ACCOUNTING FOR SUSTAINABILITY

CONNECTED REPORTING

A practical guide with worked examples

Contents:

Introduction

Sustainability issues such as climate change and the over-consumption of the Earth's finite natural resources – increasingly living off the Earth's capital rather than its income – are challenges that are likely to lead to major changes in the way we live and work, in our economic model and in the level and type of government regulation.

In the face of this "sustainability revolution", it is increasingly important for organizations to understand how such issues will impact on their continuity and long-term success, and to be able to communicate clearly both the impacts and the company's response to investors and other stakeholders. It is only through the integration of environmental and social factors into business and management reporting that the fundamental connection between strategic direction, financial performance and sustainability impacts will be made clear.

What is connected reporting?

Connected reporting aims to provide a new approach to corporate reporting and to address the growing dissatisfaction, amongst both preparers and users, with the incompleteness, length and complexity of many organizations' Annual Report and Accounts.

A connected report should be focused on the needs of long-term investors and executive management. Reported information should identify and explain the connection between the organization's strategic objectives, the industry, market and social context within which the business operates, the associated risks and opportunities it faces, the key resources and relationships on which it depends, and the governance, reward and remuneration structures in place. Further, it should explain the connection between delivery of the business's strategy and its financial and non-financial performance.

The result is a more concise, rounded and balanced picture of an organization's overall performance, which reflects the organization's strategy and the way it is managed.

What does this guidance cover?

This guidance is focused on how environmental and social sustainability factors can be reported using a connected reporting approach. It is primarily intended for use within the Annual Report and Accounts, within investor presentations, or as part of internal reports to management.

Sustainability is considered from two perspectives: firstly, what environmental and social impacts are material to the achievement of the organization's strategic objectives; and secondly, how do those objectives, and actions taken in response to them, contribute to a more sustainable economy and society. There is a strong degree of overlap and interrelation between these two perspectives. It is unlikely, for example, that an organization will be able to pursue a strategy with significant harmful impact on a local community, without there being a risk of reputational damage, a potential for regulatory response and loss of licence to operate.

The aim of this guidance is to provide organizations with a simple approach to making this connection between strategic direction, financial performance and environmental and social considerations, and is broken down into three key steps, each of which is presented in more detail on pages 4 to 9.

1. **Connecting business strategy and sustainability**
The identification of material sustainability issues and description of how each of these impact on the organization's strategic objectives.

2. **Key Performance Indicators (KPIs) and actions taken**
The evaluation of action taken to address each material sustainability issue and the identification of KPIs to measure performance.

3. **The Connected Performance Report**
A balanced assessment of progress against agreed targets and towards intended outcomes.

The guidance is followed by three worked examples – for a supermarket (found on page 12), a property investment company (page 22) and a water and wastewater company (page 30). These examples highlight different ways that connected reporting can be applied in practice.

In addition, online guidance, including good practice examples of connected reporting by companies around the world, can be found at: www.accountingforsustainability.org/reporting

Since we applied a connected approach to reporting on 'The Northern Way' in our 2008/9 Annual Report, there has been a definite reduction in the number of questions asked by investors. Not only does the reported information pre-empt many questions, but the fact that the data in the annual report is supported by a consolidation of monthly data adds further credibility.
Paula Widdowson, Corporate Responsibility Director,
Northern Foods plc

Underlying principles

Good corporate reporting derives much of its credibility from strong underlying characteristics. The International Accounting Standards Board's Conceptual Framework Exposure Draft makes reference to the fundamental characteristics of relevance and faithful representation, and the enhancing qualitative characteristics of comparability, verifiability, timeliness and understandability. Such characteristics should underpin the information presented within a connected report.

In addition, reporting should be balanced, concise, focused on the material issues and include forward-looking disclosures which are made in good faith and, like the rest of the information, can be explained.

Who is this guidance for?

This guidance is primarily aimed at Finance Directors, Company Secretaries, Heads of Investor Relations, Heads of Sustainability and their respective teams within listed companies and other public interest entities. It provides practical guidance to help these teams to integrate environmental and social factors, which are material to the organization's success, into management reporting, investor communications and the Annual Report and Accounts.

In applying the guidance, a multi-disciplinary approach is needed, with finance, sustainability and human resources teams working closely together and drawing on the expertise from a range of individuals within the organization.

How was this guidance developed?

The Connected Reporting Framework was first set out in a report by The Prince's Accounting for Sustainability Project in 2007. Since then, it has been adopted by a range of organizations including Aviva, BT, EDF Energy, HSBC, Hammerson and Northern Foods. In addition, it has been adapted for use by all public sector organizations in the UK based on Treasury guidance, due for adoption in 2010.

The development of connected reporting reflects consultation with over 100 organizations. This guidance builds on the 2007 report to provide practical implementation guidance. It draws on the work of a range of organizations, as well as academic research conducted during 2009 into the experience of eight organizations that have either piloted the Connected Reporting Framework since 2007 or are considered leaders in integrated reporting. This academic research will be published in May 2010. A list of key organizations that have influenced or contributed to the guidance is provided on page 36.

2010 consultation process

A consultation and piloting process will be conducted in 2010 to test this guidance, with the final version planned for release in the second half of 2010. The consultation process will consider steps to integrate recommendations made by The Prince's Accounting for Sustainability Project with those of other organizations towards the creation of a common connected and integrated reporting framework.

1.

Connecting business strategy and sustainability

What should be reported?

- **Market context:** An analysis of the environmental and social trends which have a material impact on the sector, market and regulatory context within which the business is operating, where possible in quantitative terms and supported by evidence.
- **Business model:** A description of the implications for the way that the business operates and generates value in response to identified environmental and social trends.
- **Objectives and strategies, risks, resources and relationships:** The connection between material sustainability impacts and issues, the achievement of the company's objectives and implications for the strategies it has adopted. The analysis of material sustainability issues should include:
  - principal risks and opportunities, an explanation as to why they are important and an estimation of their impact in either financial or operational terms;
  - assessment of the sustainability of key resources (natural, human and financial) and key relationships (e.g. supplier, customer, employee, regulator, community) upon which the strategy is dependent;
  - reference to the approach followed by management to determine which sustainability factors are material; and
  - a description of the actions being taken by management to effect organizational change, including development, training and incentives.

How?

1.1	Identify the social and environmental issues that are most relevant to the organization, the sector and markets in which it operates, ensuring that: • an assessment is made of the full range of products/services offered, markets served and site locations; • both global issues (such as climate change, population growth and over-consumption of finite resources) and those which are more localized (such as the availability of a skilled workforce) are considered; • issues with potential future impacts are considered, as well as those affecting the organization at present; • broader impacts are assessed, including the direct impacts of the organization on the communities and the environment in which it operates, as well as more indirect upstream (supplier) and downstream (customer) impacts; and • stakeholders, with whom relationships are critical to the success of the business, are consulted and their views considered.
1.2	Determine which of the identified issues are material to the organization's performance, by taking into account: • risks, resources and relationships, the potential impact of issues on the way that the business operates and on the achievement of the organization's strategic objectives (which may highlight the need for objectives to change); and • the extent to which issues that have an impact on external parties, but do not represent a cost to the business ("externalities"), are likely to become internalized through additional regulation or impacts on the organization's reputation.
1.3	Report on each material issue, using both qualitative and quantitative analysis, to provide an explanation of how it impacts on the organization's objectives, strategy and operations, including: • **Market context**, for example, changing patterns in customer demand towards more sustainable products, as evidenced by trend data on market share of ethically sourced products as a percentage of total market. • **Business model**, for example, within the food retail sector, changes to structure of relationships with suppliers to improve security of supply in the face of projected scarcity of key products resulting from increasing water stress. • **Risks and opportunities**, for example, the value of property considered at high risk from the physical impacts of climate change as a percentage of the total. • **Resource availability**, for example, the impact of sustainability performance on ability to secure project finance from banks which are signatories to the Equator Principles (representing over 80% of the global project finance market) or the availability of finite natural resources upon which production growth objectives are dependent. • **Relationships with key stakeholders**, for example, the linkage between employee satisfaction, cost of absence and retention rates.
1.4	Make available to users, for example on the organization's website, an outline of the process followed to identify material issues. This should, in particular, explain why any measures generally considered significant at sector, national or international levels are not considered material for disclosure by the business. This will help to avoid concern about possible cherry-picking and will provide insight into management decision-making and risk management processes.

2.

Key Performance Indicators (KPIs) and actions taken

What should be reported?

- The actions taken to address each material sustainability issue, including steps to mitigate key risks or capitalize on opportunities identified, in support of delivery of the business strategy.
- The Key Performance Indicators (KPIs) selected to measure performance, including the accounting policy adopted for each indicator, and the relationship to business performance, if possible quantified in financial terms.
- A description of how management is incentivized to deliver intended outcomes, including the link with governance, remuneration and rewards.

How?

2.1	Identify the actions taken to address each of the material environmental and social issues resulting from Step 1.
2.2	Establish the intended outcome for each action, ensuring there is an explanation of how it will: • help the organization achieve its strategic objectives; and • help achieve a more sustainable society and environment.
2.3	Set out how progress towards intended outcomes will be measured, identifying KPIs for each material issue, as relevant. KPIs should: • enable comparability from year to year and with other organizations, and as such should be: – based on generally accepted indicators, where available at a sector, national or international level (for example, Global Reporting Initiative indicators), and tagged using XBRL (eXtensible Business Reporting Language) where relevant taxonomies exist; and – aligned with national or internationally agreed measures of sustainable development; • form part of the ongoing decision-making and reporting processes within the organization, rather than being reported on an annual basis for external purposes only; • be either narrative or quantitative in nature; and • be underpinned by disclosure of the following elements to facilitate verifiability and understandability (either within the report or made available to users on the company's website): – definition; – calculation methodology; – underlying assumptions; – level of uncertainty; – scope and boundaries.
2.4	Identify the relationship between selected KPIs and financial or business performance, where possible quantifying the relationship in terms of impact on revenue, expenditure, investment, cash flow or measures of operational performance.
2.5	Align management performance appraisal and incentive structures with selected KPIs, based on time-horizons over which outcomes can be measured.
2.6	Describe clearly in the connected report: • the actions taken in response to each material issue; • how these will achieve the intended outcomes; • the KPIs which demonstrate performance, highlighting the connection with the strategic direction of the business; and • the governance arrangements in place to incentivise and reward behaviour contributing to the delivery of intended outcomes.

"It is great for me that we can tell people what is happening, and that we can save money. That is one of the biggest benefits of the Connected Reporting Framework. If people ask for a financial figure you can point to one, whereas a figure based on technical data often doesn't have the same impact. You can show that, for a property company, unsustainable practices can cost more."
Paul Edwards, Head of Sustainability, Hammerson plc

3.

The Connected Performance Report

What should be reported?

- Clear targets for each KPI, where feasible.
- Actual performance against baselines, prior years, targets and industry or other benchmarks.
- Financial or business performance measures alongside each sustainability KPI to explain the connection to the business's results.
- Commentary on progress towards both targets and intended broader outcomes.

How?

3.1	Agree on targets for each KPI and supporting performance measures, ensuring that each target: • aligns to the organization’s financial targets/plans; • considers time horizons that are applicable to the issue, the industry or the organization itself; • considers levels set by peers, industry and national averages or other benchmarks; • includes a baseline against which it will be measured; and • considers the sufficiency of the response to address the identified sustainability issue. For emerging issues, as a first stage it may be necessary to establish an approach to measuring the impacts before specific targets can be set.
3.2	Ensure appropriate information collection processes are established to provide complete, accurate and consistent information. Where possible, integrate and align sustainability-related data capture systems and processes with financial systems.
3.3	Report on the actual performance achieved in the reporting period, with reference to: • the agreed targets; • the reporting baseline; • performance in prior years, where possible providing trends over the past five years; and, • peers, industry and national averages or other benchmarks. Ensure that reported performance includes absolute as well as normalized data where relevant (for example, total energy use rather than just energy efficiency measures), enabling investors to conduct their own analysis of impacts.
3.4	Report related financial or business performance measures alongside KPIs, providing a clear indication of the relevance of sustainability performance to the business’s results. If quantification of financial impact is not possible, report in qualitative terms.
3.5	Provide disclosure of any restatements to historic data, including the breakdown between changes as a result of acquisitions or disposals and changes due to improvements in data collection or changes in accounting policies adopted.
3.6	Create a commentary which provides an explanatory narrative of performance and progress against targets and towards intended broader outcomes, reflecting a balanced perspective of: • reasons for successes and failures; • challenges to progress and how management is responding; and • explanation of plans to deliver strategic objectives, including how targets will be achieved.

“In order to tackle climate change, the depletion of finite natural resources and other sustainability challenges, projections and targets are essential to assess the sufficiency of an organization’s response. The use of safe harbour provisions or similar safeguards to protect companies that make these statements in good faith will help remove legal concerns and facilitate meaningful disclosure.”

Paul Druckman, Chairman Trucost and Fédération des Experts Comptables Européens Sustainability Policy Group

Introduction to the worked examples

These examples have been produced as a supplement to the 'how to' guide and demonstrate howconnected reporting might be applied in practice.

There are three examples, a supermarket group, a property investment company and a water/wastewater service supplier. Each is an extract from the organization's Annual Report and Accounts. These sectors were selected to cover a variety of different sustainability impacts, degrees of regulation and levels of maturity in reporting on sustainability.

The examples are designed to demonstrate the relevance of sustainability issues to the achievement of strategic objectives. Full connected reporting requires sustainability impacts and related financial and non-financial information to be included in the Annual Report and Accounts as an integral part of the overall picture given, rather than in a separate section or a separate report. The information is brought together in the following examples for ease of presentation in this context and also because organizations may, as a first step, wish to start with a separate section before moving on to full connected reporting.

Each example varies in length and detail. This reflects discussions during the consultation process on the level of information that investors might require. In addition, some of the information included in the examples is forward-looking, in line with the changes being suggested for the 'management commentary' (also known as the Management Discussion and Analysis or Business Review) in annual reports. This information may necessitate the inclusion of a provision to make it clear that the projections are provided in good faith and on the basis of the best information available, but are indications rather than commitments. This provision (known as a 'safe harbour' provision) has not been included in these examples.

The examples are not intended to provide a template for organizations to follow, nor to represent a model set of issues, impacts and actions. Instead, it is anticipated that organizations which wish to adopt connected reporting will be able to use both the guidance and the examples to help them consider how to develop a connected approach in the context of their business.

It is hoped that there will be co-ordination between organizations in the same industry group to agree a common approach to connected reporting in their sector. A significant amount of work is already being done in this area by various organizations. Examples include initiatives such as the European Federation of Financial Analysts Societies, the Global Reporting Initiative and the World Business Council for Sustainable Development. It is important that this work is co-ordinated internationally to reduce duplication and create the cohesion and consistency in reporting that is needed, while retaining flexibility for an organization to adopt the approach that is specific to its business.

GRO Foods plc

12-21 →

The GRO Foods plc example was created by a team from PricewaterhouseCoopers comprising finance, retail, sustainability and climate change specialists. The example was also subject to industry consultation, which included a round-table discussion attended by Finance Directors and other representatives from a number of major supermarket groups and the investment sector, as well as industry experts.

The aim of this example is to demonstrate the strategic relevance not only of a supermarket group's direct impacts, such as energy use and waste, but also the more indirect impacts, such as the use of finite natural resources in the supply-chain, interaction with employees and local communities, and end-user consumption, where the majority of sustainability impacts in this industry are found.

"Sustainability issues, such as those contained in this example, are fundamental to our strategy as our customers are demanding that we address these areas. This creates value drivers that should be presented as part and parcel of the Annual Report and Accounts. Moving forward, there is a need for sector comparability, built on information that is used to manage the business, much of which is already collected."
Darren Shapland, Chief Financial Officer, J Sainsbury plc

GP Office Investment

22-29 →

The GP Office Investment example was created by Upstream Sustainability Services, a business unit of Jones Lang LaSalle, with input from finance, investment and sustainability professionals and has been tested through consultation and round-table discussion with a range of representatives from the property sector. The example is set in the context of typical landlord/tenant arrangements.

Property investors undoubtedly have a large ecological footprint, particularly through their development activities and the operational management of assets. The UN Environment Programme estimates that the built environment accounts for around 40% of all energy consumption, 30% of raw material use and 25% of solid waste production. However, complex landlord and tenant arrangements can often hinder efforts towards improved transparency and accountability. This worked example seeks to explore the causal relationship between sustainability and financial returns of property including capital values, rental income and risk modelling.

"The example represents an important and new line of inquiry on sustainability and value at the property portfolio and corporate level, and has received positive feedback from a number of our members."
Gareth Lewis, Director of Finance, European Public Real Estate Association (EPRA)

BWC plc

30-35 →

The BWC plc example was developed by a working group of finance and sustainability representatives from seven of the UK's largest water and wastewater companies, and was reviewed and discussed at a meeting of the Water UK Council (which mainly comprises the Chief Executives of the member companies).

The water industry is subject to strong regulation in all areas of its core business – the quality of drinking and treated wastewater, environmental improvement and price control. As a result, around £80 billion has been spent in the last 20 years on capital projects to upgrade infrastructure and meet statutory environmental and quality requirements. Co-ordination between policy makers, regulators and individual service suppliers is therefore particularly critical in this industry to help ensure more sustainable outcomes are achieved.

"We presented this example to our Council as we could see how reporting on the connection between the strategic direction and financial and sustainability performance could be of benefit to our members. The example received a positive response from Council, and following the meeting, a number of members expressed an interest in applying this approach in the context of their own business."
Pamela Taylor, Chief Executive, Water UK

GRO Foods plc

Extracts from the Business Review

(About GRO Foods and Our vision are extracted from the introduction to the Business Review)

About GRO Foods

GRO Foods is a UK listed supermarket selling a wide range of food and non-food products from stores in six countries. The main markets are in Europe (60%) and the USA (25%). In recent years much of our sales growth has come from the emerging Asian economies of India and China, which now account for 15% of total sales. The Group owns 700 stores and employs 150,000 people globally.

Our vision

The Group's vision is to be the leading supermarket in the provision of responsibly sourced, quality food and non-food products.

The impact of sustainability issues on our key strategic objectives

The following section describes how sustainability issues impact on the achievement of our four key business objectives.

1. Sales growth

Strategy

This objective will be achieved by improving the shopping experience, expanding the number of retail outlets, particularly in high growth areas, and continually innovating to deliver great value products that meet the needs of our customers.

Sustainability context

Expanding our retail network increases the impact we have on the environment, mainly through increased carbon emissions and use of water in both our direct and indirect operations. It also increases the importance of rising concerns regarding health issues such as obesity and diabetes.

Risk and opportunities

We have amended our store development model to build only "eco-stores", which use at least 70% less energy than standard stores, and as a result are experiencing a 22% improvement in the level of planning permission granted. We are also focusing on mitigating environmental threats to our stores to enhance the value of our property stock.

Governments are legislating to reduce the salt and sugar content of food products and we face risks if we are not well placed to meet changing requirements. We are therefore developing our own-brand food lines to ensure they meet both the appropriate legislation and the consumer demand for great tasting, affordable food that meets a growing desire for more balanced diets.

Staying ahead of legislation and communicating the nutritional benefits of our products has resulted in an increase in the number of weekly customer visits from 18 to 18.5 million. The UK's Food Standards Authority (FSA) is at the forefront of science in this area and we are applying UK guidelines across our operations worldwide.

2. Improving operational efficiency and delivering cost savings

Strategy

We look to deliver ever greater value to our customers and improve returns to our shareholders by enhancing efficiency and lowering costs. To mitigate the impacts on our business of volatile and increasing energy costs and emerging carbon and waste reduction legislation, we are focusing on reducing our energy use and minimising waste.

Sustainability context

As a retailer, we use significant amounts of energy, which in 2009 cost £40 million and equated to carbon emissions of 360,000 tonnes. While we could buy more "green energy", we feel it is more prudent to seek to reduce our energy consumption and invest in our own renewable energy capacity. We are also reducing emissions from our transport by more efficient loading and the introduction of electric vehicles.

Waste is another impact with which the retail sector is increasingly associated, whether from packaging, food waste generated directly by our own stores, or indirectly by our suppliers and customers. This year we created packaging waste of 650,000 tonnes, construction waste from new stores of 450,000 tonnes and sent 35,000 tonnes of waste to landfill. We have committed to halve the weight of packaging of our products, reduce our new build construction waste by 50% and divert all food waste from landfill to energy generation and composting by 2014.

Risk and opportunities

Medium-term, energy price volatility poses the greatest threat to our cost base. More immediately, legislation such as the UK's Carbon Reduction Commitment (CRC) will take approximately £5 million from our 2011 cash flow, while UK landfill tax is set to double by 2013. When similar legislation is imposed across all our markets, as anticipated, the risk will be multiplied many times over.

We will reduce our environmental impact and achieve cost savings by reducing the amount of energy used. The cumulative benefits of our waste reduction programmes have resulted in £10 million in cost savings in 2009.

Our Key Performance Indicators

The table below outlines our KPIs for each of our four strategic objectives.

Strategic objective	KPI targets (by 2014)	2009 Performance	Benchmark
1. Sales growth	• 5% sales increase year-on-year • 4% like-for-like sales increase per year	• 5% increase • 4.1% increase	The grocery sector in our key markets has grown on average by 2.2% year-on-year in the last five years and is forecast to grow at 3.3% per annum for the next five years. Our growth targets are above the average for the sector.
2. Operational efficiency and cost savings	• Reduce operating costs by 5%	• 2% reduction	Sector average operating margin among grocery retailers in our developed markets was 4.5% in 2008/09. We will maintain our above average margin position
3. Securing a sustainable supply base	• Mitigation plans in place for all of the top 1,000 own-brand product lines identified 'at risk'	• Mitigation plans in place for a further 85 product lines	The Department for Environment, Food and Rural Affairs estimates 37% of England's acreage for vegetables grown in the open is "at risk" from flooding due to climate change. The UN Food and Agriculture Organization estimates that agricultural productivity in developing countries may decline between 9% and 21% as a result of climate change. We will remain ahead of the market in developing a secure, sustainable supply chain.
4. Supporting our employees and the communities in which we operate	• Less than 10% employee turnover per annum • 3% absenteeism or less	• 10.4% employee turnover • 3.3% absenteeism	Average staff turnover in the UK retail sector is 17%. We will maintain our market leading position on this benchmark.

3. Securing a sustainable supply base

Strategy

Our business depends on the quality and availability of goods for our customers. Increasingly we seek to ensure that our purchases promote social and environmental well-being, while simultaneously protecting our supply base from the risks associated with climate change and diminishing natural resources.

Sustainability context

The majority of the business's environmental and social impacts are in our supply chain, which is complex and global in nature. The major impacts include carbon emissions, water use, land use changes and labour standards.

There is now significant awareness of the sustainability impacts that a major company generates as a result of the goods and products it procures. Customers, in particular, are ever more attuned to the sources of the food and products that they buy. It is both our responsibility and in our interest to maximize the positive and minimize the negative impacts of procurement decisions.

At the same time, climate change and water stress threatens our business, making it increasingly challenging to source many agricultural products from traditional locations.

Risk and opportunities

This year 30% of our own-brand food and beverage products came from a certified sustainable source, supporting increased market share of 2% in these product categories. We are also using local suppliers in all our markets where there is a notable environmental benefit or customer preference.

Since 2007, we have assessed 300 of our top 1,000 own-brand food and beverage products to ensure that they are insulated as far as possible from the impacts of climate change and water stress. Of the products we have assessed to date, 170 have been identified as "at risk" and we have already put in mitigation plans for 85 of these.

4. Supporting our employees and the communities in which we operate

Strategy

We aim to be welcomed in the communities in which we currently operate and into which we seek to expand. We do this by investing in the skills and welfare of our employees and by aligning our community involvement activities with community and employee interests.

Sustainability context

Over 90% of employees in retail outlets come from the communities in which stores are located. Perhaps our most valuable direct social contribution is providing these employees with a safe place to work, where they can acquire skills that equip them throughout their careers and enable them to develop and progress within our company.

These employees become our greatest advocates in the communities where we operate. Thus, promoting the welfare of our employees and serving our communities is fundamental to our reputation and our licence to operate. In recent years, we have also realized the benefit of linking employee engagement activities with community involvement.

Risk and opportunities

We face competition for talent from all our major competitors. In addition, turnover of staff and absenteeism add significant costs to our business – at least £50 million in 2009. Managing these risks requires significant investment in training, over £14 million this year. We are seeing a return on this investment with reduced absenteeism and employee turnover, down to 3.3% and 10.4% from a baseline of 3.5% and 11.0% respectively.

While we contributed directly £13 million globally to community activities, we are getting a significantly greater return to our business through improved employee morale and relations with communities. This has delivered substantial benefits to local communities and resulted in very positive media coverage, equivalent to an estimated £19 million spent on advertising in local and national press.

Our Connected Performance Report

The purpose of our Connected Performance Report is to report on the performance of specific actions taken to address the sustainability issues described and how these can contribute to the achievement of our overall strategic objectives.

Extract from our Operating and Financial Review – The Connected Performance Report

In order to achieve sales growth we will increase floor space over the next five years and ensure that both new and existing stores are 'eco-efficient' and mitigated against the physical and regulatory risks of climate change. We will continue to invest in new product innovation, providing healthy, quality foods that our customers expect from us. We will meet the increasing demands of our customers for healthy food products by reducing the salt and sugar content of our own-brand products, following the recommended targets set by the UK's Food Standards Agency.

1. Sales growth

Target

New stores

- Open 160 new stores from 2007 to 2014; 100 will be in Europe and 60 will be in India and China.
- All new stores will be 'eco-stores' that require 70% less energy compared to standard stores.

New product innovation

- Increase sales of our healthy 'Balanced' food range by £200 million by 2014.
- Reduce salt and sugar content in our main product lines (bread, cereal, frozen convenience and ready meals) to meet and exceed the FSA's recommended limits.

Performance

Investment in growth
Number of new stores opened
Total premium to build eco stores (£ million)
Total lifetime savings in energy costs over a 25 year lifespan (£ million)

	Salt and Sugar per 100g serving			
	FSA targets (2010)		Current GRO content	
Main lines	**Salt**	**Sugar**	**Salt**	**Sugar**
Bread	0.8g	N/A*	1.1g	4.0g
Cereal	0.8g	N/A*	1.0g	3.0g
Frozen convenience (average)	0.8g	N/A*	16.0g	1.0g
Ready meal (average)	0.8g	N/A*	12.0g	1.5g
Total main product lines				
Total other product lines				
Total 'Balanced' range				
Total				

* The FSA does not provide RDA for sugar. They suggest sugar should account for approximately 11% of daily calorific intake. Our calculations are based upon relative contribution that each food product would make up in an average person's daily diet.

2007 (Baseline)	2008 (Actual)	2009 (Actual)	2010–2014 (Target)
10	20	20	110
95	190	190	1,045
79	146	142	718

GRO target (2015)		2009 Investment in R&D (£ million)	2009 Advertising/ Consumer engagement spend (£ million)	2009 Food sales (£ million)	2014 Sales target (£ million)
Salt	Sugar				
0.7g	3.5g	1.0	0.5	500	800
0.7g	2.5g	1.5	0.5	1,000	1,700
8.0g	0.1g	3.0	2.0	2,500	3,000
8.0g	0.2g	2.5	2.0	3,000	4,000
		8.0	5.0	7,000	9,500
				7,800	9,240
				200	400
				15,000	**19,140**

Comments

During 2009, GRO obtained planning permission for 45 new stores in Europe and five stores in India and China.

Compared with standard stores, environmental stores have a higher planning application acceptance rate, an improvement of 22% in our European markets.

Significant additional investment is required to build our new ‘eco-stores’, but these require 70% less energy than standard stores and will reduce emissions by this amount as well. More efficient refrigeration, lighting, heating and ventilation systems in these new stores will significantly help to achieve these energy savings.

Sales of our ‘Balanced’ range reached £200 million in 2009.

We invested £8 million in research and development to reduce the salt and sugar content of the four main product lines. We will not meet the FSA’s proposed targets for salt content in bread and cereals by 2010, but are on track to meet these targets by 2015. Reductions in the salt content of frozen convenience and ready meal products will not meet the 2010 targets either, but our research shows that our salt and sugar contents of these products are lower than that of our competitors, and we are targeting significant reductions by 2015.

We have seen an increase in the number of weekly customer visits from 18 million per week to 18.5 million since 2008. A survey conducted in 2009 indicates that approximately 50% of this increase is attributable to our new, healthier product ranges, associated advertising and other customer engagement activities to promote healthy living.

Extract from our Operating and Financial Review – The Connected Performance Report

One of our biggest costs is energy use, which accounts for approximately 15% of total operating costs (approximately 5% stores and 10% transport) and we are developing energy efficiency programmes which will allow us to increase sales while reducing greenhouse gas emissions and help us meet the required legislation. Waste is also a significant cost as a result of landfill and associated transportation costs and we also have a specific waste reduction programme in place to reduce these costs.

2. Improving operational efficiency and delivering cost savings

Target

Reduce total energy use

- Increase investment in renewable energy so that 40% of all energy needs will be generated from such sources by 2014.
- Reduce CO_2 emissions by 120,000 tonnes (18%) by 2014 against a 2007 baseline.
- Reduce our CO_2 emissions per square metre by 44% by 2014 against a 2007 baseline for existing stores.
- Reduce road miles travelled per pallet of stock by 10% by 2014.

Performance

	2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
Annual energy cost (£ million)	45	43	40	38	35
GRO – kg CO_2e /m^2 of floor space	320	320	300	290	180
Renewable energy generated on-site (% of total)	18	18	25	30	40
Investment in on-site energy generation (£ million)	8	8.5	10	9	8
Investment in energy efficiency measures (£ million)	20	15	15	10	30
Annual savings[1] (£ million)	9	9.5	10	10.5	15
Average payback period (years)[1]	3	2.5	2.5	1.8	2.5

1 Savings and payback periods in respect of investments in on-site energy generation and efficiency measures made since 2007

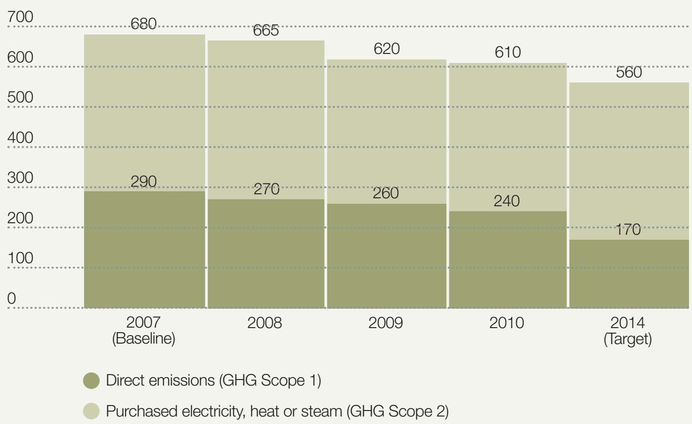
Minimize waste

- Divert all food waste from landfill by 2014.
- Reduce packaging weight in our products by an average of 50% by 2014.
- Reduce construction waste to landfill by 50% by 2014.

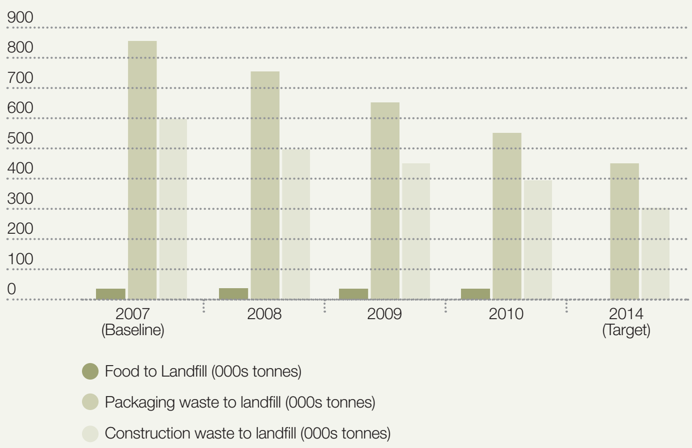
	2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
Expenditure to reduce all waste (£ million)	(5)	(10)	(20)	(20)	(30)
Annual savings[1] (£ million)	1	5	10	40	100
Average payback period (years)	5	2	2	0.5	0.75

1 Savings generated specifically from the investment made since 2007

CO₂ equivalent emissions (kt)



Waste to Landfill



Comments

In 2009, we invested £15 million in energy efficiency and £10 million in on-site renewable energy technology. Both these investments have reduced total energy costs and resulted in annual savings of £10 million.

25% of our store energy is from renewable sources which has helped us to reduce the risk of exposure to reduced energy availability and price volatility. This means we are on track to meet our 2014 target of 40% on-site power generation.

We reduced carbon emissions by over 3% in 2009 and are on track to meet the 2014 reduction target of 180 $kgCO_2e/m^2$, a 44% reduction against a 2007 baseline. The EU target for carbon emissions reduction is 20% by 2020 and we are aiming to maximize our contribution towards this target.

We are reducing road miles travelled per pallet of stock by increasing use of shipping and rail which has resulted in fewer trucks on the road. We are also streamlining transport from warehouses and have introduced a new logistics management system to help further improve efficiency.

In 2009 we diverted over 70% of all food waste from landfill to either anaerobic digestion or composting, resulting in savings in Landfill Tax and transportation. We are well on track to achieve our 2014 target of zero food waste to landfill.

We conducted trials with all top tier suppliers in 2009 on 50% of our top selling product lines to reduce packaging. For all products we successfully reduced packaging by 10%. This reduced cost of goods sold by up to 15% in some categories which covered our investment in the trial and enabled any further savings to be passed onto our customers.

We have signed up to the Waste & Resources Action Programme (WRAP) voluntary agreement on halving construction waste to landfill by 2014. We are seeking to implement this policy in developing markets by working with suppliers to develop recycling capacity.

In 2009 by reducing food, packaging and construction waste we realized savings of £10 million, which means we are on track to achieve our 2014 targets.

Extract from our Operating and Financial Review – The Connected Performance Report

GRO's supply chains are complex and global in nature and we create social and environmental impacts along all points of these chains. Such issues pose risks to the long term sustainability of our business and we are committed to addressing them in the most responsible way. We also recognize the challenges to security of supply posed by climate change and we are taking action to mitigate these risks in collaboration with our suppliers.

3. Securing a sustainable supply base

Target	Performance
Supplier standards	**Own-brand products from certified sustainable sources**
• Increase the percentage of own-brand food and beverage products that are from certified sustainable sources to 50% by 2014.	Value of sales (£ million) Percentage of total own-brand food and beverage sales (%)
	Own-brand products from local sources
• Increase the number of local suppliers used in all regions where we operate by 3,000 by 2014, against a 2007 baseline.	Total number of local suppliers Value of sales from local suppliers (£ million) Cost of changing to local suppliers (£ million) Annual savings through reduced shipping and transport costs (£ million) Net financial benefit from changing to local suppliers (£ million)
Assess and mitigate the risks from environmental and social risks to the supply chain	**Environmental and social risk – top 1,000 own-brand product lines**
• By 2014, assess our top 1,000 own-brand product lines and, in collaboration with our suppliers, implement mitigation plans for all those identified as 'at risk'.	No. of product lines assessed for risk (total number) Sales value of product lines assessed for risk (£ million) No. of product lines identified 'at risk (total number) Mitigation plans in place for product lines identified at risk (%)

Comments

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
200	300	475	800	1,200
10	25	30	35	50

Through our procurement of goods we contribute millions of pounds to farmers in low income countries. In order to gain independent approval of our contribution in these countries, as favoured by our consumers, we are increasing the volumes of own-brand products from certified sustainable sources.

Additionally, increasing the proportion of certified sustainable products in our supply chains mitigates risks, particularly in security and consistency of supply as well as improving quality.

Customers have shown a sustained interest in purchasing these products over the economic downturn. They tell us this differentiates GRO in the market and this has helped us to increase market share by 2% in these product categories this year.

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
3,000	3,300	3,600	4,000	6,000
100	120	140	180	360
3	4	5	5	8
5	6	8	10	18
2	2	3	5	10

Developing a selection of locally sourced produce is an important part of our sustainable supply chain strategy. Customers tell us they are concerned about supporting local businesses. They have responded extremely well to our efforts in providing locally sourced produce and this has been a key contributor to increasing our market share in 2009.

Increasing use of local suppliers for seasonal produce has also led to cost savings through reduced shipping and transport costs, which has saved the business £8 million this year.

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
100	200	300	500	1,000
1,000	1,500	2,100	2,500	5,000
50	125	170	–	–
40	40	50	60	100

In 2009 we assessed environmental and social risks in the supply chain for a further 100 of our top 1,000 own-brand product lines, accounting for a further £600 million in sales.

To date, we have identified 170 product lines ‘at risk’ and have created mitigation plans for 85 of these.

We will continue to work with our suppliers to complete the assessment of the remaining 700 product lines, applying the lessons learnt from our work this year.

Extract from our Operating and Financial Review – The Connected Performance Report

The success of our business depends on the well-being and job satisfaction of our employees and their motivation to provide the best service to our customers. With over 90% of our retail sales force coming from the community in which the store is based, we see serving the needs of employees and communities as intrinsically linked and are committed to investing in both the wellbeing of our employees and the community we serve.

4. Supporting our employees and the communities in which we operate

Target	Performance
Employee engagement and morale	
• Achieve employee engagement scores of 70% or above.	Total number of employees (FTE)
• Reduce employee turnover to 5% or less per year.	Gross total wages paid (£ million)
	Employers total tax paid (£ million)
	Annual employee turnover (%)
	Employee absenteeism (%)
	Employee absenteeism costs (£ million)
	Investment in training (£ million)
	Employee engagement scores (%)
	Total savings from reduced employee turnover, absenteeism and associated costs (£ million)

Positive impact on the community

- Be recognized as contributing positively to the communities where we operate.

Performance in 2009

Inputs (company contribution)	**Leverage** (additional contributions due to our efforts)	**Outputs**
• £13 million (cash) • Worldwide, 100,000 hours given by employees, equivalent to £650,000 • Food redistributed to communities, equivalent to £6 million	• £10 million additional funding from UK Environment Agency and NGO, Edu-Carbon • £15 million donated by customers through in-store collection • £1.2 million raised by employees for local causes	• 400 UK schools receive energy saving advice and education • 250 GRO Walk to School Programmes, 90 GRO School buses • Outreach activities in over 200 communities in China and India

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
143,541	147,800	149,780	153,700	160,000
2,511	2,600	2,650	2,734	2,910
206	211	220	235	250
11.0	10.7	10.4	10.0	9.2
3.5	3.5	3.3	3.2	3.0
55	53	50	50	45
10	12	14	16	24
56	56	60	63	70
5	5	12	13	15

Comments

A fundamental aspect of our strategy is to ensure our employees' well-being. We believe that satisfied employees will recommend our offering to their neighbours and enhance our reputation in the communities in which we operate.

We are investing in training that will increase the skills of our employees. This training not only provides us with more literate and skilled employees, which enables us to run our business better, but it has also been shown to make a huge difference to employee satisfaction and subsequent retention.

We want to be known for the skills that we help people from our communities to develop. We are using opportunities to participate in community activities as part of a new retail skills programme, as well as a means to promote employee engagement. Our research shows that employees who feel able to express their values through their workplace give an additional 2%–3% discretionary effort.

Impacts (community)	**Impacts** (business)
• UK-wide CO_2e reduction of 0.5 million tonnes • Reduced congestion • Improved local environments in key emerging market communities	• £3.2 million additional sales attributed to GRO Bus programme • Increased brand awareness equivalent to £19 million of advertising • Recognition among local authorities and central government, supporting access and planning applications

GRO directly invested £13 million in charitable or community activities in 2009. We identify community or charitable activities where our employees, customers and wider community believe there is the greatest need. We align this with assessments of where we can achieve the greatest community impact, along with activities that make clear commercial sense.

The focus on environment and education is helping to improve the physical environment in local communities, reducing traffic and pollution through GRO's Walk to School initiative and the GRO school bus programme.

We are undertaking work to understand better the impacts of our community activities and will report on this in next year's Operating and Financial Review.

GP Office Investment

Extracts from the Business Review

About GP Office Investment

GP Office Investment, a wholly-owned subsidiary of ABC Investment plc, is a fund manager specialising in commercial offices in the United Kingdom. It manages four funds, incorporating:

- £3.75 billion of assets under management as at 31st December 2009
- 7.4 million square feet of Net Lettable Area
- 160 multi and single-let properties providing office space to 382 occupiers
- an asset allocation of: 45% West End Offices, 35% City Offices and 20% provincial Business Parks

Strategic objectives

ABC Investment has set the following strategic objectives to guide its five year strategy across all areas of investment activity, including equities and real estate:

1. Increase value of assets under management
2. Achieve a superior rate of return on investment for our clients
3. Maintain a strong brand identity with an emphasis on market innovation
4. Maintain strong relationships with key stakeholders

Key sustainability impacts on strategic objectives

We have identified three over-arching sustainability issues that are material to the achievement of the group's strategic objectives and which take into account both the long-term drivers of performance and our role as a responsible fund manager. Each of these issues and their corresponding impacts are described below.

In order to determine which issues are material, each year we assess a broad range of sustainability issues for the magnitude of perceived risk and opportunity they present to the business (in financial, reputational, operational and physical terms) and the level of investor and occupier interest, gauged through direct consultation.

1. Changing occupier requirements

Meeting the evolving requirements of occupiers is essential if we are to maintain high occupancy rates and protect rental income – even more so in challenging market conditions. As occupier demand patterns change to incorporate a growing concern for sustainability issues, so too must our response. Research by the European Commission found that 84% of international occupiers believed sustainability would be critical to their business in 2009. We continue to observe a similar trend with increasing demand for 'green buildings', particularly from occupiers who wish to align their real estate occupation strategies with their corporate responsibility commitments. As a demonstration of this trend, sustainability was cited as an important factor in 76% of lease renewals we renegotiated in 2009.

We believe there is significant market potential for green buildings. These are deemed to be assets which incorporate a broad range of sustainability factors into their design and are able to operate with minimal impact on the environment, whilst enhancing the socio-economic fabric of their respective localities. Not only are sustainable assets more marketable, but also there is emerging evidence to suggest that sustainable buildings maintain market level rents and capital values more effectively than less sustainable alternatives. To capitalize on this opportunity, we continue to acquire properties with strong sustainability credentials, including those with externally verified building ratings.

Whilst building ratings alone do not deliver sustainable buildings – indeed, evidence suggests that there is not always a direct correlation between the building rating attained and actual performance in relation to energy and water efficiency – we recognize their role in ensuring a more complete approach to sustainable design. It is for this reason that we participate in other asset specific and portfolio-wide sustainability benchmarks to provide a more rounded perspective on our performance relative to peers. For instance, over 65% of our assets scored above the survey average in Jones Lang LaSalle's The Third Dimension risk profiling survey.

The provision of adaptable, flexible and durable buildings with change in use potential is also an important occupier concern. These buildings are less likely to suffer obsolescence and are more responsive to changing work patterns in increasingly wireless and virtual office environments. More flexible and technology-driven occupation requirements present both a risk and opportunity to future rental income. Through targeted capital investment in adaptability and flexibility we aim to increase the life expectancy of assets under ownership. In doing so, we have maintained steady void rates even in challenging economic conditions. We also recognize the importance of a diversified portfolio, not only to meet occupier demand but to reduce exposure to property market fluctuations. Many of our assets therefore contain a mix of potential uses.

2. Weather vulnerability and climate change risks

According to the most recent projections, climate change has the potential to impact materially our ability to deliver strong investment returns, through increased maintenance costs and rising building insurance premiums, where we are wholly or partially responsible for these costs. There are also potential impacts on net asset values through extreme weather events such as flood and storm damage. Since 2004, the number of extreme weather related insurance claims has increased by 40% to 14, with total claims amounting to over £300,000. To protect asset value, we recognize that our acquisition strategy must factor in the immediate and longer term physical impacts of climate change and the risk to buildings that are not protected. This includes disposal of assets which are considered a high flood risk. Since 2004, we have reduced the number of our assets of this type from 11 to 6.

3. Resource availability and use

The instability of commodity markets which supply non-renewable fuels (coal, oil and gas) and the prospect of increasing water shortages may place a strain on the price and availability of these resources. We need to take action now to reduce risk exposure to market spikes which can impact on our operating costs and ultimately render buildings obsolete where the cost of retrofitting may not be commercially viable.

The business case for investing in energy efficiency is compelling considering we spend around £20 million per year on energy. Where we have an influence over energy efficiency in our assets, we are committed to implementing all 'low' and 'no cost' measures. Where investment is more significant we require payback within three years. In 2009 our investment in energy efficiency measures totalled £1 million and provided an estimated £2.4 million in energy savings. We project similar investment and savings over the next three years.

In addition to the need to invest in energy efficiency, there is also likely to be higher incidence of obsolescence for buildings which do not meet local energy regulatory standards or occupier needs. Taxes and fiscal penalties levied on carbon emissions may also reduce asset value. We therefore continue to prioritize energy monitoring in light of the rapidly growing carbon market – most immediately in preparation for the Carbon Reduction Commitment Energy Efficiency Scheme in the UK which we estimate will require payment of around £1.6 million in 2011. This payment will be recouped through increased service charges.

In relation to the production and use of waste arising from our asset management activities, we are focused on reducing our exposure to rising costs. As the cost of disposing of waste to landfill outstrips the cost of recycling or reuse, the business case for alternative waste disposal routes is clear. For the assets where we are responsible for waste management, we saved £540,000 in 2009 by diverting waste from landfill, and estimate that savings will rise to £910,000 by 2012.

The Connected Performance Report

The Connected Performance Report provides a forward looking perspective on the actions taken to manage risks and opportunities associated with the three sustainability issues identified, and the impacts on both financial and non-financial performance. In some cases, the direct financial cost is not material at present. However, we believe that a failure to factor in these issues now has potential to undermine future performance.

While the information provided focuses on areas in which we have either direct managerial or financial control, we continue to work with our occupiers to influence their behaviour towards more sustainable occupation practices. We also manage issues other than just those deemed material and further detail on these can be found in our Sustainability Report.

Where appropriate we have also made references to the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines to ensure alignment with good practice reporting standards.

The Connected Performance Report

1 Changing occupier requirements

To ensure that we maintain high occupancy rates we must foster strong relations with our occupiers by responding to both their growing demand for green buildings and their requirements for innovative fit-outs which are flexible to changing work patterns.

Action and outcome

Occupier satisfaction

Offices which meet the needs of occupiers enable them to sustain their productivity, thereby contributing to the economy and society.

Through post occupation evaluations carried out at newly let premises or following lease renewal, we survey occupiers annually on satisfaction levels associated with key aspects of property management as well as the perceived value of our sustainability efforts. We have also begun to seek feedback from occupiers on sustainability issues during post occupation evaluations, including the importance of sustainability factors in new lettings and lease renewals.

Building ratings

Assessing our buildings using ratings and benchmarks enables us to prioritize and target sustainability improvements across the portfolio.

Sustainability ratings are considered in the asset appraisal process conducted prior to acquisition. We believe that ratings such as BREEAM, LEED and Energy Performance Certificates provide a useful tool to assess and benchmark sustainability credentials. We also utilize them in design and construction of refurbishments rather than having to incur cost later to retrofit.

We continue to use appropriate benchmarks and risk profiling tools from other sources to complement sustainability ratings. These help to inform asset acquisition and disposal and sustainability improvements.

Adaptable buildings

Adaptable and flexible buildings that are suitably located are more inherently sustainable as they typically have longer useful lives.

Our investment strategy seeks out assets which demonstrate these characteristics, have a low likelihood of functional obsolescence over the life of ownership and consequently have lower rates of depreciation. We see this as an important future determinant of asset value, as such buildings typically require less investment to cope with changing use. They are also likely to maintain their rental value more robustly and reduce void time during occupier changeover. Our flexible approach to building fit-out ensures that lighting, heating, cooling and interior space designs are adaptable for wide-ranging occupier requirements.

Performance

Occupier satisfaction Index scores (out of 5)

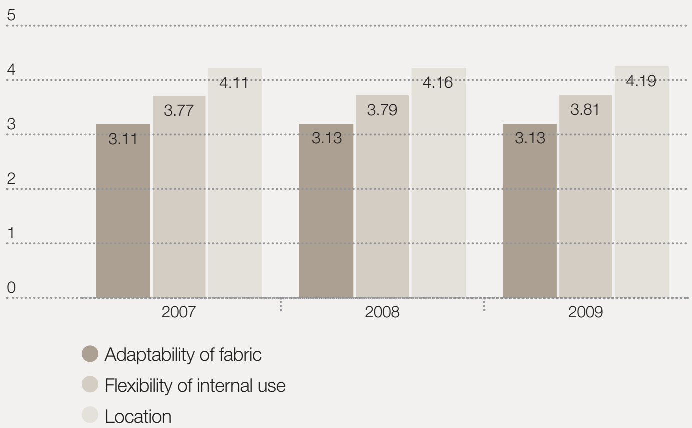
	2007	2008	2009
Communication	3.71	3.69	↑ 3.73
Responsiveness	3.74	3.74	↑ 3.76
Understanding needs	3.81	3.84	↑ 3.85
Overall satisfaction with property management team	3.72	3.80	↑ 3.82
Occupied space flexible in use	3.54	3.53	↑ 3.57

Value of assets by BREEAM rating

BREEAM 2008 rating*	Value of Assets – BREEAM Offices (£m)
Outstanding	20
Excellent	80
Very Good	80
Good	200
Pass	20

* Including both ‘design-stage’ and ‘post-completion’ assessments

Fit for purpose assessment (1 = low 5 = high)



Commentary

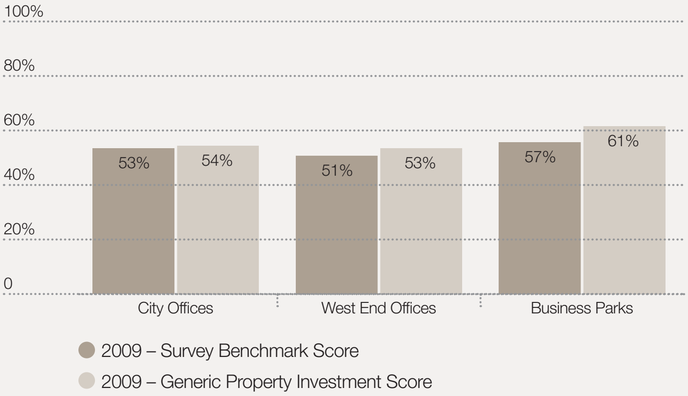
Sustainability and new lettings/lease renewals

	2007	2008		2009
Total value of new lettings and lease renewals (£m)	20	12	↓	8
New lettings and lease renewals where sustainability cited as an 'important' factor (%)	59	63	↑	76

Our occupier survey results show that we continue to demonstrate strong performance across a broad range of occupier satisfaction measures. In particular, feedback suggests that our offices accommodate changes in use and that we are able to respond to evolving occupier requirements quickly and with minimal disruption.

Since 2007, the number of lettings where sustainability has been cited as an 'important' factor has increased, reflecting growing concern for issues such as energy and material specification amongst occupiers.

Jones Lang LaSalle's Third Dimension Sustainability Risk Profiling

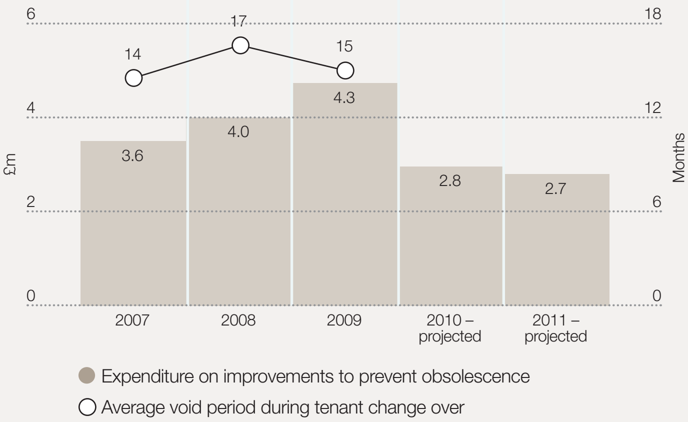


Around £180 million of our most recently constructed developments (by current value) are certified to the BREEAM standard at 'Very Good' or higher.

For existing assets, we use alternative assessments such as Jones Lang LaSalle's The Third Dimension survey which analyses the sustainability risk profile of over 2,000 properties. For the property types we own and manage, our score was higher than the survey average score in all three asset classes. This suggests that our portfolio has an inherently lower sustainability risk profile than that of our peers.

We believe that presenting our performance in respect of both of these assessments has marketing advantages that will become increasingly important. Indeed, evidence from the University of California, Berkeley has shown for the first time – with a statistically significant sample – that green buildings command higher rental rates and even higher rental premiums than otherwise identical buildings. We aim to present evidence to reinforce this important finding in our next Connected Performance Report.

Expenditure on asset improvements



To assess whether our assets are 'fit for purpose' we have developed a methodology which scores buildings against three criteria. By measuring these independently on an annual basis we are able to determine the extent to which our assets are becoming more or less fit for purpose. In addition, we are exploring the link between the fit for purpose score and both the capital value and the rental income.

Ongoing expenditure to prevent obsolescence of our existing assets continues to fall, following significant capital investment which we believe will reduce the rate of depreciation over the life of the building. However, we also acknowledge the impact of market cycles on void periods and will continue to explore the relationship between this and depreciation so that we understand and are able to articulate the correlation more robustly.

2. Weather vulnerability and climate change risks

Climate change poses a physical threat to assets under ownership through flooding, storm damage and subsidence. Ensuring that assets are future-proofed for extreme weather events may help protect long-term asset value and reduce both tax and insurance liabilities. It also differentiates our acquisition strategy from that of our competitors, providing us with a more targeted investment pool from which to select assets.

Action and outcome

Climate change adaptation

Assets which are protected against climate change enable business continuity during extreme weather events, as well as safeguarding human comfort and health.

We are implementing a Climate Adaptation Strategy to ensure our acquisition and disposals account for the risk that extreme weather events might pose to future asset value. With the help of climate change modelling techniques, analysing our portfolio provides a method for evaluating the risk associated with owning assets in locations where extreme weather can physically affect an asset, for example, through flooding, storm damage or subsidence.

Performance

Extreme weather risk

Weather related insurance claims* (£m)	
No. of extreme weather related insurance claims	
No. of assets at high risk of flooding**	

* In respect of assets where we are responsible for insurance

** Greater than 1 in 100 chance of river flooding each year – based on Environment Agency assessments

3. Resource availability and use

Energy, water and waste are significant operational costs for our business. As availability diminishes and regulatory controls increase, the cost of procuring these resources also increases, which can make our service charge less competitive.

Action and outcome

Energy efficiency

Reducing energy consumption also reduces greenhouse gas emissions – the cause of climate change.

Monitoring our energy use remains a key priority for our business – particularly in light of the forthcoming Carbon Reduction Commitment (CRC) Energy Efficiency Scheme. For assets where we purchase energy on behalf of our customers, our objective is to pass on cost savings from efficiencies to occupiers via reductions in service charges. As part of our carbon reduction strategy, we are targeting the installation of smart meters across our portfolio to improve measurement and monitoring capabilities. We also continue our programme of energy audits to ensure that our building management systems are being used to their full potential and that obsolete plant and machinery is being replaced with more energy efficient alternatives where appropriate.

Performance

Investment in energy efficiency [GRI EN30 – Partial]

Energy efficiency investment	Total spend in 2009 (£m)	Average payback
No cost	0.00	Immediate
Low cost*	0.15	11 months
Capital expenditure	0.85	36 months

* Investment in individual projects that are less than £100,000

CO_2e savings and Carbon Reduction Commitment Energy Efficiency Scheme liability [GRI EN18 – Partial]

Energy efficiency investment	2009	Projected 2010	2011	2012
CO_2e saving (tonnes)	6,732	6,500	6,500	6,500
Equivalent energy saving (£m)	2.4	2	2	2
CRC liability (£m)*	n/a	n/a	1.55	1.55

* CRC liability will affect cash flow for one year but will be recovered from occupiers. Liability costs based on £12 per tonne of CO_2 and estimated carbon emissions in 2011 and 2012.

2004	2005	2006	2007	2008		2009
0.27	0.30	0.27	0.28	0.31	↑	0.33
10	12	9	11	12	↑	14
11	11	10	9	7	↓	6

Commentary

We have incorporated weather risk assessment into our asset appraisal process. The business case for doing this is strong – the cost of insurance claims related to extreme weather in 2009 was just over £300,000. We therefore continue to reduce the number of assets under ownership that are classed as high risk, particularly from flooding.

We are also planning an adaptation programme to retrofit existing buildings with technologies that will reduce the risks of damage from extreme weather.

Whole building (landlord + tenant) energy efficiency

kg CO_2/m^2/year

Commentary

Emissions from energy consumption totalled 129,984 tonnes of CO_2 in 2009. We monitor and target carbon efficiency in our existing assets and our efficiency continues to improve by approximately 5% per annum across various office types. This is achieved mainly through low and no cost efficiency measures, such as the optimisation of Building Management System control settings and replacement of old energy inefficient lights, but also through targeted capital investment. Our targets will ensure that we exceed Good Practice Upstream Sustainability Benchmarks by 2010.

Our corporate commitment is to reduce landlord and tenant CO_2 by 20% by 2012. This will involve active engagement with occupiers to ensure that they are implementing energy efficiency practices within their own demise. In doing so, we hope to recoup our CRC Energy Efficiency Scheme carbon credit bonus of 10% and 20% respectively in 2011 and 2012 for high performance in the league table.

Action and outcome

Water efficiency

Water is a valuable natural resource which is scarce even in the UK. Reducing consumption therefore lessens the strain on fresh water supply.

Water is an emerging concern, and one that we believe will increase in importance over time as regulatory controls on supply and demand become tighter. By fitting water saving devices and closely monitoring consumption levels, we continue to target water efficiency improvements in the common parts of our managed assets. Our investments are typically low or no cost, and savings are passed on to occupiers once the initial expenditure has been recouped. We also engage with occupiers to encourage water efficiency practices within their own demise.

Performance

Investment in water efficiency [GRI EN30 – Partial]

Water efficiency investment	2009	Projected 2010	Projected 2011	Projected 2012
Low*/no cost (£m)	0.15	0.15	0.15	0.15
Water savings (£m)	0.17	0.20	0.20	0.20

* Investment that are less than £20,000

Waste

Reducing total waste produced and the proportion sent to landfill reduces strain on scarce landfill sites and the consumption of virgin materials.

Where we have responsibility for waste management, waste is becoming a significant operational cost in light of annual landfill tax increases. We work actively with our occupiers to improve recycling rates and thereby reduce the service charge portion allocated to waste services.

Reuse and resale of building materials such as plasterboard and aggregates is emerging as a new source of revenue. We are developing a waste management strategy which capitalizes on unlocking value from waste including energy from incineration of commercial waste.

Savings from waste diversion and revenue from sale of waste [GRI EN30 – Partial]

Water efficiency investment	2009	Projected 2010	Projected 2011	Projected 2012
Savings from diversion of waste from landfill (£m)*	0.54	0.70	0.86	0.91
Revenue from sale of waste (£m)**	0.01	0.03	0.05	0.06

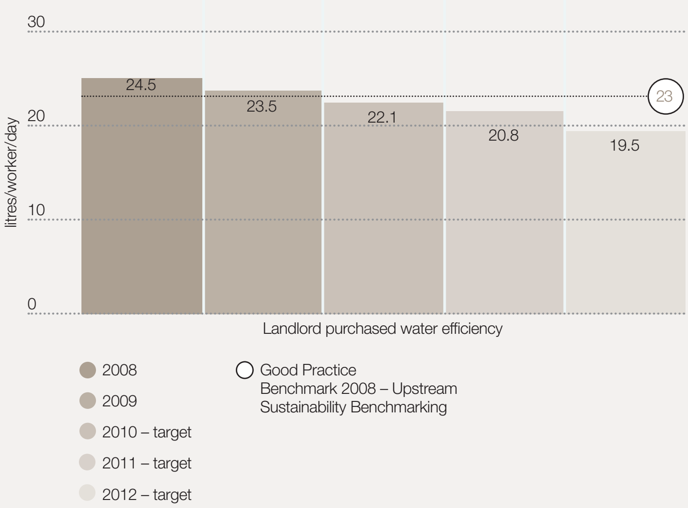
* Projections based on £8 per tonne increase in landfill tax to 2011

** Deriving directly from our assets therefore attributable to us

Commentary

Whole building (landlord + tenant) water efficiency

[GRI EN8 – Partial] litres/worker/day



Investment in water efficiency initiatives has a relatively quick payback period (typically less than 1 year). We are therefore witnessing improvements in water efficiency across the portfolio, savings from which are passed on to our occupiers. Water efficiency is improving at a rate of approximately 5% per annum and we are on course to achieve our 2012 target.

Waste disposal route by mass (landlord + tenant)

[GRI EN22 – Partial] % of waste by disposal route

With the corresponding increase in the amount of waste we collect for recycling and Material Recovery Facility (MRF) processing, savings associated with diversion of waste from landfill continue to increase. We are also generating a small, but growing amount of revenue from the sale of waste products which would have ordinarily been sent to landfill, such as plasterboard and cardboard.

BWC plc

BWC is assumed to employ 2,560 staff, serve 2 million customers in 960,000 properties (household and non-household) and places approximately 545 million litres per day of drinking water into the supply.

Extract from the Business Review: Key sustainability issues for our business

Introduction

As our Chief Executive has already detailed, the demands of modern lifestyles, the impact of climate change and the need to protect the environment and natural resources for future generations create a complex and demanding set of short and long-term challenges for us. Sustainability is at the very heart of meeting these challenges, not just to ensure that we remain a sustainable business, but to ensure that we operate in a manner that takes account of our impact on the environment and the society in which we operate. In order to do this effectively, we need to have a good understanding of the impact that sustainability issues will have on the achievement of each of our core objectives. An analysis of this is given below.

Provide an efficient, continuous supply of quality water

Ensuring an efficient, continuous supply of quality water is the top priority for our customers. We must ensure that we can meet this expectation against the backdrop of climate change, demographic changes and increasing long-term demand. Alongside this there are pressures on us to reduce our use of water from rivers and groundwater sources, while managing an ageing supply network. Several powerful trends have combined to affect supply; diffuse pollution has made some of our water sources more difficult to treat and natural storage of water has been eroded through increased urbanisation, leading to faster run-off of rainwater and lower recharge of groundwater. Weather patterns have also become noticeably more intense, with similar consequences.

Ultimately, this means that we will not have sufficient water available to meet long-term demand unless we invest in bridging the supply-demand gap. To meet these challenges we must replace ageing assets, accelerate the installation of metering, reduce leakage and increase water efficiency through work with the domestic and commercial sectors. We must choose flexible options to ensure that short-term demographic and economic fluctuations are balanced by the need to ensure that we use existing supplies in a sustainable way, using new technologies and a more integrated supply network.

Deal effectively with wastewater

It is critical to us that our customers have confidence that we will take away their wastewater and treat it to the highest environmental standards before returning it to our region's rivers. We have continued to show our ability to deliver this core service, as river water quality in our region has continued to improve over the last 15 years, with an increase in the proportion of rivers of good standard.

There are however significant challenges which will impact on our achievement of this business objective. The implications of the Water Framework Directive could lead to increased energy use and GHG emissions, which may outweigh the water quality benefits. We, our regulators and policy makers must consider the whole environment when assessing the impacts and solutions to meet this challenge.

We do however recognize that despite our work to improve river quality we still have some way to go in addressing our impact from unplanned pollution incidents. Alongside this we must educate our customers about the issues of disposal of fats, oils and grease, as well as other non-flushable products to the sewers.

One of the most serious service failures that our customers can experience is sewer flooding. Our customers have told us that they would pay for significant reductions in sewer flooding, particularly for internal flooding. We must therefore aim to eliminate flooding of properties from sewers, except as a result of exceptionally high rainfall that exceeds the design standards for our system. Our ability to meet this aim is inextricably linked with many of the issues discussed in respect of our climate change, provision of water and regulatory regime business objectives.

Deliver an affordable service

We recognize that while the majority of our customers can afford to pay their water bill, there are customers who have difficulty in settling their accounts, and this proportion has grown in the current economic climate. Increasing levels of bad debt and collection costs affect both our ability to deliver excellent returns to our shareholders and to fund the future investment required to achieve a sustainable future. Because of this, we must and will pursue those customers who are able to pay, but choose not to. This is in the interests of all our customers. For those who are genuinely in financial hardship, we must seek to identify them earlier in the collection process in order to offer help to enable them to manage their debt.

Respond to climate change

Climate change and how we respond to it has significant implications for all our other business objectives and therefore is at the very heart of our business planning. The last two years have seen unprecedented flooding, coupled with the need in some areas for hosepipe bans to address the issues of demand exceeding supply. These impacts are only an indication of the weather to be expected as our climate changes. We must address these challenges by ensuring the resilience of our network and assets to the effects of climate change and working with our customers and regulators to ensure that we can continue to supply water to meet demand.

We must also consider our impact on the causes of climate change. As a company we need to make our contribution to reducing carbon dioxide emissions through investing in renewable energy and achieving significant efficiencies in energy use. As a part of this we also recognize the role of water efficiency in reducing both our carbon footprint and that of our customers. In this respect, we are actively promoting water conservation and raising awareness of the link between domestic water heating and carbon emissions.

The Carbon Reduction Commitment is due to commence in April 2010. Given that we are already subject to regulatory quality drivers that increase energy consumption, and much work has been done on energy efficiency, it may be difficult for us to achieve significant reductions relative to other participants. We must therefore continue to work with government and regulators to understand the implications of the Carbon Reduction Commitment and communicate this to our customers and stakeholders to ensure that they are aware of the cost pressures the mechanism will exert.

Provide our people with the right skills to deliver

In order to deliver service improvements and efficiencies, we need to have the right people and resources available to us now and in the future. However, we face a high level of demand and competition for the skills that we need, particularly in engineering and sciences. Therefore, if we do not invest in attracting and transferring knowledge to new talent, we risk losing our corporate memory. We must be able to recruit and retain the right talent through modern pay structures and training and developing a motivated and diverse workforce that is appropriately rewarded. We must also provide our teams with the tools and techniques to identify efficiencies themselves.

Fund investment and operating expenditure whilst providing an acceptable return and capital growth

The scale of improvements since privatisation has meant that annual income from customers has been insufficient to finance the capital programme. As a result, borrowing has increased steadily. To continue to fund investment we need a stable regulatory regime that will provide confidence and an acceptable rate of return.

Alongside this, we are vulnerable to significant changes in cost which cannot be financed in the short term by higher prices, particularly energy costs. We recognize that we must increase our resilience to fluctuations in global energy prices. In response, we are focused on energy efficiency and diversification of supply, through increased renewable energy generation, and our target is to generate 20% of our own energy by 2020. This will help to increase security of energy supply and mitigate future price increases.

Promote an appropriate regulatory regime

Increasing expectations for good environmental performance through legislation such as the Water Framework Directive will have significant impact on treatment processes and the demand for resources such as chemicals and energy.

Achieving substantive change in the industry over the next decade and beyond will require a new approach to the regulatory regime in which we operate. This should be flexible in the setting of standards and consider novel treatment solutions that reduce our resource impact. It should also include supporting a move towards a regime based on integrated catchment management ensuring that one environment is not improved at the expense of another.

Whilst we work with our regulators to promote an appropriate regulatory regime we will continue to consider alternative technologies rather than use chemical dosing, further optimize our use of chemicals and energy where we can, and investigate new sustainable solutions to ensure we deliver on our other business objectives which are inextricably linked to this.

Material issues

In order to understand and prioritize our action on the sustainability issues that are most material to our business and our investors, we have considered two key criteria. The first is the significance of current impacts on the achievement of our strategic objectives, and the second is consideration of issues that currently represent costs that are external to BWC, but are likely to become internalized in the future through either additional regulation or impacts on the organization's reputation.

We have identified six issues which we feel are the most material to the organization and which are common themes in the analysis above. These are:

1. **The need to respond to climate change**
2. **The availability of water as our key resource**
3. **Affordability of our services to our customers**
4. **The availability of a skilled workforce**
5. **Energy consumption, which constitutes a significant cost to our business**
6. **The consumption of other key resources, such as chemicals**

We have reported on the actions taken in respect of each of these issues in our Connected Performance Report.

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1. Climate change

Issue and action	Desired outcome	Non-financial indicator
• Reduce total GHG emissions. • Obtain an advantageous position in the Carbon Reduction Commitment (CRC) performance league table.	• A reduction in Greenhouse Gas emissions in line with national targets to reduce the company's impact on climate change and make BWC a low carbon company.	Total GHG emissions (tCO_2e)

2. Water availability

Issue and action	Desired outcome	Non-financial indicator	
• Increase domestic metering. • Meet the long-term supply demand balance in the most cost effective manner.	• Sufficient water to meet demand in the most efficient manner, whilst ensuring that customers are aware of what they are using.	Leakage (Ml/d*) 134Ml/d 2009 132Ml/d Target 2015	Meter coverage (%) 60% 2009 70% Target 2015

* Million litres per day

3. Affordability

Issue and action	Desired outcome	Non-financial indicator
• Actively manage levels of bad debt. • Provide assistance to those customers who are unable to pay.	• Provision of an affordable service and the right assistance for those who cannot pay.	% of customers on social tariff or payment assistance 2% 2009 <3% Target 2015

Financial indicator	Commentary
Yearly CRC payment: bonus/(penalty) £1.936M: £136K 2011 projected (first year) Remain in bonus position Target 2020	**Non-financial:** (–) The increase in overall GHG emissions is linked to increased energy use and process emissions from the enhanced wastewater treatment at the Greywater plant. **Financial:** (+) Early action in gaining the Carbon Trust Standard and increased coverage of automatic meter readers should help produce a favourable performance ranking and result in a CRC bonus payment in the first year. Our carbon management plan should reduce emissions further and maintain this position in the future.

Financial indicator	Commentary
Cost per customer to meet 2035 water demand £75.5 2008 £75.3 2009 £58.0 Target 2015	**Non-financial:** (+) The installation of 20,000 water meters in 2009 has increased the overall coverage by 2%. The investment programme for the next five years will increase the percentage in line with the 2015 target. Communication on efficient consumption to customers with new meters has also helped to reduce overall use. The leakage target has been met for the seventh year running. **Financial:** (+) The increase in meter coverage has led to a slight reduction in demand, which helps to close the overall supply-demand gap. The investment programme also includes actions to reduce leakage and is on target.

Financial indicator	Commentary
% level of bad debt from domestic customers 5% 2009 5% Target 2010 3% Target 2012	**Financial:** (–) Levels of bad debt have increased due to the economic climate. A debt management strategy is in place and is expected to keep bad debt level below target over the next few years. **Non-financial:** (+) There has been a good level of take up on the arrears allowance scheme allowing those who want to pay being able to contribute. The Assistance Trust fund is helping over 85% of those who apply.

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4. Skilled workforce

Issue and action

- Provide employees with the right skills.
- Retain corporate knowledge.
- Maintain employee satisfaction.

Desired outcome

- A motivated and satisfied workforce that has the right skills to do the job. Successful planning ensures that corporate knowledge is retained.

Non-financial indicator

Overall employee satisfaction

76%
2009

85%
Target 2012

% employees through 'New Talent' schemes

3%
2009

5%
Target 2015

5. Energy consumption

Issue and action

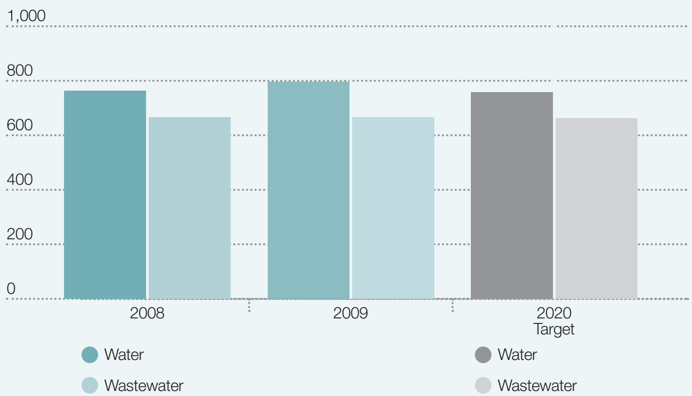
- Reduce energy consumption through efficiency and innovation.
- Manage energy costs as a percentage of total costs.

Desired outcome

- Efficient use of energy at an affordable rate to provide the treatment required for our services.

Non-financial indicator

Energy use/million litres of water (Kwh/Ml)



Wastewater

755kwh/Ml
Target 2012

Water

640kwh/Ml
Target 2012

6. Other resource consumption

Issue and action

- Optimise use of chemicals to manage cost.
- Find alternative chemicals to substitute finite resources.

Desired outcome

- High standards of treatment and compliance without excessive cost. A secure supply of chemicals from non-finite sources.

Non-financial indicator

Sourcing sustainable chemicals

Data in thousand tonnes	2008	2009	Target
Water treatment chemical tonnage – virgin sources (manufactured/mined)	19.43	19.70	18.76
Water treatment chemical tonnage – co-product sources	2.90	3.05	2.80
Water treatment chemical tonnage – bi-product sources	6.67	6.75	6.44
Sewage treatment chemical tonnage – virgin sources (manufactured/mined)	3.75	3.75	3.62
Sewage treatment chemical tonnage – co-product sources	0.56	0.65	0.54
Sewage treatment chemical tonnage – bi-product sources	1.29	1.40	1.24

Financial indicator	Commentary
Cost avoided as a result of absence rate below the national average **£128,472** 2009 BWC rate = 7.52 days UK average = 8 days **>£100,000** Target 2009 BWC rate = <7.61 days UK average = 8 days	**Non-financial:** (+) An increase of 2% in levels of satisfaction due to the engagement programme and restructure of performance related bonus scheme. Improvement shown in eight out of ten categories. (+) Increase in apprentice intake over the next two years will increase number of operational employees through the scheme. **Financial:** (+) The reduction in absence rates has saved us over £128,000 in comparison to last year and further improvements are expected to continue to create savings against a 2008 baseline.

Financial indicator	Commentary
Energy cost as % of total costs **7.8%** 2008 **7.5%** 2009 **7.0%** Target 2013	**Non-financial:** (–) Water: There has been a decrease in pump efficiency at key sites, where pumps are due to be replaced in the next investment period. (–) Wastewater: Commissioning of a new process at the Greywater treatment plant has increased energy use to meet new consent conditions. An optimisation process is also underway which is aimed at making the Greywater plant more efficient. **Financial:** (+) Energy costs increased in 2009, but proportionally less than other operational costs. Negotiations are underway with our energy providers to secure a competitive long-term price structure.

Financial indicator	Commentary
Chemical cost as % of total costs **5.4%** 2008 **5.6%** 2009 **5.0%** Target 2013	**Non-financial:** (–) The level of chemicals for water treatment increased in 2009 due to weather conditions and an increase in river water turbidity. Advanced treatment for wastewater in the Greywater plant also increased chemical use for part of the year, with the full effects expected in 2010. **Financial:** (–) The cost of chemicals for wastewater treatment is expected to rise due to a reduction in available suppliers and new treatment processes.

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