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Meeting	Audit Committee
Date	21 September 2010
Subject	**Carbon Reduction Commitment**
Report of	Assistant Director of Finance
Summary	This report sets out to clarify a number issues raised at the last meeting of the Audit Committee in respect of the Council's approach to Carbon Reduction Commitment (CRC) and the risks associated with this new statutory framework.

Officer Contributors	Nigel Bell, Senior Asset Manager – Asset Management Commercial Directorate
Status (public or exempt)	Public
Wards affected	Not Applicable
Enclosures	None
For decision by	Audit Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not Applicable

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1. RECOMMENDATIONS

1.1 That the contents of the report be noted.

2. RELEVANT PREVIOUS DECISIONS

2.1 None.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 The presence of strong risk management policies and procedures is paramount to the Council achieving all of its corporate priorities and as such impacts on all the corporate objectives.

3.2 There is one risk from the Directorate's Risk Register currently included in the Corporate Risk Register. The risk is:

- Environmental Management - organisation making effective use of natural resources (KLOE 3.1).

4. RISK MANAGEMENT ISSUES

4.1 The risks associated with the Council's approach to Carbon Reduction Commitment (CRC) were first raised in the Sustainability First Stat in June this year. At this point, a potential cost of £8.5m was identified as a possible impact. This is the worst case scenario and this was used to highlight that carbon reduction needs to be taken seriously by organisations as the potential cost of ignoring the CRC, or reporting it incorrectly, could, if audited in year 5, result in substantial backdated fines.

4.2 Under the CRC there are penalties associated with late and inaccurate data reporting but we are not envisaging that we will incur such fines and work is currently in progress to collect the necessary data in time.

4.3 Provision for the cost of allowances has been built into the Council's medium term financial plan in the sum of £300K. The actual allowances required may be in excess of or less than this sum.

4.4 No provision has been made for non compliance with reporting requirements but these requirements are being proactively managed.

4.5 CRC has been highlighted as a key Council operational risk.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 This proposal will not give rise to any issues under the Council's Equalities and Diversity policies.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 The potential financial implications are set out under Section 4 above.

7. LEGAL ISSUES

7.1 None other than what is contained in the main body of the report.

8. CONSTITUTIONAL POWERS

8.1 Constitution part 3 Responsibility for functions, section 2 responsibility for Council functions, details the terms of reference for the Audit Committee to provide independent assurance of the adequacy of the risk management framework.

9. BACKGROUND INFORMATION

9.1 At the last meeting of this Committee, a report was presented on the Environment and Operations risk register. One item on the register related to a potential financial risk, in respect of the Councils readiness and progress of the statutory carbon reduction commitment. A number of questions were raised regarding the potential impact of this risk, and whether any provision should be included within the accounts of the authority in relation to this risk. The purpose of this report is to provide further clarification on those issues raised.

9.2 What is the Carbon Reduction Commitment?

- The CRC Energy Efficiency Scheme (CRC) is a regulatory incentive to improve energy efficiency in large public and private sector organisations. The scheme started in April 2010 and is currently administered by the Environment Agency. The CRC arises as part of the UK's strategy for improving energy efficiency and reducing carbon dioxide emissions as required by the Climate Change Act 2008.
- It is a mandatory scheme that aims to improve energy efficiency and reduce the amount of carbon dioxide (CO_2) emitted in the UK.
- CRC will affect large organisations in both the public and private sector. Organisations that meet the qualification criteria, which are based on how much electricity they were supplied in 2008, will be obliged to participate in CRC. Participating organisations will have to monitor their emissions and purchase allowances, initially sold by the Government, for each tonne of CO_2 they emit. The more CO_2 an organisation emits, the more allowances it has to purchase. So there is a direct incentive for these organisations to reduce their emissions.
- By increasing energy efficiency, the scheme will help organisations save money by reducing their energy bills. These savings should be well in excess of the costs of participating in the scheme.
- In addition, the better an organisation performs in terms of reducing its emissions, the higher it will appear in the annually published league tables showing the comparative performance of all participants. This in turn provides a further benefit: all the revenue raised from selling allowances is 'recycled' back to participants, and their league table position affects how much of the revenue each organisation receives.
- Organisations face penalties associated with inaccurate or delayed reporting of performance.

9.3 Reporting

For administrative purposes, the scheme is divided into set phased time periods with each phase comprising a number of principle components:

Qualification period - Organisations assess whether or not they qualify to make an information disclosure or participate fully in CRC based on qualifying electricity consumption from January 2008 to December 2009.

Registration period - Organisations which are required to take action under the scheme must either submit their information disclosure or register as a participant with the administrator between April and September 2010.

Footprint Year - Organisations are required to monitor their total emissions in energy use and determine what emissions must be included in the CRC and also provide a footprint report to the administrator - April 2010 – March 2011.

Compliance Years - These run from April to March, during which time all participating organisations must purchase allowances for each tonne of CO2 they emit based on expected energy use and monitor their usage. First compliance year is April 2010 – March 2011.

Reporting - Organisations must report their actual emissions by the end of July after each compliance year and surrender allowances to cover to their reported emissions.

Revenue Recycling - In the October following reporting, participants will receive a Revenue Recycling Payment based on their performance in that year.

At present, we are completing the compilation of the necessary data for scheme registration and are working with Legal Services to define the Council's structure under the CRC. This will enable the Council to provide a realistic estimate of allowance requirement.

At the same time, energy supplier information is being gathered for the corporate estate and schools to enable us to request the appropriate supplier statements of consumptions towards the end of the current financial year. This will enable us to purchase the necessary allowances and submit our annual report next year.

9.4 Penalties & Allowances

The reference to the £8.5M potential cost of the CRC was originally presented at the Sustainability First Stat in June this year where it was used to highlight that carbon reduction needs to be taken seriously by organisations, and potential cost of ignoring the CRC, or reporting it incorrectly, could if audited in year 5, result in substantial backdated fines.

9.4.1 Under the CRC, there are penalties associated with late and inaccurate data reporting, but we are not envisaging that we will incur such fines and work is currently in progress to collect the necessary data in time.

9.4.2 Under the CRC, there is not an emissions target set, but participants including both public and private sector organisations are league tabled. A penalty or recycling payment is made depending on a league table position, which is based on the extent to which participants have reduced emissions. It is acknowledged that over time each league table position are likely to change dramatically as organisations with poor performing assets catch up and potentially have more scope to improve.

9.4.3 In relation to the £300K (potentially in the range £300-£500K), this refers to the annual cost of purchasing allowances for the Council's emissions and is not a fine. A bonus or penalty of up to ±10 per cent is administered at the end of the first year with the maximum bonus or penalty increasing by 10 per cent each year for the first five years. Although significantly it should be recognised that in order to purchase £300K of allowances the organisation will have spent in the region of £4M on energy use.

9.4.4 The bulk of the potential fines result from producing inaccurate/incomplete data or providing data/reports beyond the required deadline. There are some fines (Incorrect reporting; failure to keep adequate records & Failure to comply with the performance commitment - surrendering sufficient allowances) which are based upon the figure of £40 for each tCO_2; these are the fines which can swiftly add-up.

9.5 Risks

League table ranking: Participants who fail to perform under the CRC will be "named and shamed" by the publicity of the league table, and will in effect bear extra costs (because they will not benefit from recycled payments).

League table metrics: Participants seeking to expand their UK operations (or number of portfolio properties) may be penalised by the league table ranking system which (following the introductory phase) largely considers a participant's absolute growth in emissions which would naturally increase with an expansion in business operations/growth.

Cost: The CRC is likely to significantly increase the cost of using energy in the UK as participants will need to purchase allowances in proportion their energy consumption. In addition, participants will be required to meet the administrative costs of scheme participation (e.g. relating to forecasting, monitoring and complying with reporting obligations).

Civil liability: In the event of non-compliance with the requirements of the CRC scheme, the CRC Administrator may impose civil penalties and may publicise the non-compliance. For example, in the event of failure to register under the scheme deadlines or for failure to submit an annual report, a fixed penalty of £5,000 (and daily fines thereafter) may be levied. In the event of failure to carry out the performance commitment, a fine of £40/tonne of CO2 may be levied in respect of each allowance that should have been obtained.

Criminal liability: CRC participants may incur criminal liability where, for example, they have failed to comply with an enforcement notice or attempted to deceive or mislead the CRC Administrator. Criminal penalties can include fines of up to £50,000 (on conviction in the Magistrates' Court), or an unlimited fine (on conviction in the

Crown Court). Group companies participating in the CRC as a single entity will be jointly and severally liable.

Directors' and officers' liability: Individual directors and officers may be subject to personal liability where an offence is proved to have been committed with their consent, connivance or neglect. In extreme circumstances, they could be subject to imprisonment for a term not exceeding three months on conviction in the Magistrates' Court, or for a term

9.6 Recycling of Allowances

The recycling of allowance fees via the league table mechanism is also a risk that the council faces. The risk is that the council's performance will not be rated sufficiently high enough to receive back the equivalent payment it made in purchasing the allowances for the year.

The exact amount to be recycled to participants depends upon the number of allowances bought as a whole and the position of the council in the scheme's league table. Bonuses are awarded for good performance and penalties are imposed for lower performance. Unfortunately, this is impossible to predict accurately as it is based upon; our performance; our emissions as a percentage of all scheme emissions and the total allowances sale revenue. The maximum cost cannot be calculated by multiplying the bonus/penalty rate by our own allowance payment.

9.7 Mitigation

From April, additional staff resources have been made available for Energy Monitoring & Targeting purposes and the Council's Team Energy Accounting Software is in the process of being upgraded to improve monitoring for both the CRC and UOR. In addition, the Councils temporary Energy Efficiency Programme Manger is providing additional support for CRC activities.

The Council is currently participating in the London Energy Project CRC Health Check initiative which will provide a peer review and risk assessment on the Council's approach to CRC. In addition Strategic Finance has attended a number of CIPFA Carbon Finance Network Workshops and Asset Management, the London Energy Project CRC Workshops.

The majority of the Council's CRC emissions will be from the schools estate and we have written to all the Schools Head Teachers and undertaken presentations to the Head Teachers Forum to raise awareness of the issues and their responsibility.

A CRC Steering Group will shortly be set up to bring together existing administrators and stakeholders to formulate the ongoing approach to

- Compliance & Liability
- Allowance purchase strategy
- Footprint & Reporting
- Carbon Reduction & Investment Strategy
- Resources (Staff & Capital)

9.8 Financial Provisions

Questions have been raised as to whether the accounts of the authority should reflect the potential impact of CRC either as a specific provision or as a contingent liability.

Within the medium term financial plans, a provision has been made in the sum of £300k for 2011/12. At this stage, it is impossible to determine accurately what the actual financial implications of the scheme will be. Much will depend on ensuring that appropriate reporting mechanisms are in place and this will also be influenced by the Councils approach to risk associated with its 'trading strategy' for allowances. This latter point will be the subject of a more detailed paper later in this year.

The Council could of course receive a bonus depending on the relative performance of the Council in reducing emissions. The financial plans of the authority therefore take account of the potential short term operational affect of the CRC regime.

However, as mentioned above, there is a potential risk in relation to non compliance with statutory reporting requirements of the scheme. This has been rightly recognised as a risk for the Council within risk registers and is being managed as a high priority.

At the last meeting of the Committee, questions were raised on whether a specific provision or contingent liability should be recognised within the Accounts of the Council at this stage. The potential implications of the reporting requirements of the scheme have been clearly recognised by the Council as a high risk and are being managed accordingly.

Given the mitigating actions that the Council is enacting, it is not felt appropriate to raise a contingent liability as it is anticipated these risks will be proactively managed to ensure they do not materialise into actual penalties. Not making any specific provision at this stage does not undermine or reduce the Council's commitment to ensure that it tackle this issue

10. LIST OF BACKGROUND PAPERS

10.1 Environment and Operations Risk Register.

10.2 Medium Term Financial Plan.

Legal: MAM
Finance: CM