

You would have had to have spent the last few months on Mars not to be aware of the eye-watering cost to the taxpayer of its bail out of the banking sector – running to the hundreds of billions. The toll to be taken by UK industry of reduced liquidity and recession is expected to be heavy. The actions of government have been under the microscope. The costs of dealing with climate change on the other hand, have had less publicity lately.

The Climate Change Bill has now received Royal Assent (November 2008) and it sets out the UK Government's agenda for meeting its commitments to reduce Greenhouse Gas emissions by 80 per cent of 1990 levels by 2050. The price-tag of tackling climate change is also eye-watering; the Government estimates the costs at over £200bn. Interestingly they value the benefits at a little more than £100bn, which seems inconsistent with the central assertion of the Stern review. Stern said that the costs of abatement, whilst huge, were far less than the costs wrought by a changing climate if we did nothing.

This is the first of a series of pieces by BDO Stoy Hayward, leading up to the Climate Conference in Copenhagen in late 2009 when representatives from around 170 governments will try and reach a crucial international agreement on tackling climate change beyond 2012. BDO Stoy Hayward will review key issues around energy efficiency, security of supply and de-carbonisation of the global economy.

Before a binding international agreement extending beyond Kyoto is reached, the UK is pressing on with its own programme. Here we review the latest piece of legislation designed to ensure UK commitments to 2050 EU targets are met. It promises to place substantial cost on UK business arguably at a time when it could do without it, but will the Bill succeed in its climate change objectives?

The Carbon Reduction Commitment will affect organisations that consume over 6,000 MWh of half-hourly metered electricity during the period from 1 January 2008 to 31 December 2008.

How can BDO Stoy Hayward help?

BDO Stoy Hayward's Energy and Utilities team can work with you to build a picture of the likely impact of these changes on your organisation, and specifically the impact on your financial statements. We would be delighted to meet with you for an exploratory discussion.

For further information about the services provided by our Energy and Utilities Group please contact:

Ian Plunkett on 020 7893 2628, email ian.plunkett@bdo.co.uk (Audit and Advisory services)
Brent Goldman on 020 7893 2243, email brent.goldman@bdo.co.uk (Transaction Services)
Michael Ware on 020 7893 3354, email michael.ware@bdo.co.uk (Project Finance: advisory)
Nick Udal on 020 7893 2410, email nick.udal@bdo.co.uk (Tax services)

www.bdo.co.uk



'Audit Team of the Year' 2008
'Tax Team of the Year' 2008
'Corporate Finance Deal of the Year' 2008
'Employer of the Year' 2007

BDO Stoy Hayward LLP operates across the UK with some 3,000 partners and staff. BDO Stoy Hayward LLP is a UK limited liability partnership and the UK Member Firm of BDO International. BDO International is a world-wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country. The Belfast office is operated by a separate Partnership.

BDO Stoy Hayward LLP and BDO Stoy Hayward – Belfast are both authorised and regulated by the Financial Services Authority to conduct investment business.

Copyright © December 2008. BDO Stoy Hayward LLP. All rights reserved.



This document is printed on 9lives 80, a paper containing 80 per cent recycled fibre and 20 per cent virgin Totally Chlorine Free (TCF) fibre sourced from sustainable forests. 9lives 80 is produced by an ISO 14001 accredited supplier.



Carbon Reduction Commitment

Carbon Reduction Commitment (CRC) – it's coming so we'd all better be ready...

Why soon the rationing of carbon won't just be for cement manufacturers, aluminium smelters and power companies....



BDO Stoy Hayward

Carbon Reduction Commitment

The Climate Change Bill

The Climate Change Bill became law on 26 November 2008. It is the statutory embodiment of the Government's commitment to reduce greenhouse gas emissions by 80 per cent from 1990 levels by 2050. The Bill has been receiving press coverage in recent months, largely due to the impact that it will have on company reporting of greenhouse gas emissions.

Another important element of the Bill is that it contains enabling powers for new carbon trading schemes targeted at reducing emissions. The CRC is one such scheme and the Government estimates that it will affect between 4,000 and 5,000 high energy using (but so called low energy intensity) organisations.

What is the Carbon Reduction Commitment?

The CRC is a carbon trading scheme. Its aim is to cap and reduce carbon emissions of organisations which account for approximately 14 million tonnes of carbon per annum. Being within the scope of the CRC means an organisation will have to put in place ways of measuring their carbon emissions.

Who will it affect?

The scheme will be compulsory for organisations (including parent companies and subsidiaries) that consume over 6,000 MWh of half-hourly metered electricity during the period from 1 January 2008 to 31 December 2008. This is roughly equivalent to an annual electricity bill of c. £500,000. Where an organisation has a

foreign parent, the UK subsidiary's electricity consumption will be considered. All government departments and state schools will also be included, regardless of their annual bill.

Emissions already covered by the European Emissions Trading Scheme ('EU ETS') or by a Climate Change Agreement (the deals already reached with high intensity industrial users) will be exempt. Organisations or their individual subsidiaries with more than 25 per cent of their emissions covered by Climate Change Agreements will be completely exempt from the CRC.

Many UK organisations, such as banks, local authorities, retailers and hotel chains, have high overall energy consumption even though they are not inherently intensive energy users. High consumption is because of the large number or size of the sites from which they operate. These organisations all need to be ready.

Government data shows that this latter category accounts for around 10 per cent (and rising) of the UK's CO2 emissions.

How will it work?

At the end of each year organisations must ensure that they have sufficient carbon allowances to cover their carbon dioxide emissions. Any shortfall must be met by purchasing additional allowances from other participants in the CRC or the EU ETS. Any excess allowances can be sold to other CRC participants.

Each year, there will be a reconciliation process which will culminate in the Government publishing a league table ranking the performance of the participants.

Many UK organisations, such as banks, local authorities, retailers and hotel chains, have high overall energy consumption even though they are not inherently intensive energy users.

Organisations will be ranked according to their annual average emissions during the scheme, the first year being April 2010 to March 2011. Although the scheme is revenue neutral overall, organisations will receive a bonus or penalty depending on their position in the league table. This will substantially penalise the worse performing businesses.

How will it affect my organisation?

The ultimate aim of the CRC is to reduce the emissions of participants over time by using a carrot and stick approach. Organisations will need to become familiar with the operation of the CRC and how to comply with it to avoid penalties. This will include introducing measures that not only

measure carbon emissions but reduce them. The CRC will have a cash flow impact, both in terms of acquiring allowances and the bonus/penalty regime. Organisations will need to factor this into their cash flow forecasting.

In accounting terms, there is little formal guidance from either the IASB or the ASB on how to account for emission allowances. The IFRIC issued IFRIC 3 'Emission Rights' in 2004, but this was withdrawn in 2005. Empirical evidence shows that companies within the EU ETS have adopted a number of different methods of accounting for emission allowances. One simplifying matter with the CRC is that there is no free issue of emission allowances unlike the EU ETS. However, there will be a number of organisations bringing carbon onto their balance sheets for the first time. No one knows what the price volatility of permits will be after the introductory phase – value movements will need to be reflected in income statements.

When will it be introduced?

The CRC commences in April 2010. During the three year introductory phase, organisations will have to purchase allowances at £12/tonne to abate their emissions. The purchase of emissions will be uncapped and emissions can be banked indefinitely against future years within a given phase, such as the introductory phase. After 2013, the CRC will move to an auction process for allowances using sealed bids. Furthermore, from this point there will be a cap on the numbers of emission allowances available under the CRC which will reduce over time.

What happens next?

Because the 6,000MWh threshold for the scheme is to be based on 2008 (calendar year) consumption on half-hourly meters, organisations that believe they may fall within the scheme should already be collecting data of fuel usage across the entire building portfolio in readiness for submission of relevant data next year. (The Government has already written to the chief executives of all UK organisations it deems likely to fall into the CRC).

There will be a number of organisations bringing carbon onto their balance sheets for the first time.

Qualification packs for supply of the data are due to arrive on the desks of all operations using half-hourly metering systems in February 2009. All information on the total electricity consumption and details of meters must be returned to the scheme regulator by June 2009 with a declaration that they should, or should not, be included in the scheme.

The CRC will have a cash flow impact, both in terms of acquiring allowances and the bonus/penalty regime. Organisations will need to factor this into their cash flow forecasting.

In summary

The CRC seems to have good prospects for increasing the efficient use of energy for major commercial users. However, whilst revenue neutral overall, the scheme promises to place a major administrative burden on business.

The cap and trade system chosen follows the principles of the EU ETS, although it represents another layer of legislation for business to deal with. It prompts an interesting economic debate around whether carbon prices should be levied by government on users of energy as well as producers of carbon. The EU ETS already ensures the major producers of CO2 (power companies and industrial producers of carbon) pay for emissions – so what is the rationale for levying a second carbon price on the same carbon further down the chain?

One of the issues is that we have some daunting targets and we haven't time to wait for market forces (carbon price input costs passed through to energy prices paid by consumers) to provide the signals needed to change consumption behaviour. The Government has decided that more intervention is needed.

The UK Government have shown determination to legislate to force business users to reduce energy use. This is likely to have the desired effect, after all reductions will be mandated. However issues remain the same as with the EU ETS system. Until a global agreement is reached, the risk is higher of 'carbon-leakage' where industries in cap and trade regions choose to re-locate to places that do not place a levy on carbon emissions or energy usage. This of course frustrates any reduction in overall global emissions and damages industry in carbon regulated economies. This is an issue that surely must be addressed in Copenhagen.

