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Description

Today's CFOs are involved in strategy determination and implementation together with their traditional role of reporting and compliance. A factor in the complexity of the CFOs role has been the increase in accounting regulation through standard development as a response to corporate governance challenges over the past 30 years. There has been little research into the choices made by CFOs in accounting methods, especially in the Australian environment. The focus of this paper is to highlight the opportunity to research an accounting area where there is currently much debate and issues around the choice of accounting method and disclosure. This area is accounting for emission trading schemes. Currently there are no accounting standards covering emission trading. This leads to two opportunities, the first is to add to and inform both the academic and professional discussion on how best to develop appropriate standards within Australia. The second relates to researching how CFOs make choices in their accounting methods. This paper explains the background and the opportunity for this research.

Location

Innovation Campus, Mike Codd Building, 1st floor, Room 102

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SYDNEY BUSINESS SCHOOL
UNIVERSITY OF WOLLONGONG

Accounting for Carbon in Australia – How does a CFO choose the most appropriate accounting approach?

Ron Bryant

Today's CFOs are involved in strategy determination and implementation together with their traditional role of reporting and compliance. A factor in the complexity of the CFOs role has been the increase in accounting regulation through standard development as a response to corporate governance challenges over the past 30 years. There has been little research into the choices made by CFOs in accounting methods, especially in the Australian environment.

The focus of this paper is to highlight the opportunity to research an accounting area where there is currently much debate and issues around the choice of accounting method and disclosure. This area is accounting for emission trading schemes. Currently there are no accounting standards covering emission trading. This leads to two opportunities, the first is to add to and inform both the academic and professional discussion on how best to develop appropriate standards within Australia. The second relates to researching how CFOs make choices in their accounting methods.

This paper explains the background and the opportunity for this research.

The Role of the CFO

The role of the CFO is changing. In the past, the CFO was the accounting specialist with a focus on past transactions. They were the gatekeepers for the organisations operational decision making, they ensured initiatives generated a positive rate of return to move forward (Kuehn 2008). The CFO was a supervisor of the budget process, a forecaster of future needs and of ways to fund those needs, an overseer of expenditure, a guardian of assets and a procurement officer (Brown 1990). They spent their early career in finance departments and had little contact with other parts of the business, nor did those business areas seek their advice as their focus was on budget variances and expense accounting (Hope 2006).

Today however, more and more is demanded of the CFO and their teams. Ten years ago it was recognised that highly progressive CFOs were extending their decision making and reporting role to include an assertive role in strategy determination and implementation (Johnsson 2002). The CFO was no longer confined to the financial domains of treasury, tax, audit, financial reporting and investor relations (Favaro 2001). The CFO is now expected to be a business generalist, expert in risk management and a source of business intelligence (Hope 2006).

So what has contributed to the expanded role of the CFO?

In the US, the popularity of the CFO as a position within the organisation, was influenced by the 1970's funding crisis and the abrupt shift in accounting regulations (Zorn 2004). The speed and breadth of unprecedented levels of complexity and change has also played its part in he transformation of CFOs (Johnsson 2002). In his book "Reinventing the CFO" Hope suggests the CFOs role was under external pressures and internal pressures to change (2006).

External pressures

- Until the 1980's a strong balance sheet measured the success of the firm, appropriate for the industrial age, however more increasingly to succeed today the firm needs attract respond rapidly to new threats and opportunities and keep talented people.
- Corporate governance scandals have driven government and regulators to demand more of CEO's and CFOs. This has put pressure on internal controls and reporting procedures for the CFO and their teams.
- The increase in accounting standards, particularly from national to international standards has increased the workload of the CFO and created reporting anomalies where although the business fundamentals remain the same, profits are reported differently.
- Shareholders are more demanding and prepared to challenge board strategies and decisions.

Internal Pressures

- The complexity and amount of data flowing into the organisation is challenging managers to make sense of it.
- Forecasting takes too long and is quickly out of date.
- Limited focus on how risk and uncertainty affect decision making.

To adapt to this complexity and change the modern CFO has four additional roles to being the traditional master of finance:

- Strategist – The CFO is able to link strategies with a deep economic understanding of the business.
- Information Specialist – The CFO needs to link investment opportunities to the strategic and financial performance.
- Communicator – The CFO needs to articulate the financial and strategic performance both internally and externally.
- Leader – Contribute and add to the decision making at senior executive level, developing and nurturing strong and constructive relationships within the business and executive (Favaro 2001).

Witzel (2010) suggests a number of areas CFOs can improve to compete in the future including:

- appropriate training in areas such as planning, forecasting, risk management and corporate strategy;
- Integrate the finance function with the rest of the organisation;
- Work out the role of finance, is it for compliance or to enable and support the business, or a balanced combination. Setting the vision for finance will set expectations within finance and the organisation.

The CFO and Accounting Standards

What do we know about the role of CFOs and how they choose accounting standards? From existing research we know the following:

- Older generations of managers are more conservative (Bertrand and Schoar 2003);
- Managers that have an MBA qualification follow more aggressive strategies (Bertrand and Schoar 2003);
- Managers promoted from legal backgrounds tended to revise expectations down, that is, they are sensitive to litigation risk (Bamber, Jiang and Wang 2010);
- Managers from accounting and finance background develop precise and conservative disclosure styles (Bamber, Jiang and Wang 2010);
- Managers with military experience favor more precise forecasts that revise expectations down with a low tolerance for ambiguity and valuing honesty and integrity over self interest (Bamber, Jiang and Wang 2010);
- Managers with MBAs are more accurate in their forecasts and tend to guide expectations up (Bamber, Jiang and Wang 2010).

Although the existing research has tried to establish relationships between the CFO and the managing "style" of the CFO, none of this can be related to existing research on how a CFO might make accounting choices.

This is important for a number of reasons:

- When major changes occur in accounting presentations, what disclosure will be chosen and what are the underlying factors that form this decision;
- A choice of different accounting presentations will potentially have different impacts on the share price or financial ratios for example. How does one choose?

To explore these questions it is proposed to focus on an accounting area where there are currently much debate and issues around the choice of accounting method and disclosure. This area is accounting for emission trading schemes.

Accounting for Carbon – Emission Trading Schemes

European Experience

The European Union Emission Trading Scheme has been operating since 2005. The accounting for market permits has been in the absence of defined accounting standards and this absence has led to different accounting methodologies being practiced.

PricewaterhouseCoopers and the International Emissions Trading Association surveyed a number of companies participating in the European Union Emissions Trading Scheme and identified six separate approaches to accounting for market permits. The challenges they identified in the absence of an agreed accounting standard included;

- Most significant issue was the time spent developing appropriate accounting policies as well as reacting to alternative approaches identified;
- Comparability of treatment and therefore of financial performance and financial position with other entities and within the same group;
- Reporting to senior management when adopting internal policies;
- Lack of guidance when faced with potential acquisitions and investments decisions;
- The lack of clear guidelines has been a source of frustration and drain on resources for those entities affected (2007).

Australia's Carbon Price

The Australian Government's Climate Change Plan on the passing of the Clean Energy legislation covers the following:

- From 1 July 2012, a fixed carbon price will start at $23 a tonne, for three years.
- From 1 July 2015, the carbon price will be set by the market through an emissions trading scheme.
- Around 500 of the biggest polluters in Australia will be required to pay for their pollution under the carbon pricing mechanism.

For the first 3 years of the climate change plan (up until 2015), the accounting issues will have to be covered by existing accounting standards. The carbon price has no profit concept so it does not relate to income like an income tax. It is a cost of production for the 500 or so firms and will likely be applied under AASB 136 Impairment of Assets (CPA Australia 2011).

The commencement of the emission trading scheme in 2015 will raise different accounting issues. The use and trading of market permits raises measurement and recognition issues not realised within the fixed price period. Australia has no previous experience with emission trading schemes, however we can draw upon the experience in the European Union Emission Trading Scheme.

As at May 2012, the Australian Accounting Standards Board (AASB) does not have a project on accounting for emission rights. In the December 2011 AASB meeting, the Board noted any action it would take to issue an Interpretation would depend on the level of diversity in accounting treatment expected to emerge within Australia relative to the diversity of treatment emerging elsewhere (Australian Accounting Standards Board 2011).

The International Accounting Standards Board (IASB) is no closer in developing standards on emission trading schemes. Discussions on emission trading have been deferred with a decision to include as an ongoing project in the second half of 2012.

Dellaportas recognised the risk of divergent practices for Australia given the lack of accounting guidance (2008). This uncertainty has not gone unnoticed by CFOs. In December 2011, the Group of 100 wrote to the AASB stating their concerns with the lack of guidance and diverging accounting practices in Europe. They requested action before the commencement of the flexible price in 2015 (Australian Accounting Standards Board 2012).

Standard setting is a political process, the first attempt by the standard setters to develop guidance was performed with little outside consultation. This resulted in the withdrawal of guidance due to the volatility of the accounting treatments and the potential impact on those affected (MacKenzie 2009; Lovell and MacKenzie 2011).

Methodology

The methodology chosen to explore this research is by case study and the type of case study proposed is a holistic multiple case design as outlined by Yin (2009). The proposed approach is to treat each CFO and their organisation as a separate case.

Under the case study methodology, it is proposed to engage with CFOs in organisations directly affected by the Clean Energy legislation. This engagement will be in two parts:

- Presentation of the impact of different accounting methods on the financial statements of targeted organisations, using publicly available financial information based on methods adopted in the European Union Emission Trading Scheme;
- Semi structured interviews of the CFOs to assess the key factors they would consider when deciding which is the most appropriate accounting approach to adopt.

The structure of the interviews will be in three sections. The first will be semi-structured questions to explore the key issues in determining the appropriate accounting method for the CFO. The second will be to present the different accounting methods using the organisations publicly available financial data. The third will be semi-structured questions to explore the underlying factors that formed their decision after the presentation of alternatives.

It is planned to perform up to five interviews initially, code and analyse the data and review the questions and approach. More interviews will then be performed until theoretical saturation is reached.

Benefits of this Research

The benefits can be broken down into two areas. The first relates to the accounting treatment for emission trading schemes. The carbon price debate is a hot topic, as we enter the first phase under the legislation, this research will add to and inform both the academic and professional discussion on how best to develop appropriate standards within Australia. Given the interest in carbon pricing and trading, this Australian view will also inform the development of international accounting standards.

The second relates to the CFOs themselves. Little literature is available on how CFOs make choices in their accounting methods, this is particularly so in Australia. Exploring the background of CFOs, their qualifications and experience, will add to the knowledge of how CFOs make these accounting judgements and what motivates such choices.

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