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Professor Ross Garnaut
Garnaut Climate Change Review Secretariat
Level 2, 1 Treasury Pl
EAST MELBOURNE VIC 3002

By email: contactus@garnautreview.org.au

Dear Professor Garnaut

Emissions Trading Scheme Discussion Paper

CPA Australia represents the diverse interests of more than 117,000 finance, accounting and business advisers. We are committed to working with governments and their agencies to ensure current and future economic and social policies foster an environment that facilitates sustainable economic growth.

CPA Australia believes the policy responses to climate change should be based on

- The proposed Australian Emissions Trading Scheme (AETS)
- technology, incentives for, and the removal of barriers to, behavioural change, and
- building capacity and capability.

The integrity, robustness and credibility of the proposed AETS is fundamental to the success of this central policy initiative. Accordingly, we believe the regulatory, including assurance mechanisms necessary to ensure such robustness and integrity must be addressed in greater detail in the final report of the Review.

The enclosed submission focuses on the design and operation of the AETS. Unfortunately, we are not in a position to provide recommendations on the permit allocation and compensation issues raised in the Discussion Paper at this time.

If you have any questions regarding the above, please do not hesitate to contact Mr Gavan Ord, CPA Australia's Business Policy Adviser on 03 9606 9695.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Paul Drum', written in a cursive style.

PAUL DRUM
Director- Policy and Research
CPA Australia

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Emissions Trading Scheme Discussion Paper

CPA Australia's strong interest in climate change issues is driven by the fact that our members, with their specialist business skills in the accumulation, processing, presentation and interpretation of business information are fundamental to enabling Australian business to successfully prepare for and adapt to climate change.

For our members to be able to effectively advise business on, for instance, the allocation of resources where there is a price on emissions, the mechanism to create such a price signal must be credible and simple.

CPA Australia strongly believes that the integrity, robustness and credibility of the proposed Australian Emissions Trading Scheme (AETS) is fundamental to its success. Therefore, regulatory, including assurance mechanisms necessary to ensure such robustness and integrity must be addressed in greater detail in the final report of the Review.

This submission seeks only to provide input on how the AETS should be designed and operated. We are not in a position to provide recommendations or guidance on the permit allocation and compensation issues raised in the Discussion Paper at this time.

CPA Australia believes that a properly designed emissions trading scheme that incorporates a well-calibrated cap, will address the failure of not pricing greenhouse gas emissions. Such an approach though is clearly only one part of a comprehensive suite of policies required to effectively reduce emissions.

Integrity, robustness and credibility of the AETS

In considering the integrity, robustness and credibility of the AETS, consideration must be given to the regulatory mechanisms used to ensure the integrity of the operation of the capital markets, such as the requirement that financial information is independently audited and that auditors are subject to extensive regulation. These mechanisms largely ensure that the public has confidence in the operation of the capital market.

Where there is a commonality between the objectives of the AETS and the regulatory mechanisms intended to ensure the integrity of the operation of the capital markets, those regulatory measures should be replicated in the design of the AETS. This would benefit all stakeholders in the AETS. Participants would be familiar with the regulation of the capital markets and the regulator could gain from the significant knowledge the regulators of the capital markets have developed. This would reduce the compliance burden of the scheme and it places the regulator of the AETS in a better position to meet the time frame for the introduction of the AETS.

Recommendation 1

Where there is commonality between the objectives of the AETS and the regulatory mechanisms intended to ensure the integrity of the capital market, those regulatory mechanisms should be replicated in the design of the AETS.

Reporting

The development of all reporting methodologies for greenhouse gas reporting should be from a single source. We strongly counsel against adopting more than one source of standards as such an approach is not consistent with the development of robust reporting, reduces the comparability of reported information and could lead to arbitrage opportunities for entities participating in the AETS and those reporting under the *NGER Act*.

In particular, the National Greenhouse and Energy Reporting System Regulations Policy Paper states that there is widespread support for the use of definitions of scope 1, 2 and 3 emissions based on the *Greenhouse Gas Protocol* and the *Standard for Greenhouse gases – Part 1: Specification with guidance at the organisation level for quantification and reporting of greenhouse gas emissions and removal* (ISO 14064-1). The adoption of differing standards may lead to regulated entities choosing a definition of Scope 2 emissions which may result in reporting less emissions than the alternative.

Given that the definition of what emissions to measure and report is fundamental to the operation of the trading scheme, the *Greenhouse Gas Protocol* should be adopted as the sole standard for defining emissions. We understand the *Protocol* to be the standard most widely used internationally. Using one standard will assist with the effective and efficient operation of the trading scheme, promote greater comparability in the information disclosed and may be an important step in assisting the AETS link with other schemes.

Recommendation 2

The development of all reporting methodologies for greenhouse gas reporting should be from a single source and the Greenhouse Gas Protocol should be adopted as the sole standard for defining scope 1,2 and 3 emissions.

Assurance

CPA Australia is of the view that the integrity and reliability of disclosed emissions, energy consumption and energy production information is a function of subjecting such disclosures to assurance and ensuring that these engagements are conducted by appropriate individuals. Akin to traditional financial statements audit engagements, independence of the assurance practitioner is critical to ensuring the integrity and reliability of the assurance report.

CPA Australia is concerned that under the *NGER Act*, there is no mandatory requirement for emissions data to be independently assured. The current requirement is that an 'audit' of emissions data reported under the *NGER Act* is only required if the Greenhouse Energy Data Officer (GEDO) has reason to require such an 'audit'.

Unless emissions data reported by scheme participants is subject to independent assurance, then the robustness of the information disclosed under the scheme will not be of the standard expected by the community and could lead to concern about the integrity and operation of the AETS as a trading mechanism.

It is also important that references to external 'audits' and external 'auditors' be clarified to refer instead to (external) 'assurance' and 'assurance practitioners' respectively. The proposed use of standards issued by the Auditing and Assurance Standards Board (AUASB) as the standards that engagements performed under *NGER Act* should meet clearly indicates that such an engagement is an assurance engagement. Audit engagements and assurance engagements perform different purposes under AUASB pronouncements therefore the terminology used in the *NGER Act* and the AETS should be consistent with the terminology used in the AUASB standards. Using the two terms interchangeably creates confusion, especially amongst auditors and assurance practitioners.

Assurance practitioners should have a common basis upon which they assure emissions data, energy consumption and production and that the AUASB is the most appropriate statutory body to develop such standards. We are concerned that the National Greenhouse and Energy Reporting System Regulations Policy Paper proposes that the GEDO will have the authority to declare what is to be an assurance standards. We believe the same objective would be better achieved by the legislative instrument made under section 75 of the *NGER Act* include direct reference to ASAE 3000 *Assurance Engagements other than Audits or Review of Historical Financial Information*.

We would also like to highlight the proposed standard ASAE 3100 *Compliance Engagement* issued by the AUASB. This proposed standard has been developed as an adjunct standard to ASAE 3000 and is directed towards the conduct of compliance engagements by assurance practitioners. We recommend that once issued, ASAE 3100 be assurance standards required for the *NGER Act* and the AETS.

In relation to the eligibility requirements of assurance practitioners, professional bodies like CPA Australia and Engineers Australia have in place well established and extensive codes of ethics to ensure their members act in the public interest. Members of professional bodies are compelled to meet minimum standards of education and experience, abide by a code of ethics as well as other standards of professional conduct (including quality assurance processes) in which the concept of independence is central. Possession of professional membership(s) should therefore be recognised

as one pathway to be eligible as an “assurance practitioner”. Such membership will ensure assurance engagements achieves minimum standards of quality.

Professional bodies can also assist the regulator determine what necessary knowledge and expertise is required to be an eligible assurance practitioner through a competency standard. By way of reference, the professional accounting bodies have developed an audit competency standard to assist the Australian Securities and Investments Commission (ASIC) determine whether the skills and experience of an applicant are sufficient to register them as a company auditor. The knowledge and expertise eligibility requirements for assurance practitioners should therefore be detailed in competency standards drawn up by professional bodies and approved by the Scheme’s regulator.

Regulations supporting the assurance framework for emissions data should (where appropriate) replicate the audit framework found in the *Corporations Act 2001* (and its regulations) and the *ASIC Act 2001* (and its regulations). The framework supporting the regulation of financial audits is well established and we believe transferable to this regime. Replicating appropriate requirements would make implementation of the assurance framework easier for the regulator and assurance practitioners.

In relation to ethical standards for assurance practitioners, we recommend against the regulator creating their own ethical standards. The ethical requirements imposed on auditors under the *Corporations Act 2001* and by the Accounting Professional and Ethical Standards Board (APESB), as well as the codes of ethics of other professions are more than sufficient and do not need to be replicated. Where an assurance practitioner is not covered by a code of ethics, the ethical standards issued by APESB should apply to such practitioners.

Recommendation 3

CPA Australia is of the view that the reliability of disclosed emissions, energy consumption and energy production information is a function of subjecting such disclosures to mandatory assurance and ensuring that these engagements are conducted by appropriate individuals.

Recommendation 4

It is important that, for the sake of clarity, references to external ‘audits’ and external ‘auditors’ refer to (external) ‘assurance’ and ‘assurance practitioners’ respectively.

Recommendation 5

Assurance practitioners should have a common basis upon which they assure emissions data, energy consumption and production. That common basis should be ASAE 3000 Assurance Engagements other than Audits or Review of Historical Financial Information (as issued by the AUASB). When proposed ASAE 3100 Compliance Engagements is issued, this should be the standard.

Recommendation 6

Possession of professional membership(s) be recognised as one pathway to be eligible as an assurance practitioner.

Recommendation 7

The knowledge and expertise eligibility requirements for assurance practitioners under the NGER Act be detailed in competency standards drawn up by professional bodies and approved by the regulator.

Recommendation 8

APESB be the independent standard setter for ethical conduct for assurance practitioners that are not members of a professional body that has a code of ethics.

Free access to standards

There are a number of mentions of external standards for the reporting, measuring, monitoring and assurance of emissions data, energy use and energy production in proposed regulations for the

NGER Act. Examples of such standards include ISO 14064-1 *Standard for Greenhouse gases – Part 1: Specification with guidance at the organisation level for quantification and reporting of greenhouse gas emissions and removal* and the *Greenhouse Gas Protocol*. The setters of such standards are private organisations and only some provide access to their standards free of charge. In contrast, statutory standard setters such as the AUASB and the Australian Accounting Standards Board (AASB) provide free access to their standards.

It is CPA Australia's understanding that any reference to external sources of standards in regulations, gives such standards the force of law. As such standards have the force of law, it is an important public policy issue that the community (and not just regulated entities) have free access to such standards.

It is therefore important that the regulations supporting the the AETS only reference external standards that are available to the public free of charge. This may require the Government to enter into arrangements with the owners of such standards to ensure this policy outcome is achieved. The Government could draw upon its experience in achieving free access for Australians to the support materials owned by the International Accounting Standards Board (IASB).

Recommendation 9

Regulations underpinning the operation of the AETS and the NGER Act only refer to external standards that are available to the public free of charge. This may require the Government to enter into arrangements with the owners of such standards to ensure this is achieved.

Compliance

It is noted that technology based solutions such as XBRL (extensible business reporting language) in the proposed Standard Business Reporting Programme may be a useful platform of interoperability between financial and environmental management systems. We therefore recommend that the regulator of the AETS and the GEDO (if they are different entities) work with other Federal Government agencies to reduce the compliance burden on businesses by incorporating their reporting requirements into the Standard Business Reporting Programme.

There is a need for early and careful consideration of how the reporting requirements under the AETS and the *NGER Act* might compel businesses to make additional disclosure under other legislative requirements. For example, the most broadly applicable mandatory requirement for public disclosure of environmental performance is prescribed by paragraph 299(1)(f) of the *Corporations Act 2001*. This paragraph requires disclosure in the Directors' Report of performance in relation to any applicable significant environmental regulations under a law of the Commonwealth, a State or a Territory.

In these terms, it is important for there to be consideration of whether or not any of the Government's proposals are to be regarded as being in the nature of environmental legislation or regulation that would bring performance in relation to energy and emissions reporting within the ambit of broader corporate disclosure. Without presenting a view on the desirability or otherwise of such a conclusion, CPA Australia believes that certainty needs to be provided both in terms of market expectations as to the availability of disclosures and directors' understanding of their obligations.

Recommendation 10

The regulators of the AETS and other greenhouse gas reporting requirements work with other Federal Government agencies to incorporate their reporting requirements into the Standard Business Reporting Programme.

Recommendation 11

Certainty needs to be provided as to whether or not any climate change policy proposals would trigger additional reporting requirements under paragraph 299(1)(f) of the Corporations Act 2001.

Allocation

An issue emerging from the proposed 2010 commencement of the AETS is whether the Government will have sufficient quantity and quality of assured emissions and abatement information with which to make informed decisions on emission caps or the allocation of emission permits (if not all permits are auctioned). The Government should therefore use assured emissions and abatement data from 2007-08 and earlier years (that is, information not reported under the *NGER Act*).

Recommendation 11

Given the proposed 2010 commencement date of the AETS and the need to have access to as much assured data as possible to make decisions on emission caps and permit allocations, the Government should use independently assured emissions and abatement data from 2007-08 and earlier years.

Abatement

It is important for the Government to encourage as much early abatement activity as possible. Meeting this objective requires the development of a robust carbon offset market that has the confidence of the community. It is however important to balance the need for integrity and possible international linkages of abatement scheme projects and not imposing such rigorous standards (procedural and/or technical) that they discourage developers of abatement schemes. Imposing standards on proposed abatement schemes that are too rigorous will discourage many smaller participants in the agricultural and forestry sectors. This applies to both abatement schemes approved under the AETS and the voluntary carbon offset market.

The development of a robust carbon offset market requires the developers of carbon offset schemes to use a single source of standards to calculate the abatement of emissions from their project. CPA Australia recommends that the standards for measuring abatement should be the standards required under the Department of Climate Change's Greenhouse Friendly program. This standard should be adopted by all carbon offset schemes, including schemes that are not seeking accreditation under the Greenhouse Friendly program.

Recommendation 12

A balance must be struck between the compliance requirements needed to ensure the integrity of abatement activity and to encourage as much abatement activity as possible.

Recommendation 13

The standards for measuring abatement should be the standards required under the Department of Climate Change's Greenhouse Friendly program.

Further issues for consideration in the design of the AETS

The following questions have arisen from our analysis of the EU ETS and publications reviewing the EU ETS, particularly the analysis undertaken by the UK Office of Climate Change and the UK Department of Environment Food and Rural Affairs titled “*Analysis Paper on EU Emissions Trading Scheme Review Options*” and published in September 2007.

The below questions, together with the above recommendations are in the opinion of CPA Australia, important considerations in the design of the AETS. We believe the below questions should be considered as part of the deliberations on the design of the AETS. We are not in a position to provide recommendations or guidance on these questions at this time.

General

- Will Australia implement the AETS in phases as in the EU, bringing in new sectors at different phases and if so, how will such sectors be defined?
- What will be the baseline level of emissions against which reductions are measured? Will the baseline level be from one year or an average over a number of years?
- If there is to be partial free allocation of permits, what will be the income tax, GST and stamp duty treatment of such an allocation?
- Will businesses that do not qualify to participate in the AETS be able to opt-in to the AETS? If so, what criteria will be imposed to assess whether such businesses should be able to opt-in?
- Will there be a civil penalty regime to underpin the AETS? If so, will there be flexibility in applying penalties in the introductory phase of the AETS?

Trading

- Will non-participants in the AETS, including individuals, be able to buy and sell emission permits in the AETS?
- Will the trading of permits be through a trading facility? If so, will there be a legal framework laying down how and where trading in permits should take place?
- How will transactions be recorded by the regulator? How will ownership of a permit be tracked from the time it is issued until it is cancelled?
- If Australia has a registry system to track permits, will that system be integrated with the international registration system used under the Kyoto Protocol?

The AETS Regulator

- Who will regulate the AETS? Will it be an independent statutory body?
- Will the regulator be empowered to interfere in the free operation of the market? If so, what mechanisms could the regulator use to interfere and under what conditions could the regulator interfere?

Monitoring, Reporting and Assurance

- How frequently will participants in the AETS have to report emissions? Should it be half-yearly or quarterly reporting (unassured) as well as annual reporting (assured)?
- For scheme participants whose emission reports for the previous year are not assured as satisfactory, will there be any restrictions on them participating in the AETS?
- Will the AETS allow for staggered release of assured emissions data so as not to ‘flood’ the market with too much information at the same time and to spread the workload of assurance practitioners?

- Will there be monitoring and reporting guidelines developed to assist participating entities? If so, what status will such guidelines have and who will develop such guidelines?