Carbon Pollution Reduction Scheme: what may be the business impacts

Discussion paper

CPA AUSTRALIA

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First published 2008

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ISBN 978-1-876874-10-0

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Introduction

This paper is designed to encourage discussion on what businesses and members may need to know in order to manage the implementation and on-going participation in Australia's proposed emissions trading scheme, the Carbon Pollution Reduction Scheme (CPRS). We are seeking comment on this discussion paper to give us a better understanding of the issues members will need to be prepared for so that we can design an effective member offer in response to the scheme.

The government recently released its green paper on the proposed CPRS. The green paper provides a detailed outline of the key design features of the CPRS, however some details, particularly scheme targets are yet to be released.

The key design features of an emissions trading scheme are:

- it will be a cap and trade scheme which will commence some time in 2010
- it will have a wide coverage
- there will be a mix of auctioned permits and free permits (the free permits will be compensation for trade-exposed industries)
- the compliance and trading obligations under the scheme will directly impact about 1000 entities
- the operation of the scheme will put a market price on carbon pollution, which will change the relative price of goods and services, and may lead to changes in production and consumption decisions across the economy. The extent of the increase will depend on the emissions embodied in the production of the good or service. The green paper estimates that the impact of a permit price of $20.00 per tonne would be an average price rise of 16 per cent for electricity and nine per cent for gas, and an increase in the CPI of 0.9 per cent.

Carbon Pollution Reduction Scheme: what may be the business impacts

We seek feedback on whether the following list of potential issues — which was prepared in consultation with members — appropriately reflects the major strategic, financial and operational issues that may need to consider emerge from the introduction of the scheme:

Raising member and business awareness

- Lack of awareness of the fundamental design features of the proposed scheme.

Financial reporting issues

- There is currently no accounting standard on emissions trading. A standard is expected in 2010 from the International Accounting Standards Board. The European experience with their emissions trading scheme is that in the absence of a standard, six main accounting approaches have emerged when accounting for emissions trading in financial statements.
- How will risk issues with respect to AASB 7 *Financial instruments: disclosures* come into play in relation to operational / market / credit risks of the carbon market?
- Is a forward contract a financial asset (settled net in cash and not held for the business's own use) or is it an intangible asset (all other contracts being the right to acquire the future permit)?

Collection of emissions data

- Raising awareness and knowledge of the methodologies that are acceptable to determine emissions. For example, there are to be four different methodologies that most liable entities will be able to use to calculate their emissions, each with increasing accuracy and measurement costs. For a business, each methodology may produce different emissions results, which will lead to different costs for that business or different levels of compensation. Businesses will have to determine whether the benefits of the more accurate methodologies for measuring emissions outweigh the costs, including the costs of permits and the cost of investing in technology required to more accurately measure emissions.
- Businesses will need to calculate their current emissions and forward emissions profile so that this can be incorporated into strategic planning, investment decisions and budgeting. Businesses should apply different assumptions on permit pricing to determine the potential impacts of the scheme so that they can plan accordingly. This includes potential impacts on asset values and revenue lines.

Assurance

- Businesses will need to know how to satisfy an assurance of the emissions it reports, that is the quality of the data they will need to collect.

Compliance obligations

- Raise awareness of the compliance obligations proposed for the scheme.
- Raise business awareness and knowledge of the different sort of permits that a liable entity can purchase to meet their compliance obligations under the scheme. This would involve introducing business to the proposed international linkages of the scheme, and the opportunities this creates for liable entities to meet their compliance obligations by buying permits from outside the scheme.
- What if any interface exists between the compliance requirements of the scheme, the National Greenhouse and Energy Reporting Scheme, the Global Reporting Initiative and other sustainability reporting standards?

Finance and treasury issues

- Calculating the discount factor for long-tail carbon exposures.
- Incorporating a price on emissions in the calculation of the present values of existing exposures.
- It is assumed that a market will not only trade in the actual permits, but also forward markets and related financial instruments will emerge. Businesses will have to consider whether to use such financial products to mitigate risks of price volatility in the carbon market.
- Businesses will have to consider whether they need to build systems to help them manage the trade in permits or whether they outsource the management of such a trade.
- Businesses will need to determine how they will finance the purchase of permits.
- If businesses decide to manage the purchase and trade in permits themselves, they will need to consider not only the cash flow and financing aspects of purchasing permits but also their tactics. If the management of the purchase of permits is not effective, this has the risk of exposing the business to issues such as not meeting their compliance obligations.
- Businesses will need to be aware of their forecasted future emissions profile so they can decide whether they need to participate in the annual auction of emission permits issued for the three following years. Part of this decision-making process will include a consideration of the number of future vintage permits available for auction and the cash-flow position of the business.

General business issues

- Assessing the risks and opportunities to business.
- Businesses may need to identify the training needs of staff to prepare them for the scheme.
- Identifying issues that businesses need to consider to assist them manage the implementation of the scheme, for example, who will manage the implementation (it should be the CFO), who will be measuring the emissions, who will be reporting emissions, who will be purchasing and trading permits, who will be balancing reported emissions with permits held, and how will the financial issues that the scheme raises be incorporated into sound decision making? Given the financial implications of the scheme, who will have on-going management of obligations and where within an organisation will that person sit, for example will they report to the CFO?
- Businesses should review their current contracts for cost-pass-through provisions and ensure new contracts are negotiated to take into account the impacts of the scheme.
- Businesses should be aware of customer concerns on emissions and see if they have the products and services to take advantage of those concerns. Businesses should be aware of the ACCC’s concerns in relation to false or misleading claims on the ‘green’ credentials of products and services.

Taxation implications of the scheme

- Businesses will need to be aware of the tax implications of the scheme.
- Businesses may need to model the various pricing and market scenarios to identify potential impacts on tax payable and tax loss profiles.

Project analysis

- Businesses will have to consider the impact of putting a forward cost on emissions on capital budgeting and project analysis. Given the uncertainty over future permit prices, this analysis should include a range of permit-pricing scenarios to aid decision making.

Cash flow

- Businesses will need to consider the impact of having to purchase emission permits on annual budgeting. The green paper proposes that there will be at least four auctions of permits a year, the last auction for a year will take place after the close of that year and after a liable entity will have to report their emissions, but before the final date for surrender of permits for that year.

Systems

- Businesses will need to ensure that their systems for capturing emissions data is integrated with their financial systems.

Impact on the valuation of assets

- Businesses will have to consider the impact the scheme may have on the impairment calculations for their assets. The proposed scheme is an indicator of impairment for entities that are large, direct emitters because the cost of buying permits may be significant. For example, if the recoverable amount of an entity's assets is based on expected cash outflows and inflows from continuing use of the asset, a business may need to consider whether those cash flows should be adjusted for the impact of the scheme.
- Where goodwill or indefinite-life intangible assets are included in a business's value-in-use calculations, entities must disclose the key assumptions they have used in their impairment test. This could include an explanation of whether the proposed scheme has been factored into the impairment calculation, and if so, how.
- Businesses may also need to consider and calculate the potential impact on the valuation of assets and liabilities of the scheme on potential merger and acquisition targets.

Pricing

- Businesses will need to calculate the impact of a cost on emissions on profit margins. A business will then need to make decisions about whether to pass on such costs and / or reduce costs through being more energy / emissions efficient. This will apply to all businesses through the supply chain effect.
- Businesses may need to undertake life-cycle analysis of their products and services to calculate the emissions profile of each product and identify potential opportunities for abatement.

Corporate governance

- Businesses will need to consider how the governance arrangements relating to the implementation of the scheme are going to be managed.
- Businesses will need to consider how they build their carbon strategy into their broader strategy.

Risk management

- The introduction of the scheme raises a number of challenges to businesses which, if not managed, could lead to the market forming incorrect perceptions over the impact that the scheme will have on a business. It is important for some businesses that have a high exposure to the scheme to have a strategy to transparently communicate that impact to the market.

Abatement opportunities

- Businesses will need to be able to assess the emissions profile of their business and identify areas best suited for abatement, including investing in low emissions technology. This will include undertaking cost-benefit analysis of those abatement opportunities and, given the uncertainty with future prices, be able to include a range of permit prices in that analysis.

Disclosures

- Businesses that believe they will be significantly affected by the proposed scheme should explain the expected future impact on their results and any actions taken to date in relation to the proposed scheme in their directors' report. Similar information should be provided in the review of operations and activities under the ASX listing rules.
- Businesses subject to the *National Greenhouse and Energy Reporting Act 2007* and the *Energy Efficiency Opportunity Act 2006* need to disclose that fact in their directors' report when discussing the business's performance in relation to environmental regulation (section 299(1)(f) of the *Corporations Act* 2001)

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CPA105513 09/2008