



Australia's carbon
pricing mechanism
Key issues for
business

On Sunday 10 July 2011, Prime Minister Julia Gillard announced the long awaited details of Australia's carbon pricing mechanism. The Clean Energy Future package establishes a carbon price and expands renewable energy, energy efficiency and land use policies and programmes. The Government expects the legislation to be passed by Parliament in late calendar 2011.

From 1 July 2012, every tonne of carbon dioxide equivalent (CO₂-e) produced by approximately 500 of Australia's largest direct emitters will be priced at **\$23/tonne**. The carbon price will be fixed for three years from 2012 to 2015 (indexed annually by 2.5%). From 1 July 2015 a floating market-based Emissions Trading Scheme (ETS) will commence whereby the Government sets the emissions level cap for Australia and the market determines the price of permits. Therein lies the linkage of the carbon price to the emissions reduction target. The greater the reduction target (ie 5% by 2020 and 80% by 2050) the lower the annual emissions cap and the higher the carbon price. The first five years of caps will be announced in the FY14 Budget. During the fixed-price period, the large emitters will be required to buy a fixed-price permit from the Government in exchange for every tonne of CO₂-e produced. Once the floating ETS commences the carbon price will be subject to a \$15 floor price and a ceiling price of \$20 above international carbon prices, with each rising annually at 4% and 5% respectively.

Who is liable?

The government has indicated that approximately 500 companies will be directly liable for the carbon price. Generally, a threshold of 25,000 tonnes of direct CO₂-e emissions will apply for determining whether a facility will be covered by the carbon pricing mechanism. All direct emissions except for emissions from transport fuels or synthetic greenhouse gases will count towards the thresholds. Liable entities will be those with 'operational control' in line with the National Greenhouse and Energy Reporting Act (NGER) definition.

The sectors covered by the carbon pricing scheme are **stationary energy, industrial processes, fugitive processes** (other than decommissioned coal mines), **non-legacy waste** and limited coverage of the **transport** sector (see box). Agriculture and land-use emissions are excluded. The scheme will cover four of the six greenhouse gases under the Kyoto Protocol – carbon dioxide, methane, nitrous oxide and perfluorocarbons (PFCs) from aluminium smelting. Other synthetic greenhouse gases are excluded.

Household sector compensation

As expected there is significant compensation for households with the focus on low-to-middle income households. Approximately 50% of revenue generated from the scheme will be used to compensate households. The key aspects of the household compensation proposals are as follows:

- Increase in the tax-free threshold rising to \$18,200 in 2012-13 rising to \$19,400 in 2015-16
- Increases in family benefit payments, pensions and allowances to assist households to meet cost increases
- Households will also be exempt from the carbon price on transport fuel use.

Transport sector coverage

The coverage of the transport sector is complex:

- Domestic aviation, domestic shipping, rail transport and non-transport use of fuels will be covered by the carbon pricing mechanism
- Transport fuels will be excluded from the carbon pricing mechanism. However an equivalent carbon price will be applied through separate legislation to liquid fuel emissions for some business transport and non-transport use via changes in the fuel tax credits and fuel excise regimes
- A carbon price will not apply to household transport fuels, light vehicle business transport and off-road fuel use by the agriculture, forestry and fishing industries
- From 1 July 2014, the Government will look to establish a carbon price for heavy transport's on-road liquid fuel use.

Industry assistance

The industry assistance mechanisms outlined by the Government include a number of complex measures:

Jobs and Competitiveness Program – Emission-Intensive Trade-Exposed (EITE) assistance

EITE industries will receive assistance of \$9.2 billion over the three years to 2015. This assistance will be in the form of free permits set at two assistance levels – 94.5% or 66%, and grants to increase energy efficiency. Assistance is based on an entity's specific activities and approximately 50 activities are expected to be eligible including aluminium smelting, zinc, paper and pulp, steel making, cement and glass production. Assistance will be reduced by 1.3% each year as a 'carbon productivity contribution' to act as an additional incentive to reduce emissions. Existing activities assessed under the deferred Carbon Pollution Reduction Scheme (CPRS) will continue to be eligible. It has also been announced that the Liquefied Natural Gas (LNG) industry will receive a special 50% assistance level in relation to their LNG production each year as a separate activity.

The Government has also announced that special assistance of \$300 million over five years will be given to the steel industry to encourage innovation and efficiency in the sector. This is in addition to any EITE assistance received by the steel industry.

The Productivity Commission will review the EITE assistance, including the steel industry special assistance, in 2014-15 with three years notice provided regarding any changes.

No matter what your industry, all organisations should understand the potential impacts, risks and opportunities presented by the carbon pricing mechanism

Manufacturing industries – Clean Technology Program

A \$1.2 billion Clean Technology Program will be set up to assist manufacturing industries improve energy efficiency and reduce emissions through grants and research and development incentives. Large users of electricity, gas and those directly impacted by the carbon pricing mechanism will be able to access the \$800 million Clean Technology Investment Program on a co-investment basis – every \$3 invested by industry will receive \$1 from the Government. There is also \$200 million in special assistance for the food and foundries industries and a \$200 million competitive grants innovation program.

Coal sector

The coal sector will receive assistance via the \$1.3 billion Coal Sector Jobs package over six years to assist the most emission-intensive coal mines (gassy coal mines) manage the transitional impact of the carbon pricing scheme. This may include the shut-down of such mines over time.

Electricity sector – Energy Security Fund

An Energy Security Fund will be established to assist the electricity generation sector deal with the impact of the carbon price and also assist in ensuring energy security for Australia. The fund has two key objectives:

- Payment for the closure of approximately 2,000 megawatts of very high emitting coal-fired generation capacity by 2020 (these are expected to be a number of existing brown-coal generators in Victoria and South Australia)
- Limited transitional allocation of free permits and cash estimated at \$5.5 billion over six years to assist high emitting coal-fired generators adjust to the introduction of a carbon price. This assistance may also include government loans or loan guarantees to assist with refinancing obligations.

Offsets and international linkages

During the fixed price period the use of international credits will not be allowed and companies will not be able to sell domestic permits overseas. International permits will be allowed to offset an entity's carbon liability in the floating price period with a 50% limit until 2020.

Carbon Farming Initiative (CFI)

Kyoto-compliant Australian carbon credit units (ACCU) established under the CFI can be used in the fixed price period to meet up to 5% of an entity's carbon liability. Once the floating ETS commences there is no limit on the ability to use ACCUs to meet the carbon liability under the scheme. This is expected to present significant opportunity for organisations in the land-use and agricultural sectors.

What does this mean for business?

All organisations need to be ready for two transition steps as a result of the carbon pricing scheme:

1. Assessing either the direct impact and indirect impact of the fixed carbon price from 1 July 2012 and
2. Preparing for the introduction of an ETS with international linkages from 1 July 2015



Key issues

We have identified the top issues for CFOs and senior management to consider as they digest the carbon price mechanism proposals:

Implications for the 2011 reporting season – organisations should continue to monitor their continuous disclosure obligations in light of the Government's announcement as well as consider the potential impact on asset carrying values and financial report disclosures as part of the June 2011 reporting season. Consideration should be given to assessing the impact of the announcement on existing and planned investments, including taking into account the availability of compensation and assistance and the ability to pass through any increase in input costs.

Review direct emissions profile – with the carbon price impact directly related to the extent of emissions, organisations should ensure they can accurately and reliably measure and forecast their emissions and related carbon liability. This means assessing the current measurement methodologies for robustness to ensure that all calculations and judgements are fully supported and based on reliable and timely source data. The financial liability aspect means that it is vital that a robust audit trail is maintained for the emission measurement and carbon liability calculation process.

Assess ability to access Government assistance – the Government's Clean Energy Future package details significant and specific assistance to various industries. Organisations should review the package to identify whether they are eligible for any assistance available – whether it is EITE assistance, access to grants under the Clean Technology Program or other assistance to the coal, steel or electricity sectors in particular.

Determine pass-through impacts in supply chain – the extent to which the permit cost can be passed-through will have a significant impact on the profitability of the organisation. It will be important to model the impacts on the cost structure of a business or industry including costs associated with the pass through of input costs such as electricity, gas, transport and construction materials. Contractual agreements should be reviewed to determine the extent of pass-through and as new agreements are negotiated consideration should be given to the treatment of the carbon price.

Accounting for carbon permits – there is currently no guidance in either Australian or International accounting standards on how to account for emissions permits. It is important that organisations review their accounting policies for any current voluntary permit schemes as well as consider their options with regard to accounting for their carbon liability and carbon price permits. The 'fixed price' and Government compensation elements may introduce additional accounting consequences. Consistency in approach and clear disclosure will be important to assist investors understand the accounting impacts.

Tax implications – the announcement indicates that the tax treatment for permits is largely consistent with the previous CPRS, where permits will be deductible under a 'rolling balance' method. As the details are confirmed organisations should ensure that they understand the timing and cash flow implications of permit payments. These permit payments are expected to be administered in a similar manner to company tax payments.

Systems and processes – managing carbon permits is a new activity for most organisations and therefore appropriate governance structures, policies, procedures and systems need to be put in place to manage the process. Buying permits (and in later years, trading permits and hedging strategies) will be complex and therefore planning should start now to ensure that adequate systems are in place for the 1 July 2012 start date. Organisations need to prepare to incorporate the assets, liabilities and risks associated with managing carbon in their financial and risk management processes.

Carbon management strategies – carbon management strategies will have a major impact on future earnings, especially in industries such as energy, resources, chemicals and manufacturing. Thus, the CFO and the finance function have to be a critical part of a company's formulation of its carbon management strategies.

Even if organisations do not have a direct carbon price liability, they will be impacted by the indirect flow-through of the carbon price. The extent of the flow-through will be different between products and industries. All organisations need to have a good understanding of their current emissions and energy use to be able to properly assess and mitigate the financial impacts.

New opportunities – renewable and clean energy

A carbon price will present opportunities for many organisations. Those with activities in the renewable energy and innovative technologies sectors can expect to see increased demand for their products. Within the policy package significant funding was identified for innovation and energy efficiency with the most significant being the establishment of the Clean Energy Finance Corporation (CEFC). The CEFC will be set up to increase investment in renewable energy, energy efficiency and other low-emissions technologies. It will have \$10 billion in funding over 10 years from 2013-14 and will be focussed on the commercialisation and deployment of technologies for businesses to transform Australia to a low carbon economy. Funding will be split between renewable energy and clean energy.

The CEFC may provide finance in the form of commercial loans, concessional loans, loan guarantees or equity. The CEFC will not invest in capture and storage technologies.

Timeline

It is expected that draft legislation will be released at the end of July 2011 at which point many more details will become known and it will be possible to obtain a greater understanding of what this means to individual businesses. The complete package of legislation for the carbon pricing mechanism is expected to be passed by both houses of Parliament by the end of calendar 2011. That does not leave a lot of time for consultation and understanding so business needs to start preparing now for the introduction of a carbon price.



Key contacts

No matter what your industry, all organisations should understand the potential impacts, risks and opportunities presented by the carbon pricing mechanism. For further information please contact:



Brad Pollock

Lead Partner – Sustainability & Climate Change
Tel: +61 (0) 2 9322 7458
Email: bpollock@deloitte.com.au



Chris Leach

Partner – Tax
Sustainability & Climate Change
Tel: +61 (0) 2 9322 7109
Email: cleach@deloitte.com.au



Paul Dobson

Director – Sustainability & Climate Change
Tel: +61 (0) 2 9322 5422
Email: padobson@deloitte.com.au



Peter Castellas

Director – Sustainability, Climate Change & Cleantech
Tel: +61 (0) 3 9671 7408
Email: pcastellas@deloitte.com.au

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