Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB members**	**Date:**	2 December 2014
From:	**Ahmad Hamidi**	**Agenda Item:**	3.13
Subject:	**Emissions Reduction Fund – An Update**	**File:**	

Action

For information – an update on the progress of the Emissions Reduction Fund.

Attachments

Appendix: **Emissions Reduction Fund – A Summary of Legislative Developments**

Overview

The Emissions Reduction Fund (ERF) is to replace the repealed carbon tax from 1 July 2014. The ERF is envisaged to embody three elements:

(a) ***Crediting emissions reductions***

An Australian Carbon Credit Unit (ACCU) would be issued by the Government for each tonne of emissions reductions delivered by an emissions reduction project. The crediting mechanism envisages the extension of the Carbon Framing Initiative (CFI) (which was operative under the carbon tax regime) to other abatement projects.

(b) Purchasing emissions reductions

The Government will run competitive reverse auctions to purchase ACCUs to be created under emissions reduction projects at the lowest available cost. Successful bidders would enter contracts with the Government for delivery of ACCUs and payment by the Government.

(c) Safeguarding emissions reductions

The safeguarding mechanism, expected to become operative from 1 July 2016, would keep emissions by emitters within their historical baselines. The related legislation is expected, inter alia, to clarify how the baseline for individual facilities/entities are determined, the consequences of emitting above the baselines and whether ACCUs can be bought on the market to pay for excess emissions.

Financial reporting implications

At this stage the ERF does not seem to have any financial reporting implications that are not capable being dealt with under Australian Accounting Standards. In addition to following up domestic legislative developments, staff plan to continue monitoring the IASB's and IPSASB's work on emissions trading schemes (including the baseline and credit schemes) with a view to assessing any possible financial reporting implications for Australia.

Appendix: Emissions Reduction Fund – A Summary of Legislative Developments

Introduction

1. Emissions Reduction Fund (ERF) is the Australian Government's proposed mechanism for managing carbon emissions that replaces the repealed carbon pricing mechanism (CPM). The CPM became operative on 1 July 2012 with a first three-year phase involving a fixed price for each tonne of carbon equivalent (Co_2-e) missions known as carbon tax. Thus 2013-2014 was the last compliance year for emitters but liable entities would need to satisfy reporting obligations under CPM for that year which involves final reporting of emissions in October 2014 and final payments of carbon tax by February 2015. As for previous fixed phase compliance years non-compliance penalties will apply. The possible financial reporting implications for such entities are set out in the AASB staff paper written to address the fixed price phase[1] and is available on the AASB website under the Research Centre's tab.

2. The ERF is an important component of the Australian Government's Direct Action Plan and is expected to operate alongside existing emissions reduction schemes such as the Renewable Energy Target and energy efficiency standards on appliances, equipment and buildings. The ERF is designed to provide incentives for businesses, landowners, state and local governments, community organisations and individuals to adopt emissions reduction practices and technologies.

3. The ERF White Paper, released on 24 April 2014 sets out the design of the ERF. The ERF's aim is to help achieve Australia's 2020 emissions reduction target of five per cent below 2000 levels by 2020. To establish the ERF, the Government has provided $2.55 billion in the 2014-15 budget.

4. The principles guiding the design of the ERF are:

   (a) Lowest-cost emissions reductions
   (b) Genuine emissions reductions
   (c) Streamlined administration.

5. The white paper notes that businesses have identified a wide range of productivity-enhancing activities that the ERF can unlock. These include:

   - upgrading commercial buildings;
   - improving energy efficiency of industrial facilities and houses;
   - reducing electricity generator emissions;
   - capturing landfill gas;
   - reducing waste coal mine gas;
   - reforesting and revegetating marginal lands;
   - improving Australia's agricultural soils;
   - upgrading vehicles and improving transport logistics, and
   - managing fires in savanna grasslands.

ERF-constituent elements

6. The ERF is envisaged to embody three elements:

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1. AASB Staff paper – *Possible Financial Reporting Implications of the Fixed Price Phase of the Carbon Pricing Mechanism for Emitter Entities*, Ahmad Hamidi-Ravari, July 2012 (updated to July 2013)

Crediting emissions reductions

7. The Clean Energy Regulator (CER) will issue on behalf of the Australian Government one Australian Carbon Credit Unit (ACCU) for each tonne of emissions reductions delivered by an emissions reduction project as currently occurs under the Carbon Framing Initiative (CFI). Crediting rules will be set out in emissions reduction methods. ACCUs can then be sold to the Government through a reverse auction. Under the crediting mechanism, credits are granted for emissions reductions that would only be achieved under the ERF. That constraint arises from the 'additionality' test which prescribes that emissions reduction activities already occurring or activities already receiving incentives under other Government programs will not be eligible to create ACCUs. That would also exclude emissions reductions arising from moving emissions producing activities to another location.

8. Credits will only be issued when the CER is satisfied the abatement has occurred as reported by the participant.

9. Under the proposed ERF, current CFI projects will automatically transition to the ERF.

Purchasing emissions reductions

10. The CER will run competitive reverse auctions to purchase ACCUs to be created under emissions reduction projects at the lowest available cost. The bidders submit a price per tonne of proposed abatement and the CER will select projects with the lowest price per tonne of CO_2-e. The CER will then enter into contracts with successful bidders which would guarantee payment in return for delivery of ACCUs.

11. The CER may set a confidential benchmark price being the maximum price for a tonne of CO_2-e for the reverse auction, below which bids are considered. There are a number of prequalification requirements for those wanting to participate in auctions.

12. The emissions reduction projects are proposed to satisfy a number of criteria:

    (a) the project must not have begun implementation before registration (*newness requirement*);
    (b) project cannot be mandatory under a Commonwealth, state or territory law (*regulatory additionality requirement*); and
    (c) project activities must not be likely to be carried out under another Government Program in the absence of project registration under the ERF (*government program requirement*).

13. There are a number of steps in participation. The projects must be registered with the CER indicating the estimated volume of abatement in accordance with an approved method. The methods for estimation of emissions reductions are to be developed by the Ministry of Environment. The CER must be satisfied that the project, inter alia, meets additionality requirements, is consistent with an applicable method and the applicant is a fit and proper person. An auction qualification process applies due diligence checks to confirm it is credible that the project can generate the stated emission reductions within the timeframe specified. The auction will be decided on price only and the successful bidder must sign a standardised contract with the CER to deliver ACCUs for payment at the price bid at auction. Project owners would need to submit regular reports on their registered projects and emissions reductions. The CER would use a risk-based approach to the audit of projects.

14. Contracts will include provisions to make good, unless under-delivery is not within the control of the participant.

Safeguarding emissions reductions

15. The safeguard mechanism encourages businesses to keep emissions within historical baselines. This is intended to help ensure that emissions reductions paid for through the ERF are not offset by increases in emissions by these businesses elsewhere in the economy.

16. The safeguard mechanism applies to around 130 large businesses that already report under National Greenhouse and Energy Reporting Scheme (NGERS)[2] and have direct emissions of more than 100,000 tonnes a year (the threshold for reporting under the NGERS is generally 25,000 tonnes per year which results in about 500 entities reporting). This is expected to cover about 52 per cent of Australia's emissions. It commences from 1 July 2016, pursuant to relevant consultation process being completed[3].

17. Baselines will be determined using data already reported under the NGERS and would reflect the highest level of reported emissions for a facility over the historical period 2009–10 to 2013–14

18. The safeguard mechanism will apply to direct emissions (scope 1[4]), including direct emissions from energy production. Electricity generators will be responsible for the direct emissions from electricity production, not the electricity users.

19. No revenue from firms is sought, nor will any be budgeted by the government as part of the safeguard mechanism. Would that mean going above baseline involves no penalties? For an answer, we need to wait for relevant legislation/regulation.

Consultation and Legislation

20. The Australian Government consultations/draft legislation to date:

    (a) 9 May 2014 - The Emissions Reduction Fund exposure draft legislation was published with a comment date of 23 May 2014.

    (b) 18 June 2014 - The Government introduced to Parliament a bill to implement the Emissions Reduction Fund. The Carbon Farming Initiative Amendment Bill 2014 will expand the Carbon Credits (Carbon Farming Initiative) Act 2011.

    (c) 3 September 2014 - Draft Emissions Reduction Fund methods on landfill gas, alternative waste treatment and coal mine waste gas released for public consultation. Consultation period closes 1 October 2014.

    (d) 25 September 2014 - Draft Emissions Reduction Fund methods on commercial buildings and avoided clearing of native regrowth released for public consultation. Consultation period closes 23 October 2014.

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2 The National Greenhouse and Energy Reporting Act 2007 (NGER Act) introduced a single national framework for reporting and disseminating company information about greenhouse gas emissions, energy production, energy consumption and other information specified under NGER legislation. One objective of the NGER Act is to underpin Australia's emissions trading scheme. The data reported under the NGERS would also be used for the ERF purposes.

3 The Senate amendment to the Carbon Farming Initiative Amendment Bill 2014 in October 2014 included change of commencement date of the safeguard mechanism to 1 July 2016 with public consultation on safeguard mechanism legislative rules by 1 October 2015.

4 Scope 1 emissions are defined in the *National Greenhouse and Energy Reporting Regulations 2008* to mean the release of greenhouse gas into the atmosphere as a direct result of an activity or series of activities that constitute the facility.

(e) 15 October 2014 - Draft Emissions Reduction Fund methods on facilities, wastewater treatment and transport released for public consultation. Consultation period closes 12 November 2014.

(f) 31 October 2014 - the Senate made amendments to the *Carbon Farming Initiative Amendment Bill 2014*.

(g) 24 November 2014 - The House of Representatives agreed to senate amendments and the ERF legislation thus passed both houses on that date. The CER has noted it will begin formally administering the ERF once legislative amendments commence and the necessary legislative rules are made.