

Carbon proposals on the radar of Aussie mining entities

What's the issue?

On 28 July 2011, the Federal Government released draft legislation relating to their clean energy proposals, including a mechanism for pricing carbon. The draft legislation is currently under parliamentary review and could pass through both houses of Parliament prior to the end of the year. If this happens, the legislation would apply from 1 July 2012. In this edition of *Digging into IFRS*, we focus on the financial reporting impacts of the carbon pricing scheme on entities in the mining industry.

What is the scheme and who does it impact?

The carbon pricing scheme will impact an entity differently depending on whether it is directly liable under the scheme (liable entity) or is indirectly impacted (eg, by purchasing electricity from a liable entity). Most entities in the mining industry will be significantly impacted if the legislation is passed through Parliament due to intensive energy requirements and dependence on carbon fuels.

Directly impacted entities (liable entities) – the Government estimates that approximately 500 of the largest emitters in Australia will be liable to purchase and surrender carbon units for every tonne of carbon dioxide equivalent they produce.

The carbon pricing scheme proposes an initial price of \$23 per tonne of carbon emitted from 1 July 2012. The price would rise by 2.5 per cent in real terms each year until 1 July 2015 (the fixed price period). During this fixed price period, entities would purchase carbon units to satisfy their obligation to the Government and some eligible entities may receive freely allocated units as part of the Government's assistance measures. From 1 July 2015, a flexible market based price would apply.

Indirectly impacted entities – even though an entity may not be directly liable under the scheme, increased costs through an entity's supply chain could significantly impact on business costs, such as the price of electricity.

What are the major accounting impacts for mining reporters to consider at December if the legislation is passed?

Impairment. All mining entities will need to consider the guidance in AASB 136 *Impairment of Assets*. Mining entities conducting their annual impairment test of goodwill and indefinite life assets would need to build into their impairment testing the impact of the carbon price on discount rates and estimated cash flows.

For all liable mining entities, passing of the legislation through Parliament would most likely be an impairment trigger requiring, them to perform an impairment test on all affected groups of assets. Likewise, an impairment trigger could arise for other indirectly affected entities which expect to experience significant cost increases as a result of the carbon price.

Other considerations. Mining entities will also need to consider whether pricing carbon will affect the value of certain equity investments or derivative contracts; the impact on purchase price allocation (where an entity has undertaken a business combination during the period to December 2011); and in some cases, the impact on going concern. Assumptions about the scheme should be reflected in the disclosures of critical accounting estimates and judgements.

What are the accounting considerations for liable entities on commencement of the scheme?

Liable entities will need to develop accounting policies to account for the scheme, which may include: purchased and freely allocated carbon units; emissions liabilities; and other government assistance. IFRS contains no specific guidance regarding the accounting treatment for emissions schemes. However, different accounting approaches are applied in other territories with emissions schemes, which are highlighted below.

Full market value approach. Carbon units purchased from the Government are treated as intangible assets; and are initially measured at fair value, then subsequently at fair value or deemed cost. Where the Government issues units for less than fair value, the benefit received is recognised as a government grant. As the entity produces emissions, it recognises a provision for its obligations, measured at the market price of the permits required to cover the emissions.

Cost of settlement approach: initial market value. This approach is similar to the full market value approach, except for the measurement of the emissions liability; this is based on the carrying value of the units held to the extent that they cover the emissions. Any excess emissions are measured at the market value of the additional units required to settle the obligation.

Cost of settlement approach: nominal amount. Permits purchased or received are initially and subsequently measured at cost; nil for freely allocated permits. The emissions liability is also based on the carrying value of the units held to the extent that they cover the emissions; any excess is measured at the market value of the additional permits required to settle the liability. Therefore, for emissions obligations covered by the units received for free (nil cost), the value of the liability would be nil.

The accounting for emissions schemes remains on the IASB's agenda; an update is expected from the IASB before the end of 2011. In the meantime, entities should continue to monitor the progress of the legislation. Once the legislation passes, liable entities will need to consider the accounting approach further and assess what the most appropriate accounting policy is in light of the specifics of the Australian Scheme and with regard to any further guidance which may become available.

Our industry expertise

Entities should consider the right approach for their circumstances. Insight from an industry expert.

"The accounting for emissions schemes remains a developing area with various approaches currently being used in practice in other territories with emissions schemes. The different approaches can result in significantly different outcomes for balance sheet and income statement." Debbie Smith, Partner, Melbourne.

PwC has been providing professional services to entities in the energy and resources industry for more than 100 years. Using our insight and experience we help entities confront the industry's main challenges, including those related to the application of International Financial Reporting Standards.

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Other publications of interest...

Mine 2011: the game has changed presents an analysis of global trends in the mining industry as represented by the Top 40 mining companies by market capitalisation. Download it from www.pwc.com.au/industry/energy-resources/publications/mine.htm

Accounting changes affecting the energy and resources sector in 2010/2011 analyses the 50+ financial reporting developments that will affect entities in their 2010 and 2011 financial statements. The material identifies the accounting changes likely to have a high, medium and low-level impact on entities in the energy and resources sector; each of the 'high impact' changes have been analysed in more detail by PwC's industry experts. Request a copy by emailing ifrs.communications@au.pwc.com

Financial reporting in the mining industry describes the financial reporting implications of IFRS across a number of areas particularly relevant to the mining industry. Download it from www.pwc.com.au/industry/energy-resources/publications

The future of IFRS for extractive activities and Potential changes to financial reporting for mining and oil & gas entities considers the possible changes to financial reporting following the release of the IASB's exposure draft on accounting for extractive activities. This two-part series analyses the key proposals and their impact on current practice and shares the high-level views of more than 200 interested parties from the Australian business community who attended PwC events on the topic in 2009. Download it from www.pwc.com.au/industry/energy-resources/publications

Applying IFRS to your business

IFRS in brief provides high-level guidance on current accounting issues that may have a significant impact on entities' balance sheet, disclosure obligations, and/or communication with stakeholders. It is issued fortnightly and typically consists of two pages of guidance on two accounting issues. It shares the insight and experience of PwC's IFRS experts and answers the questions: What is the issue? Am I affected? What do I need to do? Download it from <http://www.pwc.com.au/publications/index.htm>

