

ACCOUNTING FOR ENVIRONMENTAL BENEFITS

IN THE ENVIRONMENTAL PROFIT & LOSS

KERING


PREFACE

To date, the Environmental Profit & Loss (EP&L) has primarily been used as a means to evaluate the negative impacts of a business on the environment. In addition to the 'Losses' of an EP&L, there is also the potential for 'Profits' where a business works with its supply chain to deliver benefits to society.

The objective of this paper is to set out an accounting framework to integrate such positive contributions into the EP&L. We do not consider how we measure and value, but rather how we integrate and account for 'Profits' alongside 'Losses' in an EP&L context.

In doing so, there are a number of challenges that need to be overcome, including defining:

- What the appropriate baseline should be; if this is to be defined on a project basis, how do we link these net benefits with the broader EP&L analysis (which is gross)?
- How to attribute impacts to Kering, particularly where our actions deliver benefits beyond our direct value chain
- Defining rules for additionality and leakage
- Setting out best practice for trading off between impacts and locations. Is 'no net loss' meaningful across a multi-national value chain? How do we define rules for 'offsetting' Losses with Profits?

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- Neil Brown, Investment Manager, AllianceTrust Investments
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In November 2011, Kering brand PUMA published the first Environmental Profit & Loss (or EP&L for short), which calculated the environmental impacts of the brand's own operations and those of its supply chain. Since then Kering has further developed the EP&L methodology and extended the scope across all of the Group's brands, becoming the first international group to complete such an exercise and disclose the results in 2015.

Following Kering's development of the EP&L, the tool has generated significant interest from governmental bodies, sustainability experts, the integrated reporting community and academics, with many other companies now also conducting their own EP&L analysis.

WHAT IS AN EP&L?

An EP&L is a means of placing a monetary value on the environmental impacts along the entire value chain of a given business.

More than 70 indicators of emissions and resource use, grouped into 6 environmental impact areas, are measured or

estimated along the supply chain. The likely environmental changes that result from these emissions or resource use are estimated based on the local context and the consequences of these changes on people's wellbeing, and are valued in monetary terms. Figure 1 illustrates some examples of this.

	TIER 0: OPERATIONS AND STORES	TIER 1: FINAL ASSEMBLY	TIER 2: PREPARATION OF SUBCOMPONENTS	TIER 3: RAW MATERIAL PROCESSING	TIER 4: RAW MATERIAL PRODUCTION
GHGS 	ENVIRONMENTAL REPORTING	UPSTREAM IN THE SUPPLY CHAIN			
WATER CONSUMPTION 					
WASTE 					
WATER POLLUTION 	ADDITIONAL ENVIRONMENTAL IMPACTS				
AIR EMISSIONS 					
LAND USE 					

FIGURE 1: THE EP&L VALUES THE CONSEQUENCES OF EMISSIONS AND RESOURCE USE IN A GIVEN CONTEXT

	EMISSIONS AND RESOURCE USE	ENVIRONMENTAL CHANGE	CHANGE IN WELLBEING
 AIR POLLUTION	Emissions of pollutants (PM _{2.5} , PM ₁₀ , NOx, SOx, VOCs, NH ₃) in kg	Increase in concentration of pollution	Respiratory disease, agricultural Losses, reduced visibility
 GREENHOUSE GAS EMISSIONS	Emissions of greenhouse gases (CO ₂ , N ₂ O, CH ₄ , CFC's etc) in kg	Climate change	Heath impacts, economic Losses, change in natural environment
 LAND USE	Area of tropical forest, temperate forest, inland wetland etc in hectares	Reduced ecosystem services	Heath impacts, economic Losses, reduced recreational and cultural benefits
 WASTE	Hazardous waste and non-hazardous waste in kg	Climate change, disamenity and contamination	Reduced enjoyment of local environment, decontamination costs
 WATER CONSUMPTION	Water consumption in m ³	Increasing water scarcity	Malnutrition and disease
 WATER POLLUTION	Release of specific heavy metals, nutrients, toxic compounds in kg	Reduced water quality	Health impacts, eutrophication, economic Losses

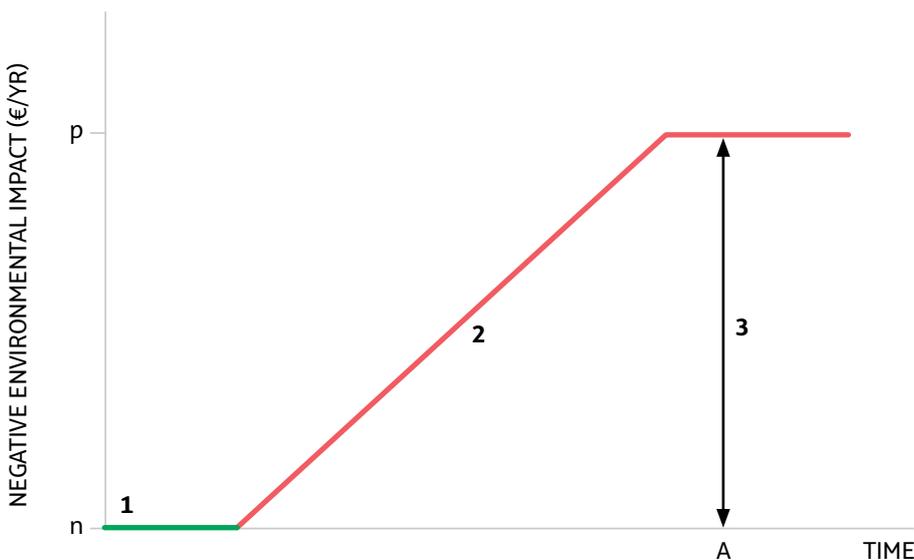
A standard company EP&L presents the gross environmental impacts of the business, such that the implied baseline for the overall results is the level of environmental quality (emissions, resource availability, and delivery of ecosystem services) in the absence of the company's activities. Put another way, the EP&L measures the environmental impacts of the business relative to a scenario where the business did not exist and no other business took its place.

For example, the EP&L measures a company's gross anthropogenic greenhouse gas emissions (rather than evaluating them relative to the industry average for example), or the full loss of or change in ecosystem services following conversion of a natural forest to pasture land, rather than evaluating the change relative to likely alternative land uses.

In Figure 2, the overall EP&L is given by the difference between current environmental quality (or level of impact) and a baseline. For simplicity in this diagram we assume that a move away from 'the natural state' results in a negative impact, however in reality it is more complex than that. The natural state is a constantly changing system and the scale of services change as part of this. The scale of the values are also dependent on the extent to which humans interact with

the environment, which is also an evolving relationship. The measurement of impact focuses on the effects of specific activities on the environment, it is not designed to make judgements over theoretical changes from one ecosystem to another. For example, while deserts typically provide lower value ecosystem services, natural deserts are an essential part of the environment.

FIGURE 2: BASELINE IN THE OVERALL EP&L



1. Impacts in the absence of the human intervention is 0, given by 'n'.
2. Human intervention results in a reduction of environmental quality and increased negative impacts ('p').
3. The overall EP&L impacts at time A are given by the red arrow, 'p' minus 'n'.

Building on the PUMA 'proof of concept', Kering with the support of PwC have further developed and refined this approach. This is driven by a need to use the EP&L not only for reporting impacts but also as a tool to manage impacts and their associated risks.

As more sustainable raw materials and production processes are identified it is important these improvements can be reflected in the EP&L. Kering would also like to be able to communicate its ongoing progress in managing these impacts and risks to external stakeholders, including the financial community, consumers, governments and NGOs. This document sets out how to account for these benefits in the EP&L.

This paper focuses primarily on issues which relate to Kering Group's business and experiences, but we intend for the principles to be transferable to other businesses, just like the EP&L.

THE EP&L ANALOGY

A financial Profit and Loss account (P&L) summarises the revenues, costs and expenses of a business over a set period. A P&L will show a profit when revenues exceed costs, and a loss when the converse is true.

An EP&L summarises the environmental impacts¹ of a business and those of its supply chain, resulting from activities conducted over a given period of time. The scale of environmental impacts is measured against a baseline without the presence of the business and no competing business takes its place. It is therefore a 'gross' analysis capturing the total environmental impacts of the business.

This is conceptually different from a 'no net loss' or 'net positive' approach, where impacts are considered relative to an alternative plausible reality.

For simplicity, in the original PUMA EP&L publication, Losses were described as "activities that adversely impact the environment", and Profits were described as "activities which benefit the environment".

Negative impacts on the environment are analogous with costs in a P&L, and benefits to the environment with P&L revenues (Box 1).

BOX 1: CLARIFICATIONS ON THE USE OF PROFIT & LOSS TERMINOLOGY

Costs = environmental degradation and negative environmental impacts on society. E.g. conversion of natural ecosystems, or emissions of air pollutants

Revenues = environmental improvement and positive environmental impacts. E.g. restoration of natural ecosystems, or a reduction in air pollutants

Losses = where costs exceed revenues

Profits = where revenues exceed costs

BUSINESSES RARELY GENERATE NET ENVIRONMENTAL BENEFITS

Businesses tend to consume natural resources, converting them into products and services, and creating emissions to air, discharges to water and other waste in the process. These unwanted side-effects of production, as well as any unsustainable use of natural resources, result in negative environmental impacts, or Losses in the EP&L.

In order for a business to provide positive environmental impacts in EP&L terms it must create benefits which would not have occurred without the presence of the business. Many activities will result in a reduction in negative impacts, and some may yield positive EP&L impacts.

For example:

- On-site generation of renewable energy: Where a company replaces its demand for coal-dominated grid electricity with on-site renewables, this represents a reduction in demand and therefore in negative impacts from coal power stations. The company cannot claim 'credits' for the reduced impacts because without the company's existence the demand for that electricity would not exist either. However, where the company is generating more than it uses and sells renewable energy back to the grid, thereby reducing the impacts of other electricity users, this represents a positive impact outside of the supply chain because without the company's existence the grid electricity impacts would be higher.

1 – The EP&L does not consider the value of Natural Capital stocks, but rather the changes in the flow of environmental benefits and dis-benefits associated with a company's activities. The Financial P&L is also concerned with flows, while the Balance Sheet considers the company's capital stocks.

- Restoration of degraded ecosystems which are otherwise unproductive: If a company takes on a degraded ecosystem which is unproductive and restores some of its former ecosystem services, this would represent a positive impact because in the absence of the company the land would have remained degraded and unproductive, and would not have been restored. However, if the land was marginally productive and the restoration displaced an activity on this land, the new land use impacts of the displaced activity need to be netted-off from any positive impacts on the restored areas.

These calculations are not intended to support actual or theoretical transformations of low value ecosystems to higher value ecosystems, but rather are intended to focus on the restoration of land to its original 'natural' state from a degraded state due to an organizations activities.

MEASURING AND DEMONSTRATING A BUSINESS'S POSITIVE IMPACTS

The EP&L does not propose that it would be desirable to reduce all environmental impacts to zero and restore all systems to a more natural state. Our civilisation depends on some level of environmental degradation to create space to live and to support the needs of humanity; the EP&L does not attempt to measure or judge at what point increasing environmental degradation has a net negative effect on our society. This would involve judgement around entitlement to degrade the environment and who is using up assimilative capacity as opposed to reducing the ability to do so.

While the overall EP&L results for a business will rarely show an overall Profit, it is nevertheless important for a company to be able to measure and recognise the success of its efforts to reduce its environmental impacts or actively improve the natural environment. This is the focus of this paper.

THE EXISTING EP&L ACCOUNTING FRAMEWORK

The EP&L has increased Kering's understanding of its environmental impacts and it continues to help and inform better decision making, improving the way Kering does business. Specifically, the EP&L enables Kering to:

- Understand where impacts are
- Develop a knowledgeable decision making process
- Steer business strategy in a responsible way
- Strengthen the business and manage risks now and in the future
- Be transparent with stakeholders

Before considering the relevant accounting principles for environmental benefits in the EP&L, this section briefly presents the existing accounting principles the EP&L has used to date (Table 1).

TABLE 1: EXISTING ACCOUNTING PRINCIPLES FOR THE EP&L

EP&L ACCOUNTING PRINCIPLE	RATIONALE
SCOPE	
1. The business and value chain scope shall include the activities with the most material impacts (covering >90% by impact value)	To ensure completeness
2. The impact scope shall include the most material indicators under air pollution, land use, GHGs, waste, water consumption, water pollution (covering at least 90% by impact value)	To ensure completeness
3. Results shall be calculated based on a clearly defined reporting period (e.g. calendar year or financial year) and shall include all impacts associated with activities within, or resulting from, production during that reporting period	To ensure consistency and comparability across reporting periods
4. Future impacts resulting from activities within the current reporting period shall be estimated and discounted back to the current reporting period	To ensure consistent treatment of impacts that occur in the future (e.g. climate change, land use change, use and end of life activities)

EP&L ACCOUNTING PRINCIPLE	RATIONALE
ALLOCATION AND ATTRIBUTION	
5. Impacts shall be attributed to the company based on economic contribution to production	Where the company is not the sole driver of activities which result in impacts, the impacts need to be split and attributed to each actor. For example, the production of cows provides meat as well as leather and other co-products. The impacts of cow production are split between co-products based on the value of each co-product at the abattoir.
BASELINE / COUNTERFACTUAL	
6. Overall EP&L results shall be calculated as a gross impact, representing the total environmental impacts directly and indirectly associated with a company's activities ²	The objective of the EP&L is to present the impact of the activities of the business so that it can better understand the impacts created by production of its goods/services. As such the implicit baseline is that no activity would otherwise have taken place.
RESULTS PRESENTATION (INTERNAL AND EXTERNAL)	
7. Impacts should be reported in biophysical units and monetary units separately	Biophysical units present the quantity of emission and resource use, monetary units estimate their impact or consequence for society. This ensures that the local context is taken into account and the value to society is reflected.
8. Results should be linked to a relative confidence rating	Best available data are used wherever possible, however, different data sources and calculation methods can result in varying levels of confidence in the final results.
9. Minimum requirements for external reporting results: Results should differentiate between: <ul style="list-style-type: none"> - Six impact areas - Four tiers of the supply chain plus operations - Location of impacts 	External disclosure should follow a common framework. Additional detail can be provided at the discretion of the companies involved.

2 – We do not consider the non-environmental benefits of production (such as gross value added or human capital)

The discussion that follows considers the additional principles that are required for considering how to account for environmental benefits in the EP&L. Table 2 summarises these principles.

TABLE 2: EXISTING ACCOUNTING PRINCIPLES FOR THE EP&L

EP&L ACCOUNTING PRINCIPLE	RATIONALE
SCOPE	
10. Companies who want to show the improved impact from actions taken in the period, be it a prior project or a specific baseline project, must be set and agreed with the relevant stakeholders.	Improvements will often show as a reduction in a loss in the overall EP&L results. Specific baselines allow improvements to be illustrated.
11. Project-specific baselines shall be calculated if the company wishes to demonstrate additionality, in such cases the additional and non-additional portion of the change should be illustrated	Some improvements are as a result of actions which would have happened anyway. If a company wants to demonstrate additional improvements this needs to be supported by project specific baselines.
12. Where an activity leads to improvements in impact across the value chain of a third party, those impacts shall be attributed based on the company's level of activity or funding for the activity	Enabled impacts outside of the value chain need to be allocated between the responsible parties.
13. Improvements outside of the value chain shall be presented alongside the EP&L results, but shall not be netted off from them	The company's EP&L should only contain impacts relating to its value chain. Where other impacts are enabled outside its value chain these can be identified separately.

ACCOUNTING FOR ENVIRONMENTAL BENEFITS IN THE EP&L

The current EP&L accounting and reporting framework only includes what is termed here the overall EP&L results. Even though the overall EP&L results for most companies will almost always show a Loss, it is still important to illustrate and recognise positive changes over time, and to be able to explain any negative changes.

This section builds on the existing framework to present Kering's position on how changes in the EP&L shall be accounted for and how to present them alongside the overall EP&L results. Several key issues are discussed, and at the end of each sub-section new accounting principles to be included in the existing framework are proposed.

ACCOUNTING FOR POSITIVE AND NEGATIVE CHANGE

Year on year changes in how a company operates are motivated by a whole range of factors. In some cases targeted efforts may be made to improve environmental impacts, in other cases impacts may reduce or increase as an unintended consequence of decisions. There will also be external factors out of the immediate control of the company which will affect the results over time, such as climate change. The overall EP&L results will implicitly reflect external factors and the outcome of the company's decisions made during the current reporting period irrespective of the motivation.

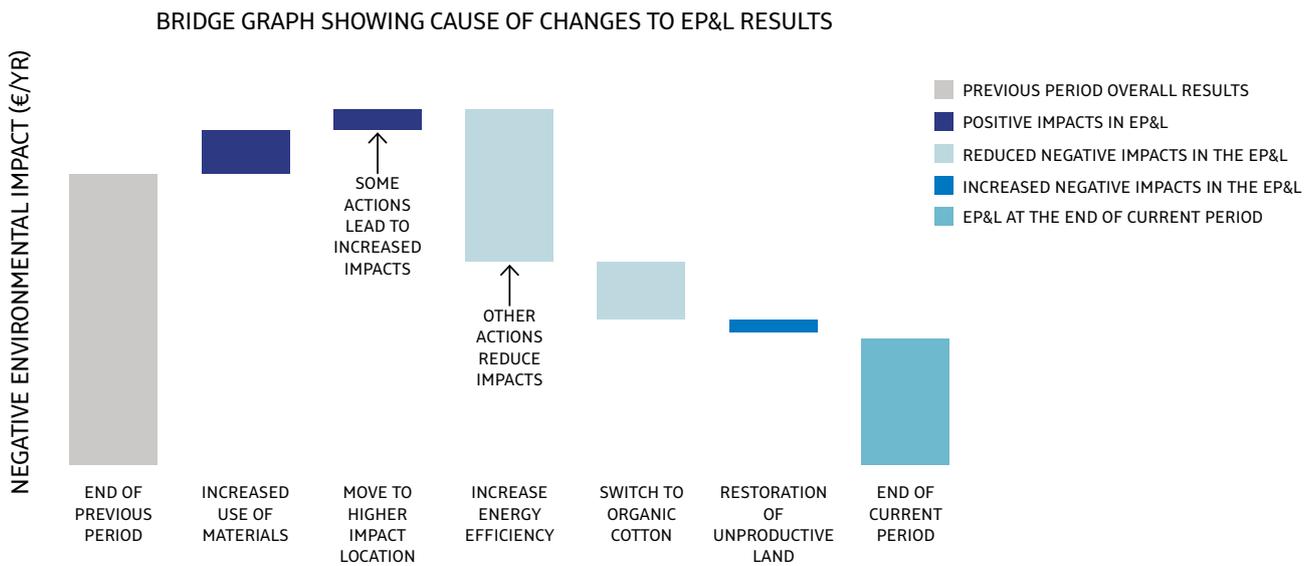
For a company, it is important to be able to explain and illustrate the changes in EP&L results over time. Furthermore, it may want to make explicit the positive actions taken. In order to do this, we propose that the impacts of actions taken are presented separately on the face of the EP&L. Figure 3 presents an example using a bridge graph to illustrate this for the valued results³. The steps on the bridge graph are purely illustrative. The following section presents a categorisation of drivers of change which can be used to explain changes. We propose to allow the company to decide on the level of detail at which to illustrate the changes.

For companies doing an EP&L for the first time but who nevertheless want to make explicit the impacts of their positive actions, they can either calculate their results for the previous reporting period as a reference, or calculate a project-specific baseline (see section below) just for the areas they want to highlight.

The overall EP&L should still confirm to Principle 6, that the implicit baseline is that no activity would otherwise have taken place. The project specific baseline is only used here to demonstrate the scale of environmental benefits, presented separately as revenue items in the EP&L.

New accounting principle: Companies who want to show the improved impact from actions taken in the period, a specific baseline must be set and agreed with the relevant stakeholders. This could be results from a prior period, or a project specific baseline.

³ – Companies should report physical and valued results, alongside a note on confidence, as per accounting principles No 7 and 8. Physical results cannot easily be summarised and require a more detailed tabular presentation for each indicator.



3. NOTES TO ACCOUNTS

[Include details of specific changes, breaking down categories presented in (2) into more detail and describing actions taken. Also include details of project-specific baselines and additionality (see below)].

ACCOUNTING FOR TYPES OF CHANGE

The level of detail at which the company can present the changes to their EP&L will depend on many factors, not least available information. We propose to leave it at the discretion of the company to decide the appropriate level of detail based on their objectives. Here we suggest some categories which could be used and some specific examples.

Design decisions

- Change in types of raw materials used

Sourcing decisions

- Changing sourcing locations of raw materials to/from more/less impactful areas
- Changing suppliers to/from more/less impactful areas
- Encouraging supplier improvements through procurement standards

Production processes

- Restoration of ecosystems through sustainable production processes
- Change in process efficiency of production
- Change in production locations

Structural changes

- Vertical and horizontal integration
- Supporting suppliers through investment in clean technology

Volume

- Change in quantity of production or sales
- Regulation change
- Change in compliance requirements
- EP&L methodology
- Improved quantification of emissions or resource use
- Improved valuation methodology

External factors

- Inflation and socio-economic changes
- Environmental changes (e.g. climate change)
- Other exogenous third party actions

ACCOUNTING WITH PROJECT-SPECIFIC BASELINES

The example in Figure 3 presents the previous year's results as the point of comparison for improvements in the EP&L. However, if without the company's intervention the impacts would have continued to deteriorate (or improve) through the current reporting period, the results will not be the most accurate reference point. In such cases, project-specific baselines can be calculated to better reflect the scale of additional benefits resulting from the company's actions.

Project-specific baselines are only feasible for a well-defined intervention where the impact of the actions can be reasonably attributed to the company and what would have happened in the absence of the company's intervention can be assessed.

We do not suggest additional and non-additional impacts have to be distinguished within project-specific baselines, however, some companies may find it useful when engaging external stakeholders. Appendix 1 presents the principles for assessing additionality. However, we suggest that companies do not set their own baselines, but involve the relevant stakeholders to ensure an objective and informed view is provided.

New accounting principle: Project-specific baselines shall be calculated if the company wishes to demonstrate additionality. In such cases the additional and non-additional portion of the change should be illustrated.

ACCOUNTING FOR THE ALLOCATION OF IMPACTS

There are two types of allocation which could be required:

1. Several companies contributing to make an activity happen, resulting in a positive or negative impact. E.g. co-funding of ecosystem restoration project.
2. A single company contributing to an activity which causes changes in impacts across several companies' value chains. E.g. investment in solar energy at a supplier who is also the supplier to other companies.

The first, where there are many companies contributing to an action, is similar to the leather and beef allocation question for cattle grazing and is covered by the existing accounting principles; the impacts are allocated based on the economic value or contribution towards making the activity happen.

The second requires the impacts to be split between impacts in the company's value chain and those in third party value chains. This should be done based on the amount of the activity which the supplier employs for the company relative

to third parties. For example, if the improvement relates to electricity, then relative use of electricity can be used. If the activity is less easily measured then the impacts can be split based on the supplier's revenue from the company relative to third parties.

The next section identifies how these impacts should be accounted for and presented.

We do not suggest additional and non-additional impacts have to be distinguished within project-specific baselines, however, some companies may find it useful when engaging external stakeholders. Appendix 1 presents the principles for assessing additionality. However, we do suggest that companies do not set their own baselines, but involve the relevant stakeholders to ensure an objective and informed view is provided.

New accounting principle: Where an activity leads to improvements in impact across the value chain of a third party, those impacts shall be attributed based on the company's level of activity or funding for the activity.

ACCOUNTING FOR BENEFITS OUTSIDE OF THE VALUE CHAIN

Some companies invest in projects which deliver environmental benefits outside of the company's production or value chain.⁴ This would include, for example, the purchase of forest carbon credits or biodiversity 'offsets'. It could also include investments in improving the efficiency of a supplier's operations, which as a result, reduce the impacts of other companies who use the same supplier.

We propose that 'offsets' and impacts outside of the value chain are valued as per the standard EP&L valuation methodologies, but that the value of these benefits are reported separately to the main EP&L results.

Improvements outside of the value chain could, in theory, be 'netted off' from EP&L impacts. However, we propose to keep impacts outside of the value chain separate from value chain EP&L results, because they do not relate to the core operations of a company (which is what the EP&L is designed to illustrate). Furthermore, offsets, which could form a significant proportion of impacts outside of the value chain, are many and varied, both in terms of their objectives, mode of calculation and level of validation, monitoring and assurance. If offsets were to be included directly in EP&L results this could incentivise companies to seek out cheap (financially), low quality⁵ 'offsets' rather than to focus on

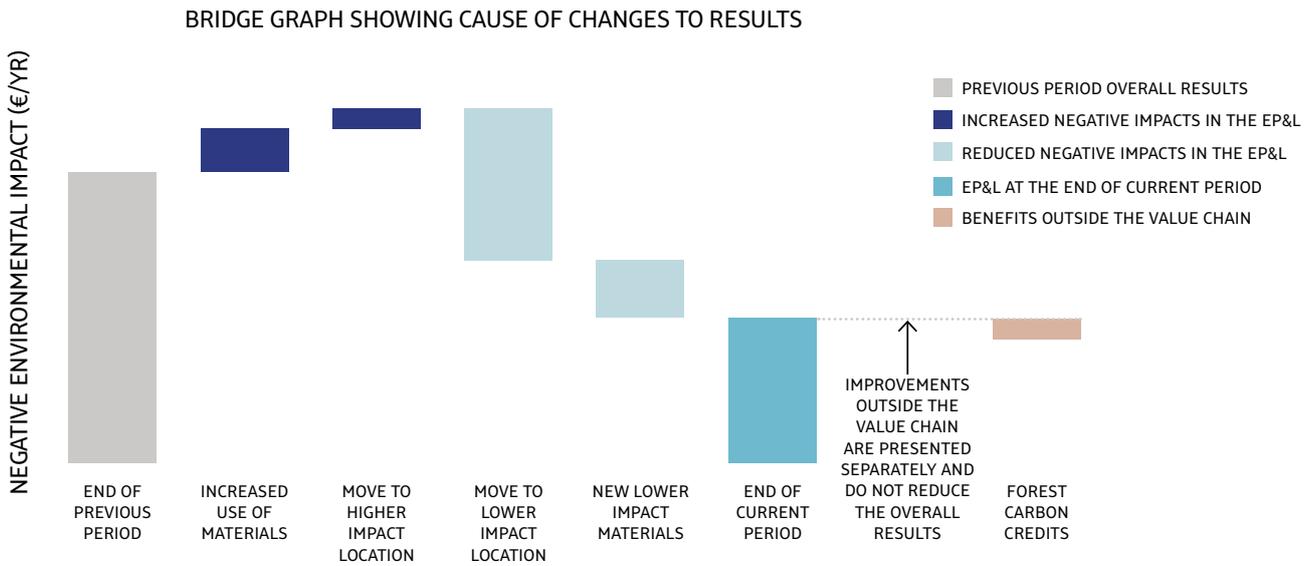
reducing their own impacts first. Inclusion of offsets and other impacts outside of the value chain in a 'net EP&L' figure also brings the question of equivalency to the fore. The EP&L converts all impacts into monetary values, such that changes in welfare of the same magnitude are valued equally, putting different types of impacts in different locations on the same scale. For a company this is helpful because it allows for meaningful comparison across diverse impact types and enables prioritisation of efforts. However, it does not imply that all possible trade-offs to reduce overall welfare impacts are acceptable (e.g. it does not imply reductions in carbon emissions make increased water pollution 'ok' from a net welfare point of view). A company will always need to refer to other sources of information and consider ethical and distributional factors before making significant prioritisation decisions within its value chain. By contrast, a decision to purchase an 'offset' could be taken in relative isolation from other considerations, suggesting a further reason to present 'offsets' and other impacts outside the value chain from the value chain EP&L results. Figure 4 (overleaf) presents an example of this.

New rule: Improvements outside of the value chain shall be presented alongside the EP&L results, but shall not be netted off from them.

4 – The Value Chain, or Value Web, is not always easy to delineate. For Kering, we define it as any activities which directly or indirectly contribute to the production, use or disposal of Kering's products. This does not therefore include purchase of carbon offsets, philanthropic work or the benefits of Kering's investments in suppliers which are shared with other brands outside the Kering group.

5 – There are a range of different offset verification schemes available, some more robust than others in terms of additionality and equivalency.

FIGURE 4: PRESENTATION OF IMPROVEMENTS OUTSIDE OF THE VALUE CHAIN ALONGSIDE EP&L RESULTS



APPENDICIES

APPENDIX 1: DEMONSTRATING ADDITIONALITY

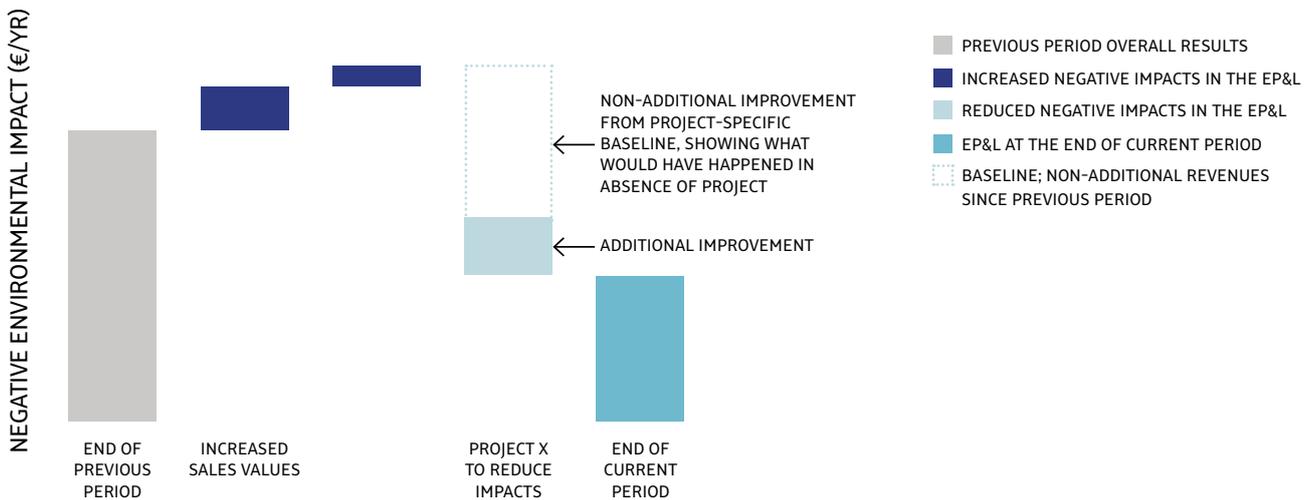
The principles of additionality have been well established in the carbon offsetting literature, particularly through the Clean Development Mechanism and Reduced Emissions from Deforestation and Degradation. Additionality is critical in carbon markets because companies can sell credits if they can demonstrate the delivery of additional carbon savings.

Both additional and non-additional benefits will reduce the overall EP&L impacts, because the EP&L represents the total gross impacts of a company. For the EP&L there are no financial gains attached to demonstrating the additionality of improvements. We therefore propose that calculating

project-specific baselines is not mandatory, but is available as a useful tool to demonstrate improvements to external stakeholders. In such cases a project-specific baseline can be illustrated as per the bridge graph in Figure 5.

Figure 5 demonstrates how impacts can reduce with or without a company's action, but also demonstrates that a company striving to be more sustainable will deliver additional improvements. The dotted area is the reduction in impacts which would have happened with or without the company's action. The light blue area shows that there has been an additional reduction in impacts, which is entirely contributable to the company's actions.

FIGURE 5: PRESENTING PROJECT-SPECIFIC BASELINES AND ADDITIONAL IMPROVEMENTS – BASELINE WITH DECREASING NEGATIVE IMPACTS



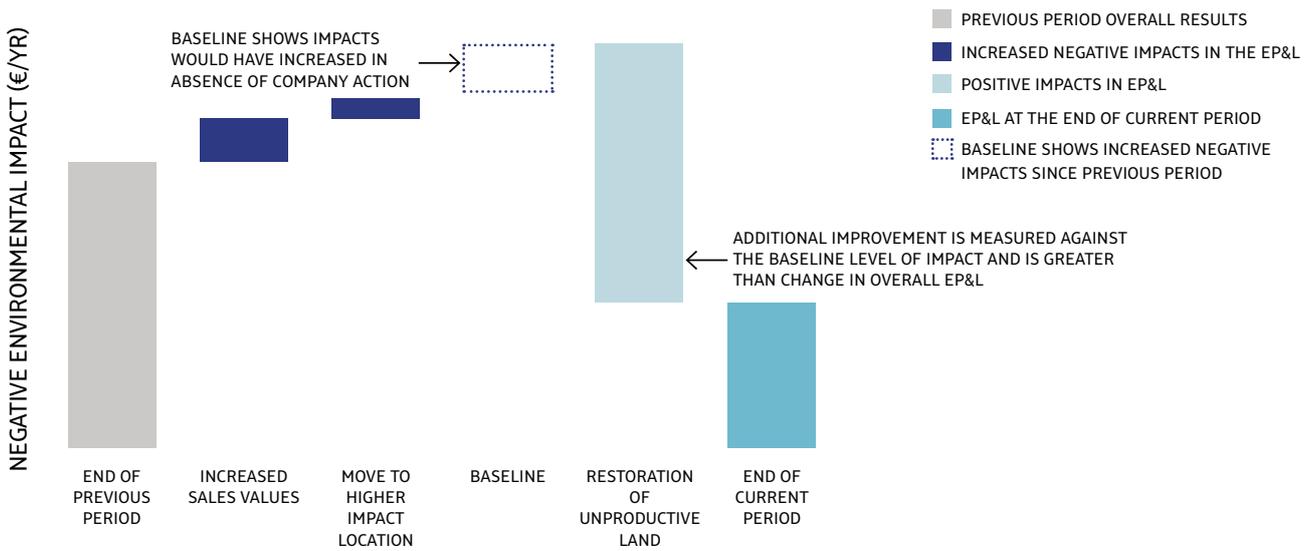
The example presented in Figure 5 shows where the additional improvement (pale blue area) is less than net improvement (dotted area and pale blue area) since the last period. However, if the baseline shows that the

negative impacts would have increased without the company's intervention, the additional improvement would be greater than the net improvement between the two reporting periods.

For example, Kering is supporting sustainable wool production that is regenerating grasslands. Without intervention the grasslands would have continued to degrade, the additional benefit is therefore greater than the change in EP&L results between reporting periods. For this

example, the change is also illustrated as a positive impact because the grassland where previously unproductive would not have been restored without intervention. Figure 6 depicts this example.

FIGURE 6: PRESENTING PROJECT-SPECIFIC BASELINES AND ADDITIONAL IMPROVEMENTS – BASELINE WITH INCREASING NEGATIVE IMPACTS



ADDITIONALITY CRITERIA:

Figure 7 presents the logic behind the additionality test; it has been adapted from the additionality rules developed for the Clean Development Mechanism under the Kyoto Protocol.

The objective of the additionality test is to understand if the activity providing the environmental benefit would have happened anyway, holding all else equal, if the activity had not been implemented as a sustainability project. Four key criteria need to be considered, as explained below.

Additionality will need to be considered and demonstrated on a case-by-case basis, with supporting evidence provided with any results. Independent assurance over the validity of the results may add weight to reported figures, at the discretion of the Kering Group entity(s) involved.

EXPLANATION OF FIGURE 7:

The first decision point on the tree identified the percentage of that activity that was supported by the company to attribute the benefits. If another company funded the activity entirely it is non-additional, but if it was part funded then that portion of the benefits can be considered under the additionality criteria A1 to A4.

A1: Is the activity mandated by regulation?

If regulation requires the activity to be implemented, the company would have had to do it anyway and it is therefore a non-additional improvement.

A2 and A3: Does the activity directly improve profitability of the company? Has the company had to overcome significant barriers in implementing the activity?

Passing one of these criteria is sufficient to progress to A4. However, if the project improves financial performance and there are no significant barriers which had to be overcome in implementing it, a rational company would have implemented it anyway, so it is non-additional.

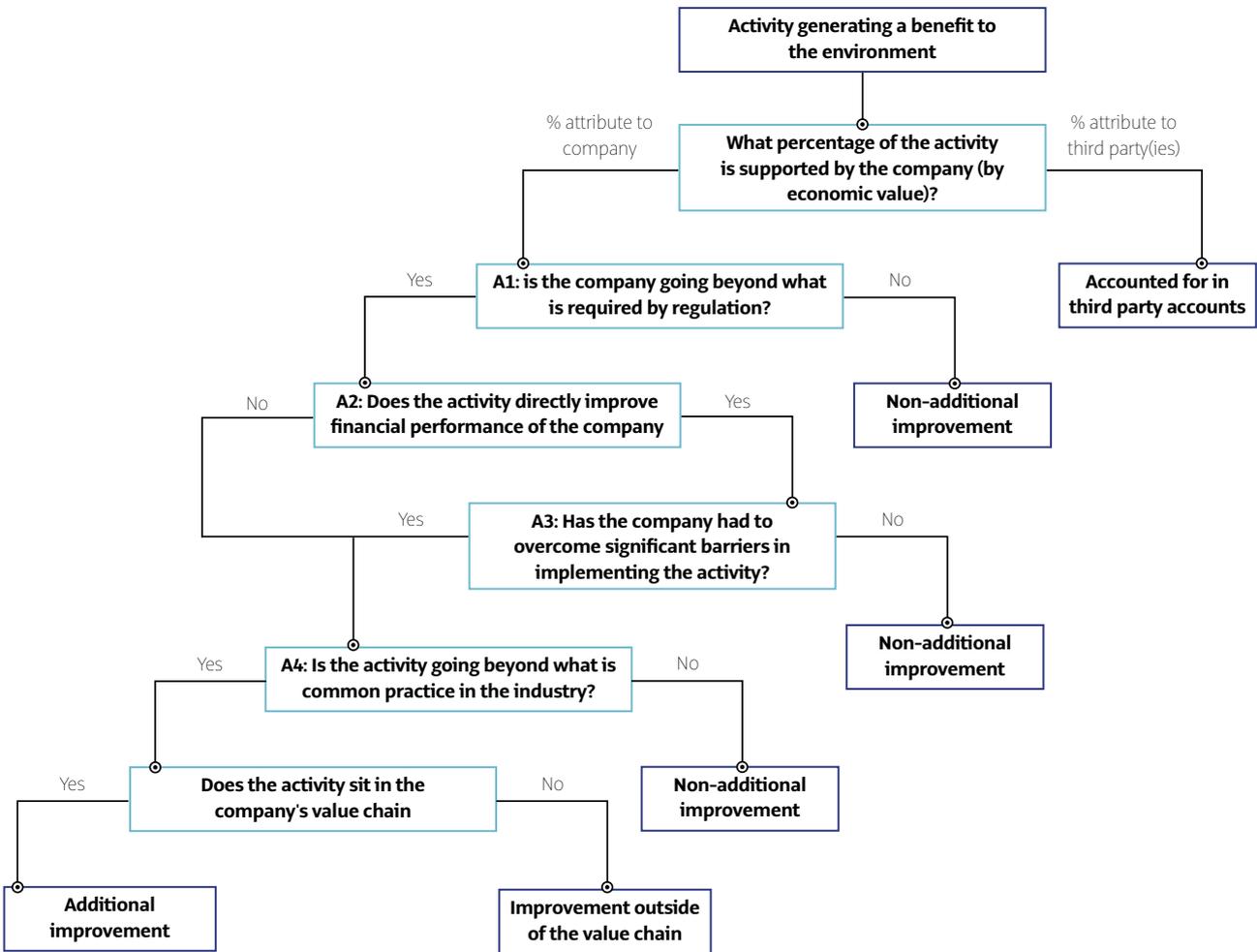
On the other hand if the project results in reducing financial performance or if the company had to overcome significant barriers then it is unlikely the activity would have been implemented had it not been motivated by sustainability ambitions. 'Significant barriers' could be legal, social, technological, ecological or financial barriers, for example:

- Legal barriers associated with property rights or land access
- Collaboration between numerous polarised stakeholders
- Requirements to develop a new technology
- Maintaining predator populations whilst continuing grazing activities
- Large upfront investment requiring project finance support

A4: Is the activity common practice in the industry?

Even if the company overcame significant barriers, or experienced reduced financial performance following implementation, activities which are common practice in the industry are not considered additional.

FIGURE 7: LOGIC TO DEMONSTRATING ADDITIONALITY



APPENDIX 2: REVIEW OF OTHER APPROACHES

Table 2 presents a high level comparison of other related mechanisms and frameworks. The EP&L has a

fundamentally different objective to these which is the primary driver of differences.

TYPE OF MECHANISM / FRAMEWORK	PRINCIPLE OBJECTIVE	COMPARISON OF APPROACH TO ACCOUNTING FOR ENVIRONMENTAL IMPROVEMENTS
<p>'Net positive' corporate policy e.g. Rio Tinto in Madagascar</p>	<p>To demonstrate greater positive impacts on biodiversity than negative impacts.</p>	<p>Rio Tinto's pilot project for their policy is focused at one site in Madagascar and is measured in Quality Hectares and Global Distribution [of an affected species], a measure of impact on endemic species.</p> <p>Rio Tinto has defined (with the IUCN) a counterfactual baseline against which their impacts are measured. This baseline shows a negative trend in biodiversity impacts, so Rio Tinto can have a net positive impact by restoring more ecosystems than they damage through their mining activities.</p> <p>Conceptually, this is comparable to the project-specific baselines defined here, but they do not present improvements alongside an overall gross (negative) impact like the EP&L.</p>
<p>Carbon offsets e.g. Voluntary Reduced Emissions from Deforestation and Degradation (REDD+)</p>	<p>To financially reward a reduction in net carbon emissions.</p>	<p>Carbon is a fungible emission, such that an emission anywhere in the world, from any source, has an equivalent contribution to climate change. Similarly, a reduction in carbon in the atmosphere has the same contribution to reducing climate change impacts irrespective of how it is sequestered. Carbon offsets and trading schemes take advantage of this fact by allowing companies (and other actors) to prioritise the lowest cost abatement using tradable emission credits.</p> <p>In contrast to the EP&L, additionality is therefore essential, because it ensures funds are only used to reward reductions which would not have happened anyway.</p>

TYPE OF MECHANISM / FRAMEWORK	PRINCIPLE OBJECTIVE	COMPARISON OF APPROACH TO ACCOUNTING FOR ENVIRONMENTAL IMPROVEMENTS
Water quality trading e.g. Chesapeake Bay	To maintain a given level of water quality at the lowest cost.	<p>Within a highly localised water system, pollutant emissions are considered equivalent, allowing a credit trading system not dissimilar to carbon trading. A maximum daily load is set and local industry is awarded emission credits which can be traded to reduce the overall cost of abatement.</p> <p>Additionality is not relevant because it is the overall level of reduction which is important (this is set by a cap on the available credits).</p>
GHG Protocol	Provide guidance on the quantification and reporting of GHG emissions.	The GHG Protocol sets out a framework for corporate measurement and reporting of direct and indirect GHG emissions. Like the EP&L guidance set out in this paper, the Protocol recommends companies report emissions relating to offsets and GHG trading separately from their operational and supply chain emissions. It also recommends additionality is demonstrated for offsets, but is not required for changes in supply chain and operational emissions.

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