without a simplified reporting standard.

What are the costs and benefits of Scope 3 reporting on smaller organisations within their supply chain? Please provide any evidence you have of these.

There are several costs and benefits of Scope 3 reporting on smaller organisations, particularly within their supply chain. The key costs include upskilling, collecting data, and developing and implementing a reporting system. Some costs are also linked with reallocating, or hiring staff, purchasing technology solutions, and engaging with third-party vendors. This indicates that there is a need to simplify reporting standards and tailor them to the needs of SMEs.

However, SMEs will experience a series of benefits, and 83% of global SMEs recognise the importance of sustainability to their business. The benefits include but are not limited to:

- Attracting new customers
- Access to green finance
- Attracting sustainability conscious employees
- Improved access to markets (e.g. green certification)
- Improved access to funding and financial incentives if they are seen to be aligned with sustainability and ESG agendas.
- Cost efficiencies (e.g. due to reduced energy consumption)

Question 22: If you supply data to a larger entity, what effect (including financial impacts) has this had on your organisation?

Whilst Sage does not supply data to a larger entity, our customers do. Our analysis of reporting frameworks demonstrates that sustainability requests to SMEs are increasing in frequency and complexity. These requests have led to increased costs to SMEs because most, currently, lack the time, expertise, and budget to measure and track their sustainability performance appropriately. Our analysis and research show that 73% of SMEs are concerned about the upfront costs of reporting and 65% of SMEs describe the current reporting standards as complex. These present the two key “upfront” barriers to sustainability reporting. The key effect this has had is to procure additional resources to understand the data request, measure, and track emissions, as well complete the actual reporting.

Question 25: What benefits does robust Scope 3 reporting provide to stakeholders outside of the investment community?

Robust Scope 3 reporting provides detailed information on where the key GHG emission impacts lie - it provides a ‘hotspot’ analysis of activities that have higher GHG emissions. This information allows stakeholders to focus time and resources, to ensure the most efficient approach to GHG emissions reduction. It drives direct collaboration between stakeholders and facilitates direct and efficient action. Without robust Scope 3 reporting, stakeholders will not know where or how to start addressing GHG emissions reduction. With it, the financial impacts can be reduced as much as possible, and the most significant GHG emissions reduction achieved.

Question 26: Overall, do you think the SECR regulations are achieving their original objectives? If you do not think they are achieving the original objectives, or are partially achieving the objectives, please explain why.

The SECR regulations are achieving their original objectives as they are pushing companies to report. However, Sage believes that the regulations are failing in their objective to reduce emissions because they have made Scope 3 emissions reporting voluntary. Due to the significant impact that Scope 3 emissions have on the overall carbon footprint of a company, this decision does not help, or drive, GHG emissions reduction.

SECR also only requires affected businesses to report. There is no requirement to reduce emissions. In principle, published emissions could be scrutinised and businesses could be put under pressure to reduce their emissions faster, but in practice this does not happen.

Question 27: Have there been any unintended effects of the SECR regulations that you think Government should consider? Please include whether there are any equality impacts to be taken into consideration.

The lack of complete Scope 3 emissions reporting has resulted in companies progressing with their GHG emissions reductions under false pretences (in as much as they have been reducing emissions at all). It has indirectly led companies to believe that measuring, tracking, and reporting on Scope 1 and 2 emissions only, is sufficient to decarbonise their business. It has also resulted in companies believing that by measuring, tracking, and reporting on Scope 1 and 2 emissions that they are making a significant contribution to the reduction of global GHG emissions. This has further developed equality impacts given ignoring Scope 3 emissions means there is not support or collaboration to measure, track, and reduce emissions related to all activities affecting the reporting company's business.

Secondly, the provision of a narrative describing energy efficiency actions in the previous year can lead to a qualitative response, with no direct link to the energy or carbon performance of the organisation. Our belief is that a narrative is required this should be focused on explaining any variance in GHG emissions or the given energy intensity metric.

Question 28: Are the current SECR requirements targeted at the correct population of businesses (including LLPs)? If not, which types of businesses and of which size do you think the requirements should apply to? If you think that different requirements should apply to different populations of businesses, please specify.

SMEs are responsible for around half of all business emissions, so any strategy which omits them from the requirement to report (and reduce) emissions will fail. To succeed, any such strategy must cover all businesses. If this puts a burden on small businesses, then the Government should seek to find a way to alleviate this burden including through supporting automation and common data standards as set out above. Allowing SMEs not to report should not be an option as it is not consistent with legal obligations under the Climate Change Act.

Question 29: SECR reporting is currently required within a company's annual report. Would it be more appropriate to report on SECR in another document or format?

This information should be reported to a common database (or at least be made available to a common trust framework) in a consistent, machine-readable format. The current practice of reporting to Companies House, which includes printing out a PDF and scanning it back is inefficient and ineffective.

Question 30: How can the government streamline current energy and emissions reporting requirements for organisations in scope of SECR while still meeting the SECR objectives?

Government can support the automation of emissions calculation, but cannot, and should not streamline the requirements. Emissions reporting is only effective if it is comprehensive. While this may appear more burdensome, in reality it is not, as the effort required to calculate a partial carbon footprint is entirely wasted.

Question 31: Under the existing SECR framework, there are different reporting requirements for quoted companies and unquoted companies/LLPs. Are these differing requirements appropriate? If not, what reforms would you suggest?

The differences are not appropriate. All businesses should be required to report all emissions.

Question 32: What resources do you currently use to comply with SECR (e.g., ERG guidance, conversion factors, the GHG Protocol, etc) and do you feel these are sufficient? If these aren't sufficient, what do you think is missing?

Sage currently uses ERG guidance, DESNZ GHG conversion factors and follows the GHG protocol to confirm the methodology to use. These are currently sufficient for reporting on Scope 1 and 2. However, ERG guidance is flawed in that it does not ensure reporting organisations use the location-based methodology for Scope 2 reporting. At present it allows companies to use the market-based methodology which does not provide a true or accurate reflection of actual emissions from Scope 2 sources.

Question 33: What benefits has compliance with the current SECR regulations had for your organisation?

Complying with current SECR regulations has allowed Sage to start our journey to measure, track, report and reduce our Scope 1 and 2 emissions. The process has allowed Sage to see the benefits these actions bring, which has led to us committing to expanding our measuring, tracking, and reporting to Scope 3 emissions. This has resulted in Sage being able to reduce emissions from all Scopes.