

Accounting for emissions trading

What is the issue?

The Government has recently announced initial details of its proposed Carbon Pollution Reduction Scheme (CPRS), which is intended to apply to entities from 1 July 2010. The proposed scheme will put a price on carbon by requiring entities to hold a permit for every tonne of carbon dioxide equivalent emitted.

The purpose of the scheme is to help Australia reduce its greenhouse gas emissions. Currently there is no mandatory guidance that deals specifically with the accounting for emissions trading.

Impact on profit and loss	✓
Impact on balance sheet	✓
Impact on disclosures	✓
Impact on stakeholder communication	✓

Who does the proposed Carbon Pollution Reduction Scheme affect?

Entities that:

- Are large direct emitters of greenhouse gases (entities with facilities that have direct annual emissions of 25,000 tonnes of carbon dioxide equivalent or more). In Australia approximately 1,000 businesses will have an obligation to acquire and surrender carbon pollution permits under the scheme. For example, power stations, trucking companies and mining companies.
- Trade in carbon pollution permits (including financial institutions).
- Are large users of energy that are not directly covered by the proposed CPRS.

What should entities consider about the proposals?

There are a number of accounting implications arising from the proposed CPRS that entities should consider within the next 12 months. Specifically:

- The impact the scheme will have on their impairment calculations;
- The disclosures they may need to include in their directors' report and annual report; and
- How to account for forward purchase agreements of carbon pollution permits.

How does the proposed scheme affect entities' impairment calculations?

The proposed scheme is an indicator of impairment for entities that are large direct emitters because the cost of buying the carbon pollution permits is likely to be significant. When more detail is known about the proposals some entities will need to reassess the recoverable amount of their assets to determine whether they need to be written down.

For example, if the recoverable amount of an entity's assets is based on a value-in-use calculation (that is, the expected cash inflows and outflows from continuing use of the asset), the entity would need to consider whether those cash flows should be adjusted for the impact of the proposed CPRS.

Although there is insufficient information to reliably estimate any impact on future cash outflows now, December reporters should pay close attention to the CPRS white paper that the Government is expected to release later this year. If it provides firmer details on the proposed scheme, such as information that would enable entities to estimate the likely cost of carbon pollution permits and the potential flow on effects on energy prices, entities may need to reassess the recoverable amount of their assets in their next set of financial statements.

Where goodwill or indefinite-life intangible assets are included in entities' value-in-use calculations, entities must disclose the key assumptions they have used in their impairment test. Depending on the type of entity, this may include an explanation of whether the proposed CPRS has been factored into the impairment calculation and, if so, how.

What disclosures need to be made?

All entities need to include in their directors' report comments about likely developments in their operations in future financial years and the expected results of those operations. Further, listed companies must specifically disclose their business strategies and prospects for future years.

Disclosures about the proposed CPRS

Entities that will be significantly affected by the proposed CPRS should explain the expected impact on their future results and any actions taken to date in their directors' report. For example, an entity might state that it is likely to be classed as a liable entity under the proposed scheme, which will mean that it will need to acquire carbon pollution permits. The entity would need to disclose the likely impact this could have on its financial results and any actions taken to date in relation to the proposed CPRS. Similar information should be provided in the review of operations and activities under the ASX Listing Rules.

Accounting for emissions trading (cont'd)

Disclosures about the National Greenhouse and Energy Reporting Act

Entities impacted by the proposed CPRS will be subject to the reporting obligations of the *National Greenhouse and Energy Reporting Act 2007*, which was passed by the Federal Government in September last year.

This Act establishes a mandatory corporate reporting system for greenhouse gas emissions, energy consumption and production from 1 July 2008. Entities that need to report their greenhouse gas emissions and energy use under this Act for the 2008/09 period should begin collecting the relevant data now. These entities have until 31 October 2009 to submit this data to the Greenhouse and Energy Data Officer. Entities that are not subject to the reporting requirements of this Act for the current period may be required to report in subsequent periods as the threshold for reporting decreases. To find out if your entity is required to report this data visit www.pwc.com/au/climatechange.

Entities caught by this Act need to disclose that fact in their directors' report when discussing the entity's performance in relation to environmental regulations.

Disclosures about the Energy Efficiency Opportunity Act

Some entities may also need to meet the reporting obligations of the *Energy Efficiency Opportunity Act 2006*. This Act requires certain entities to assess their energy use and report publicly on the results and business response to the assessment in the corporate sustainability section of their annual report. To find out if your entity is subject to the requirements of the Act visit www.pwc.com/au/climatechange.

Entities caught by this Act need to disclose that fact in their directors' report when discussing the entity's performance in relation to environmental regulations.

How do entities account for the forward purchase of carbon pollution permits?*

While the CPRS is not intended to become operative until July 2010 at the earliest, entities are already entering into transactions that are effectively forward purchases of carbon pollution permits. These entities want to know how to account for these contracts now, while the proposed CPRS is being finalised and before the actual permits are being issued.

The forward contracts will either be considered financial assets or intangible assets of the entity.

To qualify as a financial asset, the forward purchase contract must be able to be settled net in cash and it must not be held for the entity's own use. The contract would be recognised initially and subsequently at fair value with any changes in the fair value recognised in profit or loss.

All other contracts are considered intangible assets, being the right to acquire the future permits. These contracts would be recognised initially at cost, and subject to impairment testing if the price for carbon pollution permits falls below cost. A revaluation to fair value would only be permitted if an active market for these rights to acquire permits has developed. For this to be the case there must be willing buyers and sellers at any time and prices must be available to the public. We don't expect this to be the case for some time.

*The views expressed here are based on the application of current accounting standards. The IASB has an active project on its agenda about the appropriate accounting for emissions trading schemes, which may affect these answers.

What do affected entities need to do now?

- Consider the impact of the proposed CPRS on your entity's impairment calculations and disclosures
- Consider discussing the expected impact of the proposed CPRS on your entity's future results in the directors' report
- Understand the financial reporting implications of complex transactions involving carbon pollution permits. Talk to your PwC advisor or the PwC Sustainability & Climate Change team for help if you need it.

PwC insight: Closely monitor the developments

We expect the IASB to begin discussing the appropriate accounting for the proposed CPRS at the end of this year. The IASB plans to release an exposure draft on the proposed accounting in the second half of 2009, and a final standard in 2010. The scope of the project will be broad and cover the accounting of all tradable emissions rights and obligations arising under an emissions trading scheme.

The AASB is monitoring the IASB's progress on this project closely. If the IASB is unlikely to complete its project in time for the 1 July 2010 deadline, the AASB may provide interim guidance for Australian entities. There will be scope to influence the developments through comments on the exposure draft, which we encourage entities to engage in.

Resources to help you keep up to date with IFRS developments

- **AASB Action Alert** covers the activities of the Australian Accounting Standards Board and how it will respond to recent IASB pronouncements. It is usually published monthly and is available at www.aasb.com.au
- **IASB Update** covers the activities of the IASB and decisions reached at its most recent meeting. It is usually published monthly and is available at www.iasb.org
- **IFRIC Update** covers the activities of IFRIC and tentative decisions reached at its most recent meeting. It is usually published every two months and is available at www.iasb.org