Categorizing GHG Emissions Associated with Leased Assets

Appendix F to the GHG Protocol Corporate Accounting and Reporting Standard – Revised Edition

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Introduction

Many companies lease some of their assets, such as building space or vehicles, and must decide how to account for and report GHG emissions associated with these assets. To do so, first you must know the type of your company's leased assets so that you can categorize the resulting emissions in your company's operational boundary (i.e., scope 1, 2 or 3). Whether the emissions are categorized as scope 1 (direct), scope 2 (indirect), or scope 3 (indirect) for your company depends on the selected organizational boundary approach (i.e., equity share, financial control or operational control) and the type of lease.

The following leasing guidance should be used to determine:

- Whether emissions that would normally be categorized as scope 1 (direct) in a non-leasing situation should be categorized as scope 1 (direct) or scope 3 (indirect)[1] in a leasing situation.

- Whether emissions that would normally be categorized as scope 2 (indirect) in a non-leasing situation should be categorized as scope 2 (indirect) or scope 3 (indirect) in a leasing situation.

Emissions that are categorized as scope 3 (indirect) in non-leasing situations, such as upstream and downstream emissions, would also be categorized as scope 3 (indirect) emissions in leasing situations and so are not discussed further in this Appendix.

This guidance has been designed to ensure that the categorization of emissions from leased assets by lessors and lessees does not lead to any double-counting of emissions in scopes 1 and 2.

Differentiating Types of Leased Assets

The first step in determining how to categorize emissions from leased assets is to understand the two different types of leases: finance or capital leases and operating leases.

- *Finance or capital lease.* This type of lease enables the lessee to operate an asset and also gives the lessee all the risks and rewards of owning the asset. Assets leased under a capital or finance lease are considered wholly owned assets in financial accounting and are recorded as such on the balance sheet.

[1] Companies that have power-generating facilities and would normally categorize the facilities' emissions as scope 1 (direct) in a non-leasing situation must determine whether these emissions would be scope 2 (indirect) or scope 3 (indirect) in a leasing situation. For more guidance, refer to the calculation tool on the GHG Protocol's Web site, www.ghgprotocol.org, which deals with indirect emissions from electricity.

- *Operating lease.* This type of lease enables the lessee to operate an asset, like a building or vehicle, but does not give the lessee any of the risks or rewards of owning the asset. Any lease that is not a finance or capital lease is an operating lease.[2]

One way to determine whether an asset is leased under an operating or finance/capital lease is to check the company's audited financial statements.

Categorizing Emissions from Leased Assets (Lessee's Perspective)
Next you must determine whether the emissions associated with the leased assets should be categorized as direct (scope 1) emissions or indirect (scope 2 or 3) emissions in your company's operational boundary.

- *Finance or capital lease.* Under a finance or capital lease, the lessee is considered to have ownership and both financial and operational control of the leased asset. Therefore, emissions associated with fuel combustion[3] should be categorized as scope 1 (direct), and emissions associated with use of purchased electricity should be categorized as scope 2 (indirect), regardless of the organizational boundary approach selected (see table 1).

- *Operating lease.* Under an operating lease, the lessee is considered not to have ownership or financial control but to have operational control of the leased asset. Therefore, the categorization of emissions as direct or indirect depends on the organizational boundary approach selected. If the lessee uses the equity share or a financial control approach, the emissions associated with fuel combustion as well as with the use of purchased electricity should always be categorized as scope 3 (indirect). But if the lessee uses the operational control approach, emissions associated with fuel combustion should be categorized as scope 1 (direct), and emissions associated with the use of purchased electricity should be categorized as scope 2 (indirect) , (see table 1).

If these guidelines for categorizing emissions from leased assets have been correctly applied, indirect emissions from the use of purchased electricity may sometimes be categorized as scope 3 instead of scope 2. This is the case when a leased building is held under an operating lease and the organizational boundary approach used is either equity share or financial control.

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[2] Financial Accounting Standards Board, Statement of Financial Accounting Standards, no. 13, "Accounting for Leases" (1976).
[3] For this discussion, we assume that most emissions that could be categorized as direct emissions are associated with fuel combustion. However, companies may also have other sources of emissions, such as emissions from industrial processes or HFC emissions from refrigeration and air conditioning, which could also be categorized as direct emissions. For these other potential sources of direct emissions, companies should follow the leasing guidance described for fuel combustion. We have focused on fuel combustion in this Annex for simplicity in explaining the leasing guidance.

Table 1. Emissions from Leased Assets: Leasing Agreements and Boundaries (Lessee's Perspective)

	Type of Leasing Arrangement	
	Finance/Capital Lease	**Operating Lease**
Equity Share or Financial Control Approach Used	Lessee does have ownership and financial control, therefore emissions associated with fuel combustion are scope 1 and with use of purchased electricity are scope 2.	Lessee does not have ownership or financial control, therefore emissions associated with fuel combustion are scope 3 and with use of purchased electricity are scope 3.
Operational Control Approach Used	Lessee does have operational control, therefore emissions associated with fuel combustion are scope 1 and with use of purchased electricity are scope 2.	Lessee does have operational control, therefore emissions associated with fuel combustion are scope 1 and with use of purchased electricity are scope 2.[a]

Note: [a] Some companies may be able to demonstrate that they do not have operational control over a leased asset held under an operating lease. In this case, the company may report emissions from the leased asset as scope 3 but must state clearly in its GHG inventory report the reason(s) that operational control is not perceived.

Categorizing Emissions from Leased Assets (Lessor's Perspective)

Some companies may lease assets to other companies, for example, real estate companies that lease office or retail space or vehicle companies that lease vehicle fleets. Whether emissions from these assets should be categorized by the lessor as direct (scope 1) or indirect (scope 2 or 3) depends on the organizational boundary approach and the type of leasing arrangement, because ownership and financial and operational control—in the case of finance or capital leases—and operational control—in the case of operating leases—is transferred to the lessee.

- *Finance or capital lease.* The lessor does not have ownership or financial or operational control of these assets. Therefore, the associated emissions always are scope 3 (indirect) for the lessor, regardless of the type of organizational boundary approach used (see table 2).

- *Operating lease.* The lessor has ownership and financial control of these assets but not operational control. Therefore, if the equity share or a financial control approach is used, the emissions associated with fuel combustion should be categorized as scope 1 (direct), and the emissions associated with the use of purchased electricity should be categorized as scope 2 (indirect) for the lessor. However, if the operational control approach is used, emissions from fuel combustion and the use of purchased electricity will always be scope 3 (indirect) for the lessor, (see table 2).

Table 2. Emissions from Leased Assets: Leasing Agreements and Boundaries (Lessor's Perspective)

	Type of Leasing Arrangement	
	Finance/Capital Lease	**Operating Lease**
Equity Share or Financial Control Approach Used	Lessor does not have ownership or financial control, therefore emissions associated with fuel combustion are scope 3 and with use of purchased electricity are scope 3.	Lessor does have ownership and financial control, therefore emissions associated with fuel combustion are scope 1 and with use of purchased electricity are scope 2.
Operational Control Approach Used	Lessor does not have operational control, therefore emissions associated with fuel combustion are scope 3 and with use of purchased electricity are scope 3.	Lessor does not have operational control, therefore emissions associated with fuel combustion are scope 3 and with use of purchased electricity are scope 3.[a]
Note: [a] Some companies may be able to demonstrate that they do have operational control over an asset leased to another company under an operating lease, especially when operational control is not perceived by the lessee. In this case, the lessor may report emissions from fuel combustion as scope 1 and emissions from the use of purchased electricity as scope 2. The lessor must clearly state in the GHG inventory report the reason(s) that operational control is perceived.		

Proper categorization of emissions from leased assets by lessors and lessees ensures that emissions in scopes 1 and 2 are not double-counted. For example, if a lessee categorizes emissions from the use of purchased electricity as scope 2, the lessor should categorize the same emissions as scope 3, and vice versa.