AASB Staff paper – Possible Financial Reporting Implications of the Fixed Price Phase of the Carbon Pricing Mechanism for Emitter Entities (Version 3)[1]

Ahmad Hamidi-Ravari
Senior Project Manager, Australian Accounting Standards Board

(July 2012, updated to July 2013)

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 adopting accounting treatments discussed in this paper in the circumstances of the emitter entity.

Executive summary

This staff paper is intended to inform AASB constituents about the key financial reporting issues that may arise for emitter entities during the fixed price phase of the carbon pricing mechanism (CPM) and possible accounting treatments in respect of those issues based on current Australian Accounting Standards. It does not intend to deal with all likely issues that may arise.

Another staff paper published in February 2013 deals with the financial reporting implications of the carbon tax for Government (see quick links on the www.aasb.gov.au).

The following table depicts the Accounting Standards that could apply in accounting for the effects of the carbon tax by for-profit (FP) and not-for-profit (NFP) entities[2]:

Activity	Item to be accounted for	Accounting Standard and type of entity
Permits purchased	Financial asset	AASB 139 (FP, NFP)
Free permits received	Intangible asset or Financial asset Government grant	AASB 138 (FP, NFP) or AASB 139 (FP, NFP) AASB 120 (FP); AASB 1004 (NFP)
Emissions made	Provision (liability)	AASB 137 (FP, NFP)
Entity qualifies for Australian Carbon Credit Units (ACCUs)	Intangible asset Government grant	AASB 138 (FP, NFP) AASB 120 (FP); AASB 1004 (NFP)
Shortfall in permits and penalties incurred for the shortfall	Liability	AASB 137 (FP, NFP) and AASB 139 (FP, NFP)
Carrying amount of assets no longer recoverable	Asset (reduction)	AASB 102, AASB 136, AASB 139, (FP, NFP)

1 This staff paper may be amended for changes in legislation, regulation or accounting requirements. In such cases the revised version will show the date of the version and indicated by a 'version number' to alert the reader of the amendments.
2 Carbon tax may also impact on contracts, existing provisions and income tax, not reflected in the table.

Background

1. 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.

2. The CPM envisages an 'annual compliance period[3], from 1 July to 30 June, which may not conform with an entity's annual financial reporting period.

3. The legislation envisages two phases for the CPM; a fixed price phase in which permits (referred to in the law as carbon units) have a fixed price set by the Government; and a flexible price phase in which permits can be traded.

4. 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_2-e) would need to pay a carbon tax by surrendering one permit for every tonne of CO_2-e emitted in 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.

5. During the fixed price phase the Government 'sells' permits to emitters as the means of settling their emission obligations. There is no cap on the number of permits that can be purchased from the Government.

6. 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. Free permits are allocated to eligible entities from 1 September in the compliance year.

7. International carbon units may not be used to extinguish emission obligations during the fixed price phase but entities may use Australian Carbon Credit Units (ACCUs) generated under the Carbon Farming Initiative (CFI)[4] to extinguish up to 5% of their emission obligation. As an exception, entities whose emission obligation 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.

8. The flexible price phase, involving an emissions trading scheme (ETS), is to run from 1 July 2015 onwards. 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.

9. 'Banking'[5] or 'borrowing'[6] permits purchased, or received freely by an emitter entity, from the Government is not generally allowed during the fixed price phase but banking

---

3 Referred to in this paper as 'compliance year'.
4 See Appendix B to this paper for an explanation of CFI and ACCUs.
5 Use of permits of a certain vintage year in the following years.

is allowed in respect of ACCUs. There is, however, the possibility that permits relating to flexible vintage[7] years 2015 and beyond could be bought through Government auction during the final year of the fixed price phase[8].

10. For the flexible price phase, banking and borrowing of permits are to be allowed. Eligible international carbon units may be used to extinguish up to 50% of emission obligations. There will be no limit on the use of ACCUs for that purpose.[9] There would, however, be a limit on the use of Kyoto units. 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.

11. 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.

General observations

12. In the fixed price phase, a carbon tax does not appear to raise any recognition, measurement, presentation or disclosure issues for emitter entities beyond those dealt with under current Australian Accounting Standards for other non-income taxes. However, there are numerous matters, some inter-related, to consider.

13. The financial reporting implications of the flexible price phase will need to be considered by the AASB 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 the IASB will not be forthcoming with any necessary pronouncement or guidance in time to provide a basis for accounting treatments in the flexible price phase.

14. Due to the breadth of the subject of accounting for the effects of carbon tax, professional judgment will need to be applied in identifying relevant issues and applying the Standards in the circumstances of each entity.

Issues addressed in this paper

15. This paper focusses on the following topics/issues:

    (i) the nature and classification of permits;

    (ii) recognition of a liability for emissions;

    (iii) recognition of a liability on receipt of free permits;

    (iv) capitalisation or expensing of carbon tax;

    (v) accounting for free permits in the Australian context;

---

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

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

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

9 See Appendix A, paragraph A.27.

(vi) presentation of assets and liabilities;

(vii) accounting for ACCUs;

(viii) impairment;

(ix) accounting for shortfall charges;

(x) onerous contracts and existing provisions; and

(xi) the impact on income tax.

The nature and classification of permits

16. Permits, whether purchased or received freely in respect of a compliance year, satisfy the definition of an asset in the AASB Conceptual Framework. They are future economic benefits controlled by the emitter entity as a result of a past event – being the purchase or receipt of the permits. In the fixed price phase, the future economic benefits may flow to the emitter entity by:

    (a) using the purchased permits to settle emission obligations in respect of a compliance year, or by returning surplus purchased permits to the Government for a refund when settling the emission obligations for that year;

    (b) using the free permits to settle emission obligations in respect of a compliance year, or selling them back to the Government for cash, or selling them to another entity[10] for cash. Cashing out with the Government would be at a discounted price allowing for the time value of money.

17. Arguments exist as to the classification of permits, purchased or free, under Australian Accounting Standards. The following considers some of the arguments raised.

Purchased and free permits as financial assets

18. Some argue that because:

    (a) permits, purchased or free, are offset against the entity's emission liability as if a currency;

    (b) free permits embody a right to be cashed out with the Government; and

    (c) purchased permits embody a right to be cashed out with the Government if there is a surplus of them at hand on final settlement;

    they meet the definition of a financial asset by analogy under AASB 132 *Financial Instruments: Presentation* and AASB 139 *Financial Instruments: Recognition and Measurement* but would fall outside the scope of those Standards on the ground that their future economic benefits arise from statutory rights, rather than from a contractual arrangement with another party.

19. Consistent with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, financial assets arising from statutory rights could be accounted for, by analogy,

---

10 For example, permits might be sold to a financial institution under a repurchase agreement. Repurchase agreements are used by entities for raising short-term working capital where a financial institution buys securities from an entity on the condition that the entity buys them back at a certain price on a certain date.

in the same way as those arising from contractual arrangements providing they were not subject to another specific Standard.

Purchased permits as intangible assets

20. Some argue that purchased permits are intangible assets under AASB 138 *Intangible Assets* on the grounds that they are identifiable non-monetary assets without physical substance and exhibit features similar to licenses and quotas. There are, however, others that do not agree with this classification for the following reasons:

    (a) Purchased permits are not emission licenses or quotas; rather they are essentially instruments that can be used to extinguish debts. For most licenses or quotas, the entity simply cannot undertake the activity to which the license or quota relates unless they are granted first. Under the CPM, an entity could operate and emit for a time, which could theoretically extend to the whole compliance year, without possessing purchased permits. However, shortfall charges would apply.

    (b) Purchased permits cannot be sold to another entity, or cashed out with the Government (except where there is a surplus of them on final settlement). They do not create an opportunity to generate an inflow of cash or another financial asset. That is, they are not needed, per se, for an emitter entity to produce cash inflows or other financial assets.

21. Accordingly, it would seem hard to argue that during the fixed price phase purchased permits are in the nature of intangible assets on the grounds that they are similar in nature to licenses and quotas.

Free permits as intangible assets

22. It is also argued that free permits are not in the nature of licenses or quotas, rather they are instruments to extinguish debt or used to manage short term cash flow needs. Unlike licenses and quotas, which are issued to the entity before engaging in the related operations, free permits are allocated to eligible entities from 1 September in the compliance year. These entities can sell the permits to the Government or another entity, thus being able to operate, theoretically, without possessing them during the compliance year as in the case of purchased permits, provided they pay relevant shortfall charges.

23. Accordingly, it would seem hard to argue that free permits are intangible assets on the grounds that they are similar in nature to licenses and quotas. However, free permits might be classified as intangible assets for other reasons, set out below.

24. Unlike purchased permits, free permits may be sold back to the Government or to another entity. Therefore, a carbon broker may buy free permits from an emitter entity and trade them even though that broker was never going to emit carbon. In this instance, the permits seem to be better characterised as tradable rights, providing an opportunity for players (an emitter in a market or a trader) to create cash inflows. In such a market even emitters can and will, if the market operates as intended, operate as traders. The emitter entity can make money, that is, create cash inflow by controlling the permit.

25. Arrangements can be put in place so that there is liquidity in the market that in turn provides the opportunity for the emitter entity and trader to make money. In such

circumstances, permits could be argued to be an intangible asset[11] for the emitter entity and a trading stock for the carbon broker.

26. These circumstances are similar to those under which the since withdrawn IFRIC 3 *Emission Rights* treated permits issued in an ETS as an intangible asset. They were tradable instruments that may have been purchased in the market, for which prices varied with market conditions and provided an opportunity for the players to create cash inflows.

27. Permits treated as intangible assets under AASB 138 by the emitter entities would be initially recognised at cost, which would normally also be fair value. The emitter entity may adopt an amortised cost model or a revaluation model for subsequent measurement.

Progressive surrender of permits

28. During the fixed price phase, most emitter entities are required to report an ‘interim emission number’, and surrender permits in respect of their interim emissions by 15 June of the compliance year. The interim emission number is calculated as 75% of the entity’s Provisional Emission Number (PEN)[12] 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[13]. The progressive surrender obligation during the fixed price phase is similar to the approach taken to payments for some forms of taxation, such as company tax and the goods and services tax (GST).

29. During the fixed price phase, permits may be purchased by emitter entities from 1 April to 15 June in the compliance year and during the period from the time emission data for the compliance year is reported (date of final assessment)[14] to 1 February after the compliance year in relation to the final settlement of emission obligations. Once permits are purchased, the form of the legislation is that the permits purchased will automatically be deemed to have been surrendered by emitter entities to meet their emission obligations and an entry is to be made in the registry by the scheme regulator to record that surrender.

30. Free permits granted by the Government to eligible emitter entities attach to a vintage year and can be surrendered by emitter entities to extinguish an emission obligation, like purchased 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 takes place between 1 April and 15 June in the compliance year to satisfy emitter entities’ provisional surrender obligations and from the date of final assessment (at the latest 31 October) to

---

11 AASB 132, paragraph AG10, contrasts intangible assets and financial assets, indicating that the former creates an opportunity to generate an inflow of cash or another financial asset.

12 See Appendix A, paragraph A.2.

13 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 – accessed 3 April 2013).

14 The emissions data 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 to the Regulator, at the latest, by 31 October after the compliance year.

1 February after the compliance year in relation to the final settlement of their emission obligations.

31. It might be argued that the purchase and automatic surrender of permits in relation to interim emissions before 15 June in that year amounts to an extinguishment of the emission liability to the extent of permits purchased. This might be seen as the entity, in substance, paying up for (all or part of the) its interim emission liability as if in cash, and accounting for the settlement accordingly. Alternatively, the purchase and automatic surrender of permits might be thought of as separate events. That is, one might recognise an asset for the purchase and subsequently derecognise that asset to reflect the surrender. The two-step approach might have appeal as a precursor to the flexible price phase.

32. Irrespective of which approach is taken, given the way purchased permits will be applied to reduce the liability before 15 June in the compliance year and that they will be purchased for the final settlement after the year end, the only practical issue at the year end is likely to be estimating the unsettled liability. Only those entities that have purchased permits earlier than they need to will have an asset to classify.

Recognition of a liability for emissions

33. Under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* an entity should recognise a provision when:

    (a) it has a legal or constructive present obligation arising from a past (obligating) event;

    (b) an outflow of resources embodying economic benefits to settle that obligation is probable; and

    (c) a reliable estimate can be made of the amount of the obligation.

    The existence of a present obligation would mean the entity has no realistic alternative to settling that obligation.

34. The emitter entity would be obligated to surrender permits for all its emissions in the compliance year if it emits beyond the emission threshold set out in the legislation. The entity would apply AASB 137 in recognising its emission liability. The entity would recognise a provision when the obligating event occurs and a reliable estimate of the amount of its obligation can be made. Some might argue that passing the threshold is the obligating event, but staff are of the view that the emission of carbon is the cause. In their view, when emission occurs, the probability of passing the threshold would be a factor in determining when to recognise the emission liability incurred. Thus an emission on day one of the scheme by a heavy emitter would be expected to result in the recognition of a liability on that day[15].

    (*Important development: please refer to Appendix C to this paper for coverage of the potential implications of Interpretation 21 'Levies' issued in June 2013)*.

15 In some cases, under AASB 137 it is conceivable that the event which accounting would see as giving rise to an obligation may take place earlier than the date or circumstances which leads to the related legal liability.

Recognition of a liability on receipt of free permits

35. Paragraphs 33-34 set out views on when to recognise an emission liability under AASB 137. There is, however, a further view that advocates the immediate recognition of a liability on the date free permits are allocated to the emitter entity. This view argues that the emitter entity receiving free permits is unconditionally obligated to comply with the scheme requirements and cannot avoid those obligations through future actions. In particular, it is argued, the entity receiving free permits is obligated to return them to the Government if it ceases to be eligible for using them. In late 2010, the IASB discussed the issue of whether a liability exists when an entity receives an allocation of free permits. It tentatively decided that such a liability exists on the ground that the definition of a liability is met. That view, which is controversial, is expected to be further considered in future IASB deliberations on ETSs. At this stage, it would seem that the IASB would need to issue a new pronouncement for this view to be applicable.

Capitalisation or expensing of carbon tax

36. When a liability is recognised for carbon tax, the usual consideration of recognising an expense or an asset for a non-income tax arises. When the tax is incurred in producing an asset that is recognised in the financial statements, it would usually be capitalised – the exception would be if the resulting incremental carrying amount of the asset were not recoverable. In other circumstances, the tax would be an expense. Expressed more specifically:

    (a) if carbon tax is regarded as a cost that is incurred in bringing inventories of produced goods to their present location and condition (and not a cost relating to idle capacity), it would be included in the cost of inventory under AASB 102 *Inventories*;

    (b) where the goods produced by an entity are used in own construction activity by that entity, the carbon tax would be capitalised under AASB 116 *Property, Plant and Equipment* provided the cost is necessary to bring the item to the location and condition for it to be capable of operating as intended; and

    (c) emitter entities engaged in non-production activities would most likely treat the carbon tax as costs of services rendered.

Accounting for free permits in the Australian context

(a) For-profit entities − AASB 120

37. For-profit entities recognising free permits as an intangible asset under AASB 138 would apply AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*. Free permits would be treated as non-monetary government grants and there would be a choice of recognising them at fair value or at a nominal amount for both the asset and government grant.

38. The nominal amount approach, however, was not supported by the IASB or IFRIC in their early debates on the subject and was excluded from IFRIC 3. This was largely on the ground that this approach would lead to recording a net liability, rather than an asset for free permits and a liability for all emissions, including those covered by free permits.

39. For-profit entities recognising free permits as financial assets by analogy cannot avail themselves of the nominal amount approach. This is because the free permits would initially be measured at fair value, consistent with AASB 139.

(b) Not-for-profit entities − AASB 1004

40. In accounting for free permits, not for-profit (NFP) entities would apply AASB 1004 *Contributions* and are not allowed to apply AASB 120. AASB 1004 would require free permits to be recognised at fair value with a credit to income[16].

41. The measurement of free permits at fair value during the fixed price phase would entail the consideration of the fair value hierarchy for measurement – see AASB 13 *Fair Value Measurement*.

Presentation of assets and liabilities

42. Two approaches have been suggested for presenting assets (permits) and liabilities (emission obligations) arising from the fixed price phase of the CPM:

    (a) the 'separate positions' approach under which the asset and the liability represent separate positions; and

    (b) the 'single position' approach, under which there is only a net asset or a net liability position, depending on whether there is an excess or deficiency of permits held.

    This issue largely depends on the approach taken to resolving the classification issues discussed above in paragraphs 18-27.

    In relation to free permits, there are limitations in adopting a single position approach during the fixed price phase on the grounds that:

    (a) Free permits may not be held with the sole intention of being used to extinguish emission liabilities – that is, the asset and liability elements might be dealt with individually.

    (b) If free permits are recognised as financial assets by analogy, then the 'separate positions' approach would need to be adopted for presentation since the emission liability recognised under AASB 137 is not a financial liability.

    (c) Offsetting principles in AASB 132 would not apply if free permits are classified as intangible assets and accounted for as non-monetary grants.

    As noted in paragraph 32, in relation to purchased permits treated as having been applied to settle partially the liability for the compliance year, there will only remain the balance of the liability at year end.

Accounting for ACCUs

43. ACCUs are granted to farmers and landholders who voluntarily undertake projects under the Carbon Farming Initiative (CFI) using farm management practices that build carbon stores and reduce harmful greenhouse gases. The Administrator of the ACCU scheme will issue a certificate of entitlement for a specified number of ACCUs once

---

16 Note work is currently being undertaken on a project to replace AASB 1004.

certain criteria are met by the participating entity. Each ACCU represents one tonne of CO_2-e.

44. Apart from purchased and free permits, liable entities may use ACCUs to extinguish their emission obligations. As indicated earlier (paragraph 7), during the fixed price phase, up to 5% of an entity's emission obligations may be extinguished using ACCUs and in some cases the entity might be able to use ACCUs to extinguish its emission liability entirely. There is no limit on the use of ACCUs during the flexible price phase.

45. ACCUs do not have an expiry date, and can be 'banked' or sold for future use. Liable entities can buy ACCUs from entities generating them or from carbon brokers.

46. There are similarities between ACCUs and certified emission reductions (CERs). CERs[17] are credits given to entities in less developed countries under the Kyoto clean development mechanism for projects (such as reforestation) that reduce greenhouse emissions. Entities in developed countries with excess emissions can purchase CERs on the market to satisfy their Kyoto emission targets.

47. There are also similarities between ACCUs and renewable energy certificates (RECs). RECs are granted to electricity generators that derive their output from renewable energy sources. The generating entities sell the RECs to electricity distributors and retailers who are obligated to source part of the power they sell from renewable sources. They extinguish this obligation by surrendering RECs they buy from generating entities.

Accounting treatment of ACCUs

48. As assets, the future economic benefits of ACCUs flow to the generating entity through sale to other entities or use in extinguishing emission liabilities arising from the entity's other activities. Entities generating ACCUs would generally classify them as intangible assets under AASB 138, on the grounds that their control creates an opportunity to generate an inflow of cash through sale to another party or to avoid a future cash outflow by settling any own emission obligations. Unlike free permits, ACCUs do not meet the definition of a financial asset.

49. As government grants ACCUs are accounted for by for-profit entities under AASB 120 and not-for-profit entities under AASB 1004. The grant would be recognised when there is reasonable assurance that the entity will comply with the attached conditions and that they will be received. The conditions attached to granting ACCUs would include various legal and regulatory requirements that should be satisfied before the entity receives a certificate of entitlement to ACCUs from the Administrator. Of importance is the 'additionality' requirement under which abatement must be additional to what would occur in the absence of the project undertaken by the generating entity.[18] This would also mean the project undertaken by the generating entity would only become economically viable if there is Government assistance in the form of ACCUs.

50. Depending on the circumstances and judgement involved in each case, the entity might capitalise costs incurred in generating ACCUs as part of a related asset or as the cost of obtaining the ACCUs.

---

17 CERs are issued by the Clean Development Mechanism Executive Board of the United Nations Framework Convention on Climate Change.

18 CFI Handbook, Department of Climate Change and Energy Efficiency, 2012, page 16.

51. For some entities, namely certain broker-traders, ACCUs might fall under the scope exclusion in AASB 102 *Inventories*, requiring measurement at fair value less costs to sell.

Impairment

Impairment of permits

52. As noted earlier, different asset types could be envisaged for the classification of permits. Impairment of these assets is addressed under relevant Standards. For example:

    (a) when permits are classified as intangible assets, AASB 136 *Impairment of Assets* applies; and

    (b) when permits are classified as financial assets by analogy, then impairment requirements of AASB 139 apply by analogy.

53. During the fixed price phase purchased permits are unlikely to be impaired as they would be surrendered on purchase and refunded on settlement if there is a surplus. However, there would be impairment considerations in relation to free permits held. Free permits that have not been surrendered in extinguishment of the emission liability of the related compliance year or have not been sold to the Government by 1 February following the related compliance year would be cancelled by the Government.

Impairment implications for other assets

54. The introduction of a carbon tax may result in the carrying amounts of some assets of the entity not being fully recoverable. The entity would apply relevant impairment requirements under Australian Accounting Standards AASB136, AASB 139 and AASB 102 to address the issue. Consistent with AASB 136, the substantive enactment of the CPM legislation might have constituted an impairment trigger.

55. Many NFP entities determine impairment of certain assets by reference to depreciated replacement cost (DRC), because the future economic benefits of the asset are not primarily dependent on the asset's ability to generate net cash inflows. For these entities, value in use is the DRC of an asset where the entity would, if deprived of the asset, replace its remaining future economic benefits[19]. As long as service potential is not affected, there is no impairment concern from introducing a carbon tax in relation to these entities.

Accounting for shortfall charges

56. Shortfall charges become due when the required number of permits commensurate to quantities emitted are not surrendered by the due dates. In the fixed price phase, the procedure for surrender of permits is progressive and slightly different from that applied in a flexible price phase. As noted in paragraph 28 above, permits representing 75% of estimated emissions for the compliance year should be surrendered by relevant liable entities by 15 June in the compliance year. A deficiency in the number of permits surrendered would lead to a provisional shortfall charge. A provision may need to be

---

19 See, AASB 136, paragraph Aus13.1.

recognised under AASB 137 for the shortfall in the permits and a liability may need to be recognised consistent with AASB 139 for the shortfall charge. The entity may have a final shortfall charge on settlement (which would be before 1 February of the financial year after the compliance year). Delay in extinguishing the shortfall charge liability would in turn attract a further penalty.

Onerous contracts and existing provisions

57. A carbon tax may lead to onerous contracts under AASB 137 if the cash flow from the contracts to which the tax is allocated are not adequate to cover the additional cost. Existing provisions recognised as liabilities may also be affected by the carbon tax legislation.

Impact on income tax

58. Carbon tax would be a deductible expense for income tax purposes. Under AASB 112 *Income Taxes,* there could be deferred tax consequences relating to the changes in the carrying amount of assets and liabilities brought about by recognising the permits/carbon tax.

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 allows the Regulator to 'buy-back' these units. 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, so that the buy-back price reflects the present market value of the carbon unit. 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 5 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.

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 (if any) 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[20].

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_2-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.

---

20 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.

Appendix C: Interpretation 21 *Levies* and the Australian Carbon Tax

C.1. IFRIC 21 *Levies* was issued unamended in Australia as Interpretation 21 *Levies* in June 2013. At its July 2013 meeting, the AASB considered how the Interpretation, if applicable, might affect the accounting in the fixed price phase of the Carbon Pricing Mechanism (CPM).

C.2. Interpretation 21 , paragraph 12, states:

> "12 If an obligation to pay a levy is triggered when a minimum threshold is reached, the accounting for the liability that arises from that obligation shall be consistent with the principles established in paragraphs 8–14 of this Interpretation (in particular, paragraphs 8 and 11). For example, if the obligating event is the reaching of a minimum activity threshold (such as a minimum amount of revenue or sales generated or outputs produced), the corresponding liability is recognised when that minimum activity threshold is reached."

C.3. The AASB came to the tentative view that judgement would be required in determining how the threshold criterion included in the Interpretation would be applied in recognising carbon emission liabilities, at least in some circumstances (for example, when there is separation, by some periods, between the act that causes emission and emissions taking place in a period to which thresholds apply).

C.4. The AASB noted that, depending on how the Interpretation's scope exclusion is applied, the Interpretation might be read as requiring a liability to be recognised when, and only when, the annual threshold level of emission specified in the legislation is met by a continuing entity. The view in the existing staff paper (that is existing before Interpretation 21 was issued) reflected in paragraph 34 of this staff paper, was that the obligating event is the emitting of carbon and a liability is recognised when it is probable the annual threshold will be exceeded.

C.5. The AASB also noted that how broadly the term 'threshold' is interpreted is a matter of judgement. Conceivably it could be seen to embrace, in principle, such matters as thresholds to be met before long service leave and pension entitlements vest. It would be surprising if Interpretation 21 was intended to address such matters.

C.6. The AASB decided that its concerns about Interpretation 21 should be raised with the IFRS Interpretations Committee citing various examples of analogous circumstances, not limited to the CPM. The AASB also requested that staff should revisit their paper to see how best to inform constituents that, in the meantime, emitter entities would need to use judgement in considering the potential effect of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and Interpretation 21.