Climate Governance Initiative Australia

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FACT SHEET 4:

Internal Carbon Prices

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Internal carbon pricing[1] is a mechanism designed to incorporate the cost of greenhouse gas (GHG) emissions into financial decision-making by placing a hypothetical or real cash cost on carbon emissions.

AASB S2 requires entities to disclose whether and how the entity is applying a carbon price, and the price applied to each metric tonne of GHG emissions. In light of this requirement, directors should have an overall understanding of internal carbon pricing and its role in an organisation's climate strategy and transition plan.

There are various approaches and methodologies when implementing an internal carbon price, however AASB S2 specifically references two of the most common approaches – **shadow pricing** and **internal fee**. These are set out in the table.

Type of internal carbon price	What is it?	How can it support business?
Shadow price	A hypothetical carbon cost, with no actual cash flow implications	• Can provide input into investment, capital expenditure, research and development, procurement and project selection decisions by building in a hypothetical cost of GHG emissions. • As a hypothetical price, it may be easier to subsequently implement as there is no change to department budgets or finance arrangements. • A shadow price can help organisations understand their initial carbon footprint. It can also be used as a benchmark to implement a more strategic internal carbon price.
Internal fee	A per-unit fee based on the amount of GHG the organisation emits (e.g. $70 per tCO2e) charged to emitting divisions, business units or projects	• Functions similar to a transfer pricing system, in that it places an actual cash cost on carbon emissions charged to emitting business units to influence decision-making and drive behavioural change. • Creates a revenue stream for investment in adaptation and mitigation projects, such as emission reduction projects, carbon offset purchases or flood mitigation infrastructure.

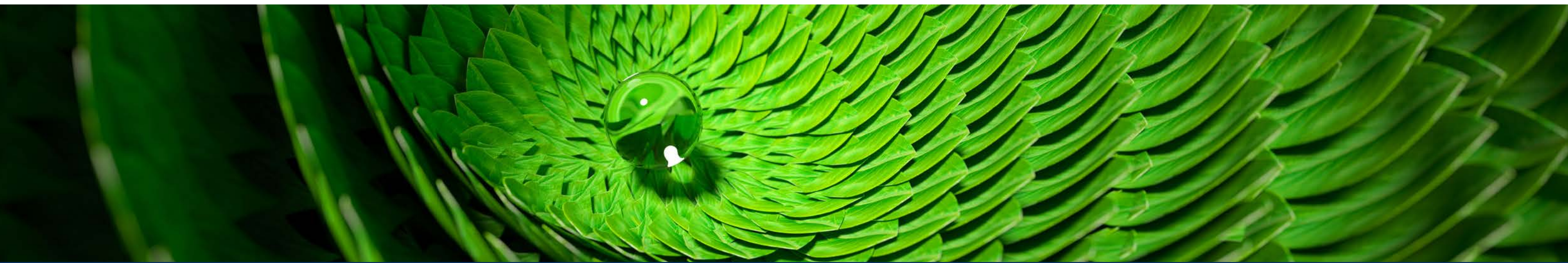
1 Deloitte, (2021) Internal carbon pricing.

According to a survey undertaken by the CDP (formerly Carbon Disclosure Project) in 2021[2], five in 10 companies that disclosed an internal carbon price in 2020 used shadow pricing. These findings are also replicated in the Australian market.

Directors may wish to implement an internal carbon price to manage climate transition risks and to strategically prepare the organisation in the event that an external carbon price is imposed by government in the future. Finland, the UK and France have all mandated an external carbon price on specific sectors or fuel products.

More sophisticated internal carbon price mechanisms involve calculating the actual/ estimated cost to abate a single unit of carbon (sometimes referred to as an 'implicit price').

2 CDP Disclosure Insight Action, (2021) Putting a price on carbon: The state of internal carbon pricing by corporates globally.



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