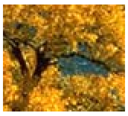
Carbon Report 2006/7

Report on business operations carbon asset management and application of the CarbonNeutral® Protocol

Containing an independent assurance report by PricewaterhouseCoopers LLP

November 2007

The CarbonNeutral Company

Carbon Report 2006/7

This Carbon Performance Statement comprises reporting on key elements of our carbon management activity and carbon portfolio for the year ended June 30, 2007. We have focussed on those matters considered to be most relevant to understand our carbon management process. Our reporting has been prepared on the basis of our Carbon Reporting Policy which comprises our two primary management frameworks:

- The CarbonNeutral Protocol (CNP), which provides guidance and requirements for organisations wanting to communicate all or part of their operations as being CarbonNeutral®
- Our Policy for Accounting and Reporting Carbon (PARC), which sets out our internal processes for transacting carbon with project partners and clients and the way in which we account for and report these transactions. (PARC)

These frameworks are supported by more detailed guidelines in some areas. Relevant in the reporting context is the Forestry Monitoring procedure used in 2007.

The Carbon Performance Statement has been subject to assurance by PricewaterhouseCoopers LLP, their Assurance Report can be found below.

The objective of this Carbon Performance Statement is to explain the key steps of the CarbonNeutral® process, to show how we manage the risks associated with delivering our carbon offset service and to present new levels of transparency of our carbon management procedures and performance.

There have been legitimate challenges of the concept of offsetting, but we remain convinced that if done with integrity and transparency, carbon offsetting achieves a positive impact through raising carbon awareness, encouraging emission reductions and by accelerating investment in low carbon projects and initiatives. In 2007 we have voluntarily extended our public reporting to provide new information about our management processes and also present, for the first time, details of our "Carbon Statement". We have also chosen to have more extensive and rigorous independent scrutiny through our assurance exercise. Our goal is to demonstrate the integrity of our approach and by example to help set standards and best practice for the wider industry.

This statement is structured to mirror the key elements of our business as follows:

1. Working with clients to help them understand the greenhouse gas emissions from their activities and encouraging them to prepare internal emission reduction plans
2. Sourcing and contracting with Emission Reduction projects, which will generate carbon credits according to various standards
3. Matching up the carbon credits that we have contracted to specific client activities, through the Carbon Accounting process in order to reduce net emissions from those activities to zero
4. Helping clients communicate the action they have taken to stakeholders through the use of the CarbonNeutral® logo(s).

1. Working with clients

Client Emission Assessments

The CarbonNeutral Protocol requires all relevant greenhouse gas emissions relating to organisations, events and other activities that carry a CarbonNeutral label to be quantified using the WBCSD-WRI greenhouse gas protocol or ISO 14064 (with the exception of small businesses (emissions <200tCO_2/yr)). It also requires that assessments are complete and accurate and client data used for assessing emissions is not more than 24 months old.

To meet requirements of the CarbonNeutral Protocol, an established emissions assessment process is in place. We have a contract with a suitably-qualified third party, The Edinburgh Centre for Carbon Management (ECCM) for the completion and review of these assessments. Individuals at ECCM have the skills required to identify the boundaries for these assessments and to assess the emissions from activities within those boundaries using appropriate emissions factors. In the majority of cases the assessments are performed by ECCM which involves liaising directly with the client to collect data and assisting in the data collection process where required, visiting key client sites for the more complex assessments, analysing the data to produce a greenhouse gas footprint and documenting the findings and assumptions used in a report. In the remaining cases, ECCM either reviews a client's own assessment to confirm that the scope aligns with the scope of CarbonNeutral® label being sought and that it has been conducted in accordance with the WBCSD-WRI GHG Protocol or ISO14064, or, in the case of small businesses, it reviews a simplified assessment that has been prepared by our own staff. The review in particular involves checks to ensure that the scope of the assessment has been correctly defined, the correct emissions factors have been used and that the calculations have been performed correctly.

We are further refining the scope of the ECCM review to determine how we can increase attention to the reliability of the assessments being made without duplicating work with clients. This will involve putting greater emphasis on requiring confirmation of the completeness and accuracy of the assessment conclusions.

The CarbonNeutral Protocol requires that organisations undertaking CarbonNeutral® initiatives 'declare' the emissions being offset. The original intention had been to use the CarbonNeutral Register for this purpose. Based on a review of the potential confidentiality of client data we have not implemented this requirement during the reporting period and we have decided to remove this requirement from future versions of the Protocol.

Client Reduction Planning

Prior to obtaining CarbonNeutral status, clients are required to consider the opportunity for emission reductions. While the achievement of an absolute reduction cannot be mandated; they are required to develop a reduction plan. We help in this process through the provision of literature and/or discussions with us and ECCM. This requirement exists for all CarbonNeutral schemes except Events, Promotions and Developments. As well as being good for the environment, this makes sound business sense as internal emissions reductions generally represent an ongoing cost saving (e.g. through reduced energy consumption).

Copies of these reduction plans are held by us as well as the client. Since this reduction planning step only became a requirement in April 2006, there is not yet sufficient data to assess the level of internal reductions achieved by clients, but we plan to be able to report on achievements in this area, for example for some larger clients or in aggregate, in our next report.

2. Sourcing and contracting with Emission Reduction Projects

The CarbonNeutral Protocol sets out requirements for the quantification of emissions benefits of projects as well as the overall impact of the sale of carbon credits on the project's ability to be implemented (total additionality). In addition it sets out requirements for monitoring and 3rd party verification of the emission reductions generated by the project. These elements are all essential to ensure the credibility of any carbon offsetting programme.

We have only contracted with projects that meet these requirements and the supporting project documentation (including Project Design Documents and Verification Reports) is made publicly available on the CarbonNeutral Register on the CarbonNeutral website. The projects on the Registry represent all those technology projects from which carbon has been allocated to clients since 1st January 2007 (approximately 80% by volume of all technology projects contracted). Publishing project documentation enables us to meet our obligation to provide buyers with information about the offsets offered.

During the year we have continued our strategy of sourcing an increasing proportion of our carbon credits from technology projects. This is in line with client demand and our aim to bring forward the delivery horizon of our project portfolio.

3. The Carbon Accounting process

Carbon Accounting and Reporting

Reliable and timely 'matching' of client emissions to carbon credits sourced by TCNC from projects (both technology and forestry projects) is critical to the integrity of claims made by those clients. Over time we have developed principles and procedures governing carbon accounting; we continue to refine and improve them. In 2007, for the first time, we are publishing our main principles and procedures in our Policy for Accounting and Reporting Carbon (PARC).

Carbon allocation and retirement

The CNP and the PARC require that carbon offset instruments be allocated to clients in a timely manner to ensure that CarbonNeutral® claims can be substantiated. TCNC has met the required carbon allocation deadlines on its internal stock management system with all allocations being made within one calendar month of the sale. Allocations are specifically classified against a client account within our stock management system. The system is set up so that carbon can only be allocated once. A reconciliation between the carbon stock system and the financial system is conducted at the end of each month - this is vital to ensuring that there are adequate controls between our commercial activities and the sourcing of carbon credits needed to support these activities. In the absence of a common standard to retire carbon credits, we define retirement as retaining title to the carbon with a commitment not to resell it. In the case of forestry projects, contracts are generally for 100 years and therefore 'delivery' will not be completed until the end of this period. With forestry projects we make the same commitment not to resell as with technology projects and implement a process of monitoring project performance (see further details in the risk management section below).

Consistent with our decision not to disclose emission reduction plans, individual transactions have not been listed on the CarbonNeutral Register for reasons of commercial sensitivity.

It is important that we maintain a sufficient carbon balance to ensure we can meet our existing and planned offset commitments. This demands active and close management of our carbon portfolio. We completed a risk based review of our project portfolio at the end of the 2007 reporting period to identify our carbon "balance". This review process will continue to be enhanced during FY08 and applied on a regular basis. It enables us to achieve a higher degree of control over our carbon balance and so maximise secure use of our carbon resource.

Through this review we have categorised our carbon stock to identify where carbon delivery is, or is likely to be, delayed or where carbon performance is expected to fall since first estimates. Comparison of the results of this review is made against current year commitments to determine, as its primary goal, the extent of any carbon shortfall. The same exercise also allows identification of any carbon excess and so helps us achieve good stock management.

Following from the 2007 review, we have:

- Determined to replace 112,178tCO_2e of allocated carbon from 6 underperforming technology-based emission reduction projects (projects generating renewable energy, improving energy efficiency or capturing fugitive methane emissions). This represents 7% of the total technology carbon sourced until the end of FY07. At the time of reporting, 98,867tCO_2e had already been replaced with alternative technology credits. Prior to the end of FY08, alternative projects will be confirmed to supply replacement credits for the outstanding shortfall of 13,311tCO_2e and this will be detailed on the CarbonNeutral Register.

- Implemented a policy of holding back a proportion of carbon contracted for forward delivery, so that project underperformance is less likely to result in a mismatch between carbon allocated to clients and carbon actually delivered by projects.

- Updated our risk management policies for forestry sequestration projects. In particular through establishing a procedure for assessing forestry condition of UK and European projects to highlight risk to carbon delivery and agreeing the basis for creating a 'reserve buffer account' of carbon credits, which can be drawn upon in the event of failure of a forestry project. A similar risk assessment procedure for international forestry projects is under development, which will complement the existing monitoring activities; until then we have assigned these projects a medium risk rating (in addition one international forest is being assessed for material failure to deliver). The buffer account, which will be established over a period of three years, does not yet contain any carbon credits, but there is a commitment by the Company to fund it in line with PARC requirements by the end of FY08. Based on the risk assessment results at the time of reporting, this requires the purchase of 54,773 tCO_2e.

The review process has highlighted a number of areas where we need to establish more detailed procedures and definitive criteria, for example developing more definitive criteria for the assessment of delivery risk.

Our carbon statement for FY07 is presented below:

		TECHNOLOGY	FORESTRY	TOTAL
ASSETS	**Carbon sourced**			
	tCO_2e sourced prior to FY07	209,439	582,557	**791,996**
	tCO_2e sourced during FY07	1,439,240	70,186	**1,509,426**
	Total	**1,648,679**	**652,743**	**2,301,422**
	Carbon delivered			
	tCO_2e delivered prior to FY07	56,650		**56,650**
	tCO_2e delivered during FY07	638,616		**638,616**
	Total	**695,266**		**695,266**
	Carbon sourced (tCO_2e) at FY07 end, to be delivered after FY07[1 & 2]	781,404		**781,404**
	Weighted Average maturity (in months) of tCO2 delivery	21		
LIABILITIES	**Carbon contracted**			
	tCO_2e contracted prior to FY07[3]	335,747	560,220	**895,967**
	tCO_2e contracted during FY07	468,781	77,345	**546,126**
	Total	**804,528**	**637,565**	**1,442,093**
	Discharge of liability			
	tCO_2e discharged prior to FY07	56,059		**56,059**
	tCO_2e discharged during FY07	209,520		**209,520**
	Total	**265,579**		**265,579**
	tCO_2e contracted to be discharged after FY07	538,949		**538,949**
RISK MGMT	**Risk management**			
	% of Carbon sourced released for allocation	86.6%		
	% of Carbon released for allocation which is delivered	48.7%		
	Total shortfall of technology carbon allocated to clients, not delivered on schedule (tCO_2e)			
	Of shortfall, expected to be delivered in future years	34,267		**34,267**
	Of shortfall, to be replaced by alternative project	13,311		**13,311**
	Of shortfall, tCO2 replaced by alternative projects at the time of reporting[4]	98,867		**98,867**
	Total	**146,445**		**146,445**
	Total forestry buffer requirement (tCO_2e)[5]			
	% of forestry carbon from low risk projects		65.6%	
	% of forestry carbon from medium risk projects		20.8%	
	% of forestry carbon from high risk projects		10.5%	
	% of forestry carbon from 100% buffered Project[6]		2.8%	
	% of forestry carbon from failed projects prior to FY07 end		0.3%	
	Total forestry buffer requirement (tCO_2e)		54,773	**54,773**

Notes to the Carbon Portfolio

1 Is defined as total technology carbon sourced to end FY07 - total tech delivered to end FY07 – tech shortfall to be written off (both allocated to client, and not allocated to client) + over delivery
2 Due to the ex-ante accounting approach for forestry projects, this figure does not include forestry contracts
3 The carbon contracted data for prior to FY07 has been calculated based on available records as a result of the level of documentation retained
4 This shortfall has been replaced by alternative projects subsequent to the year end.
5 The forestry risk assessment procedures, in particular for international sources (i.e. non-European) is under review to ensure consistency across all locations. The international forests represent 20% of the total forest sequestration capacity,
6 This project is currently being assessed for material failure, representing 18,256tCO_2e

General note:

Documentation supporting carbon transactions prior to 2000 is incomplete. As a result the pre-FY07 carbon contracted and sourced data, in particular, may be incomplete.

4. Communication

It is important for all stakeholders that the CarbonNeutral® logo conveys a consistent, reliable message. We recognise that there is increasing risk of misleading, potentially fraudulent use of the logo and plan to develop a control process to achieve rigorous management of the logo, in particular covering release of logos to clients, monitoring of their use and the withdrawal of logos for those clients that choose not to renew CarbonNeutral status.

We completed a one off review of a sample of 135 client websites in December 2006 to identify the level of consistency between permitted and actual use of the CarbonNeutral logo. No significant inconsistencies were identified.

Assurance Report to the Directors of The CarbonNeutral Company Ltd

We have been instructed by the directors of The CarbonNeutral Company Ltd ("the Company") to perform limited assurance procedures on the Carbon Performance Statement of the Company for the year ended 30 June 2007 which comprises reporting on:

- o Status of management activity completed in the year ended 30 June 2007 to support implementation of the Company's Carbon Neutral Protocol
- o Management's carbon statement as at June 30 2007 prepared in accordance with the Company's Policy for Accounting and Reporting Carbon (2007)

There are no generally accepted international reporting standards applicable for this information. The Company's Policy for Carbon Accounting and Reporting and CarbonNeutral Protocol together form the basis for preparation of the Carbon Performance Statement for which the Directors are solely responsible, and are available at:
www.carbonneutral.com/uploadedfiles/CarbonNeutral's%20Policy%20for%20Accounting%20and%20Reporting%20Carbon-Nov2007.pdf; and
www.carbonneutral.com/uploadedfiles/Performance%20&%20Assurance%20Statement%20FY2007.pdf
Collectively, these form the Company's Carbon Reporting Policy which forms the criteria against which we have assessed the Carbon Performance Statement.

Respective responsibilities of the Directors and PricewaterhouseCoopers LLP

The Directors are responsible for preparing the Carbon Performance Statement based on the Company's Carbon Reporting Policy. Our responsibility is to express to the Directors a conclusion on the Carbon Performance Statement based on our limited assurance procedures.

In accordance with the terms of our engagement letter dated 2 August 2007, our responsibilities do not extend to considering any other information provided by The CarbonNeutral Company. This report, including the conclusion, has been prepared for and only for the Directors as a body for management purposes to assist them in assessing the Company's performance and activities in relation to carbon management and performance reporting in comparison to the criteria for the year ended 30 June 2007 in accordance with the terms of our engagement letter.

Our work has been undertaken so that we might report to the Directors those matters that we have agreed to state to them in this report and for no other purpose. Our report must not be recited or referred to in whole or in part in any other document nor made available, copied or recited to any other party, in any circumstances, without our express prior written permission. We permit the disclosure of this report, in full only, by the Directors on the Company's website, to enable those stakeholders using the Company's Carbon Performance Statement 2007 to verify that an independent limited assurance report has been commissioned by the Directors of the Company and issued in connection with the Carbon Performance Statement 2007 of the Company, and without assuming or accepting any responsibility or liability to those and other stakeholders on our part. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Directors as a body and The CarbonNeutral Company for our work, for this report or for the conclusions we have formed.

Inherent limitations

Non-financial performance information is subject to more inherent limitations than financial information, given the characteristics of the subject matter and the methods adopted for the definition and gathering of information. Qualitative interpretations of relevance and materiality and estimates of margins of uncertainty on data are subject to individual assumptions and judgements. It is important to read the data and statements in the context of the Company's Reporting Policy.

Assurance work performed

We conducted our limited assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) – "Assurance Engagements other than Audits and Reviews of Historical Financial Information" (ISAE3000") issued by the International Auditing and Assurance Standards Board. The following limited assurance procedures were performed:

- Making enquiries of relevant management of The CarbonNeutral Company.
- Interviewing relevant management from the third party provider responsible for the assessment of carbon contracted data, monitoring forest condition (European only) and selected project assessments.
- Evaluating the structure and basis of management's carbon management systems and controls, including monitoring of third party information.

- Performing limited testing on a selective basis of carbon data including: contracted, sourced and delivered as well as carbon stock management (allocated and unallocated).
- Performing limited work to test the basis for management assertions.

Limited assurance is substantially less in scope than reasonable assurance and as a result less assurance is provided. Limited assurance excludes reasonable assurance procedures such as tests of controls and verification of assets, liabilities and transactions.   Our limited assurance procedures did not include work to confirm the original source data including for example, client carbon assessments or project performance. We did not undertake any project or forestry visits.

Conclusion

On the basis of our limited assurance procedures, nothing has come to our attention that causes us to believe that the Carbon Performance Statement of The CarbonNeutral Company Ltd for the year ended 30 June 2007 is not prepared, in all material respects, in accordance with the Company's Carbon Reporting Policy.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP, Chartered Accountants, London
16 November 2007

Notes

(a) The maintenance and integrity of The CarbonNeutral Company Ltd website is the responsibility of the Directors; the work carried out by the assurance providers does not involve consideration of these matters and, accordingly, the assurance providers accept no responsibility for any changes that may have occurred to the performance statement since they were initially presented on the website.