TE TAI ŌHANGA
THE TREASURY

Reference: 20240112

19 April 2024

[redacted]

Dear [redacted]

Thank you for your Official Information Act (OIA) request, received on 21 February 2024. You requested the following:

> *I have seen the briefing to the Incoming Minister of Finance from February 2024. I have also seen the fiscal context slide pack. Both are available here.*
>
> *Page 27 of the slide pack contains advice on adapting to climate change and enabling the low emissions transition. Could you please let me know whether the Minister has, or will soon, receive further detail on this topic?*
> *Could you please provide copies of briefings, Ministerial papers or memos, as well as policy analysis and briefings to senior Treasury staff which relate to this topic? If this hasn't happened yet, but is expected to happen soon, could you please let me know?*

We clarified with you that the request was for advice from after the formation of the current Government. We also extended the deadline for responding to your request by 20 working days.

Information being released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	30 November 2023	Treasury Report: T2023/1981: Upcoming December ETS auction: Potential fiscal implications	Release in part
2.	24 January 2024	Aide Memoire T2024/148: Talking Points for meeting with the Minister of Climate Change	Release in part
3.	30 January 2024	2024 FEC Briefing Notes - Annual Review of the Treasury 2022-23 - Climate Change	Release in part
4.	15 February 2024	Joint Report T2024/152: The 2+2 Climate and Finance Ministers Relationship with Australia	Release in part

1 The Terrace
PO Box 3724
Wellington 6140
New Zealand
tel. +64-4-472-2733

https://treasury.govt.nz

5.	20 February 2024	Treasury Report T2024/263: The accounting treatment of New Zealand's commitment under the Paris Agreement	Release in full (except phone numbers)

I have decided to release the documents listed above, subject to information being withheld under one or more of the following sections of the OIA, as applicable:

- contact details of officials, under section 9(2)(g)(ii) – to maintain the effective conduct of public affairs through protecting Ministers, members of government organisations, officers and employees from improper pressure or harassment,
- advice under section 9(2)(i) – to enable … [the Crown] to carry out commercial activities without prejudice or disadvantage,
- advice still under consideration, section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials, and
- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage.

Direct dial phone numbers of officials have been redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing, social engineering and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including the Treasury's website.

Information publicly available

The following information is also covered by your request and will soon be proactively released by the Climate Change Interdepartmental Executive Board:

Item	Date	Document Description
6.	16 November 2023	Climate Change Interdepartmental Executive Board - Meeting papers Tuesday 21 November 2023
7.	30 November 2023	Climate Change Interdepartmental Executive Board - Meeting papers Tuesday 5 December 2023 (pack 1)
8.	30 November 2023	Climate Change Interdepartmental Executive Board - Meeting papers Tuesday 5 December 2023 (pack 2)
9.	25 January 2024	Climate Change Interdepartmental Executive Board - Meeting papers Wednesday 31 January 2024

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the OIA:

- the information requested is or will soon be publicly available.

Information to be withheld

There are two additional documents covered by your request that I have decided to withhold in full under the following section of the OIA:

- advice still under consideration, section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury's website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Nicky Lynch
Manager, Climate Change

Table of Contents

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Upcoming December ETS auction: Potential fiscal implications

Date:	30 November 2023	**Report No:**	T2023/1981
		File Number:	SH 10-8

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Note** the contents of this report and **refer** the report to the Minister of Climate Change. **Indicate** any further advice you may wish to receive on this topic.	6 December 2023

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Tim Borren	Senior Analyst, Climate Change	s9(2)(k)	N/A (mob)	✓
Nicky Lynch	Manager, Climate Change		s9(2)(g)(ii)	

Minister's Office actions (if required)

Return the signed report to Treasury. If agreed, **Refer** a copy of report to the Minister of Climate Change's office.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Upcoming December ETS auction: Potential fiscal implications

Executive Summary

As part of the Emissions Trading Scheme (ETS), the Government auctions ETS units four times a year. The final auction of the year will take place on 6 December. We think it is likely that the auction will not fully clear. Partial clearance or no units sold are more likely outcomes. This would have a fiscal impact and could result in media queries. This report briefs you on possible outcomes and their fiscal impacts to provide background in case you are asked for comment.

Key points to be aware of are:

- The auction not clearing would have no impact on the operating balance. The impact relates to cash receipts, not revenue or expenses. It would have an impact on net debt.
- These impacts have already been factored into the preliminary HYEFU forecasts that we have discussed with you.
- s9(2)(i)
- From the perspective of achieving emissions budgets and targets, the auction not clearing would be positive, as this would reduce the number of units available in the market, which would be positive for the ability of the ETS to influence emissions.

In general, clear, consistent signals from the Government about the role that it expects the ETS to play in future are likely to be helpful in reducing overall volatility in the market.

Cash proceeds could be up to $900 million lower in total than at PREFU if the auction does not clear. The outcome of the December auction will be available in time for the actual result to be reflected in the fiscal forecasts presented in the HYEFU, should some units be sold. If some are sold, the cash position in the forecasts would improve relative to our current HYEFU assumptions.

In previous Economic and Fiscal Updates, forecasts for ETS cash proceeds informed the size of the Climate Emergency Response Fund (CERF). We understand that you intend to use the available cash proceeds remaining in the CERF to contribute to your fiscal plan. If the 6 December auction does not clear, this reduces ETS cash proceeds. Assuming you intend to use the remaining CERF to fund your fiscal plan, the lower cash proceeds will have an impact on net debt, all else being equal. We will provide advice on options to manage this impact through advice we will be providing tomorrow on the Mini Budget scope.

To support the integrity of the ETS market and prevent any impact on market activity, we recommend that you avoid making any external comment in advance about the likely outcome of the auction.

Recommended Action

We recommend that you:

a **note** the contents of this report

b **indicate** if you would like to receive any further advice on the ETS or the implications of ETS auctions, and

c **refer** this report to the Minister of Climate Change.

Referred/Not referred

Nicky Lynch **Manager, Climate Change**	Hon Nicola Willis **Minister of Finance**
_____/_____/_______	_____/_____/_______

Treasury Report: Upcoming December ETS auction: Potential fiscal implications

Purpose of report

1. The purpose of this report is to brief you on the potential outcomes of the upcoming Emissions Trading Scheme (ETS) auction on 6 December and their potential fiscal implications. We think it is likely that the auction will not fully clear. This would have a fiscal impact, and could result in media queries.

2. We have also provided suggested answers to potential questions you may be asked about the auction and fiscal implications (Appendix 1).

Operation of ETS auctions

3. The ETS is New Zealand's main tool for pricing greenhouse gas emissions across the economy. Businesses with obligations in the ETS are required to surrender emissions units – 'New Zealand Units' (NZUs) – to cover their emissions. Emitting firms included in the ETS must buy units to cover their emissions, which are then surrendered to the Government.

4. The Government also gives NZUs to eligible foresters for carbon dioxide that is absorbed by their trees. Foresters can sell these units on the ETS secondary market or hold on to them. In some cases, foresters need to hold units to surrender when their forest is harvested.

5. There are three main ways emitters can obtain NZUs to meet their surrender obligations:

    - purchase at Government auctions
    - receive for free from the Government under its industrial allocation policy (some "emissions intensive and trade exposed" firms receive NZUs from the Government), or
    - purchase on the secondary market (open market where existing NZUs are traded), either from the existing "stockpile" of NZUs in private ownership, or from units generated by forestry removals.

6. The Government supplies a set number of units to the ETS market each year, selling them to emitters for cash at four quarterly auctions. The auction price is set by supply and demand in the auction. NZX holds the contract with MfE to operate the auction platform and conduct the auctions.

7. ETS auctions are constrained by price control and volume settings set by the Government:

    - *Auction reserve price (or "floor price"):* the minimum acceptable price at which units are sold.
    - *Confidential reserve price (CRP):* A confidential price related to the current secondary market price, below which units will not be sold. The purpose of the confidential reserve price is to prevent units from being sold at a price significantly below the prevailing secondary market price.
    - *Cost containment reserve (CCR):* If the auction price reaches a certain 'trigger price', an extra volume of units is offered for sale to buyers – referred to as the

‘cost containment reserve’. The additional volume supplied to the market helps contain high prices. In the 6 December auction, there are two tranches of CCR units with two trigger prices.

8. At an auction, registered bidders submit bids for a specific volume of units at a price the bidder specifies. To determine the auction clearing price, all bids are ranked from the highest to lowest price. Units are then allocated to these bids in this order until either there are no more bids, or all of the units are allocated. The clearing price is the bid price of the lowest-ranked bid that receives units. Figure 1 is an illustrative example showing how the clearing price is determined when all units are sold.

Figure 1: Determining the auction clearing price[1]

9. There are two price floors that apply in each auction. These include a published auction reserve price and an unpublished “confidential reserve price”. Bids must exceed the published auction reserve price to be considered, and for a partial clearance to occur, no bid must trigger the CRP.

10. NZUs not sold are rolled forward to the next auction, provided it is in the same calendar year. If NZUs remain unsold at the end of all auctions within a calendar year, those NZUs are not rolled over into the following year.

Outcomes from 2023 auctions to date

11. The previous three auctions in 2023 did not clear. No NZUs were sold and all of the units on offer have therefore been rolled into the December auction. In addition, new ETS settings were published in July 2023, capping the December auction at 15 million units.

12. The Government updates the ETS unit limits and price control settings every year. Decisions to revise ETS settings in July this year will come into effect for the December auction. The auction reserve price will increase from $33.06 in previous auctions to $60 and the trigger price for the Cost Containment Reserve will increase from $80 to $173 and $216.

13. Table 1 shows that the volume of bids for the previous two auctions have been significantly below the number of units available. When this occurs, <u>only a single bid</u>

[1] https://environment.govt.nz/assets/Publications/Files/Guidelines-for-NZ-ETS-Auction-participants.pdf#page=13

needs to be below the confidential reserve price for the whole auction not to clear and no units sold. This is because, when the volume of bids is less than the volume available, the clearing price is effectively equal to the lowest bid.

Table 1: Volume of bids in the previous three auctions this year

2023 auction	**Auction reserve price**	**Units available (excl. CCR)**	**Units bid for**	**Units sold**
March	$33.06	4,475,000	4,887,800	0
June	$33.06	8,950,000	3,058,200	0
September	$33.06	13,425,000	7,674,400	0
December	$60.00	15,000,000	*TBD*	*TBD*

Potential outcomes for the December auction

14. 15 million NZUs will be available at the December auction, composed of:
    - 1,575,000 of 'new' NZUs (i.e., the regulated auction volume for this auction)
    - 13,425,000 of unsold NZUs available from the previous three auctions[2]

15. Secondary market prices are $73.50 as at 29 November and have been around this level for the past month. Because the confidential reserve price is related to recent secondary market prices, for the auction to clear, the auction clearing price will need to be somewhere close to this level.

16. For a given auction, there are three possible outcomes: full clearance; partial clearance; or no clearance. These are outlined in Table 2 below. We think it unlikely that full clearance will occur – partial clearance or no clearance are more likely outcomes in our view.

Table 2: Potential auction outcomes

Outcome	**Description**
Auction fully clears	All NZUs available for the December auction are sold. This includes the rolled forward NZUs from the previous three auctions. This would occur if the total volume bid for is *equal to or greater than* the volume available *and* the auction clearing price is above the confidential reserve price.
Partial clearance	Some NZUs are sold, but the volume is lower than the total volume available. A partial sale occurs if the total volume of bids is *less than* the volume of units available, and none of the bids are below the confidential reserve price. In this case, all of the volume that is bid for is sold at the auction clearing price. Unsold NZUs will not be rolled over to future auctions, as this is the last auction for 2023 and NZUs are not rolled over between calendar years.

2 A further 8 million units are technically available from the Cost Containment Reserve, but these are highly unlikely to be released given that the current secondary market price is $70 and the trigger price for releasing the tier 1 cost containment reserve is $173.

No clearance	There are qualifying bids above the auction reserve price but the auction clearing price is below the confidential reserve price. No NZUs are sold and unsold NZUs are not rolled over to future auctions.

Implications for effective operation of the ETS

17. An auction not clearing does not necessarily mean that the ETS is not operating as intended. If the units for the 2023 remain unsold, this would effectively reduce the number of units available in the market, which would be positive for the ability of the ETS to influence emissions.

18. s9(2)(i) [redacted]

19. s9(2)(f)(iv) [redacted]

20. When an auction fails to clear, the Ministry is also required under legislation to undertake a review of the methodology for setting the confidential reserve price, however the scope of this compulsory review is limited. You are required to be consulted on the result of this review.

Fiscal implications

21. When the Government sells ETS units (i.e., through auction), it:

- records cash receipts, which reduces net debt; and
- a liability is recognised on the Crown's balance sheet.

22. The sale of ETS units at auctions does not generate revenue, and therefore does not impact the operating balance before gains and losses (OBEGAL). The sale of ETS units at auctions does reduce net debt as cash held by the Crown increases.

23. Revenue is recognised in the forecasts based on the estimated surrender of units by participants in the ETS, which is then adjusted as actual surrenders occur. As revenue is recognised, the ETS liability is reduced and there is an increase in the operating balance (OBEGAL). Revenue forecasts are based on the level of emissions expected from participants in the scheme, rather than being directly related to the number of units issued.

24. Table 3 sets out how the three possible December auction outcomes would impact cash proceeds (with corresponding impacts on net debt).

Table 3: Cash impact of different possible outcomes of the December ETS auction

Auction outcome	**Cash impact in FY 2023/24**
Auction fully clears *(including NZUs rolled over from previous declined auctions)*	Cash inflow in the first half of the fiscal year. This would likely be higher than forecast at PREFU, but will depend on the final clearing price.
Partial clearance	Cash inflow in the first half of the fiscal year may be above or below the PREFU forecast. This will depend on the number of units sold and the final clearing price.
Auction does not clear	No cash receipts in the first half of the fiscal year. This would also be lower than forecast at PREFU by $896.3 million.

25. In the latter two scenarios ("Partial clearance" and "Auction does not clear"), some available NZUs will remain unsold. These unsold NZUs will not be rolled forward to future auctions.

Treatment in HYEFU

26. The outcome of the 6 December 2023 auction will be reflected in the fiscal forecasts for the 2023/24 year presented in the HYEFU.

27. For now, the updated HYEFU forecasts assume the December auction will not clear, although this is partially offset by a change in the sale price assumed in the forecasts for future auctions. This results in cash receipts and net debt being negatively impacted by $794 million over the forecast period. This assumption was included in preliminary HYEFU figures we have discussed with you to date. For future years, the forecasts assume that auctions will clear (and the CCR is not triggered).

Table 4: Forecast ETS cash proceeds, $ millions[3]

	FY 2023/24	**FY 2024/25**	**FY 2025/26**	**FY 2026/27**
PREFU	$1,282	$751	$644	$536
HYEFU	[TBC]	$939	$824	$569
Change	[TBC]	+$188	+$180	+$33

28. The assumption that the December auction will not clear is a variation from PREFU. In the PREFU, which was produced prior to the September auction, we assumed the units that rolled over from the first two auctions of the year would be sold in the second half of the year at a price of $59.75.

[3] Note that the 2023/24 forecast proceeds include the NZU auction volume for the entire 2023 calendar year and half of the auction volume for the 2024 calendar year (therefore, there is effectively 18 months of auction volume included in the 2023/24 fiscal year). This is because the auction volume for the March and June 2023 auctions were rolled forward to this December auction, so now fall in the 2023/24 fiscal year.

Implications for climate dividend

29. In previous Economic and Fiscal Updates, forecasts for ETS cash proceeds informed the size of the Climate Emergency Response Fund (CERF). At present there is $1.0 billion remaining in the CERF.

30. We understand that you intend to use the available cash proceeds remaining in the CERF to contribute to your fiscal plan. If the 6 December auction does not clear, this change will reduce actual ETS cash proceeds. Assuming your intention is to use the remaining CERF to fund your fiscal plan, the lower cash proceeds will have an impact on net debt, all else being equal. We will provide advice on options to manage this impact through advice on the Mini Budget scope we will be providing tomorrow (T2023/2030 refers).

Appendix 1: Talking points

1. Does an auction that does not clear or partially clears mean the ETS is not working well?

- No – auctions not clearing (or partially clearing) is a normal part of how the ETS is designed to operate. It suggests that there is sufficient supply of NZUs in the market currently. Fewer units in the market can be positive for the ability of the ETS to influence emissions.

2. What does this mean for the Government's books?

If the auction does not clear:

- ETS cash proceeds in the first half of 2023/24 will be $896 million lower than was forecast in PREFU.
- There is no direct impact from this result on the operating balance, as the impact is a cash impact, not revenue or expenses.
- ETS liabilities will also be lower than was forecast in PREFU as there will be fewer units held by participants than forecast, which represent a liability to the Government until they are surrendered.

If the auction partially clears:

- ETS cash proceeds in 2023/24 could be lower than was forecast in PREFU (how much lower will depend on the proportion of units sold and the price).
- There is no direct impact from this result on the operating balance.
- ETS liabilities could also be lower than was forecast in PREFU as there will be fewer units held by participants than forecast, which represent a liability to the Government until they are surrendered (this will depend on the proportion of units sold and the price).

3. Will this affect your plans or ability to deliver your fiscal plan?

- This variation from previous forecasts will be one of a number of things that will be factored into upcoming updated fiscal forecasts at the Half Year Economic and Fiscal Update. The Government is working through a number of options for decisions as part of its Mini Budget and will provide more details when the Mini Budget and HYEFU are made public.

4. Do you expect the auction to clear?

- To protect the integrity of the ETS market and prevent any impact on market activity, we recommend that you avoid making any external comment in advance about the likely outcome of the auction.

TE TAI ŌHANGA
THE TREASURY

Reference: T2024/148

Date: 24 January 2024

To: Minister of Finance (Hon Nicola Willis)

Deadline: 26 January 2024
(if any)

Aide Memoire: Talking Points for meeting with the Minister of Climate Change

You are meeting with Minister Watts on 26 January 2024 to discuss key climate priorities and agree how you will work together on delivery of these.

We have been engaged on a draft agenda being prepared by the Ministry for the Environment (MfE). At time of drafting, the proposed agenda was:

1. Climate Priorities (25 min)

s9(2)(f)(iv) [redacted]

2. Role of the Associate Minister of Climate Change / Minister of Finance in the Climate Portfolio (5 min)

You have half an hour for the meeting. MfE has proposed decision points on each topic. Given the size of these topics, we suggest you focus your discussion on any areas where you are less comfortable with the decision points proposed.

Item 1: Climate Change Priorities

s9(2)(f)(iv) s9(2)(f)(iv) [redacted] In your capacity as Minister of Finance, you may wish to note the importance of ongoing prioritisation of resource to ensure that efforts are not spread too thinly across too many priorities.

s9(2)(f)(iv) [redacted]

s9(2)(f)(iv)

s9(2)(f)(iv)

Item 2: Role of the Minister of Finance and the Associate Minister of Climate Change in the Climate Portfolio (5 min)

Decision 1: The draft agenda suggests options for how your role as the Associate Minister of Climate Change could work.

- This may be an item Ministers prefer to discuss without input from officials. s9(2)(f)(iv)
s9(2)(f)(iv) . There may be

value in your role involving keeping an eye to general alignment of climate strategy with economic and fiscal strategy.

- s9(2)(f)(iv) [redacted]
- [redacted]

<u>Decisions 2 and 3</u>: We suggest you agree to regularly meet with Minister Watts, and to join the cross-Ministerial governance arrangements.

Carly Soo, Senior Analyst, Climate Change, +s9(2)(k) [redacted]
Nicky Lynch, Manager, Climate Change, +s9(2)(k) [redacted]

Climate Change

ELT Representative: James Beard

Author: Nicky Lynch / Vicki Plater

Key Points

Climate Change is likely to have highly significant economic and fiscal implications.

The Treasury is actively contributing to climate policy development across government. This includes work on:

- Domestic mitigation policy (such as emissions reduction plans and the Emissions Trading Scheme)
- How New Zealand progresses towards meeting its Nationally Determined Contribution under the Paris Agreement
- Adaptation policy and the response to severe weather events.

Background/Problem Statement

Climate Change represents a major challenge to New Zealand, with significant economic, fiscal and wider living standards implications. Choices that governments, communities and individuals make will have a significant bearing on how successful we are in navigating the transition.

Higher temperatures, more frequent droughts and extreme storms, and rising sea levels are already being experienced in New Zealand. These trends are expected to grow over time and are already having a significant impact on the economy, society and government's financial position.

New Zealand is also seeking to influence global efforts to mitigate the extent of climate change by achieving domestic emissions reductions targets, and pursuing our Nationally Determined Contribution under the Paris Agreement. How New Zealand achieves emissions targets has significant implications for living standards.

Key facts and figures

Climate Change Mitigation

- The Climate Change Response (Zero Carbon) Act sets a 2050 target of net-zero for all gases except biogenic methane (which has a target of reducing gross levels by 24-47% compared to 2017 levels).
- The Government published the first three emissions budgets (2022–2025, 2026–2030, 2031–2035) in May 2022. Emissions budgets will act as stepping-stones, or interim targets, to reaching our 2050 emissions reduction targets. The first three emissions budgets (for all gases) are:
    - Emissions Budget 1 (2022 – 2025): 290 Mt CO_2e
    - Emissions Budget 2 (2026 – 2030): 312 Mt CO_2e
    - Emissions Budget 3 (2031 – 2035): 253 Mt CO_2e
- Nationally Determined Contribution (NDC1): NZ's 2030 target under the Paris Agreement is a 50% point-year reduction by 2030 compared to 2005 levels.
- Achieving New Zealand's NDC1 will almost certainly require domestic and offshore mitigation. The Treasury's 2023 "Climate Economic and Fiscal Assessment" provided estimates of the total fiscal cost of purchasing offshore mitigation to achieve New Zealand's NDC1, with estimates ranging from $3.3 billion to $23.7 billion.

Climate Change Adaptation

- It can be difficult to separate the additional costs of climate change from baseline levels of risk from existing hazards such as floods and droughts.
- However, recent data suggests that the costs from extreme weather events will be increasingly material. For example, Treasury estimates that:
    - the North Island Weather Events will increase Crown expenses in the 23/24 financial year by $1.7 billion (HYEFU 2023)
    - the North Island Weather Events caused damage to physical assets of $9 - $14.5 billion (HYEFU 2023)
    - increased storms and droughts could increase net core Crown debt by 3.77% of GDP by 2061, though this is likely to be an underestimate (Long Term Fiscal Statement, 2021).
- In addition, fiscal and economic costs will increase as existing public and private assets shift from facing acceptable risk to unacceptable risk.

Additional commentary

Topical issues that could be raised are noted below.

Declined ETS auctions in 2023

- All four ETS auctions in 2023 did not clear, meaning these units were expired.
- Had these units been sold at the final ETS auction, this would have produced a cash inflow of approximately $1 billion, given prevailing ETS prices at the time of auction.
- However, the Half-Yearly Economic and Fiscal Update (HYEFU) forecasts had assumed that the auction would not clear, and therefore already included the fiscal impact of the foregone ETS cash proceeds.
- ETS auctions not clearing does not necessarily indicate that the ETS is not working as intended; the purpose of confidential reserve price is to protect against an auction clearing price significantly lower than secondary market prices, and it functioned effectively to achieve this.

Treasury advice on emissions impacts of savings decisions

- As part of the Mini Budget process, Treasury and the Climate Change Interdepartmental Executive Board assessed the climate implications of the Government's proposed savings decisions (including returning funding from the Government Investment in Decarbonising Industry or “GIDI” Fund and Clean Car Discount).
- In particular, we advised the Government on how these decisions might impact its abilities to meet emissions budgets and their statutory requirements under the Climate Change Response Act. We will perform a similar function through the Budget 2024 process.
- Our assessment was that we did not expect Mini Budget decisions to pose a significant risk to achieving our first emissions budget (2022-2025). However, impacts in the second and third emissions budgets are more uncertain. [Note for ELT: MoF has referred to this advice publicly in responses to written questions in the house- noting that *The Government is committed to meeting our climate change commitments, and as part of our mini-Budget we considered the climate implications of returning funding from different initiatives including GIDI and the Clean Car Discount. We also considered how decisions might impact our ability to meet future emissions budgets. From the advice I*

have received I do not expect mini-Budget decisions to pose a significant risk to achieving our first emissions budget.][1]

The Climate Dividend and the Climate Emergency Response Fund

- The Government has announced its intention to use funding from the cash proceeds of the Emissions Trading Scheme to support a climate dividend.
- In the Mini Budget in December, the Government identified $2.047 billion that will support the 'climate dividend' component of the tax plan. This was made up of unallocated funding from the Climate Emergency Response Fund and returned funding from the Clean Car Discount, public transport subsidies and the Government Investment in Decarbonising Industry Fund.

s9(2)(f)(iv) [redacted]

- The Treasury will continue to provide advice on the role of public investment in supporting climate objectives and how climate related costs can be managed in future.

s9(2)(f)(iv) [redacted]

[1] Oral Questions — Questions to Ministers - New Zealand Parliament (www.parliament.nz) Q6

Ministry for the
Environment
Manatū Mō Te Taiao

TE TAI ŌHANGA
THE TREASURY

Joint Report: The Trans-Tasman 2+2 Climate and Finance Ministers Meetings and Commitments

Date:	15 February 2024	**Report No:**	T2024/152 / BRF-4101
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Minister of Finance (Hon Nicola Willis) Minister of Climate Change (Hon Simon Watts)	**Indicate** your preference for: • continuing to use the 2+2 architecture • your priorities across existing 2+2 policy commitments s9(2)(f)(iv) • progressing areas that do not sit directly in the climate and finance portfolios.	21 February (ahead of the Minister of Finance's trip to Australia)

Contact for telephone discussion

Name	Position	Telephone		1st Contact
Katie Collier	Senior Analyst, Climate Change, Treasury	s9(2)(k) (wk)	N/A (mob)	
Isobel Bruun-Kiaer	Senior Analyst, Sustainable Finance, Ministry for the Environment	N/A (wk)	s9(2)(g)(ii) (mob)	✓
Nicky Lynch	Manager, Climate Change, Treasury	s9(2)(k) (wk)	s9(2)(g)(ii) (mob)	✓
Rebecca Clements	Manager, Sustainable Finance, Ministry for the Environment	N/A (wk)	s9(2)(g)(ii) (mob)	

Minister's Office actions

Return the signed report to Treasury and the Ministry for the Environment.

Enclosure: No

Joint Report: The Trans-Tasman 2+2 Climate and Finance Ministers Meetings and Commitments

Executive Summary

This briefing seeks to formally confirm your interest in using the architecture for the Australia-New Zealand Climate and Finance Ministers relationship (referred to in this briefing as the 2+2) to advance the Government's priorities. It also tests which areas you are most interested in progressing and how you would like to approach areas of work that sit outside of the climate and finance portfolios. It includes background material to support your decision-making.

We recommend that you continue to use the 2+2 architecture. This includes meeting annually as part of the 2+2 relationship and using established working-level groups. Collaboration with Australia could benefit New Zealand, particularly where we can leverage Australia's greater scale.

Commitments made through the first 2+2 meeting focus on:

- joint work to encourage the uptake of electric vehicles,
- alignment of sustainable finance policies,
- developing adaptation indicators and monitoring frameworks, and
- supporting the development of internationally aligned Guarantee of Origin Schemes (including exploring the adoption of Australia's GO Scheme in New Zealand).

We see value in prioritising progress on sustainable finance for 2024. We note that you have expressed interest in actions in this area.

s9(2)(f)(iv)

If you wish to progress areas that sit outside your direct portfolios, you will need to discuss this with the relevant portfolio Minister. s9(2)(f)(iv)
s9(2)(f)(iv)
The Climate Priorities' Ministers Group (CPMG) could provide a forum for providing wider context to other Ministers and testing overall priorities.

Depending on your priorities, it may make sense to adjust the structure of the working-level officials groups proposed by the first 2+2 meeting (and in the process of being formalised). We can progress this at an officials level if required.

Recommended Action

We recommend that you:

a **confirm** your interest in continuing to meet annually with Australian Climate and Finance Ministers through the 2+2 relationship;

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Climate Change

b **note** that subject to your decision on (a), this year's meeting will be held in Australia, and that the date is yet to be agreed;

c **note** that the first 2+2 meeting held in 2023 established a set of commitments to progress a range of specific policy areas related to climate and finance;

d s9(2)(f)(iv) [redacted]

e [redacted]

f **indicate** any other areas not covered by the current commitments that you wish to progress through the 2+2, noting that we recommend that any of these areas replace current commitments;

g **indicate** areas you are particularly interested in progressing at the Minister of Finance's upcoming bilateral meeting with Treasurer Chalmers on 23 February;

h **note** a process for involving other New Zealand Ministers in 2+2 commitments was not established for the inaugural 2+2 meeting;

i **agree** to use the CPMG as a Ministerial forum where relevant for discussion [redacted] s9(2)(f)(iv)

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Climate Change

OR

seek further advice on using the CPMG in the way described above;

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Climate Change

j s9(2)(f)(iv) [redacted]

Nicky Lynch
Manager, Climate Change, Treasury

_____/_____/_______

Rebecca Clements
Manager, Sustainable Finance, Ministry for the Environment

_____/_____/_______

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Hon Simon Watts
Minister of Climate Change

_____/_____/_______

Joint Report: The Trans-Tasman 2+2 Climate and Finance Ministers Meetings and Commitments

Purpose of Report

1. This briefing:
   a. seeks to formally confirm your interest in using the architecture for the 2+2 Climate and Finance Ministers relationship between Australia and New Zealand (referred to as the 2+2) to advance the Government's climate and finance-related priorities, and
   b. tests which areas you are most interested in progressing through the 2+2 and how you would like to approach areas of work that sit outside of the climate and finance portfolios.
2. This will help us in supporting you ahead of the next 2+2 meeting (if you wish for these to continue) and progressing your priorities more generally. We have included background material on the 2+2 for your information.

3. We have timed this report to come ahead of the Minister of Finance's upcoming trip to Australia on 22-23 February. While the 2+2 is not an explicit focus for any of the scheduled meetings, we suggest that the 2+2 be included on the agenda for the Minister and Treasurer Chalmers to discuss at their introductory meeting on 23 February.

Context for the 2+2 Relationship with Australia

4. At the 2022 Australia-New Zealand Leaders' Meeting (ANZLM), both countries' Prime Ministers committed to expand Australia-New Zealand cooperation across climate change and finance issues. This included the introduction of the 2+2 relationship and the new Trans-Tasman Roadmap to 2035.

5. The Trans-Tasman Roadmap to 2035 sets out how Australia and New Zealand will work together over the coming decade across five priority themes. Under the first priority theme 'Sustainable, Inclusive and Prosperous Economies' the Prime Ministers agreed to deliver on outcomes from 2+2 engagements. The Prime Ministers will review the Roadmap at the ANZLM mid this year.

The first 2+2 meeting established policy commitments and an architecture for collaborating going forward

6. The first 2+2 meeting was held in June 2023 in Wellington, with the Chief Executives of all four lead agencies[1] also in attendance.

7. Ministers made new joint commitments on finance and climate via a joint statement.[2] These commitments were grouped into three thematic areas.

[1] New Zealand Treasury, Australian Treasury, New Zealand Ministry for the Environment, Australian Department of Climate Change, Energy, Environment and Water.
[2] [2+2 Joint Statement.pdf (beehive.govt.nz)]

a. Climate Leadership and Governance – to enable alignment and ambition on climate targets, strategies and policies,
b. Sustainable Finance – to support a regional structural landscape that enables the flow of money into activities which support the transition
c. Adaptation and Resilience – to support cooperation on domestic adaptation challenges and cooperate on innovative solutions to boost climate resilience.

8. A list of all thematic areas and commitments is included in Appendix 1. In summary, Ministers agreed to work on:
   a. joint work to encourage the uptake of electric vehicles
   b. alignment of sustainable finance policies
   c. developing adaptation indicators and monitoring frameworks
   d. supporting the development of internationally aligned Guarantee of Origin (GO) Schemes[3] (including dedicated conversations to explore the adoption of Australia's GO Scheme in New Zealand).

9. Alongside the policy commitments outlined above, Ministers also agreed to architectural elements of the 2+2 relationship:
   a. Holding 2+2 meetings annually, alternating hosts. A date has not yet been set for the 2024 meeting, which Australia will host.
   b. Establishing three agency level working groups on overall 2+2 policy implementation, sustainable finance, and net-zero government (i.e. including decarbonising public services, sustainable procurement, disclosures and working with the Pacific).

10. Note that not all commitments sit squarely within climate and finance portfolios. For example, the commitment to co-ordinate efforts to stimulate production and supply of low-emission vehicles is within the portfolio of the Minister for Economic Development. Another example of this is the GO Scheme commitment, which remains 'on hold' in lieu of a lead NZ agency to deliver on it.

s9(2)(f)(iv)

[3] Australia's proposed Guarantee of Origin (GO) scheme looks to provide a mechanism to track and verify emissions associated with hydrogen and other products made in Australia, and to provide a mechanism for renewable electricity certification which could support a variety of renewable energy claims.

s9(2)(f)(iv)

13. A process for involving other New Zealand Ministers in 2+2 commitments was not established for the inaugural 2+2 meeting. Most of the inaugural commitments were closely aligned with existing work programmes within Treasury, the Ministry for the Environment and MBIE, so work could progress within existing resourcing.

Value of the 2+2

14. You have choices about whether to continue to use the 2+2, and which of the commitments you would like to progress. We would like to confirm your preferences before engaging with Australia on options for a second meeting in 2024.

We recommend that you continue to use the 2+2 architecture

15. Australia has communicated to New Zealand the value that it places on the 2+2 arrangements. As such, they are keen to progress and strengthen this work. Australia has expressed strong interest in learning from New Zealand's experiences to date on climate policy and institutional architecture.

16. Similarly, working and collaborating with Australia has potential to deliver benefits for New Zealand, in particular where we:
    a. have common markets (e.g. financial sector)
    b. have common geopolitical challenges or risks (e.g. supply chain issues),
    c. face common challenges where there is high value in sharing emerging experience (e.g. modelling approaches, adaptation frameworks).

17. In addition to this:
    a. Australia is moving quickly to develop its own regulatory and policy instruments, including taxonomies and sustainable finance strategies. Developments in these areas in Australia could have implications for New Zealand, so there is likely to be value in working together on alignment.
    b. In some areas we may benefit from being able to leverage Australia's larger scale (such as on supply chain issues).
    c. New Zealand businesses have been calling for this sort of coordination (for example on sustainable financing) to support ease of doing business between the two countries.

18. We have also heard you are interested in maintaining the 2+2. The Minister of Climate Change has indicated to the Prime Minister that the finance-climate relationship with Australia is a priority area for the next three years (CORM-1878 refers).

Aligning commitments with your priorities

s9(2)(f)(iv)

19. s9(2)(f)(iv)

20. As noted above, the majority of inaugural commitments were closely aligned with existing work programmes. Since then, work has progressed internally on these commitments across MfE, Treasury and MBIE. The most progress so far has been made on commitments related to the sustainable finance theme, particularly work on a climate spending taxonomy which is led out of the Ministry for the Environment.

s9(2)(f)(iv)

21. s9(2)(f)(iv) [redacted]

22. [redacted]

We recommend sustainable finance as a priority to progress and build on this year

23. We seek to understand what areas of commitment are priority for you. As a recap, and as outlined in Appendix 1, the three thematic areas from the first 2+2 meeting were:
    a. Climate Leadership and Governance
    b. Sustainable finance
    c. Adaptation and resilience.

24. s9(2)(f)(iv) [redacted]

25. [redacted]

s9(2)(f)(iv) [redacted]

s9(2)(f)(iv) [redacted]

s9(2)(f)(iv)

s9(2)(f)(iv) [redacted]

Other relevant matters

Prioritisation choices could have implications for how best to structure the policy-level architecture that supports the 2+2

36. The first 2+2 proposed three working-level groups to support the Ministerial architecture:
    a. 2+2 implementation oversight group – a joint working group to support policy implementation.
    b. Net Zero Government working group – to support decarbonising public services, public sector climate-related disclosures and sustainable procurement, and engaging public services across the Pacific.
    c. A sustainable finance strategy working group – to support providing cohesion and clarity for businesses and investors operating across the Tasman to position the region as a robust green finance market.

37. The Net Zero Government working group has been set up by the Australian Department of Finance and meets every two months. The other two groups have not yet been formalised and the New Zealand and Australian agencies currently use ad-hoc avenues for delivering on the commitments.

38. Formalising these working groups would provide a useful and light touch structure and vehicle for cut through on policy issues, information sharing and collaboration. MfE, the Treasury and MFAT have drafted a proposal to share with Australian agencies to progress when we re-engage with them.

39. However depending on which areas you wish to prioritise, there may be a case for adjusting the configuration of groups to better align with your priorities. We can progress this at an officials level as required.

The development of the second emissions reduction plan will present additional opportunities to collaborate

40. Several of the existing commitments (and s9(2)(f)(iv) [redacted] discussed below) are [redacted]

41. As agencies develop implementation plans to support the Government's ERP2 focus areas, the Ministry for the Environment propose connecting with Australia where relevant. We suggest that this could be an efficient way of ensuring that agencies outside of the 2+2 remit still support its objectives.

42. s9(2)(f)(iv) [redacted]

Next Steps

43. The Minister of Finance will be travelling to Australia in late February. We will suggest in briefing materials for that visit that the 2+2 be on the agenda for the Minister and Treasurer Chalmers to discuss.

44. Once we have received your feedback on s9(2)(f)(iv) [redacted], we will reach out to our Australian counterparts to discuss progress to date and objectives for the 2024 meeting. We can also provide you with more advice on the content and architecture s9(2)(f)(iv) [redacted]

45. As hosts for the 2024 meeting, Australia will set the date for the next 2+2 meeting. We understand Minister Watts has suggested meeting in Q2. We will work with your offices and our Australian counterparts to identify potential Q2 dates, while avoiding sitting weeks or key phases of the Budget process. The timing of the meeting could also be something that the Minister of Finance seeks Treasurer Chalmers' views on in February.

Appendix 1: Full list of inaugural commitments from both the Joint Statement and the workplan agreed at the Ministers meeting

Note that where the status is 'on hold', we are awaiting your direction on whether to progress these inaugural commitments, or direction on how to work with other Ministerial portfolios where this is necessary for delivery.

Thematic area	Commitment wording	NZ agency	Status
1. Governance and Leadership s9(2)(f)(iv) [redacted]	Hold the Australia-New Zealand 2+2 Climate and Finance Dialogue annually	Tsy & MfE	In progress
	Establish a joint working group to support policy implementation.	Tsy, MfE, MFAT	On hold
	Establish a *Net Zero Government Working Group* to support decarbonising public services, climate-related disclosures, and sustainable procurement. • Invite and engage with Pacific countries, and support regional efforts to reduce emissions.	MfE	In progress. Australian Dept of Finance have established this and act as secretariat.
	Co-ordinate efforts to stimulate production and supply of electric and zero emission vehicles into the Australasian market, including accelerating the uptake of zero emissions vehicles in government fleets, and explore the potential for collaboration on vehicle manufacturing and improving charging infrastructure. • New Zealand will collaborate with the Australian government fleet teams, including federal, state and territory jurisdictions, to accelerate the uptake of zero emission vehicles in government fleets.	MBIE	In progress
	Support the development of internationally aligned Guarantee of Origin (GO) Schemes, to track and verify emissions associated with hydrogen, renewable electricity and other renewable and low-emissions products, in our respective countries and across the Indo-Pacific, including through dedicated conversations to explore adopting the GO Scheme in New Zealand.	NZ agency tbc	On hold
	Ministers re-affirmed their commitments to the Paris Agreement and action in this critical decade	Tsy & MfE	In progress
	[Climate Change Ministers] agreed to deliver practical recommendations for future bilateral collaboration underpinned by joint trans-Tasman policy analysis	MfE	On hold
2. Sustainable Finance s9(2)(f)(iv) [redacted]	Committed to providing cohesion and clarity for businesses and investors operating across the Tasman to position the region as a robust green finance market.	Tsy & MfE	In progress
	Set up a *sustainable finance strategy working group* to support this.	Tsy & MfE	On hold
	Work together on measures to prevent greenwashing, support sustainability-related capabilities of firms, financial institutions, and financial regulators, and strengthen public sector leadership on sustainable finance.	Tsy & MfE	In progress
	Align approaches to sustainable finance frameworks, such as taxonomies, across the Tasman to enhance interoperability and support businesses operating across the economic region.	Tsy & MfE	In progress
	Committed to better coordinate the implementation of climate-related disclosure requirements for financial market participants against internationally aligned standards.	MfE	In progress
	Agreed to strengthen trans-Tasman cooperation in developing best-practice modelling of the impacts of climate change, mitigation, and adaptation	Tsy & MfE	In progress
	Committed to sharing expertise and providing transparent climate spending reporting in their respective Budgets.	Tsy	In progress

	Work together to progress the Multilateral Development Bank reform efforts, with a focus on meeting the self-identified needs of the Pacific.	Tsy & MFAT	In progress
3. Adaptation and resilience s9(2)(f)(iv)	Committed to engaging closely with key regions and industries that are transforming as Australia and New Zealand decarbonise to help proactively manage the change.	NZ agency tbc	On hold
	Cooperation on building adaptation into resilience policy and measures.	MfE	In progress
	Joint work on monitoring frameworks and adaptation indicators.	MfE	In progress
	Explore how both countries could better cooperate on domestic adaptation challenges and collaborate on innovative solutions, including in insurance, to boost regional climate resilience, including through regional knowledge exchanges.	MfE	In progress
s9(2)(f)(iv)	s9(2)(f)(iv)	s9(2)(f)(iv)	
Working with the Pacific to address climate change	Committed to further coordinate our efforts to support partner countries in the Pacific in addressing the impacts of climate change and amplifying Pacific voices in international climate and energy discussions.	MFAT	In progress

Note: The text describing the four thematic areas was not included in the Joint Statement, but is copied from the work plan agreed in the first 2+2 meeting.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement

Date:	20 February 2024	**Report No:**	T2024/263
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Nicola Willis **Minister of Finance**	**Refer** this report to the Minister of Climate Change	None

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Callum Lo	Analyst, Climate Change	s9(2)(k)	N/A (mob)	✓
Nicky Lynch	Manager, Climate Change		s9(2)(g)(ii) (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury. **Refer** a copy of this report to the Minister of Climate Change.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement

Executive Summary

The Treasury does not currently treat New Zealand's commitment under the Paris Agreement as a liability

New Zealand's first Nationally Determined Contribution (NDC1) under the Paris Agreement commits to keeping total net emissions over the period 2021 - 2030 below 571 megatonnes of carbon dioxide (or equivalent gases). Meeting NDC1 will almost certainly require supporting offshore mitigation, in addition to achieving domestic emissions budgets.

The Crown's accounts are prepared in accordance with generally accepted accounting practice (GAAP). Under GAAP, a liability is "a present obligation of an entity to transfer an economic resource because of past events." A "present obligation" can be either legal or 'constructive'. In our view:

- NDC1 does not create a legal obligation: Parties to the Paris Agreement are not legally obliged to achieve their NDCs, as set out in paragraph 10.

- NDC1 does not create a 'constructive obligation': A constructive obligation only exists if the Government's actions and statements are specific enough that it has little or no realistic alternative to meeting its commitment. In our judgement, the Government has not made sufficiently specific statements and actions to meet this test.

Even if an obligation existed, NDC1 does not meet the additional criteria for a "liability" (future economic sacrifice must be probable and reliably measurable).

Future government actions, policies and announcements could change NDC1's accounting treatment

Announcing or committing to specific plans to achieve NDC1 could cause the criteria above to be met. If this occurred, a liability would likely accrue gradually over time as emissions are produced in excess of the volume allowed under NDC1. Each incremental increase in the liability would also produce a corresponding expense, and a negative OBEGAL impact.

The exact threshold where government actions would create a liability is not precisely defined. It will depend on the overall judgement of the Treasury as to whether the criteria above are met, drawing on all relevant circumstances.

Offshore mitigation purchases could soon meet the tests for inclusion in fiscal forecasts

The Treasury's forecast period currently extends into 2028. Moving forward, the end of this forecast period will approach the end of the NDC1 period (2030). This means that we will need to consider whether the tests for inclusion in the forecasts are met, because the forecast period will increasingly cover the period when purchases could be made. As a result, future offshore mitigation purchases could soon meet the tests for inclusion in the fiscal forecasts. This would occur irrespective of whether NDC1 is treated as a liability.

Whether future offshore mitigation purchases qualify for inclusion in fiscal forecasts depends on the Treasury's judgement of whether they are sufficiently probable and sufficiently quantifiable. In making this judgement, the Treasury will consider all the actions the Government has taken towards its offshore mitigation strategy.

We will monitor developments in this area closely and will advise you ahead of any Cabinet decisions with accounting implications. In the meantime, we have taken a number of steps to provide public transparency over these costs, including through the publication of cost scenarios in the Climate Economic and Fiscal Assessment, inclusion in the fiscal risks chapter of Economic and Fiscal updates, and the addition of a note in the Financial Statements of Government explaining the current treatment.

Recommended Action

We recommend that you:

a **Note** the contents of this report.

b **Refer** a copy of this report to the Minister of Climate Change.

Refer / not referred.

Nicky Lynch
Manager, Climate Change

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Treasury Report: The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement

Purpose

1. At your recent bilateral on climate change priorities with the Minister of Climate Change, you discussed the accounting treatment of New Zealand's Paris Agreement commitment. We undertook to supply follow up advice on this matter, which this report now provides. It is for information only; no decisions or actions are required from you.

2. This report explains:
   - the Treasury's current accounting treatment of New Zealand's commitment under the Paris Agreement (including offshore mitigation purchases),
   - which events could change this accounting treatment in future, and
   - how future offshore mitigation may be treated in upcoming fiscal forecasts.

Background

3. New Zealand's first Nationally Determined Contribution (NDC1) under the Paris Agreement commits to keeping total net emissions over the period 2021 - 2030 below 571 megatonnes of carbon dioxide (or equivalent gases).

4. The ambition of NDC1 is considerably higher than the ambition of domestic emissions budgets over the same period. Meeting NDC1 will therefore almost certainly require a combination of domestic and offshore mitigation. Offshore mitigation can be accessed in a number of ways: for example, through direct investment in projects internationally, linking of Emissions Trading Schemes or purchasing of units in international markets. In any case, for offshore mitigation to be able to count towards the NDC, it must meet eligibility criteria under the Paris Agreement for Internationally Transferrable Mitigation Outcomes (ITMOs).

5. In 2023, the Treasury and the Ministry for the Environment's "Climate Economic and Fiscal Assessment" (CEFA) provided a range of scenarios for the fiscal costs of offshore mitigation. These costs varied between $3.3 billion to $23.7 billion, depending on the price achieved and the volume required.[1]

6. The Treasury does not currently treat NDC1 as a liability in the Crown's financial statements, a position that has attracted public interest and debate.

7. We closely monitor developments in both the application of the relevant accounting standards, and public debate. Recent developments include:
   - In November 2023, the International Financial Reporting Interpretations Committee (IFRIC) released a tentative decision on the accounting treatment of

[1] The Treasury and the Ministry for the Environment: Ngā Kōrero Āhuarangi Me Te Ōhanga Climate Economic and Fiscal Assessment 2023, p 86.

commitments to reduce or offset greenhouse gas emissions. This decision, and its ramifications for New Zealand, are explored in Annex One.

- In February 2024, the McGuinness Institute published a discussion paper recommending that past commitments to purchase offshore carbon credits be recognised as a liability, and future commitments as a contingent liability.[2] The arguments in the discussion paper are analysed in this report.

How the costs of NDC1 are currently treated in financial reporting

8. The Treasury produces several financial reporting publications, each with a specific purpose and scope. Table 1 below outlines how NDC1 is currently treated in these products. The information provided has evolved in recent years giving greater transparency to the fiscal implications of climate change, including through:
    - publication of the first Climate Economic and Fiscal Assessment,
    - elaboration in the Specific Fiscal Risks,
    - explaining accounting treatment in the Notes to the Financial Statements.

Table 1: The treatment of NDC1 in Treasury publications

Publication	Purpose of publication	Treatment of NDC1
Estimates of Appropriations	Provides a picture of each Vote and appropriation for Parliament.	No appropriations for offshore mitigation purchases exist yet, so NDC1 does not feature in the Estimates. However, departments have received some funding for policy work on offshore mitigation, which sits within general departmental appropriations.
Fiscal forecasts (within Economic and Fiscal Updates)	Provides an outlook of the Government's financial performance and financial position.	Potential future offshore mitigation purchases towards NDC1 are not yet included in the fiscal forecasts. This is because the Treasury has not yet been satisfied that offshore mitigation purchases are: o more likely than not during the forecast period, and o quantifiable. However, the potential fiscal costs of meeting NDC1 are described qualitatively in a "Specific Fiscal Risk".
Financial Statements of Government	Provides a record of the Government's financial performance and financial position.	NDC1 is not currently recognised in the Financial Statements of Government as a liability. However, the Notes to the Financial Statements include a description of the NDC1 commitment and an explanation of its accounting treatment.

[2] The McGuinness Institute: Risks hiding in plain sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?

Climate Economic and Fiscal Assessment	Provides information on the economic and fiscal impacts of climate change on New Zealand.	The Climate Economic and Fiscal Assessment (CEFA) was published by the Treasury and the Ministry for the Environment in 2023. It provided illustrative estimates of the costs of offshore mitigation required to meet NDC1, to provide additional transparency. Annex Two provides a summary of the offshore mitigation scenarios presented in the CEFA.

NDC1 does not currently meet the definition of a "liability"

9. A liability is defined in GAAP as "a present obligation of an entity to transfer an economic resource because of past events."

NDC1 does not create a "present obligation"

10. A "present obligation" can be either:[3]

- **a legal obligation**:

  an obligation deriving from a contract, legislation, or other operation of law.

- **a 'constructive' obligation**:

  an obligation deriving from an entity's actions where:

  - through past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
  - the entity has therefore created a valid expectation that it will discharge those responsibilities, such that it has little or no realistic alternative to avoid settling the obligation.

11. Our view is that there is no legal or constructive obligation. Our application of the relevant tests to NDC1 is summarised in Table 2 below.

Table 2: Tests for the existence of a present obligation

Test	Application to NDC1
Is there a legal obligation?	No legal obligation because: Parties do not have an obligation to achieve their NDCs under the Paris Agreement. The Paris Agreement requires a party to "prepare, communicate and maintain successive nationally determined contributions that it intends to achieve." The obligations relate to conduct and intention rather than outcome. Therefore there is no other party to whom the obligation is currently owed, that can enforce the obligation.

[3] External Reporting Board: Public Benefit Entities' Conceptual Framework, paragraphs 5.15 – 5.23. Source: https://www.xrb.govt.nz/dmsdocument/1825#page=31

Is there a constructive obligation?	No constructive obligation because: The Government has not indicated a responsibility to other parties to achieve NDC1 by a sufficiently specific statement (so that there is a valid expectation of a present obligation that the Government has little discretion to avoid). As an example of the specificity required: A constructive obligation was created when the Government announced it would voluntarily purchase insured residential property in the red zones of Christchurch. This committed to an economic sacrifice to specific parties that was not adjustable at the discretion of the Government. In our view, this level of specificity does not exist for NDC1 because: • **The Government has not announced a specific approach to achieving NDC1.** This means the Government can modify its approach. For instance, it can adjust the timing, nature, or magnitude of the costs incurred by selecting different policy options. Inherently, a commitment is not an "obligation" if it can be adjusted at the discretion of the entity which made it. • **The Government has realistic alternatives to settling NDC1 through a transfer of resources.** Because it has not announced specific plans, the Government has realistic alternatives to sacrificing its own resources to settle the NDC1 obligation. For instance, it could pass the costs of achieving NDC1 on to private entities. Not entirely achieving NDC1 also remains a possible outcome, even if this is not the government's intention, though this would carry reputational risk. • **No counterparties exist.** A constructive obligation requires clearly identified parties to whom obligations are owed. This is not the case with NDC1. For instance, the Government has not confirmed which entities it will procure offshore mitigation from. In our view, the general public is not a counterparty.

The McGuinness Institute argues that the Government's past actions, taken collectively, generate a constructive obligation

12. A recent discussion paper by the McGuinness Institute argues that the Government indicated it would accept certain responsibilities and thus created a constructive obligation through its past actions, including:
    - ratifying the Paris Agreement,
    - publishing emissions budgets,
    - publishing the first Emissions Reduction Plan,
    - reforming the Emissions Trading Scheme,
    - agreeing in-principle to an NDC Strategy in July 2023, and
    - signing a Free Trade Agreement with the European Union which includes a commitment to implement the Paris Agreement.[4]

[4] The EU FTA states that: "each Party shall effectively implement the UNFCCC and the Paris Agreement, including commitments with regard to nationally determined contributions".

13. The paper argues:

"These indicate an established pattern of past practice and published policies. These well-publicised actions and events collectively were sufficient for the New Zealand Government to indicate to the New Zealand public that it would accept certain responsibilities, and created a 'valid expectation' by the New Zealand public that the New Zealand Government will discharge its responsibilities under the Paris Agreement."

14. Our view is that these actions are not specific enough to produce a constructive obligation, for the reasons noted above. The approach remains adjustable, there are alternatives to settling the commitment through transfer of the Crown's resources, and no counterparty exists to whom an obligation is owed. The Government has not published plans specific enough to remove its discretion to pass the costs of meeting NDC1 onto private entities. Passing on some or all of these costs remains a realistic option for the Government, meaning it has not created an obligation with "little or no realistic alternative but to settle".

Even if an obligation existed, NDC1 would not meet the criteria for reporting a liability

15. Once the existence of a present obligation has been established, a liability will only be reported if:
    - a future economic sacrifice is probable, and
    - the amount of the obligation can be reliably measured.

16. Table 3 summarises the relevant tests and our application of those tests to NDC1.

Table 3: Tests for the recognition of a liability

Test	Application to NDC1
Is it probable that an outflow of resources will be required to settle the obligation?	No probable outflow of resources because: The Paris Agreement does not require NDCs to be "settled" in any way if they are not met. Where the Crown intends to meet NDC1 through domestic and offshore abatement, it has discretion to pass these costs onto the private sector.
Can a reliable estimate be made of the amount of the obligation that cannot practically be avoided?	No reliable estimate can be made because: There is uncertainty over future emissions reduction policies (both domestic emissions reduction policies and offshore mitigation purchases) and their cost-effectiveness. The Crown can shift the costs of meeting NDC1 onto the private sector, creating uncertainty over fiscal costs.

17. Our conclusion that no liability exists has been discussed with the Office of the Auditor General in the course of preparing previous Financial Statements of Government. OAG's current position is that "recognising a liability for the Government's emissions reductions targets at this point in time is a reasonable interpretation of the financial reporting standards and that the disclosures are appropriate".

18. However, given that the landscape of climate litigation continues to evolve, we will continue to closely monitor the matter for developments that could cause this judgement to change.

19. We are not aware of any party to the Paris Agreement reporting their NDC on their government balance sheet. Australian and UK government officials have confirmed this understanding.

Government choices could change this accounting treatment in future

20. Future government actions, policies and announcements could cause the criteria above to be met, thereby changing NDC1's accounting treatment.

21. If these criteria were met in future, the resulting recognition of a liability would produce a corresponding expense, and a negative OBEGAL impact. However, these impacts would likely occur gradually, accruing as New Zealand produces emissions in excess of the allowed volume under NDC1. This accounting treatment is due to recent developments in the interpretation of accounting standards, explored further in Annex One.

22. Box 1 below provides one example of a step towards offshore mitigation purchases that might affect the accounting treatment of NDC1.

Box 1: Example of a Government action affecting the accounting treatment of NDC1

The Government publishes a detailed formal strategy for pursuing offshore mitigation purchases towards NDC1, identifying:

- the types and approximate number of entities who will benefit from offshore mitigation purchases
- the amount of payments that will be made can be measured reliably
- when the payments will be made.

Such a publication could generate a constructive obligation and, depending on the exact circumstances, could lead to a liability being recognised. The timing of that recognition would depend on when all the relevant tests were judged to have been met.

23. Whether an action, policy or announcement causes the above "liability" criteria to be met is a matter of judgement, relying on all relevant circumstances. The cumulative impact of several actions could lead to the recognition of a liability where no single action would be sufficient on its own.

24. Therefore, it is difficult to determine precisely which Government actions would lead to the recognition of a liability ahead of time.

25. However, the following principles provide a general guide. Actions, policies and announcements are more likely to contribute to the recognition of a liability if they:
    - are highly specific about how NDC1 will be achieved,
    - have costs that can be reliably measured,

- have funding allocated to them,
- cannot reasonably be altered in future,
- make a commitment to identified parties, or
- are made publicly, with little discretion to avoid.

26. We will provide advice to you ahead of any Government decisions that would materially affect the accounting treatment of climate targets.

Offshore mitigation purchases could soon meet the tests for inclusion in the forecasts

27. As discussed, NDC1 does not currently meet the criteria for a "liability". However, if the Government is to achieve the NDC1 target through future offshore mitigation purchases, significant costs will be incurred in the future. These costs will need to be considered for inclusion in fiscal forecasts, published at each Economic and Fiscal Update.

28. Items are included in fiscal forecasts where they are:
    - more likely than not to occur,
    - quantifiable, and
    - likely to have a fiscal impact within the forecast period (the current fiscal year plus the following four fiscal years).

29. The Treasury's forecast period currently extends into 2028. Moving forward, the end of this forecast period will approach the end of the NDC1 period (which ends in 2030). This means that we will need to consider whether the tests for inclusion in the forecasts are met, because the forecast period will increasingly cover the period when purchases could be made. As a result, future offshore mitigation purchases could soon meet the tests for inclusion in the fiscal forecasts. This would occur irrespective of whether NDC1 is treated as a liability.

30. Factors that will influence our judgement on whether offshore mitigation purchases are quantifiable and likely to occur within the forecast period include:
    - any announcements the Government makes on its offshore mitigation strategy
    - whether the Government funds any Budget bids towards offshore mitigation
    - whether the Government enters into any agreements with overseas parties to procure offshore mitigation.

31. We would be unlikely to include offshore mitigation in fiscal forecasts prior to Cabinet decisions on an offshore mitigation strategy and indicative costings being available.

Including offshore mitigation in fiscal forecasts could make it more likely that NDC1 will be considered a liability in future

32. Publishing fiscal forecasts which include future offshore mitigation purchases could contribute to a "reasonable expectation" that the Government will make these

purchases. This could therefore influence whether NDC1 is considered a constructive obligation, and thus a liability.

33. However, this factor alone will not be sufficient to generate a liability for the Crown. It represents one of many factors which, taken together, will inform the judgement of whether the relevant tests have been met.

Offshore mitigation purchases could be classified in several different ways

34. Regardless of whether NDC1 overall is recorded as a liability, offshore mitigation purchases will be included in:
    - fiscal forecasts (when future purchases are sufficiently certain and quantifiable, as discussed above), and
    - the Government's financial statements (when purchases are actually made).

35. The accounting treatment of offshore mitigation in these publications is not yet settled, and purchases could be classified in several different ways. For instance, offshore mitigation purchases could be classified as an expense, the purchase of an asset, or (if a liability has been recorded by that stage) a decrease in the NDC1 liability.

36. One important factor is whether New Zealand can onsell offshore mitigation that it has purchased. The Paris Agreement allows for onselling, but individual purchase agreements could contain their own restrictions. However, we understand from the Ministry for the Environment that none of our negotiating partners are currently requesting this, so it is likely that units will be able to be onsold.

37. Table 4 below considers several possible accounting classifications for offshore mitigation purchases. It also explores the potential impact of onselling restrictions, and the impact of whether or not NDC1 is treated a liability (this analysis is illustrative only).

Table 4: Possible accounting classifications for offshore mitigation purchases

Conditions	**Offshore mitigation classification**	**Explanation**
The purchase agreement **prohibits** onselling. NDC1 **has** been recognised as a liability.	Decrease in the NDC1 liability (revenue- and expense-neutral)	Because a liability and an expense (and consequently the impact on OBEGAL) had already been recognised, the purchase of offshore mitigation causes that liability to decrease (as it contributes towards settling the NDC1 obligation). Cash also decreases, meaning the event is revenue- and expense-neutral. OBEGAL is unaffected.
The purchase agreement **prohibits** onselling. **No** NDC1 liability has been recognised.	Operational expenses	Because onselling of the offshore mitigation is prohibited, the purchase cannot be treated as an asset. The means it is treated as an operational expense. OBEGAL is negatively affected.
The purchase agreement **allows** onselling.	Asset purchases	Since the offshore mitigation can be onsold, it will be classified as an “asset” for the Crown

	(capital expenditure)	until it is “cancelled” to count it towards our NDC1 commitment. This would be the case regardless of whether an NDC1 liability had been recognised at that point or not. Because revenue and operating expenses are unchanged, OBEGAL is unaffected by the purchase of the offshore mitigation. Rather OBEGAL is impacted when the offshore mitigation units are required to be cancelled.

Next steps

38. We will continue monitoring developments in this area, and will advise you ahead of any Cabinet decisions that have accounting implications.

Annex One: Recent developments from the International Financial Reporting Interpretations Committee

The International Financial Reporting Interpretations Committee has recently released a draft decision on the treatment of climate commitments

The International Financial Reporting Interpretations Committee (IFRIC) is a body that seeks to maintain and support the consistent application of IFRS Accounting Standards, by responding to questions about their application. Because of is authoritative nature, IFRIC decisions impact on accounting treatments globally.

IFRIC is currently in the process of responding to a question about a zero carbon commitment by a private manufacturing company. It recently released a draft decision, stating that:

- Whether a constructive obligation exists will depend on the facts and circumstances of the case.
- If a constructive obligation exists, a present obligation is not triggered when an entity publicly states its commitment to a climate change target.
- Instead, it is triggered when the entity emits in excess of the volume that its commitment allows. This only applies if:
    - the other criteria for a constructive obligation have also been met, and
    - the entity has committed to offset that excess.
- At that point, the entity has a present obligation to retire the carbon credits required to offset those emissions.

IFRIC's draft decision was based on a hypothetical involving a private company. However, it will likely be analogised to the public sector and therefore apply to the Government.

The decision will not immediately impact the accounting treatment of NDC1

As explained in this report, our judgement is that the constructive obligation test has not currently been met for NDC1. This means that, under current circumstances, no liability will accrue even once New Zealand begins emitting in excess of its allowed volume under NDC1.

However, this would change if or when the conditions for a constructive obligation were met in future. In those circumstances, the IFRIC decision would mean that an expense and a liability would accrue as emissions are emitted in excess of the allowed volume under NDC1.

Annex Two: The Climate Economic and Fiscal Assessment 2023

The Treasury published the "Climate Economic and Fiscal Assessment" (CEFA) in 2023, which provides illustrative estimates of the fiscal cost of offshore mitigation purchases required to achieve NDC1.[5] The CEFA's illustrative estimates are calculated by multiplying the required purchase volume by an assumed purchase price in each year.

Volume scenarios

The volume of required offshore mitigation purchases to achieve NDC1 will be the difference between New Zealand's domestic net emissions and its allowed emissions under NDC1.

The CEFA considers three volume scenarios based on potential pathways for domestic emissions:

Volume scenario	Source
1. Emissions under current policies	MfE's baseline projection under current policies for domestic emissions
2. Meeting domestic emissions budgets	New Zealand's three published emissions budgets
3. 'Lower-emission' projection under current policies	MfE's 'lower-emission' projection under current policies

Price scenarios

Future prices for offshore mitigation are uncertain because these opportunities are still being developed, with many international carbon markets still relatively immature. Prices will also vary across different types of mitigation sources and locations.

The CEFA analysis considered three different per-tonne purchase price scenarios:

Price scenario	Source
1. Purchase price from emerging and developing economies	International Energy Agency's (IEA's) 2022 World Energy Outlook (assumes a scenario of high global climate ambition)
2. Average of current market prices	Current market price for four selected offshore Emissions Trading Schemes
3. Purchase price from advanced economies	International Energy Agency's (IEA's) 2022 World Energy Outlook (assumes a scenario of high global climate ambition)

[5] The Treasury and the Ministry for the Environment: Ngā Kōrero Āhuarangi Me Te Ōhanga Climate Economic and Fiscal Assessment 2023, p 86.

The CEFA's illustrative scenarios of the cost of offshore mitigation range from $3.3 billion to $23.7 billion

The illustrative scenarios vary substantially, with costs ranging from $3.3 billion to $23.7 billion. Variation is primarily driven by high uncertainty around the per-tonne costs of offshore mitigation.

Table 5: The CEFA's estimated fiscal costs of offshore mitigation purchases required to achieve NDC1[6]

		Price scenarios		
		Purchase price from emerging and developing economies	**Average of current market prices**	**Purchase price from advanced economies**
Volume scenarios	**Emissions under current policies**	$4.2 billion	$9.9 billion	$23.7 billion
	Meeting domestic emissions budgets	$3.7 billion	$8.6 billion	$20.6 billion
	'Lower-emission' projection under current policies	$3.3 billion	$7.7 billion	$18.3 billion

There is high uncertainty around the CEFA's estimates

The CEFA's estimates rely on significant assumptions and are grounded in a range of uncertainties. The estimates provided above should therefore be treated as highly illustrative and not as forecasts or projections. The total cost of offshore mitigation purchases towards NDC1 will depend on many factors, including:

- domestic policy decisions,
- the broader international context,
- decisions around what sources of offshore mitigation New Zealand ultimately procures,
- the timing of New Zealand's offshore mitigation purchases over the NDC1 period,
- policy choices about the balance of domestic versus offshore action.

[6] The Treasury and the Ministry for the Environment: Ngā Kōrero Āhuarangi Me Te Ōhanga Climate Economic and Fiscal Assessment 2023, p 86.