Carbon Allowance Accounting & Disclosure in Australia and New Zealand

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Introduction

* **Research Question(s):**

(1) How are the companies that are affected by NZ ETS and Australian Carbon Tax, financially accounting for carbon emission allowances in the absence of a uniform accounting guidance?
(2) How are the companies that are affected by NZ ETS and Australian Carbon Tax, disclosing information on carbon emission allowances in the absence of a uniform accounting guidance?
(3) What company characteristics and market features are influencing the affected companies' methods of disclosing and accounting for emission allowances?

Introduction (Cont'd)

* **Motivation:**
* Comes from absence of uniform accounting standards for carbon emission allowances under ETS, thus leading to accounting inconsistencies and difficulties in comparability of financial statements.

* Also comes from claims of Bebbington & Gonzalez (2008, pg712) that "different actions developed to tackle global climate change have accounting implications that deserve the research of accounting academics"

Introduction (Cont'd)

- **Contribution:**
- Assist accounting policy makers in developing a uniform carbon financial accounting and disclosure guidance.
- Useful for establishing guidelines for auditors to help affected companies financially account and disclose carbon allowances and other related information.
- Give meaningful insights to academics & researchers.

Background

* Climate Change
* Kyoto Protocol
* Carbon markets
* NZ ETS & Australian Carbon Tax
* Accounting implications & inconsistencies
* Need for uniform guidance

Background (Cont'd…)

- **Prominent proposals for carbon allowance accounting:**
  - Proposals divided into 2 categories – one that were IFRIC-3 or similar (**i.e. IFRIC 3, PricewaterhouseCoopers, KPMG & Macquarie University**), others that differed from IFRIC-3's suggestions (**ACCA and Warwick and Ng (2012)**).

Background (Cont'd…)

* **Prominent proposals for carbon allowance accounting :**
  * **IFRIC-3,**
  * **PricewaterhouseCoopers,**
  * **KPMG &**
  * **Macquarie University**

recommended that-

  * CEAs are intangible assets (purchased or provided free of cost by the government). Free CEAs should be accounted for at fair value.
  * Subsequent to initial recognition, CEA should be accounted for in accordance with IAS 38 (Intangible assets)
  * When a participant produces emissions, provisions for emission related liabilities should be recorded at market value in accordance with IAS 37 (Provisions, contingent liabilities and contingent assets).

Background (Cont'd…)

- **Prominent proposals for carbon allowance accounting :**
  - **ACCA**
  - **Warwick & Ng (2012)**

  The results from both the above surveys reveal that:
    - The companies generally depart from IFRIC-3 and report free CEAs at <u>cost</u> instead of <u>fair</u> value.

Background (Cont'd…)

Table 1: Double entries for recognition of allowances at different stages under the cost model and subsequent revaluation

Methods and Stages (NOTE: Same shade means accounts arising from the same journal entry)

<u>Cost model</u>	**Asset Recognition**		**Revenue recognition**	
Stage	**DR**	**CR**	**DR**	**CR**
Receipt of free allowance	Intangible asset[2]	Government grant (deferred income)[3,4]		
Purchase of allowance	Intangible asset[5]	Cash/Accounts Payable[6]		
Allowance used (emit emissions)[7]			Government grant (deferred income)	Income[8]
Used allowance delivered(surrendered)		Intangible asset	Loss (Diff between Allowance & Liability to deliver)	Profit (Diff between Allowance & Liability to deliver)
	Liability recognition		**Expense recognition**	
	DR	**CR**	**DR**	**CR**
Allowance used(emit emissions)		Liability to deliver allowances[9]	Emissions expense	
Used allowance delivered (surrendered)	Liability to deliver allowances			
<u>**Revaluation model**[10]</u>	**Asset Recognition**			
	DR	**CR**		
Revaluation (Upward)	Intangible asset			
Revaluation (Downward)		Intangible asset		
Use of Revalued amount		Intangible asset		
	Equity recognition			
Revaluation (Upward)[11]		Equity (revaluation surplus)		
Revaluation (Downward)	Equity (revaluation surplus)			
Use of Revalued amount	Equity (revaluation surplus)			

2 Subject to impairment, but is not amortised. 86% of respondents in the PwC survey support this. Also the preferred recognition in Macquarie University survey.
3 65% of respondents in PwC survey supported this double entry.
4 Preferred recognition in Macquarie University survey is a provisional liability.
5 Preferred recognition in Macquarie University survey.
6 58% of respondents in PwC survey supported this double entry. Respondents in the Macquarie University survey preferred a provisional liability.
7 PwCs view is to amortise the intangible asset on a systematic and rational basis over the compliance period.
8 50% of respondents in PwC survey supported this double entry, although 1/3 say to credit revenue, 1/3 cost of sales, and 1/3 other.
9 70% of respondents in the PwC survey said an obligation should be recognised based on a pro-rating of the forecast shortfall for the compliance year on a per unit of production basis
10 The revaluation model is an extension of the cost model.
11 79% of respondents in PwC survey said there should be no revaluation

Literature Review

* **Why would firms account for & provide voluntary disclosure on carbon allowances?**
  * Legitimacy theory perspective
  * Political economic theory perspective
  * Stakeholder theory perspective

Literature Review (Cont'd…)

- **What factors can influence firms to provide voluntary disclosure or account for in a certain way?**
  - **Country characteristics Variables**
    - Country legal system
    - Emission trading scheme,
    - ratification with Kyoto Protocol
    - Emission levels
  - **Variables other than country characteristics**
    - Size
    - Previous disclosures
    - Financing activities
    - Industry membership

Research design & Methodology

* **Research method**
  * **Sample:** Annual Reports of companies affected under NZ ETS & Australian Carbon Tax.
    * NZ companies affected under NZ ETS will be randomly selected from New Zealand Emission Unit Registry database.
    * Australian companies affected under Australian Carbon Tax will be randomly selected from Liable Entities Public Information Database (LEPID).

Research design & Methodology (Cont'd...)

* **Content Analysis** to be used.

* To assess the **carbon financial accounting practices** of the affected firms - **Coding framework used,** developed on the basis of IFRIC 3 recommendations.

Research design & Methodology (Cont’d…)

Table 2: Coding framework for accounting & measurement practice for carbon emission allowances (IFRIC 3 template)

Free	Dr Cr	Intangible assets (Allowances) Government grant (Deferred income) Recognition / Measurement
Used	Dr Cr Dr Cr Dr Cr	Intangible assets (Allowances) Equity Government grant (Deferred income) Income Emissions expense Liability to deliver allowances Recognition / Measurement
Purchased	Dr Cr	Intangible assets (Allowances) Cash / A/c payable Recognition / Measurement
Surrendered	Dr Dr Cr Cr	Liability to deliver allowances Loss due to impairment Intangible assets (Allowances) Profits or loss Recognition / Measurement
Sold	Dr Cr Dr Cr Cr	Cash / A/c Receivable Revenue Cost of goods sold Intangible assets Profit or loss Recognition / Measurement

Research design & Methodology (Cont'd…)

- To assess the **carbon disclosure practices** of the affected firms, **a disclosure template from a study undertaken by Choi, Lee & Psaros (2013) was used.**
- Choi et al's paper used a modified version of a carbon disclosure checklist it derived from Carbon Disclosure Project (CDP) and modified it

Thank you!