



The carbon price
Accounting for
carbon

From 1 July 2012 approximately 500 of Australia's largest companies will be liable for the carbon price of \$23 per tonne of carbon dioxide equivalent (CO₂ – e) emitted by those facilities which trigger a threshold of 25,000 tonnes of covered CO₂ – e emissions.

The carbon price will fall directly on companies primarily within the following industries:

- **Energy, particularly energy generation**
- **Industrial processes and heavy manufacturing**
- **Mining, particularly coal mining, and**
- **Waste**

Even if organisations do not have a direct carbon price liability, they may be impacted by the indirect flow-through of the carbon price. The extent of the flow-through will be different between products and industries. Therefore it is important that all organisations have a good understanding of their current emissions and energy use to be able to properly assess and mitigate the financial impacts.

Included within the carbon price legislation is also a significant amount of compensation and industry assistance designed to assist companies across many sectors transition to a carbon constrained economy.

The carbon price will be introduced with a fixed price phase on 1 July 2012 for three years and will transition to a floating price phase from 1 July 2015. With the carbon price set to commence from 1 July 2012 all organisations should be preparing for it – what about you?

Are you prepared?

Key issues that you should consider include:

- **Assessment of direct liability** – have you assessed which facilities are liable and estimated the direct liability arising under the carbon price?
- **Systems and processes in place from 1 July 2012** – companies will need to ensure that they have the systems and processes in place to measure their emissions throughout the year
- **Customer and supplier contracts and pass through** – have you assessed both the direct and indirect effects of the carbon price? This includes the ability to pass costs through the supply chain and the impact on pricing and profitability
- **Disclosure impacts for 30 June 2012 and beyond** – what will you disclose as the expected impact of the carbon price in your 30 June 2012 annual report? Have carbon price impacts been included and disclosed in impairment analyses at 30 June 2012?
- **Carbon strategy, hedging and long-term contracts** – companies need to consider their overall carbon strategy in regards to hedging and long-term contracts now
- **Accounting and compliance** – directly liable entities need to ensure that they comply with additional accounting, reporting and assurance requirements.

More to do and soon...

The carbon pricing legislation means that liable organisations need to account for a new carbon emissions liability as well as carbon permits (including free permits).

In addition, the legislation includes additional requirements relating to reporting carbon price emissions and assurance for larger emitters.

Accounting for carbon

There is currently no formal guidance at the International or Australian levels on how to account for permits issued under emission trading schemes and the emission liability. *IFRIC 3 Emission Rights* was withdrawn in June 2005 by the International Accounting Standards Board (IASB) because of a lack of symmetry between the recognition and measurement of the permit asset and the emissions obligation.

The elements of the 'fixed price' mechanism and government compensation introduce additional consequences that are unique to the accounting of the Australian carbon price mechanism. The Australian Accounting Standards Board (AASB) is expecting to publish a Staff Paper after their June 2012 meeting. The following discussion explores some of the accounting issues that emitters will face during the 'fixed price' phase as has been discussed in the Agenda Papers for their June 2012 meeting.

Accounting for the emission liability

A direct emitter (liable entity) will need to record its emission liability in accordance with accounting standard *AASB 137 Provisions, Contingent Liabilities and Contingent Assets*. There are two views in relation to the timing for recognition of the liability:

- An emitter is not required to record any liability unless it crosses the emission threshold set by the legislation. This view creates a skewed profit and loss impact and may not provide a true and fair view of the entity's liability position.
- The liability is recorded as and when carbon is emitted throughout the year, with the expectation that the entity will cross the annual threshold.

The measurement of the liability under this approach could be one of the following ways:

- The price expected to be paid for extinguishing the liability to the Government is discounted to its present value, or
- The liability is calculated based on a weighted average probability of the entity exceeding the threshold.

Once a liability for carbon is recorded, it is either expensed straight to the profit or loss as a cost of doing business or recorded as part of the cost of bringing an asset such as inventory or fixed assets to their intended use.

Accounting for permits

Permits, whether purchased or received free from the Government as compensation, qualify for classification as 'assets' under the AASB Conceptual Framework, since these represent future economic benefits which the emitter controls as a result of a past event (being the purchase or receipt of the permits).

There are essentially two treatments available to entities who either purchase or receive permits – **cost** or **fair value** and these are discussed below:

Permits at fair value

The fair value approach is supported by viewing these permits as 'statutory financial assets' and analogising to the accounting of financial assets under the accounting standard *AASB 139 Financial Instruments – Recognition and Measurement*.

The permits, a result of statutory requirements rather than arising from a contractual relationship with a third party, do not strictly meet the definition of a 'financial asset'. However an emitter could use these permits to settle its obligation to the Government, remit these back to the Government for cash or in certain circumstances use them to settle its liability with a third party and has certain characteristics of a 'financial asset' which allows an entity to view these as 'statutory financial asset'. During the fixed price period it is likely that the fair value of these permits will reflect their discounted fixed cost since these permits are not expected to be actively traded during this period.

Permits at cost

An entity can choose to record the permits at cost based on either of the two views:

- The permits are intangible assets in accordance with AASB 138 Intangible Assets, similar to licenses and quotas. Accordingly the permits are carried at cost unless an active market for the permits exist, in which case these could be carried at fair value. The fair value movements are however not recorded within the profit or loss but in an asset revaluation reserve within equity. It is not expected that in the fixed price phase there will be an active market or that the fair value will be significantly different to the discounted fixed cost; or
- Other assets recorded at the amount paid, which will be nil in case of 'free permits'.

Accounting for free permits

Certain entities are eligible to receive free permits from the Government as compensation against their emission liability. These 'free permits' are in the nature of non-monetary government grants under accounting standard *AASB 120 Accounting for Government Grants and Disclosure of Government Assistance*, where the grant is recorded as deferred revenue by the entity, to be recognised in profit or loss on a systematic basis over the periods in which the entity recognises the emissions expense. The grant could be recorded at either the fair value of the grant (during the fixed price phase, the fair value is likely to be the same as the discounted fixed price payable to the Government for settling the emission liability) or at cost (nil in this case).

If the entity has adopted the option to record the Government Grant at fair value, it will initially need to record the permits at fair value as well.

In all cases an entity must maintain records of the free permits it receives from the Government and what it utilises in settling its liability.

Recognition and presentation on 'net' or 'gross' **Balance sheet**

There is an accounting policy choice to emitters to recognise and present the emission liability and the permit assets as net. This is based on the argument that during the fixed price phase, a liable entity may only have a net liability or a net asset since it will either have to pay the Government for its emission or be holding permits more than it is obliged to pay.

A net approach is further supported by those who argue in favour of the permits being in the nature of a financial asset. The emitter, in this instance, considers that it has a legally enforceable right to set-off the amounts of the permit and its obligation to pay for the emission liability and would intend to usually settle net.

If the liable entity chooses to record and present the assets and liabilities on a 'net' basis, then it will need to keep track of its permits and emission liability separately for record-keeping purposes.

The other alternative is to record the emission liability separate to the permits and present them as 'gross' items on the balance sheet.

Income statement

Depending upon the accounting policy choice made in respect of the asset and liability presentation on the balance sheet, the presentation of the income from the permits and the emission expense will be either on a 'net' or 'gross' basis. Entities also need to note that there may be an impact on the profit or loss from unwinding of the discount amount in cases where the permits are recorded at their fair value and/or the emission liability is discounted to its present value. There is no specific guidance within the accounting standards as to whether these are to be treated as interest income/expense and entities have an accounting policy choice as to how they present these amounts in their financial statements.

Considerations for the flexible price period

From 1 July 2015 the carbon price mechanism will move to a flexible emissions trading system. The fixed price phase is unique to Australia while the flexible price phase is similar to an emission trading scheme seen in other parts of the world. The IASB has had accounting for Emissions Trading Schemes on its agenda since December 2007 but it has now been paused until the IASB concludes its on-going deliberations about its future work plan.

The AASB has mentioned that the accounting implications of the flexible price phase will be considered when the IASB progresses its project. However the AASB has represented that they have contingency plans in place to provide any necessary financial reporting guidance in regard to the flexible price phase, should it be established the IASB will not be issuing any pronouncements to provide a basis of accounting in the flexible price phase.

In addition to the considerations discussed above relating to the accounting for emission liability and permits which are relevant for the fixed period, entities will need to remain updated with any guidance issued by the IASB or AASB with regard to the accounting during the flexible price period prior to 1 July 2015.

Reporting and assurance

Reporting

The carbon price legislation has created additional reporting obligations for liable entities through including additional requirements in the National Greenhouse and Energy Reporting Act 2007 (NGER).

Most liable entities will be currently reporting under the NGER but the carbon price liable entities will need to separately report:

- Covered emissions from facilities that trigger the facility thresholds (25,000 tonnes of covered CO₂ – e emissions) by 31 October each year

For most entities there are differences between the current NGER reporting and the carbon price reporting obligations and therefore it is important that these differences are identified early.

Mandatory Emissions Assurance

Liable entities who control facilities which emit greater than 125,000 tonnes of covered CO₂ – e emissions are required to submit a reasonable assurance opinion over the covered emissions by 31 October each year – this is a new assurance requirement.

Companies should be considering the assurance requirements as well as ensuring that its systems and processes are robust enough to support accurate reporting and facilitate the assurance process.

Financial Audit implications

All liable entities will have new account balances and transactions in the financial statements as a result of the carbon pricing scheme.

Such transactions and balances will need to be audited as part of the financial audit and specifically considered for half-year and annual financial reporting.

AFSL Obligations: carbon emission units

From 1 July 2012, emissions units recognised under the carbon pricing mechanism will be financial products under the Corporations Act.

Any entity who buys or sells carbon permits other than from the Government and provides financial services in relation to emissions units will therefore require an Australian Financial Services Licence (AFSL) to carry on a financial services business, unless an exemption applies. For those entities that already hold an AFSL, a variation may be required and consideration given as to where the AFSL is held in the corporate structure to facilitate administration of the carbon permits.

Companies should consider the assurance requirements as well as ensuring that systems and processes are robust enough to support accurate reporting and facilitate the assurance process.

How Deloitte can help

Deloitte can assist you manage the transition to the carbon pricing mechanism.
Please contact one of the experts below to see how we can help you:



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