30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at the Analyst Representative Group meeting, to assist them in following the discussions. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff papers prepared for the ARG meeting. Paragraph numbers correspond to paragraph numbers used in the ARG agenda paper.

INFORMATION FOR OBSERVERS

ARG Meeting: **November 2007, London**

Project: **Accounting for Emissions Trading Schemes**
(Agenda Paper 5)

INTRODUCTION

1 At the December Board meeting, the Board will consider whether it should re-activate its project on emissions trading schemes or whether its resources should be applied elsewhere (eg on potential new projects on common control transactions, intangible assets and management commentary). In making this decision, the Board will consider the consequences of not addressing the topic. The purpose of this discussion is to get your feedback on whether the diversity in practice in accounting for emissions trading schemes is an issue for you.

BACKGROUND

2 Many jurisdictions have implemented, or are in the process of implementing, emissions trading schemes—schemes designed to achieve a reduction in greenhouse gases through the use of tradeable emission permits. Such schemes are an integral part of the Kyoto Protocol, the 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.

3 The theory behind emissions trading relies on the creation of value through the allocation of a right to emit pollutants. For example, in a cap and trade scheme, a central authority (eg government) sets an overall cap on the amount of emissions that can be released in a specified compliance period. This cap is then allocated to entities by distributing 'allowances to emit', each allowance granting a right to emit one tonne of CO_2 (or other greenhouse gas). Under most schemes, governments currently issue allowances to emit free of charge to entities up to the level of the cap. The cap will normally be below actual levels of emissions currently being made by entities, creating scarcity. This scarcity creates value for the holders of such rights.

4 Allowances can be traded. Accordingly, an entity that has excess allowances (ie allowances in excess of its actual or anticipated emissions) from reducing its emissions will sell its allowances to another entity that requires allowances because of growth in emissions or an inability to make cost-effective reductions in emissions.

5 In September 2005 the Board added a project to its agenda to address the accounting for emissions trading schemes. The project was meant to address the topic of emissions trading to fill the void in accounting guidance left by the withdrawal of IFRIC 3 *Emission Rights* in June 2005. In addition, the Board thought that the topic should be addressed in a more comprehensive fashion than was available to the IFRIC. The Board also decided that the emissions project should be conducted concurrently with the project to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

6 In February 2006 the Board decided to defer work on the IAS 20 project until it had made further progress on the treatment of obligations arising in conditional grants in its project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. When the Board decided to defer the IAS 20 project, it also decided to defer the emissions project.

DIVERSITY IN PRACTICE

7 It appears that there is considerable diversity in accounting for emissions trading schemes 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's cap and trade emission trading scheme.[1] It is our understanding that, in the absence of authoritative guidance, the Big Four consider several accounting approaches to be acceptable.

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

[1] 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 at **market value** at date of issue; corresponding entry to government grant.		Recognise at cost, which for granted allowances is **nil**.
Initial recognition – *Purchased* allowances	Recognise at **cost**.		
Subsequent treatment of allowances	Allowances are subsequently held at **cost or market value**, subject to review for impairment.		Allowances are subsequently held 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 on hand.
Measurement of liability	Re-measure liability at each period end. Liability is measured based on the **market value** of allowances at each period end, regardless of whether the allowances are on hand or would be purchased from the market.	Re-measure liability at each period end. For **allowances on hand**, re-measure to **carrying amount** of those allowances (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. A liability relating to any **excess emissions** would be re-measured at the **market value** at the period end.	Re-measure liability at each period end. For **allowances on hand**, at the **carrying amount** of those allowances (nil or cost) on a FIFO or weighted average basis. A liability relating to any **excess emissions** would be re-measured at the **market value** at the period end.

9 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 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 for the market value of the government grant and an expense for the emissions liability. Under Approach 3, entities 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, a liability will be recognised only if emissions exceed the allowances that an entity has on hand.

QUESTIONS FOR THE ARG

Q1 Is the diversity in practice in accounting for emissions trading schemes an issue for you?

Q2 Are companies disclosing enough information for you to be able to identify their accounting policies for emissions trading schemes? What additional information would be useful?