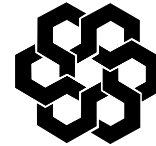

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **12 December 2007, London**

Project: **Accounting for Emissions Trading Schemes**

Subject: **Agenda Priority Decision (Agenda Paper 5B)**

INTRODUCTION

1 At its December meeting, the Board will consider agenda proposals for projects on common control transactions, intangible assets and management commentary. Given the length of time that work on the Board's project on the accounting for emissions trading schemes has been deferred, the staff thinks that it is appropriate to also consider whether the Board's limited resources should be applied in re-activating the project or whether the resources should be applied elsewhere.

2 To assist the Board in determining the priority of the emissions project, this paper outlines:

a developments since the project was added to the agenda; and

b the proposed project scope and project plan.

DEVELOPMENTS SINCE THE PROJECT WAS ADDED TO THE AGENDA

3 The Board added a project to its agenda to address the accounting for emissions trading schemes in September 2005. For your reference, Agenda Paper 5B(i)

reproduces that agenda proposal. The Board decided to address the topic of emissions trading to fill the void in accounting guidance left by its withdrawal of IFRIC 3 *Emission Rights* in June 2005. In addition, it concluded that the topic should be addressed in a more comprehensive fashion than was available to the IFRIC.

4 This section summarises developments both in practice and in Board discussions since the project was added to the agenda.

International relevance and pervasiveness

5 The use of, and interest in, emissions trading schemes continues to grow worldwide. Since the agenda proposal was written, several jurisdictions have implemented emissions trading schemes and others are currently considering schemes. For example:

a In June 2007, Prime Minister John Howard announced that Australia will introduce a 'cap and trade' emissions trading scheme, beginning no later than 2012.

b The New Zealand government has decided in principle to adopt an emissions trading scheme that will be implemented in stages, beginning in 2008 with forestry and continuing through 2013 for other sectors.

c The province of Alberta, Canada implemented a regulated greenhouse gas emissions trading system in July 2007.

6 The EU started its cap and trade emission trading scheme (the EU ETS) in January 2005. The initial phase of the scheme will end in December 2007. It has been regarded as a trial phase before the first official Kyoto Protocol phase (Phase II of the EU ETS), which will be for the period 2008-2012.[1]

[1] The Kyoto Protocol is a 1997 international agreement under which most developed countries agreed to legally binding targets that will reduce emissions of the six main greenhouse gases by at least 5% below 1990 levels over the period 2008-2012. See paragraphs A13-A19 of Agenda Paper 5B(i) for more information on the Kyoto Protocol.

7 A strong global carbon market developed in response to the emergence of emissions trading schemes. The World Bank stated that the market tripled from 7.9 billion USD in 2005 to 24.4 billion USD in 2006.[2]

8 However, an over-allocation of EU ETS allowances caused a collapse in their market value in 2006. The European Commission expects to resolve this issue in Phase II by adjusting the caps on the basis of the actual emissions data from the first phase. Of the first ten Phase II proposals submitted by Member States, the European Commission reduced the allowances by almost 7 per cent below the emissions proposed by the Member States and by 7 per cent below 2005 emissions.[3]

9 The European Commission is reviewing the results of the first phase to develop recommendations for the scheme from 2013 and beyond. It is our understanding that the scheme will continue; however it is unclear what changes will be implemented.

10 At the November 2007 SAC meeting, several Council members noted that the development of emission schemes is ongoing and questioned the appropriate timing for the Board to consider developing accounting guidance on emissions trading. That is to say, should the Board fill the void in accounting guidance now, before more schemes are developed and implemented, to stop the diversity in practice from spreading? Or would it be better for the Board to allow a period of time for the schemes and markets to develop before beginning work on the topic to ensure that all relevant issues have been identified?

11 The staff agrees that this is an important question for the Board to consider. Nonetheless, the staff thinks that many of the fundamental questions that the Board will have to answer in the project (eg if an entity receives allowances from government free of charge, should it recognise an asset and, if so, what is the corresponding entry) likely will not change as emissions schemes and markets develop. Furthermore, it has been five years since the IFRIC started to debate the topic and the EU scheme can no longer be considered to be a trial scheme.

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[2] http://edition.cnn.com/2007/WORLD/americas/09/26/brazil.carbon.ap/index.html
[3] http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1650&format=HTML&aged=0&language=EN&guiLanguage=en

Diversity in practice

12 As predicted in the agenda proposal, it appears that considerable diversity in accounting for emissions trading schemes has arisen in the absence of authoritative guidance. A recent survey by PwC and the International Emissions Trading Association (IETA) identified as many as fifteen variations of accounting for emissions being used in practice for the EU ETS.[4] It is our understanding that, in the absence of authoritative guidance, the Big Four consider several accounting approaches to be acceptable.

13 The following table outlines the main approaches that are being accepted in practice:

[4] See 'Trouble-entry accounting: Uncertainty in accounting for the EU Emissions Trading Scheme and Certified Emission Reductions.' Available at http://www.pwc.com/extweb/pwcpublications.nsf/docid/1F735507C57DEE2A802572E3004609CE.

	Approach 1	Approach 2	Approach 3
Initial recognition – *Allocated* allowances	Recognise and measure at **market value** at date of issue; corresponding entry to government grant.		Recognise and measure at cost, which for granted allowances is **nil**.
Initial recognition – *Purchased* allowances	Recognise and measure at **cost**.		
Subsequent treatment of allowances	Allowances are subsequently measured at **cost or market value**, subject to review for impairment.		Allowances are subsequently measured at **cost**, subject to review for impairment.
Subsequent treatment of government grant	Government grant **amortised** on a systematic and rational basis **over compliance period**.		Not applicable.
Recognition of liability	Recognise liability when incurred (ie as emissions are produced).		Recognise liability when incurred (ie as emissions are produced). However, the way in which the liability is measured (see below) means that often no liability is shown in the statement of financial position until emissions produced exceed allowances allocated to entity.
Measurement of liability	Liability is measured based on the **market value** of allowances at each period end that would be required to cover actual emissions, regardless of whether the allowances are on hand or would be purchased from the market.	Liability is measured based on: the **carrying amount** of **allowances on hand** at each period end to be used to cover actual emissions (ie market value at date of recognition if cost model is used; market value at date of revaluation if revaluation model is used) on either a FIFO or weighted average basis; *plus* the **market value** of allowances at each period end that would be required to cover any **excess emissions** (ie actual emissions in excess of allowances on hand).	Liability is measured based on: the **carrying amount** of **allowances on hand** at each period end to be used to cover actual emissions (nil or cost) on a FIFO or weighted average basis; *plus* the **market value** of allowances at each period end that would be required to cover any **excess emissions** (ie actual emissions in excess of allowances on hand).

14 76% of respondents to the PwC/IETA survey recognise granted allowances at nil value (Approach 3). It appears that very few preparers are using Approach 1, which is the IFRIC 3 model.

15 As demonstrated in the table, the financial statement effects of an entity's participation in an emissions trading scheme can vary significantly depending on which approach is used.

a Under Approach 1 (the IFRIC 3 model), income from the government grant (ie the market value of the allocated allowances at the date of issue) and an expense

for emissions are recognised in profit or loss. In addition, the emissions liability is re-measured at each reporting date to reflect changes in the market value of the allowances, with changes recognised in profit or loss. If an entity chooses to re-measure its emissions allowances, the change in the market value of those allowances will also be recognised, but principally in other comprehensive income. This causes an accounting mismatch in profit or loss.

b Approaches 2 and 3 result in the same net effect on profit or loss if an entity chooses the cost model for its allowances and its emissions equal or exceed the allowances granted. In such cases, the net effect on profit or loss is the market value of any emissions in excess of the allowances allocated to the entity (or the cost of any allowances purchased by the entity). However, under Approach 2, entities recognise both income from the government grant (ie the market value of the allocated allowances at the date of issue) and an expense for emissions. Under Approach 3, entities recognise no income and will recognise an expense only if emissions exceed the number of allowances allocated to the entity. This means that if an entity was granted exactly the number of allowances it needs to cover its emissions, nothing would be recognised in profit or loss.

c Although the net profit or loss effect under Approaches 2 and 3 might be the same, the statements of financial position will look completely different. Under Approach 2 (and Approach 1), both the emissions allowances and the emissions liability will be shown in the statement of financial position. However, under Approach 3, an asset is recognised only for allowances purchased by the entity (even though those allowances are identical to those that were allocated to the entity) and a liability will be recognised only if emissions exceed the allowances allocated to the entity.

16 Despite this diversity in accounting treatment, the Board should note that at the November ARG meeting, most ARG members indicated that emissions is not an issue that would be a priority for them. In response the staff notes that the differences between the approaches outlined above for the EU ETS may have been less visible recently because of the low market prices for emissions allowances (the prices have fallen to less than €1/allowance after reaching a high of nearly €30/allowance in April 2006). However, the staff expects the differences to become more visible moving

forward because, as noted in paragraph 8, the problem of over-allocation should be corrected in Phase II of the scheme.

Requests from national standard setters

17 In the absence of guidance in IFRSs, some standard setters in jurisdictions implementing emissions trading schemes are receiving enquiries on the appropriate accounting. Several national standard setters have asked us to re-activate work on emissions, noting that if we do not address the issue, they will feel pressure to develop their own guidance. Hence, if we do not take a lead on this issue, there is a risk of diversity in accounting guidance.

18 In addition, the staff thinks that the Board gave a clear signal to the marketplace that it would address the topic when it withdrew IFRIC 3. We are not aware of any developments in the marketplace that would allow the Board not to fill the void created by the withdrawal of IFRIC 3.

Possibility of increasing convergence

19 In February 2007 the FASB added a project to its agenda to provide comprehensive accounting guidance for participants in emissions trading programs. The FASB has not yet deliberated any issues, but the FASB staff is currently researching the topic.

20 In March 2007 the FASB also added a project to its agenda to provide guidance on whether ARB No. 43 *Restatement and Revision of Accounting Research Bulletins* should be amended to require fair value accounting for certain non-financial assets, including traded emissions allowances. The FASB began deliberating this project in September by discussing the definition of trading.

21 In the staff's view, it would be a missed opportunity if the FASB moves ahead with its work on emissions and the IASB does not re-activate the project. Working on the project at the same time as the FASB would provide us with an opportunity to share ideas and monitor each other's discussions. As a result, the Boards would be aware of any potential differences in thinking and would be in a better position to discuss the issues and to try to develop converged guidance. If the Board decides to re-activate the project, we will consider how best to coordinate our efforts with the FASB.

Board developments

22 In February 2006 the Board reviewed the status of its project to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. The Board had previously rejected a proposal to simply withdraw IAS 20 and, instead, had decided to replace the model in IAS 20 with that contained in IAS 41 *Agriculture* for grants relating to biological assets measured at fair value. However, in February 2006, the Board noted some concerns about the conceptual basis of the IAS 41 model, particularly in its treatment of conditional grants. The Board also noted that its work in other projects, in particular its project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, might yield insights into the appropriate treatment of obligations arising in conditional grants and, hence, enable it to develop a more robust model for accounting for government grants. Accordingly, the Board decided to defer work on the IAS 20 project until further progress was made on those projects. Appendix A provides more information about the IAS 20 project and the Board's decision to defer it.

23 In the agenda proposal for the emissions trading project, the staff highlighted the interaction with the IAS 20 project. In a cap and trade scheme, an overall cap is set on the amount of emissions that can be released in a specified compliance period. Under most schemes (eg EU ETS) this cap is allocated to entities participating in the scheme on the basis of either past emissions or projected future emissions. Allowances to emit are issued free of charge by government to entities up to the level of the cap. The issue of allowances by government satisfies the definition of a government grant in IAS 20, namely 'assistance provided by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity…'.

24 It is expected that a gradually increasing proportion of allowances will be auctioned, rather than issued by government for free. This is expected to be a more effective way of reducing total emissions because it would encourage entities to make the easiest reductions in emissions first. However, moving to an auction system too quickly might be counter-productive because entities might simply pass on the costs to consumers rather than implement carbon-reduction programmes. Therefore it is

25 Therefore, one of the major questions that must be answered in the emissions project is how an entity should account for any allowances that it receives from government for less than fair value. Put simply, the issue is that the government has given entities a valuable resource for which there is an active market. If this resource meets the definition of an asset and is recognised as such, then we need to decide on the corresponding accounting entry. When the Board added the emissions project to the agenda, it noted that it was already considering that question more generally in the IAS 20 project. Therefore, the Board decided that work on the projects should be conducted concurrently. As a result, when the Board decided to defer the IAS 20 project, it also decided to defer the emissions project.

PROPOSED PROJECT SCOPE AND PROJECT PLAN

26 The staff recommends that the scope of the project be limited to the accounting for emissions trading schemes. We would focus our efforts on developing the appropriate requirements for emissions trading schemes without broadly reconsidering the accounting for government grants. That means that work on the IAS 20 project would not be re-activated at this time.

27 The staff believes that it would be beneficial to keep the scope of the project narrow in order to develop guidance on emissions trading schemes as quickly as possible. Given the growth in the number of emissions trading schemes worldwide and the diversity in practice, there seems to be a greater need for guidance on emissions than for amendments to IAS 20 at this time.

28 Obviously there are links to the IAS 20 project. However, the staff notes that grants of emissions allowances by government for less than fair value are a unique subset of government grants in that they involve the government restricting and hence putting a price on an activity that entities could previously do for free. The staff believes that it might be possible to address the accounting for emissions trading schemes without addressing all of the issues that arise in the IAS 20 project. If we discover that this is not the case, we can broaden the scope of the project at that time.

29 Note that the staff is not recommending at this stage to take the IAS 20 project off the agenda. Nor are we saying that we would continue using IAS 20 in accounting for emissions schemes. Rather we are simply saying that in the first instance we would like to focus on the issues that arise in emissions schemes without having to address the issues that arise in the whole array of government grants.

30 Appendix B provides further details about the factors that the staff considered in reaching a recommendation on the project scope.

31 The staff also notes that the project would be limited to the accounting for the allowances and obligations that arise in emissions trading schemes. The project would not involve developing reporting requirements related to corporate social responsibility in a broader context (eg standardising carbon footprint reporting).

32 If the Board agrees with the staff recommendation, the staff proposes the following project plan:

- a The project would seek to develop principles that can be applied broadly to emissions trading schemes, rather than focusing on a particular type of scheme (eg EU ETS). Accordingly, the staff's first step would be to research the schemes that have been, or are being, developed to identify the breadth of issues that we would need to address. This research would likely culminate with an education session to the Board (in conjunction with scheme experts).

- b The staff would then likely take a comprehensive package to the Board that outlines the alternative models that could be used to account for emissions trading schemes. The staff believes that this would be the best approach because many of the issues cannot be addressed in isolation—ie the decisions on one issue will likely have implications for the other issues. In addition, given the past experience with IFRIC 3, the staff believes that it is especially important to consider the overall financial reporting effects of the alternative models, rather than to address each issue on a standalone basis.

- c The package would describe the alternative models by exploring the following issues:

i Are emissions allowances assets? Is this conclusion affected by how the allowance is acquired? What is the nature of the allowance (eg licence to emit or form of emission currency)? If allowances are assets, should they be recognised and, if so, how should they be measured initially?

ii What is the corresponding entry for an entity that receives allowances from government free of charge? Does a liability exist? If so, what is the nature of the liability and how should it be measured both initially and subsequently? This will include a consideration of all of the schemes identified in the staff's initial research.

iii How should allowances be accounted for subsequently? Would the existing models in IAS 38 or IAS 39 be appropriate for the allowances? If not, what is the appropriate accounting?

iv When should an entity recognise its obligations in emissions trading schemes and how should they be measured? How does IAS 37 apply?

QUESTIONS FOR THE BOARD

Q1 Does the Board want to re-activate work on the emissions trading schemes project?

Q2 If so, does the Board agree with the staff's proposed scope of the project and project plan?

APPENDIX A—IAS 20 PROJECT BACKGROUND

ADDING IAS 20 TO THE AGENDA

A1 The Board decided to undertake a project to amend IAS 20 for the following reasons.

a. IAS 20 can result in accounting that is inconsistent with the *Framework*. This is because IAS 20 matches the income from a grant with the expense it is intended to compensate. This can result in the recognition of a deferred credit when there is no present obligation, and thus no liability.

b. IAS 20 has a number of options creating inconsistency in accounting treatment. For example, an entity has the ability to deduct a grant from the carrying amount of the asset purchased in relation to that grant. Another option is to recognise at nil or nominal amounts non-monetary grants received. These options create inconsistent accounting between entities decreasing the comparability of financial statements and can result in an understatement of resources controlled by the entity.

c. Retaining IAS 20 would require some jurisdictions (eg Australia and New Zealand) on first adopting IFRSs to apply accounting that is less consistent with the *Framework* than the accounting they were previously using.

d. IAS 20 is inconsistent with more recent pronouncements from other national standard setting bodies that themselves are more consistent with the current *Framework* - specifically SFAS 116 *Accounting for Contributions Received and Contributions Made* (SFAS 116)[5] and UIG Abstract 11 *Accounting for Contributions of, or Contributions for the Acquisition of Non-current Assets* (UIG 11).

[5] US GAAP does not have a specific standard on accounting for government grants by business entities because SFAS 116 excludes government grants to business entities from its scope. However, SFAS 116 provides an accounting model for non-reciprocal transfers which the staff believes is relevant when examining accounting for government grants.

DECIDING TO USE THE IAS 41 MODEL

A2 In February 2004, the Board decided to replace the recognition requirements of IAS 20 with those contained in IAS 41 *Agriculture* that apply to government grants related to biological assets measured at fair value less estimated point-of-sale costs and grants that require entities not to engage in specified agricultural activity. IAS 41 requires an unconditional grant related to a biological asset measured at its fair value less estimated point-of-sale costs to be recognised as income when the government grant becomes receivable. If a government grant is conditional, including where a government grant requires an entity not to engage in specified agricultural activity, an entity recognises the government grant as income when the conditions attaching to the government grant are met.

A3 The Board decided to amend IAS 20 using the IAS 41 model for the following reasons:

a. Development of a new model from first principles needed to wait until further progress had been made in the Revenue Recognition project. This was because the Board concluded that its thinking in the Revenue Recognition project would be relevant in developing a new model for government grants (indeed, it was thought possible that non-reciprocal transfers might be in the scope of the project).

b. The only options therefore available to the Board were to withdraw IAS 20 or adopt an existing model.

c. The Board did not believe withdrawing IAS 20 was a viable option.

d. The IAS 41 model is an available alternative government grant model.

e. The IAS 41 model is considered superior to IAS 20 because it is more consistent with the *Framework* and other national standards. Using the IAS 41 model would mean all government grants would be treated consistently in IFRS. It would also eliminate most of the options in IAS 20 thereby enhancing consistency of accounting treatment.

A4 The Board decided that the scope of the project should be limited to deleting parts of IAS 20 and replacing them with appropriate paragraphs from IAS 41. The project would not, for example, reconsider the definition of a government grant and how a grant should be distinguished from an exchange transaction with the government. The Board acknowledged that the resulting standard would be a temporary solution and that at some point it would need to consider the topic of non-reciprocal transfers from first principles. However, the Board believed further work on a more appropriate model should not be completed at that time.

CONCERNS ABOUT THE IAS 41 MODEL

A5 With no staff resources specifically dedicated to the project, momentum to see through the initial objective was lost. But the Board discussed an early draft of the revised IAS 20 in July 2004 and concluded that the limited recognition requirements in IAS 41 would need to be expanded. In particular, the Board decided that it would need to clarify the distinction between a conditional and an unconditional government grant, because conditionality determines recognition of the grant in income in IAS 41.

A6 In February 2006 the Board reviewed the status of the IAS 20 project. The staff presented the following concerns about introducing the IAS 41 model:

a. IAS 41 provides recognition guidance only about income. The recognition of a conditional grant in profit or loss depends on the occurrence of a critical event—the satisfaction of the condition. IAS 41 is silent about the nature and treatment of assets and liabilities arising from a government grant.

b. The staff noted that their preliminary thinking was that conditional government grants give rise to a form of performance obligation—the obligation for the entity to do what is required under the terms of the grant to become unconditionally entitled to retain the grant. The staff noted that in some cases, measuring this performance obligation at the amount of the granted asset—which in essence is the IAS 41 model—might not be a reasonable proxy for an independent measure of the performance obligation. In other cases, the effect of the IAS 41 model is an almost perpetual deferral of income.

A7 The staff noted that the IAS 41 income recognition model could be refined to deal with the issues identified, eg by importing some of the additional guidance from SFAS 116 relating to conditional contributions and specifying that a conditional grant should be regarded as unconditional if the possibility that the condition will not be met is remote and that a condition is met when it is substantially satisfied. However, the staff observed that such guidance might appear inconsistent with the direction that the Board was going in the Revenue Recognition project and the IAS 37 project, in which the probability of future events occurring does not affect the recognition of elements but their measurement.

A8 The Board decided to defer work on the IAS 20 project until the IAS 37 project made further progress on the treatment of obligations arising in conditional grants. The Board had decided previously that the emissions project should be conducted concurrently with the IAS 20 project. Therefore, when the Board decided to defer the IAS 20 project, it also decided to defer the emissions project.

APPENDIX B—ANALYSIS OF ALTERNATIVE PROJECT SCOPE

B1 In this paper, the staff recommends that the scope of the project be limited to addressing the accounting for emissions trading schemes (paragraphs 26 to 31). This appendix outlines an alternative project scope considered by the staff and the factors considered in recommending a narrow project scope.

ALTERNATIVE PROJECT SCOPE

B2 The staff considered an alternative project scope which would be to re-activate work on both the emissions project and the IAS 20 project. There are obvious links between the projects. One of the major questions that must be answered in the emissions project is how an entity should account for any allowances that it receives from government for less than fair value.

B3 Under the alternative project scope, the Board would address the accounting for emissions trading schemes concurrently with its work on amending IAS 20. This was the Board's original plan when it added the emissions project to its agenda.

B4 When the Board deferred the IAS 20 project in February 2006, it indicated a preference to address IAS 20 properly, rather than by doing a quick fix (eg importing IAS 41 into IAS 20). Given the length of time that the IAS 20 project has been on the agenda, the staff considers that we are beyond the timeframe for quick fixes and that we should reconsider government grants from first principles.

B5 The main questions that would have to be answered in the IAS 20 project are whether the receipt of a government grant creates a liability, what the nature of that liability is, and how the liability should be measured. The staff notes that similar questions will have to be answered in the emissions project (see paragraph 31). However, the alternative project scope would involve considering all forms of government grants, not only those that arise in emissions trading schemes. This is likely to raise additional issues for the Board to address. For example, the Board would have to consider the following situations:

a. A grant conditional on an entity refraining from farming its land for five years. What is the nature of the obligation? Is it a performance obligation or a refund obligation? What is the appropriate measurement of the obligation? Some might argue that the entity has a liability for the full amount of the grant; whilst others might argue that does not faithfully depict the entity's obligation. Still others might argue that the entity should recognise an impairment of the land.

b. A grant of CU5m given to a university which must be used to rent a certain lecture theatre for five years. To retain the grant the university must use the building for the purpose of education and the cost of maintenance must be borne by the university. If the conditions are not met at any time during the next five years, the university must return the full amount of the grant. The university estimates the cost to use and maintain the building is CU100,000 a year. Should the liability be measured at CU5m until the end of the five year period when the entity has fully extinguished its obligations? Some would argue the measurement of the performance obligation (the use and maintenance of the building) based on the cost each year of CU100,000 would more faithfully represent the entity's obligation.

c. A grant of a building that has a condition requiring the building to be used for a specified purpose perpetually. Does that condition trigger the recognition of a liability with perpetual deferral of income because the condition is never satisfied?

STAFF ANALYSIS

B6 This section outlines the factors that the staff considered in recommending a narrow scope for the emissions project. There are advantages and disadvantages of both project scopes, but on balance, the staff believes that a narrow project scope is the best way to meet the objective of providing guidance on emissions trading schemes.

Technical feasibility

B7 One of the reasons that the Board deferred work on the IAS 20 project was that it thought that work in other projects, in particular the IAS 37 project, might yield insights into the appropriate treatment of obligations arising in conditional grants and, hence, enable it to develop a more robust model for accounting for government grants.

B8 Accordingly, an appropriate question to ask is whether enough progress has been made in other projects to re-activate work on IAS 20. Can we develop at this time a comprehensive model for accounting for conditional grants in IAS 20 that would gain broad Board acceptance?

B9 The staff acknowledges that the IAS 37 project team and Board have made significant progress on identifying the existence of present obligations and measuring those obligations. However, it is unclear whether enough progress has been made to address the situations described in paragraph B5. We note, for instance, that when situation (a) came up in a conceptual framework discussion, Board members expressed very different views.

B10 The staff believes that it might be possible to address emissions trading schemes without addressing all of the difficult issues that arise in government grants. This would allow further progress to be made in the IAS 37 and conceptual framework projects before re-activating work on the IAS 20 project. If after conducting additional research we discover that we cannot address the accounting for emissions trading schemes without addressing most of the issues that would arise in the IAS 20 project, we can always broaden the scope of the project at that stage.

Project timeframe/urgency

B11 Given the nature of the questions that would arise in the IAS 20 project and the different views expressed in previous related Board discussions, the staff believes that amending IAS 20 would be a medium to long-term project.

B12 We will likely be able to finalise guidance on emissions more quickly as a standalone project than if we also try to address IAS 20 comprehensively. Given the increasing number of emissions trading schemes, the existence of

B13 One of the major reasons for the IAS 20 project was to improve the accounting for government grants so that entities in some jurisdictions that were adopting IFRSs did not have to apply requirements that were *less* consistent with the *Framework* than their previous national GAAP. However, given the delay in the project, many of those jurisdictions have already had to adopt IAS 20. This might make the IAS 20 project less urgent.

Risk of developing different models

B14 Developing guidance for emissions without broadly addressing government grants creates a risk that any future amendments to IAS 20 might conflict with the emissions guidance. This might result in the emissions guidance being consequentially amended as part of the IAS 20 project, which would require entities to make two sets of changes to their accounting for emissions trading schemes.

B15 In addition, depending on the guidance that was developed in the emissions project, we might end up with three models of accounting for government grants—IAS 20, IAS 41 and the requirements for emissions.

Need to amend IAS 20

B16 Not re-activating work on the IAS 20 project leaves in place a standard which is inconsistent with the *Framework* and results in a lack of comparability and an understatement of the resources that an entity controls (see paragraph A1 of Appendix A).

Output of project

B17 The original emissions project plan envisaged amending existing standards, rather than issuing a standalone standard on emissions. However, if we decide not to address government grants comprehensively, it might be

necessary to issue a standalone standard on emissions because grants of emissions allowances would very likely be scoped out of IAS 20. We understand that the Board has previously indicated that it prefers not to issue standards addressing specific topics or industries.

Convergence

B18 As noted above, the FASB does not have a standard on the accounting for government grants. Therefore the scope of the FASB project will be limited to the accounting for emissions trading schemes. Having similar project scopes would likely make it easier to co-ordinate efforts with the FASB on the project.

Memorandum of Understanding implications

B19 The staff notes that the IAS 20 project is part of the short-term convergence projects in the MoU. However, this is an unusual convergence project because there is no US standard that covers the accounting for government grants for business entities. SFAS 116 provides an accounting model for non-reciprocal transfers but excludes from its scope government grants for business entities, ie the subject matter of IAS 20.

B20 The staff believes that the MoU should not be a barrier to choosing a narrow scope for the emissions project. The roadmap indicates that the goal of short-term convergence is to reach a conclusion (by 2008) about *whether* existing major differences in a few focused areas (including government grants) should be eliminated through one or more short-term standard-setting projects and, *if so*, complete or substantially complete work in those area. Therefore, the MoU objective could be satisfied by stating that it is not appropriate to address government grants in a **short-term** convergence project.