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ME HEKE KI PŌNEKE
WELLINGTON CITY COUNCIL

STRATEGY AND POLICY COMMITTEE
16 SEPTEMBER 2010

REPORT 3
(1215/52/IM)

DRAFT CARBON MANAGEMENT POLICY

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1. Purpose of Report

This report recommends that the Strategy and Policy Committee agrees to consult on the draft Carbon Management Policy attached as **Appendix 2** to this report.

2. Executive Summary

The New Zealand Emissions Trading Scheme (NZETS) will create assets and liabilities for the Council. Assets will arise from the Council's forests. Liabilities will arise from the Council's landfill operations and potentially some of its forests.

The NZETS will also create legal obligations that have significant penalties if not met. Further, it will impose additional costs on Council operations, especially from higher energy costs.

The draft Carbon Management Policy[1] (CMP) addresses the effects of the NZETS. It is a sub-set of the Council's wider Climate Change Action Plan (CCAP). It does not address mitigation of climate change or adaption to climate change directly, as these issues are covered under the CCAP.

A key objective of the CMP is to manage the considerable uncertainty that surrounds 'carbon prices'[2]. Other key objectives are to ensure that decisions that are materially affected by future carbon prices are robust and fiscally prudent; and that the Council meets all of its legal obligations under the NZETS and related legislation.

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[1] In this report "carbon" is used as a simplification for all greenhouses gasses covered by the New Zealand Emissions Trading Scheme.
[2] In the context of the NZETS the 'carbon price' is essentially the cost of purchasing a New Zealand Emission Unit or other emission unit allowed under the NZETS to meet obligations.

3. Recommendations

Officers recommend that the Strategy and Policy Committee:

1. *Receive the information.*

2. *Agree to consult on the Draft Carbon Management Policy 2010 (attached as* ***Appendix 2*** *to this report).*

3. *Note that consultation would occur from the second week of October to mid-November 2010.*

4. *Delegate to the Chief Executive and the Climate Change Portfolio Leader the authority to make any changes to the Draft Carbon Management Policy required as a result of decisions of this committee, prior to it being released for consultation.*

4. Background

The NZETS puts a cost on emissions of greenhouse gases (GHGs), often referred to as the carbon price. It does this by requiring certain entities, including the Council in respect of its landfill operations, to report their GHG emissions each year then surrender to Government emission units to cover these reported emissions. The Council will not be granted any free units for its landfill operations and will need to go to the market-place to acquire these.

The policy environment surrounding the NZETS is highly volatile meaning a key feature of a CMP is dealing with uncertainty over carbon prices. Uncertainty arises primarily because:

- carbon prices are imposed by regulation;
- the “politics” of climate change depends of external factors, such as the economy and political decisions in other countries, which are themselves unpredictable, and;
- the political process can influence the fundamentals of pricing almost over night.

Even if political factors were known there is still a great deal of uncertainty about what the actual price effects of the NZETS will be, because:

- the level of technology uptake is uncertain, and;
- the level to which carbon prices will be incorporated in marginal pricing of goods and services is unknown.

Because of this high uncertainty, the financial instruments normally available to manage risk are either not available or are very immature. The reality is that no one can make a reasonable projection of what carbon prices or the cost implications for the Council will be after 2012.

The carbon price might fall somewhere in the range $0 to $100+ per tonne CO2 equivalent between 2012 and 2020. Under current political realities, prices toward the bottom of this range are more likely than not.

4.1 Implications for Council

Assuming the NZETS remains in place it will affect Council in a number of ways.

The Council will face **direct effects,** including:

- A Point of Obligation[3] in respect of the emissions from its operating landfills (Southern and 21% of Spicer). This will create direct additional costs to the Council. The Council will need a mechanism to acquire enough emission units to meet its legal obligations.
- A Point of Obligation for those post-1989 forests it brings into the NZETS. This will mean the Council receives emission units and will have to repay units if carbon stocks fall. The Council will also need to manage contingent liabilities.
- A Point of Obligation should it decide to deforest any pre-1990 forest (deforest means remove the forest and change land use – it does not mean harvesting followed by forest regeneration).
- The opportunity to invest in forest management and generate additional emission units as a result of that investment.

Appendix 1 provides information on the magnitude of these direct effects.

The Council will face **indirect effects,** including:

- The opportunity to use its resources (such as land and landfill gas) for renewable energy projects, which will be made relatively more attractive by carbon pricing.
- Being exposed to increased costs of energy and inflationary pressures more broadly, since rising energy prices are likely to be reflected in the costs of many goods and services throughout the economy.

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[3] Points of obligation must annually report their GHG emissions (or in the case of forestry their emissions and sequestration) then retire emission units equal to these reported emissions.

5. Discussion

5.1 Objective of the CMP

The CMP provides a framework to aid decision-making where future carbon prices are or may be a material consideration. It will also help ensure the Council meets its legal obligations and is fiscally prudent when managing carbon-related assets and liabilities.

5.2 Scope of the CMP

The CMP addresses assets, liabilities, costs and opportunities arising from the NZETS. The CMP is a sub-set of the Council's Climate Change Action Plan. It does not address mitigation of climate change or adaption to climate change directly.

The carbon policy would apply across all Council operations. The Council would also engage with its CCOs on the CMP, particularly through the Statement of Intent process.

5.3 Core Elements of the CMP

In addition to objective and scope, other core elements of the Policy are:

- overarching principles to guide decisions on carbon management
- monitoring and evaluating a changing policy and market environment
- meeting legal obligations - emission returns and responsibilities
- a framework for assessing the financial implications of decisions
- managing the Council's NZETS-related landfill liabilities
- managing the Council's NZETS-related forest assets and liabilities
- purchasing, generating and trading strategies for emission units
- developing management policies in response to the indirect effects of the NZETS (such as rising electricity costs and transport fuel costs)
- financial implications, including reporting on Council's carbon-related assets and liabilities and finance and revenue policy impacts.

The CMP elaborates on each of the core elements, including a brief comment on the rationale for them. Many of the elements are operational in nature. There are, however, some more substantive policy proposals in the CMP, which are discussed further below.

5.3.1 Cost Recovery

The CMP proposes that the costs of complying with the NZETS be recovered from users. This would principally apply to landfill fees, which might rise by between 5-10 percent following the introduction of the waste sector into the NZETS from 1 January 2013. Yellow bags might also rise, but by a much smaller percentage. Actual price rises would depend on future carbon prices and the methodology ultimately agreed by Government for estimating landfill emissions.

Cost recovery will ensure that people disposing of waste to landfill face the external environmental costs of their actions, at least in respect of greenhouse gas emissions. This is consistent with the "polluter pays" principle and the sustainability principles adopted in the Council's LTCCP 2009-19.

An alternative would be to meet NZETS costs from general rates and/or from using the units generated from the Council's post-1989 forests. This is not recommended because it would use ratepayer funds (including the revenue that could otherwise have been generated from the sale of forestry units) to subsidise, and therefore increase, climate damaging practices.

5.3.2 Sale of units for the highest price

There may be significant differences in the price the Council needs to pay for units to meet its NZETS obligations compared to the price it can receive for its post-1989 forestry units. This is because the Council's forestry units, most of which will come from regenerating native forest, have attributes that may mean purchasers are prepared to pay a premium for them over and above the standard market price for units that are acceptable under the NZETS. There are already examples of this occurring.

The CMP proposes that the Council is able to sell any or all of the units it generates from its post-1989 forests, rather than automatically using them to meet liabilities from its landfill operations. To be worthwhile, any premium received for units would need to be greater than the administrative costs of selling the units.

Where the Council's forestry units are used to meet landfill liabilities an appropriate transfer price would be estimated in order to ensure landfill users are facing the true environmental costs of their actions.

5.3.3 No ring-fencing of income from sale of emission units

The CMP proposes that any revenue from the sale of emission units not be ring-fenced for climate change-related projects. This is because officers consider that Council should prioritise its spending across all its potential activities, rather than singling out one area of investment for non-contestable funding.

Moreover, officers note that the NZETS will improve the relative attractiveness of investments that reduce emissions. This is because projects or investments that reduce emissions will automatically have a better cost benefit ratio because of the costs imposed by the NZETS.

Ring-fencing funds is, therefore, not necessary in order for more investment to be made on mitigating climate change since the NZETS will mean it makes good economic sense to reduce emissions and/or energy consumption.

5.3.4 Buy from local growers where possible

The Council has aspirations to see forest re-established on private land throughout the district. It may help to achieve these objectives by working with local landowners on options to regenerate forests and by acquiring the emission units that are subsequently generated from them. This would provide some certainty to local landowners that the forestry units they produce would have a market. Consequently, it should help encourage local landowners to afforest marginal land.

The Council should not, however, pay significantly over market rates for units, since this would imply that landfill users are paying more than they should in order to cover the climate change effects of their actions.

5.4 Revenue and Finance Policy

Implementing the CMP may have implications for the Council's Revenue and Finance Policy (RFP), particularly if revenue from credit sales becomes available from activities that have previously not generated other income. Once the CMP is finalised officers will consider and make recommendations for any changes to the RFP.

6. Public Consultation

It is proposed that public consultation on the draft CMP be undertaken over October and early November. Oral hearings (if any) and a date for reporting back to Councillors will be scheduled following the first meeting of the new Council.

7. Conclusion

The NZETS will have direct and indirect effects on the Council. The CMP will help manage these effects in a robust and prudent manner. It will also help ensure the Council meets its legal obligations under the NZETS and associated legislation.

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Supporting Information

1)Strategic Fit / Strategic Outcome

The draft Carbon Management Policy (CMP) is a subset of the Council's overall response to the challenge of climate change. The need for a CMP was agreed in the Council's Climate Change Action Plan.

2) LTCCP/Annual Plan reference and long term financial impact

Elements of the CMP are likely to have implications for the Revenue and Finance Policy, which would need to be adjusted accordingly. In addition, some adjustments to waste service fees will need to be made from 2013 to recover the costs of the NZETS.

3) Treaty of Waitangi considerations

The draft policy does not raise any specific issues related to mana whenua or the Treaty of Waitangi.

4) Decision-Making

This is not a significant decision. Most aspects of the CMP are internally focussed. Any implications for costs of services would be consulted with the public as part of the LTCCP and Annual Plan processes.

5) Consultation

a)General Consultation

Significant internal consultation has been undertaken on the CMP. Price Waterhouse Coopers has also reviewed the CMP.

It is proposed that public consultation be undertaken over October and November 2010.

b) Consultation with Maori

The draft policy raises no specific Maori or Treat of Waitangi issues.

6) Legal Implications

No legal issues have been identified arising from the draft CMP.

7) Consistency with existing policy

The CMP is a sub-set of the Council's wider climate change action plan. The principles it contains are consistent with the Council's objectives in respect of climate change outcomes and sustainability more generally.

APPENDIX 1: Estimated Asset and Liability Implications of the NZETS for Wellington City Council

Table 1: Potential ETS landfill liability for 2008

	Emissions* ($T\text{-}CO_2\text{-}e$)	Liability ($20/$T\text{-}CO_2\text{-}e$)	Liability ($50/$T\text{-}CO_2\text{-}e$)
Southern Landfill 2008	6,400	$130,000	$320,000
Spicer Landfill 2008	12,400	$250,000	$620,000
Total	**18,800**	**$380,000**	**$940,000**

Note: * The figure was calculated using a measurement methodology developed by the Climate Change Office. Another estimate provided by Sinclair Knight and Mertz calculated the emissions for the Southern Landfill at around 17,000 $T\text{-}CO_2\text{-}e$ per annum.

Table 2: Potential one-off allocation of emission units and value for pre-1990 forest assets

	Area (ha)	Allocation (60 NZU/ha)*	Estimated value at $20/$T\text{-}CO_2\text{-}e$	Estimated value at $50/$T\text{-}CO_2\text{-}e$
WCC's Pre-1990 Forest Assets	200	12,000	$240,000	$600,000

Note: * This is the relevant allocation amount specified in section 72 of the Climate Change Response Act 2002.

Table 3: Potential annual emissions units and value for post-1989 forest assets

	Area (ha)	Sequestration rate[1] ($T\text{-}CO_2\text{-}e/ha$)	Estimated emission units[2]	Estimated value at $20/$T\text{-}CO_2\text{-}e$	Estimated value at $50/$T\text{-}CO_2\text{-}e$
PFSI forests	1325	3.0	3,975	$80,000	$200,000
Clelland forest	23	34.0	784	$15,000	$40,000
Berhampore Forests	10	34.0	340	$7,000	$17,000
Total	**1358**	**3.8**	**5,100**	**$102,000**	**$257,000**

Notes:
1: Sequestration rates are published by the Ministry of Agriculture and Forestry.
2: Estimated emission units are calculated by multiplying the area of forest by the relevant sequestration rate.

Appendix 2

Draft

Carbon Management Policy

Wellington City Council
September 2010

Introduction

The Emissions Trading Scheme (the NZETS) is a key measure in New Zealand's response to climate change.

The NZETS will put a cost on emissions of greenhouse gases; sometimes called a 'carbon price'. This will have direct and indirect affects on the Council.

Direct effects include: liabilities for methane emissions from the Council's landfill operations; potential liabilities for deforesting pre-1990 exotic forest; and receiving credits (and associated potential liabilities) for forests planted after 1989.

Indirect effects include increased energy costs, increased costs for some services and perhaps greater incentives to develop renewable energy on Council-owned land.

This Carbon Management Policy (CMP) provides a framework to aid the Council's decision-making where the future carbon price is, or may, be a material consideration. It will also help ensure that the Council meets its legal obligations and is fiscally prudent when managing carbon-related assets and liabilities.

A key challenge is to manage the considerable uncertainty that surrounds climate change policy, including the future carbon price in New Zealand.

The CMP addresses the effects of the NZETS. It is a sub-set of the Council's wider Climate Change Action Plan (CCAP). It does not address mitigation of climate change or adaption to climate change directly, as these issues are covered under the CCAP.

Objectives

The objectives of the Carbon Management Policy are:

1. to provide a framework to aid decision-making where the future cost of greenhouse gas emissions (sometimes referred to as the carbon price) is, or may, be a material consideration;

2. to ensure the Council meets its legal obligations and is fiscally prudent when managing carbon-related assets and liabilities; and

3. to indentify opportunities to minimise liabilities and/or maximise assets created under the NZETS, where this is economically efficient and fiscally prudent.

Scope and Application

The CMP addresses assets, liabilities, costs and opportunities arising from the NZETS. It applies across all Council activities.

The Council will engage with its Council Controlled Organisations on the CMP, particularly through the Statement of Intent process.

Overarching Principles

These principles will help guide decision-making in an uncertain environment.

The key principles are:

- **Meeting legal obligations** – the Council will meet all its legal obligations required under the NZETS and related legislation and regulations.

- **Conservative approach** – the Council will adopt a conservative approach to managing carbon. The Council does not have a major strategic exposure to carbon pricing nor does it have core competencies in this area. Exposing a large amount of the Council's balance sheet to carbon pricing is therefore not justified. For example, the Council does not intend to become a major carbon trader nor a speculator on future prices on carbon. Nor will the Council take aggressively short or long positions on emissions units relative to its liabilities. Assumptions about future carbon prices will also be conservative.

- **‘No regrets’ decisions where possible** –decision-makers should consider their decisions under scenarios where carbon prices become significantly higher and fall to zero. The zero carbon price scenario is particularly important, since political decisions could create such an environment with little warning. High carbon prices on the other hand are likely to be telegraphed in advance allowing time for the Council to adapt. Ideally, decisions will have a rationale and net benefit (albeit a diminished benefit) regardless of future carbon pricing, including in a scenario where greenhouse gas emissions are not priced at all.

  Decisions on acquiring or divesting assets should also consider possible implications of the NZETS and future carbon prices.

- **Buy units locally where this is competitive** – the Council has aspirations to see forest re-established on private land throughout the district. It may help achieve these objectives by acquiring units from local suppliers. The Council will not, however, pay significantly over market rates for units.

- **Acquire least-cost units** – in cases where the Council cannot acquire enough units locally or where local units are above market rates, the Council will acquire units at least cost. The Council will not require units to have any additional characteristics beyond those set by Government under the NZETS rules.

- **Investigate opportunities for economies of scale in the purchase and sale of units** – the Council will consider cooperating, where appropriate, with other local authorities or private entities to achieve economies of scale in the acquisition and/or sale of emission units. In doing so, the Council will generally not take on the performance risk of any entities with which it cooperates.

- **Consider overall economic efficiency not just Council’s direct costs** – the Council should consider the overall economic interests of Wellingtonians when making decisions, even though this may mean investing in new technologies rather than simply passing on cost increases by way of rates or fees.

Monitoring and Evaluating a Changing Policy and Market Environment

The policy and market environment for carbon pricing is changing constantly. Good decision-making requires good information.

There are many sources of such information available which the Council will analyse and summarise to aid decision-makers. Information will also be assessed to ensure its relevance to the Council and the NZETS[4].

Financial information, in particular information on the cost of emissions units, will be monitored and evaluated.

Developments in the wider political environment, including internationally, will also be monitored and evaluated.

The information and intelligence gathered will be used to inform decision-making and annual planning processes, including the setting of fees and rates and the assessment of new initiative proposals.

Framework for assessing cost and benefits of decisions

The degree of uncertainty over carbon prices challenges typical models and assumptions for making investment decisions where a future cost on carbon is a significant consideration.

This section provides standardised assumptions and other guidance when undertaking cost benefit analysis for carbon-related investment decisions.

Key issues covered are:

- the discount rate to apply for future costs and benefits of carbon
- carbon price assumptions
- scenarios to be modelled
- treatment of implications beyond the Council for cost benefit analysis.

Discount rates

The selection of discount rates is one of the most critical assumptions when undertaking discount cashflow analysis as part of any assessment of investment opportunities. Where future cashflows (either incomes or costs) depend on an ongoing carbon price, the uncertainty associated with that future price should be reflected in the discount rate used.

Higher discount rates reduce the net present value of future incomes or costs. As a general rule the more uncertain a cost or benefit is, the higher that cost or benefit should be discounted.

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[4] For example, much of the information on carbon pricing relates to the European Trading Scheme which is often not relevant to New Zealand.

Given the uncertainty over the future of carbon pricing, a premium will be applied to Council's normal discount rates when assessing cashflows dependant on a future price of carbon.

Carbon prices assumptions

The New Zealand Treasury publishes regular updates of the carbon price used to calculate New Zealand's position under the Kyoto Protocol as reported in the financial statements of the Government of New Zealand.

Where the Treasury continues to publish such information, the most recent relevant carbon price published by the Treasury will be used in all "base-case" scenarios for financial analysis. Where Treasury does not publish this information, Council officers, using the best market information available, will develop carbon price estimates to be used in financial analysis.

Future carbon prices for "base-case" scenarios will be assumed to be the current carbon price, unless there are exceptional circumstances to modify current carbon price.

Scenarios to be modelled

All analysis of investment proposals should include scenarios in which future carbon prices are significantly higher (twice) and lower (half) than the current carbon price.

One scenario should also analyse a carbon price of zero in the mid-term (five years from present) to assess the implications of an investment where there are no costs or benefits arising from carbon pricing beyond five years.

Treatment of implications beyond the Council for cost benefit analysis

For some of its activities and services, the Council might be in a position to fully pass on costs of emissions liabilities without loss of competitive advantage. However, in some cases simply passing on costs may be economically inefficient and detrimental overall to Wellington ratepayers compared to investing in technologies to reduce emissions.

The Council will take a broader view of costs and benefits into consideration when assessing investment opportunities, and will make decisions in the overall economic interests of Wellingtonians.

This may mean investing in new technologies rather than simply passing on cost increases.

All analysis should, nonetheless, still identify where costs and benefits lie, including financial implications for the Council.

In some cases analysis may include a hypothetical scenario in which the effect on fees or rates is estimated in the absence of the Council investment in a certain technology or service.

Meeting legal obligations - emission returns and responsibilities

The Council has/will have legal obligations to furnish emission returns for its post-1989 forests under the NZETS and/or PFSI and its operating landfills. There are also statutory obligations to maintain records and report certain transactions.

For landfills and pre-1990 deforestation activities, reporting must be carried out annually between 1 January and 31 March in the year following the year to which the emissions relate (reporting is carried out based on calendar years). Any obligations to surrender emission units must be met by 31 May in the year following the year to which the emissions return relates.

Returns for post-1989 forest land must be carried out over the same months of the year, but there is flexibility as to what years returns are made. The only compulsory return for post-1989 forests is once every 5 years (or the end of 2012 in the case of the first commitment period of the NZETS).

The provisions for filing returns for forests can be complex where post-1989 forest land is bought or sold.

To ensure the Council meets its legal obligations, specific legal requirements will be indentified, including those noted above, and assigned to particular business units.

Some key tasks to be assigned include:

- completing accurate draft emissions returns
- notifying relevant government agencies when specified activities or transactions occur as required under any relevant legislation
- keeping records
- filing emissions returns
- surrendering emission units
- applying for a free allocation of units for pre-1990 forests owned by the Council.

Managing the Council's NZETS-related Landfill Liabilities

The Council will actively consider opportunities, including new technologies and investment, to reduce greenhouse gas emissions and liabilities from its wholly-owned landfill operations.

Such opportunities will be coordinated with and/or included in the Council's Waste Management and Minimisation Plans as appropriate.

Any new initiatives identified will be considered by Council along with all other new initiative proposals, either as part of the Draft Annual Plan process or LTCCP processes. Analysis of the costs and benefits of such initiatives will follow the framework discussed above.

In general, the Council will recover the costs of any such initiatives by way of user fees and costs on refuse bags.

Despite initiatives to reduce emissions, some emission liabilities will almost certainly remain. The costs of these will be fully recovered from users by way of landfill fees and costs on refuse bags. Where emission units are sourced internally from forest-related activities, the transfer cost of such units will be estimated using the market carbon price at the day the units are transferred, and this transfer price will be recovered by way of landfill user fees.

Council officers will ensure that appropriate forecasting is done so that fee setting under the Draft Annual Plan and LTCCP processes has accurate information upon which to base cost recovery.

Spicer landfill

Wellington City Council owns a minority share of Spicer landfill. Key decisions on Spicer are made by a Joint Venture Committee that is structured to represent Wellington City's interest. The Joint Venture Committee is the appropriate vehicle for influencing and proposing investment decisions and pricing for Spicer, including NZETS liabilities.

Managing the Council's NZETS-related Forest Assets and Liabilities

Post-1989 Forests and PFSI Forests

The carbon management issues arising from post-1989 forests (including PFSI forests) are more complex than those arising from landfill management. This is because forests can be both sources of liabilities and generators of assets. They also create contingent liabilities that will need to be managed.

The Council will actively consider opportunities to increase carbon sequestration in its post-1989 forests. It will also carefully consider the costs and benefits of any forestry operations that reduce the amount of carbon stored in its forests.

Management of post-1989 forests will be in accordance with specific forest or land management plans which include expected forest operations and the carbon sequestration and emission implications of those operations.

Where forests are expected to be harvested at some future point, future emission liabilities will be estimated and the Council will ensure that adequate emission units are available - from (in no particular order) the forest in question, other forests within the Council's portfolio, or the purchase of units - to cover those estimated future emission liabilities.

Where a forest management plan does not propose harvesting (for example where indigenous forest is being regenerated) up to 90 percent of emission units generated from those forests will be available for sale (including for transfer to other parts of the Council to cover emission liabilities). A reserve of 10 percent of credits generated will be retained to cover unforeseen losses through such things as fires. The level of retained credits will be reviewed 5 years after the adoption of this Policy and adjusted as appropriate.

The Council will seek to optimise its returns from units generated from post-1989 forests. This may mean the Council will sell such units on the open market (as opposed to using them to cover its own landfill liabilities), where the Council can receive a premium for those units given the significant biodiversity attributes they have.

Any new initiatives identified to increase carbon sequestration, such as control of browsing animals or enhancement planting, will be considered by Council along with all other new initiative proposals, either as part of the Draft Annual Plan process or LTCCP processes.

Analysis of the costs and benefits of such proposals will follow the framework discussed above.

Pre-1990 Forest Deforestation

Under the NZETS deforestation of pre-1990 exotic forests creates liabilities. The Council does not anticipate any significant deforestation activities involving any of its forests.

Where pre-1990 exotic forests are harvested, it is expected that the affected areas will either be replanted or regenerated into a different forest type, such as an indigenous forest. In either case no emission liabilities are created under the NZETS.

Should deforestation of pre-1990 exotic forests be proposed, the deforestation costs created by such proposals will be considered by the Council as either:

- a new initiative under the Draft Annual Plan process; or
- included in the costs of a project to which the proposed deforestation relates. For example, if an infrastructure project required deforestation of an area of pre-1990 exotic forest, the costs of any deforestation liabilities will be included in the costs of the project.

Revenue from Sales and Cost Recovery

Revenues generated from the sale of emission units or from costs recovered by way of fees and charges will be treated as other revenues received by the Council.

There will be no ring-fenced use of revenues arising from the Council's response to the NZETS.

Policies to manage the indirect effects of the NZETS

The Council incorporates any expected price effects arising from the NZETS as part of its Annual Plan and LTCCP processes.

Any purchasing or investment strategies to reduce the Council's exposure to NZETS-related price increases will be evaluated as part of draft Annual Plan and LTCCP processes.

Purchasing and Trading Strategies for Emission Units

The Council will have obligations to surrender emission units in respect of its landfill operations and any net emissions arising from its forestry activities covered by the NZETS. The Council will also have the opportunity to sell units from its relevant forestry activities.

The Council will develop an appropriate level of expertise, and take expert advice as required, on the acquisition and sale of emission units, including addressing the following key issues:

- ensuring that acquired emission units meet the requirements of the NZETS
- undertaking due diligence on contracting partners, particularly where contracts involve the supply of units in future
- long-term versus spot market purchasing strategies
- managing the Council's overall net position with respect to emission unit assets and liabilities
- cooperating with other purchasers to take advantage of synergies and economies of scale
- minimising costs to Council while ensuring appropriate risk management
- taking into accounting and taxation issues, as appropriate.

The Council may also consider options to acquire emission units by way of investing in post-1989 forest activities in addition to land under its direct control. Consideration of such options will require careful evaluation for risk and value for money.

The Council will give priority to purchasing emission units from local sources, where the generation of those units is consistent with the Council's wider policy objectives (such as establishing indigenous forest on private land). Any such purchases, however, will not be at a price that is materially above market rates for units.

Financial reporting of carbon-related assets and liabilities

There is currently no International Financial Reporting Standard relating specifically to carbon-related assets and liabilities.

In December 2004 the International Accounting Standards Board (IASB) released *IFRIC 3 – Emission Rights* which specified the accounting for companies participating in government schemes aimed at reducing greenhouse gas emissions. This interpretation was subsequently withdrawn in June 2005. Since then there has been no specific guidance relating to emissions and entities have to apply the current accounting standards to develop an accounting policy for the recognition and measurement of assets and liabilities relating to emission units. The IASB is not expected to release a new draft standard until 2012.

The Council complies with existing New Zealand Generally Accepted Accounting Practice but notes that the current treatment of carbon-related assets and liabilities may change if new guidance is released.

If emission units are held to meet compliance requirements (that is, to surrender to meet an entity's liability relating to emissions) they meet the definition of intangible assets under *NZ IAS 38 – Intangible Assets* and are treated in line with the requirements of this standard. Granted allowances are recognised initially at fair value which is deemed to be the market price on the date of allocation. Purchased allowances are recognised initially at cost.

Any carbon-related liabilities are recognised when <u>all</u> of the following three conditions can be satisfied:

- There is a present obligation as a result of a past event
- There is a probable outflow of economic benefits
- The amount can be estimated reliably.

Where the Council already holds units to offset its liabilities then the unit price used to determine the value of the liability is the same as the carrying value of the asset. Any liabilities over and above this are recognised at fair value (market price) at the date of recognition of the liability and re-measured at the end of each reporting period.

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