

# **AASB staff paper: Financial Reporting Implications of the Carbon Tax for Government**

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## **Note:**

*This paper has been prepared by AASB staff. The views expressed in this paper should be considered as being those of the AASB staff only and might not necessarily conform with the Board views.*

*This paper is not authoritative accounting guidance. Professional judgement would need to be exercised in relation to the accounting treatments discussed in this paper in the circumstances of the Australian Government.*

## **Introduction**

1. This staff paper is intended to inform AASB constituents (in particular, users) about the key general purpose financial reporting issues that may have implications for the Australian Government during the fixed price phase of the carbon pricing mechanism (CPM). It also addresses possible accounting treatments in respect of those issues based on current Australian Accounting Standards. It does not deal with all the likely issues that could arise.
2. This paper follows another paper published in July 2012 dealing with the financial reporting implications of the carbon tax for emitter entities (see quick links on the [www.aasb.gov.au](http://www.aasb.gov.au)).

## **Issues addressed in this paper**

3. The following are the issues addressed in this paper:
  - (a) the nature of the Government impost;
  - (b) accounting for sold permits;
  - (c) accounting for buy-back arrangements of free permits;
  - (d) Government liability in relation to offsetting emission debt with free permits and Australian Carbon Credit Units (ACCU);
  - (e) accounting for shortfall charges;
  - (f) the cash flow statement; and
  - (g) Generally Accepted Accounting Principles/Government Finance Statistics (GAAP/GFS) harmonisation issues.

## **Background**

4. In October and November 2011, the House of Representatives and the Senate, respectively, passed the *Clean Energy Bill 2011* along with 17 other bills that together make up the legislative framework for the Clean Energy Future Plan. The legislation establishes the framework for a CPM that commenced on 1 July 2012. Further legislative detail is yet to come in the form of regulations.
5. The legislation envisages two phases for the CPM; a fixed price phase in which a 'carbon tax' is levied on certain entities based on 'permits' (referred to in the law as carbon units) with a fixed price; and a flexible price phase in which permits can be traded.
6. The CPM establishes an 'annual compliance period'<sup>1</sup>, from 1 July to 30 June.

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<sup>1</sup> Referred to in this paper as 'compliance year'.

7. The fixed price phase is to run from 1 July 2012 to 30 June 2015. From 1 July 2012, entities with emissions exceeding 25,000 tonnes of carbon dioxide equivalent (CO<sub>2</sub>-e) would need to pay a carbon tax by surrendering one permit for every tonne of CO<sub>2</sub>-e emitted in a relevant compliance year. The price of a permit for the first compliance year (2012-2013) is set at \$23, with the price to be increased in real terms annually by 2.5% until 2015. In some cases, such as emissions from certain landfills, other thresholds set by the legislation may become applicable.
8. During the fixed price phase the Government will 'sell' permits to emitters as the means for settling their emission obligations. There is no cap on the number of permits the Government can sell and the number will be determined by demand.
9. Under the CPM, there is to be significant compensation to entities within emissions-intensive trade-exposed industries and others through the issuance of free permits and other means.
10. International carbon units cannot be used to extinguish emission debts during the fixed price phase, but entities may use ACCUs generated under the Carbon Farming Initiative (CFI)<sup>2</sup> to extinguish up to 5% of their emission debt. As an exception, entities whose emission debt mainly arises from landfill emissions can surrender ACCUs to the extent of their full liability during the fixed price phase. There is no limit on the use of ACCUs during the flexible price phase.
11. The flexible price phase, involving an emissions trading scheme (ETS), is to run from 1 July 2015. The ETS is a cap and trade scheme, where the Government sets the cap on emissions and supply and demand in the market determines the price of permits. At the start of the flexible price phase, the carbon price will be subject to a transitional ceiling of \$20 above the international price of carbon increasing by 5% in real terms annually.
12. 'Banking'<sup>3</sup> or 'borrowing'<sup>4</sup> permits purchased or received freely by an emitter entity from the Government is not generally allowed during the fixed price phase but banking is allowed in respect of ACCUs. There is, however, the possibility that permits relating to flexible vintage<sup>5</sup> years 2015 and beyond could be bought through Government auction during the final year of the fixed price phase<sup>6</sup>.
13. For the flexible price phase, banking and borrowing of permits would be allowed. Eligible international carbon units may be used to extinguish up to 50% of emission obligations. There would be no limit on the use of ACCUs for that purpose. There would, however, be a limit on the use of Kyoto units<sup>7</sup>. Entities would only be able to extinguish 12.5% of their emission liabilities using Kyoto units. The Government is expected to adopt measures to facilitate linkage with European Union Emissions Trading Scheme.
14. The emissions data used under the CPM builds on the reporting framework created under the *National Greenhouse and Energy Reporting Act 2007* (NGER Act). Under the NGER Act, emitters must report their final assessment of their emissions to the Clean Energy Regulator, at the latest by 31 October after the compliance year. However, during the fixed price phase,

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2 See Appendix B to this paper for an explanation of CFI and ACCUs.

3 Use of permits of a certain vintage year in the following years.

4 Use of permits of future vintage years in the current year.

5 Each carbon unit has a vintage year, which is a particular eligible financial year.

6 This paper does not deal with the advance sales of permits relating to the flexible price phase.

7 See Appendix A, paragraph A.27.

most emitter entities should report an ‘interim emission number’, and surrender permits in respect of their interim emissions before 15 June in the compliance year. The interim emission number is calculated as 75% of the entity’s total Provisional Emission Number (PEN)<sup>8</sup> for the previous compliance year. The entity may, however, use the PEN for the current compliance year for calculation of interim emissions if it constitutes a reasonable estimate<sup>9</sup>.

15. During the fixed price phase, permits will be sold by the Government to emitter entities from 1 April to 15 June in the compliance year to enable them to satisfy their provisional surrender obligations and during the period from the time emission data for the compliance year is reported to the Regulator (at the latest 31 October) to 1 February after the compliance year in relation to the final settlement of their emission debt. Once permits are sold, the form of the legislation is such that the permits will automatically be deemed to have been surrendered by emitter entities to meet emission debts and an entry is to be made in the registry by the scheme Regulator to record that surrender.
16. Free permits granted attach to a vintage year and can be surrendered by emitter entities to extinguish an emission debt, like sold permits. Free permits are granted in a progressive manner with 75% granted early in the compliance year and the remaining 25% granted early in the next compliance year. The surrender of free permits by emitter entities would take place between 1 April to 15 June in the compliance year to satisfy their provisional surrender obligations and from the date of final assessment (at the latest 31 October) to 1 February after the compliance year in relation to the final settlement of their emission debt.
17. Appendix A to this paper contains a summary of certain provisions of the legislation on the CPM that may have general purpose financial reporting implications. Appendix B provides a summary background to ACCUs. The summaries are not intended to be exhaustive.
18. In the fixed price phase, a carbon tax does not appear to raise any recognition, measurement, presentation or disclosure issues for the Government beyond those dealt with under current Australian Accounting Standards for other non-income taxes.
19. The financial reporting implications of the flexible price phase will be further considered when the IASB progresses its project on accounting for ETSs. The AASB will consider providing any necessary financial reporting guidance under Australian Accounting Standards in regard to the flexible price phase, should it be established that a pronouncement from the IASB will not be forthcoming in time to provide a basis for accounting treatments in the flexible price phase.

### **The nature of the Government impost**

20. As indicated above, under the fixed price phase of the CPM, the Government imposes on certain emitter entities an obligation to surrender permits (or other eligible carbon units) in a relevant compliance year. It might be argued that this obligation gives rise to a tax liability by emitters. For the Government, the resulting revenue is a tax contribution for the purposes of

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<sup>8</sup> See Appendix A, paragraph A.2.

<sup>9</sup> See *Guide to Carbon Price Liability under the Clean Energy Act 2011*, Clean Energy Regulator, 2012 (<http://www.cleanenergyregulator.gov.au/Carbon-Pricing-Mechanism/Fact-sheets-FAQs-and-guidelines/Guidelines/Documents/Guide%20to%20Carbon%20Price%20Liability.pdf>).

AASB 1004 *Contributions*<sup>10</sup>. AASB 1004 regards taxes as a form of contribution and defines:

- (a) a contribution as a “*non-reciprocal transfer to the entity*”; and
- (b) a non-reciprocal transfer as “*a transfer in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer.*” (AASB 1004, Appendix A)

***Is surrender of free permits and ACCUs by emitters a tax contribution?***

- 21. The legislation envisages that entities may extinguish their emission debt:
  - (a) through surrender of purchased permits; and/or
  - (b) surrender of other carbon units for which they may have not paid money to the Government. These include permits granted freely by the Government to certain entities and ACCUs received freely from the Government or bought from other entities.
- 22. A relevant issue would be whether the surrender of free permits and ACCUs by an emitter to the Government constitutes a tax contribution under AASB 1004. For that to be so, the surrender of these carbon units would need to be in the nature of a service to the Government, or give rise to an asset of the Government, or to extinguish a liability of the Government without directly giving approximately equal value in exchange to the emitter [see paragraph 20(b) above].
- 23. The surrender of these units does not involve the delivery of a service by the emitter to the Government. Furthermore, because free permits or ACCUs are cancelled on surrender and have no utility to the Government, the surrender does not give rise to an asset of the Government. Accordingly, the only way for the surrender of free permits and ACCUs to constitute a tax contribution is to be an extinguishment of a Government liability without the Government giving approximately equal value in exchange. Paragraphs 37 to 48 of this paper discuss different views about whether the Government has a liability in relation to the grant of free permits or issuance of ACCUs, the extinguishment of which could constitute a tax contribution on surrender of those units.

***Recognition of carbon tax income***

- 24. Based on paragraph 12 of AASB 1004, income arising from the imposition of a carbon tax would be recognised by the Government when:
  - (a) the Government gains control of the tax contribution or the right to receive the tax contribution. This occurs when the emitter (liable entity) emits;
  - (b) it is probable that the economic benefits comprising the tax contribution will flow to the Government; and
  - (c) the amount of the tax contribution can be measured reliably.

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<sup>10</sup> Currently under review.

## **Measurement of income**

25. Pursuant to AASB 1004, paragraph 11, carbon tax income would be measured at the fair value of the tax contributions received or receivable. The Government would accrue an income, and a carbon tax receivable, as entities incur the tax, based on a reliable estimation of the amount of the entities' emission obligations. Any carbon tax receivable would be subject to normal impairment assessments.
26. Application of the criterion of reliable measurement requires judgment on the part of preparers. Accounting Standards provide guidance on measurement. It would be inappropriate for this paper to express a view about when revenue might be reliably estimable because it is a judgment to be made by preparers under the Standards.
27. In measuring carbon tax income during the fixed price phase, the following are relevant:
  - (a) sold permits have a fixed price for the relevant compliance year; and
  - (b) free permits and ACCUs surrendered in extinguishment of emission debt would reduce carbon tax income that the Government should accrue. The reduction would be at the price of sold permits for the relevant compliance year. This is tantamount to having an effective carbon price per tonne below the official price for the relevant compliance year (see paragraph 46 below).

## **Accounting for sold permits**

28. An emitter has the discretion to not emit carbon. If the entity ceases to emit, it could seek a refund from the Government for any excess permits it purchased from the Government. Accordingly, a liability would arise for the Government to return cash when it has received cash for sold permits in respect of emissions that have yet to occur as, at that stage, the Government is not yet entitled to tax the emission. This is a financial liability falling under AASB 139 *Financial Instruments: Recognition and Measurement* as it is the result of a contractual arrangement, involving 'offer' and 'acceptance', between the Government and the emitter entity. The liability would initially be equal to cash received from the sale of permits and would be reduced as the emitter debt grows (thus removing the emitter's opportunity to seek a refund).
29. Carbon tax income would be accrued as emissions occur and the proceeds from the sale of permits would be applied to reduce the carbon tax receivable.

## **Accounting for buy-back arrangements of free permits**

### ***Recognition of a buy-back liability***

30. Free permits may be bought back by the Government to help relevant entities manage their cash flow needs. The price for the buy-back arrangement is the price of a sold permit discounted using the Reserve Bank of Australia's benchmark BBB corporate bond rate as the discounting factor for those permits bought back by the Government up to 15 June of the compliance year. The full price of a sold permit is paid to holders if free permits are bought back by the Government after 15 June of the compliance year but before 1 February after the compliance year.
31. The Government would have an obligation arising from the grant of free permits under the legislation. It is a present obligation to buyback free permits on request from emitter entities. Under the existing legislative framework, the Government has no alternative to avoid the

obligation to deliver cash and hence, a liability would need to be recognised for the free permits estimated to be bought back in regard to each compliance year, together with a corresponding expense representing the grant of such free permits.

32. Some argue that because the Government buy-back obligation is an obligation to deliver cash to the holder of free permits, it meets the definition of a financial liability under AASB 132 *Financial Instruments: Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement*. However, the obligation, they argue, would fall outside the scope of those Standards on the ground that it arises from statutory requirements, rather than from a contractual arrangement. Those supporting this view would then argue that the requirements of those Standards should be invoked as analogous.
33. Others argue that the Government's obligation to buy-back free permits is a statutory liability of uncertain amount and timing, and would therefore fall under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. AASB 137 does not scope out liabilities arising from statute.
34. In regard to accounting for the Government's buyback liability, the following are relevant:
  - (a) in relation to free permits, certain categories of entities are eligible to receive them. The government is required by statute to deliver free permits to eligible entities and buy them back for cash or accept them in extinguishment of debt;
  - (b) the process of application for free permits by eligible entities and approval to grant the permits by Government does not amount to 'offer' and 'acceptance' and therefore could not be said to give rise to a contractual obligation.
35. The view in this paper is that the Government buy-back liability is of a statutory nature and that AASB 137, as a specific and applicable Standard, would have priority over analogy.
36. An estimate of the number of free permits that would be returned for buy-back in relation to a compliance year would be needed in order to calculate the liability of the Government and related grant expense<sup>11</sup>. The liability would need to be measured at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period (AASB 137 paragraph 36).

### **Government liability in relation to offsetting emission debt with free permits and ACCUs**

37. ACCUs are issued by the Government to entities that satisfy certain criteria under the Carbon Farming Initiative (CFI). ACCUs received by these entities can be on-sold to emitter entities, directly or through a broker, and the emitter entities would be able to use them to extinguish their emission debt under the CPM.
38. The issue is whether the grant of free permits and ACCUs to be used by emitter entities to extinguish their emission debt under the CPM has any accounting consequences for the Government. Some argue that the Government has an obligation to accept free permits and ACCUs from emitter entities in extinguishment of their emission debts on the grounds that this, in substance, amounts to the Government incurring an expense to settle such debts.

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11 The estimation of the number of permits to be returned for buy-back requires judgment on the part of the preparer and it is not a matter for this paper to express views about how a reliable estimation can be made.

39. The proponents of the existence of a liability on grant of free permits or issuance of ACCUs to be used to offset emission debt argue that:
- (a) the Government has a right under the legislation to tax liable emitters at a fixed price for each tonne of CO<sub>2</sub>-e they emit and that the Government right would otherwise manifest itself in receiving an asset (cash); and
  - (b) by accepting free permits and ACCUs to offset emission debt, the Government would be forgoing its right to a resource embodying future economic benefits, that is in substance no different from an outflow of such a resource.
40. This group, therefore, notes that the Government has a present obligation on issuing free permits or ACCUs to, in substance, transfer an asset on surrender of these carbon units to offset emission debt, and that it has no realistic alternative to settling that obligation. This would mean the Government would need to recognise a grant expense and a grant liability on issuing free permits and the ACCUs that would ultimately be used by the holder to extinguish emission debt.
41. Opponents of the existence of a liability on grant of free permits and issuance of ACCUs (to be used to offset emission debt) argue that the forgoing of a future asset inflow or future income is not the same as an outflow of economic benefits. Therefore, the issuance of free permits or ACCUs expected to be used to settle emission debt does not result in a liability for the Government on the grounds that the Government does not have a present obligation to sacrifice economic resources in the future. This group notes that this is consistent with the treatment of similar allowances in relation to other taxes such as various allowances in relation to the income tax. In these cases, the tax receivable by the Government is seen as the estimated proceeds after taking account of deductions for allowances. Therefore, the carbon tax receivable should be recorded at its recoverable amount consistent with accounting for the income tax by Government. The Government treats the tax payers' taxable income, rather than assessable income, as the subject of income recognition.

### *Staff analysis*

42. An emitter can reduce the amount of carbon tax it would otherwise pay by settling its obligations with free permits or ACCUs. But from the Government perspective, the Government will not have received an asset (or a replacement liability on more favourable terms). The Government will, therefore, have not received income.
43. The question then is whether the Government has a liability to the emitters that is extinguished by the Government forgoing tax income that the emitter would have otherwise had to pay. Or should the provision of free permits or ACCUs be viewed more like an allowable deduction that affects the effective carbon price achieved by the Government when taxing carbon emissions?
44. The AASB Framework<sup>12</sup> defines a liability as “a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits”. That definition is modified in the definition of a financial liability [AASB 132, paragraph 11(a)] to be:

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12 AASB Framework for Preparation and Presentation of Financial Statements.

“a contractual obligation:

- (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial liabilities with another entity under conditions that are potentially unfavourable to the entity”.
45. The forgoing of tax income does not meet either of the above definitions. The Government will not have an outflow of resources and it will not be exchanging liabilities. At most, the Government has an opportunity loss that does not meet the existing definition of a liability. If it did, then all allowable deductions in relation to other taxes would also meet that definition.
46. Accordingly, the appropriate view seems to be that the issuance by the Government of permits and ACCUs, for no consideration, albeit that they are transferable in the hands of the holder, amounts to affecting the income it should accrue. This is tantamount to having an effective carbon price per tonne that is below the official fixed price for the compliance year.
47. As noted in paragraph 36 above, the Government would need to estimate the number of permits that would be returned for buy-back. This is with a view to determining the related liability and grant expense, and is not a carbon tax matter per se. The process would also provide an estimate of the number of permits that would not be returned for buy-back. This latter estimate would affect the effective carbon price noted in paragraph 46 above.
48. Similarly, an estimation of the number of ACCUs to be returned for the extinguishment of emission debt would affect the effective carbon price.

### **Accounting for shortfall charges**

49. Under the CPM, shortfall charges are imposed on those emitters that are unable to deliver sufficient permits. During the fixed price phase shortfall charges may be imposed in two cases:
- (a) when sufficient permits have not been received by 15 June of the compliance year commensurate with the emitter’s interim emission number; and
  - (b) when sufficient permits have not been received on final assessment of the entity’s emissions after the compliance year end.
50. Shortfall charges imposed under the CPM would be expected to be recognised as income and aggregated with the carbon tax income. This treatment is similar to the treatment of penalties imposed under other tax arrangements such as income tax. Any subsequent remissions and write offs of the shortfall charges would be treated as an expense.
51. By its very nature, imposition of shortfall charges is a non-exchange transaction, and consistent with AASB 1004, shortfall charges should be recognised once incurred, and measured at the rate imposed under the legislation.

### **The cash flow statement**

52. The cash flow from sale of permits is of an operating nature as the collection of carbon tax constitutes an operating activity for the Government. Shortfall charges received are also of an operating nature.



## GAAP/GFS Harmonisation Issues

53. Pursuant to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, harmonisation issues arising from implementation of the CPM would need to be disclosed should treatments under GFS and GAAP differ.

### Summary

54. The following table depicts the Australian Accounting Standards that could apply in accounting for the effects of the carbon tax by Government in general purpose financial statements. The summary is at a high level and should be read in the context of the whole paper.

Activity	Items to be accounted for	Accounting Standard
Permits sold	Financial liability	AASB 139
Free permits granted:		
➤ to the extent expected to be bought back	Statutory liability	AASB 137
➤ to the extent expected to be used to extinguish emission debts	Reduces the amount of income that would otherwise be accrued	-
CO <sub>2</sub> -e emission activity of the emitter entity	Carbon tax receivable/carbon tax income (to the extent income is due)	AASB 1004
Entity has not surrendered adequate carbon units to satisfy its obligations in relation to interim emissions or on final settlement of its emission debt	Carbon tax receivable (short fall charges) Carbon tax income (short fall charges)	AASB 1004
Australian Carbon Credit Units (ACCUs):		
➤ issuance	None	-
➤ surrender in extinguishment of debt	Reduces the amount of income that would otherwise be accrued	-
Receipts and payments relating to carbon tax	Cash flows	AASB 107

## **Appendix A: Summary of certain Provisions of the Legislation on Carbon Price Mechanism that may have Accounting Implications**

### **General**

#### ***A carbon unit is a property right***

- A.1. A carbon unit issued by the Regulator is personal property and, subject to the requirements of the carbon pricing mechanism (CPM), transmissible by assignment (that is, as a result of some form of agreement to transfer the units to another person), by will (that is, as part of a deceased person's estate) and by other forms of transfer permitted by law.

#### ***The emissions number***

- A.2. The total quantity of emissions for which the entity is responsible is known as the 'emissions number'. A person's emissions number for an eligible financial year is defined to be the sum of the person's provisional emissions numbers (PENs) for the eligible financial year. PENs represent the emissions from each facility, or embodied emissions from total supplies of natural gas, for which a person is responsible for an eligible financial year.
- A.3. Vintage year, in relation to a carbon unit, means the eligible financial year that, in accordance with section 96 [of the *Clean Energy Act 2011*], is the vintage year of the unit.

#### ***Issuance of carbon units***

- A.4. The Regulator may issue a carbon unit with a particular vintage year at any time before the end of 1 February following the vintage year.

#### ***Assessment of a liable entity's liability for emissions***

- A.5. Under the CPM, liable entities will assess their own emissions numbers and report them to the Regulator under the *National Greenhouse and Energy Reporting Act 2007*. This is designed to remove any unnecessary duplication for liable entities, by retaining the existing emissions reporting framework with appropriate amendments.

#### ***Eligible emissions units in the fixed charge period***

- A.6. An 'eligible emissions unit' is a carbon unit, an eligible international emissions unit, or an eligible Australian carbon credit unit (ACCU) issued under the Carbon Farming Initiative (CFI).
- A.7. In the fixed charge period the Regulator will issue free carbon units to some liable entities. These free carbon units will be transferable but must be surrendered in the eligible financial year that corresponds to their vintage year.
- A.8. An unlimited number of carbon units whose vintage year is a fixed charge year will be available to liable entities at a fixed charge. These units will not be able to be banked for use in future years (i.e. they cannot be used for surrender in any year after the vintage year).
- A.9. 'Borrowing' will not be allowed during the fixed charge years. That is, a liable entity cannot surrender a carbon unit of a later vintage to meet its obligations for a fixed charge year.

### **Free carbon units**

- A.10. Free carbon units may be allocated to liable entities. These free carbon units can only be surrendered for their vintage year. They will be cancelled by the Regulator if they have not been surrendered at the end of 1 February of the eligible financial year after their vintage year. Free carbon units are cancelled if they are relinquished, rather than transferred to the Commonwealth relinquished units account. (This account is the Commonwealth Registry account designated as the Commonwealth relinquished units account and is used for units relinquished during the flexible charge years.)
- A.11. Some liable entities that receive free carbon units with fixed charge vintage years may not want to surrender these units against a liability for that vintage year. To ensure that persons who are issued with carbon units can sell these units when they do not wish to surrender them, the CPM requires the Regulator to 'buy-back' these units on demand from holder. The person may wish to sell these units to receive cash, which can then be used to offset the increase in monetary costs it faces due to its use of electricity or natural gas and its components as a feedstock, rather than hold these units for surrender.
- A.12. The buy-back facility will be open from 1 September of the vintage year of the carbon units until 1 February of the next calendar year. For buy-backs occurring in the period before 15 June of the relevant eligible financial year, the price paid by the Regulator for these carbon units will be discounted to 15 June of the relevant eligible financial year by the latest Reserve Bank of Australia index of the BBB corporate bond rate. From 15 June onwards the price paid will be equal to the fixed charge carbon units of that vintage.
- A.13. If the Regulator receives a request to buy-back free carbon units, it will cancel the units and remove the entries for those units from the Registry account of the liable entity that held them and will pay the buy-back amount to the person.
- A.14. There will be a standing appropriation for the Regulator for the purpose of making payments for the buyback of free carbon units.
- A.15. If an entity ceases conducting an emissions-intensive trade-exposed activity, it will be required to relinquish carbon units that had been issued to it for production that did not occur.

### **Fixed charge carbon units**

- A.16. The Regulator will also issue carbon units at a fixed charge that will be available to liable entities to discharge their emissions obligations under the CPM. These carbon units will be automatically surrendered for the eligible financial year corresponding to their vintage year. Carbon units issued for a fixed charge cannot be transferred to another entity and cannot be banked.
- A.17. In the fixed charge period, a carbon unit cannot be surrendered unless it has a vintage year of that financial year.
- A.18. The fixed charge per carbon unit is:
- \$23.00 in 2012-13;
  - \$24.15 in 2013-14; and
  - \$25.40 in 2014-15.
- A.19. In fixed charge years, a liable entity may apply to the Regulator for an allocation of fixed charge carbon units for a particular compliance year from 1 April in that compliance year until 15 June. These carbon units are for a liable entity to meet their liability to surrender carbon units by 15 June of the eligible financial year.

- A.20. A liable entity may also access fixed charge units from the date its emissions number is published until 1 February of the following year (the final surrender date). These carbon units are for a liable entity to discharge its liability for the relevant full year.
- A.21. In fixed charge years, if a liable entity surrenders units greater than the amount of its total emissions liability for the relevant year, then these units cannot be carried forward to count towards any liability for following years. The Regulator will pay a cash refund to the liable entity for the value of the excess surrendered units. The Consolidated Revenue Fund is appropriated for the purpose of making these refunds.

#### **Use of ACCUs and international units**

- A.22. In the fixed charge period, a liable entity may use eligible ACCUs up to an amount equal to five per cent of its total emissions liability.
- A.23. Eligible international emissions units cannot be surrendered during the fixed charge period.

#### ***Eligible emissions units in the flexible charge period***

- A.24. In the flexible charge years, the Regulator will issue carbon units equal to the pollution cap. These units will be transferable between Registry accounts. The Regulator will continue to issue some carbon units free of charge for industry assistance during the first three years of flexible charge phase and these will be able to be used in the eligible financial year that corresponds to the vintage year as well as any later years. The remaining carbon units will be issued through auctions conducted by the Regulator.
- A.25. Carbon units that have a vintage year that is a flexible charge year do not have a 'use by' date. They can be used for surrender in their vintage year and any year after that ('banking') There is also limited capacity to surrender carbon units that are of the following vintage year ('borrowing').
- A.26. A person may transfer carbon units during the flexible charge period.

#### **Use of ACCUs and international units**

- A.27. In the flexible charge period, a liable entity may also surrender eligible ACCUs with no limit and surrender eligible international emissions units to discharge up to 50 per cent of their total emissions obligations. There is also a sublimit of 12.5 percent for use of Kyoto units for this purpose. Kyoto units are created under the Kyoto protocol and include Assigned Amount Units (AAUs), Certified Emission Reduction Units (CERs), Emission Reduction Units (ERUs) and Removal Units (RMUs).

#### ***Shortfall charge***

- A.28. In a fixed charge year, most liable entities must meet their liability for emissions progressively:
- (a) a provisional surrender must be made before the end of 15 June of the eligible financial year to avoid a provisional unit shortfall charge. This covers 75 per cent of estimated emissions for the year ('interim emission number'); and
  - (b) a final surrender must be made before the end of 1 February of the following financial year to avoid a final unit shortfall charge, at which the time the liable entity discharges its liability for the full year.

- A.29. If the liable entity surrenders no units, or an insufficient number of units, it will be liable to pay a unit shortfall charge.
- A.30. The level of the unit shortfall charges for fixed charge years is set at 130 per cent of the fixed charge for the eligible financial year. The level of the unit shortfall charges for flexible charge years is set at 200 per cent of the benchmark average auction charge for the previous financial year, subject to regulations setting a different rate.
- A.31. In the fixed charge period, most liable entities must surrender sufficient units by 15 June to account for 75 per cent of the entity's estimated emissions for the current financial year ('interim emission number'). If a liable entity does not meet its progressive surrender obligation, it will have a provisional unit shortfall and be required to pay a unit shortfall charge. The provisional unit shortfall is equal to the total interim emissions numbers minus the number of eligible emissions units surrendered for the liable entity.
- A.32. During the fixed charge period, there will also be a unit shortfall calculated in accordance with the obligation to surrender permits by 1 February following the compliance year. This is known as the 'final unit shortfall'.
- A.33. The progressive surrender obligation during the fixed charge period is similar to the approach taken to payments for some forms of taxation, such as company tax and the GST.

### ***Relinquishment of units***

- A.34. A person may relinquish carbon units under the CPM. For example, where planned production ceases during a year, or where a court has ordered relinquishment following conviction under specified provisions of the Criminal Code relating to fraudulent conduct, including those relating to false or misleading statements in information given to the Regulator.
- A.35. Where units with a vintage year that is a fixed charge year are relinquished, the units are cancelled.
- A.36. For a carbon unit for a flexible charge year, if it is relinquished, then it is transferred to the Commonwealth relinquished units account and property is transferred to the Commonwealth.

## Appendix B: Australian Carbon Credit Units

- B.1. The *Carbon Credits (Carbon Farming Initiative) Act 2011* was passed by Parliament in August 2011. The Carbon Farming Initiative (CFI) is a carbon offsets scheme that is part of Australia's carbon market. The purpose of this Commonwealth Government scheme is to help farmers, forest growers and land managers earn income from reducing emissions like nitrous oxide and methane through changes to agricultural and land management practices. Landholders undertaking activities that conform to an approved methodology under the scheme will generate Australian carbon credit units (ACCUs). Participation in the CFI is voluntary.
- B.2. Under the legislation, there are two forms of ACCUs recognised, specifically Kyoto ACCUs and non-Kyoto ACCUs. For Kyoto eligible projects the Government proposes to allocate an Assigned Amount Unit to each ACCU created by the project. Kyoto projects are those for which the removed or avoided emissions can be used to meet Australia's climate change targets under the Kyoto Protocol or an international agreement that is the successor to the Kyoto Protocol. After the Kyoto Protocol commitment period ends in 2012, these activities will continue to receive ACCUs that can be used to meet liabilities under Australia's carbon price mechanism (CPM). After 2012 these ACCUs will be referred to as compliance ACCUs<sup>13</sup>.
- B.3. Kyoto ACCUs can be traded into the international compliance market established under the Kyoto Protocol.
- B.4. Some CFI activities are not included in the Australian greenhouse accounts under the Kyoto Protocol and do not count towards the national target. These activities can, however, earn ACCUs through the CFI, known as non-Kyoto ACCUs.
- B.5. The Government will also buy some non-Kyoto ACCUs, using revenue collected as entities pay the carbon price. The \$250 million CFI non-Kyoto Carbon Fund will be operational from July 2013. The Government will purchase non-Kyoto ACCUs via competitive tender. The price the Government will pay for non-Kyoto ACCUs will be no higher than the price of Kyoto ACCUs in the compliance market.
- B.6. ACCUs do not have an expiry date, and can be 'banked' or sold for future use. In the fixed price phase, liable entities can use Kyoto or compliance ACCUs to offset up to 5% of their carbon price liabilities except for landfill operators which can offset 100% of their emission obligations using Kyoto or compliance ACCUs. There is no limit on the use of Kyoto or compliance ACCUs in the flexible price phase for liable entities.
- B.7. Each ACCU represents one tonne of carbon dioxide equivalents (CO<sub>2</sub>-e). ACCUs can be traded. Carbon brokers help to market and trade carbon credits by linking suppliers and buyers. ACCUs are financial products for the purposes of the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*.
- B.8. Companies with liabilities under CPM are expected to buy ACCUs if doing so is more cost-effective than undertaking abatement within their own operations or meeting their obligations through purchase and surrender of permits.

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13 At the United Nations climate talks held in Qatar in December 2012, delegates agreed to extend the Kyoto protocol until 2020.

- B.9. The Australian National Registry of Emissions Units (ANREU) is the electronic system used to track the issuance, trade and retirement of emissions units under the CPM, the CFI and under the Kyoto Protocol.
- B.10. When an entity earns credits through the CFI, the Administrator will issue the credits into that entity's Registry account. Opening a Registry account is part of applying to participate in the CFI. When an entity sells its ACCUs, the Administrator transfers those credits to the new owner's Registry account. The new owner can then sell the credits to a third person or can relinquish the credits to offset own emissions. If the credits are Kyoto ACCUs, a project proponent can elect to exchange these for internationally recognised units and sell these internationally. The Administrator manages all of these functions through the Registry.