Project	**Emissions Trading Schemes**
Topic	**Related examples**

Purpose of the paper

1. Board members of both boards, at several occasions, have noted that the accounting issues in the Emissions Trading Schemes project raise cross cutting issues with other projects. Board members particularly mentioned that the decision as to whether, and when, the schemes create liabilities should be made with regard to the boards' decisions in existing IFRSs / U.S. GAAP and other projects of the boards.

2. The contentious accounting issue in emissions trading schemes is whether, and when, a future outflow that is contingent on an entity's future actions creates an obligating event. Paper 13a / memo 4a presented two alternative views as to what creates the obligating event in a voluntary emissions trading scheme:

    (a) *View 1*: A member's actual emissions create the obligating event. A member of a voluntary scheme does not incur a present obligation until it has emitted. Until emissions have occurred, the member can avoid the outflow of allowances by its future actions.

    (b) *View 2*: The membership contract creates the obligating event. A member incurs a present obligation as result of becoming a member of a scheme. As of signing the membership contract, the obligation to pay allowances is unconditional. Only the amount of allowances due under the membership contract is uncertain.

3. This paper aims at providing a broader context for the boards' discussions on the obligating event in a voluntary scheme by identifying additional examples in

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existing IFRSs / U.S. GAAP and projects of the boards. The examples support either View 1 or View 2. The list of examples is not meant to be exhaustive. Rather, the examples shall highlight some of the cross cutting issues.

Examples included in the paper

4. The paper includes the following examples:

   (a) future operating costs / exit or disposal costs (supports View 1) [IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, Topic 420 *Exit or Disposal Cost Obligations*]

   (b) regulatory actions (View 2) [IASB ED Rate-regulated Activities, FASB ASC Topic 980 *Regulated Operations*]

   (c) contingent rentals (View 2) [DP *Discussion Paper*]

   (d) non-compete agreement (View 1 or View 2) [Conceptual Framework project]

   (e) Contractual promise to keep an advertiser's name on a stadium (View 2) [Conceptual Framework project]

   (f) Contract to deliver future music recordings (View 2) [Conceptual Framework project]

Future operating costs / exit or disposal costs (View 1)

Topic	Reference	Application of View 1
Future operating costs	**IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*** ‘[…] no provision is recognised for costs that need to be incurred to operate in the future. […]’ [paragraph 18]	Future operating costs do not create a present obligation. Until an entity has incurred the costs, the entity can avoid the incurrence of costs by its future actions.
Exit or disposal costs	**Topic 420 *Exit or Disposal Cost Obligations* (formerly, Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*)** **25-2** Only present obligations to others are liabilities under the definition. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. An exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan; thus, an entity’s commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability.	Costs expected to be incurred under an exit or disposal plan, by itself, do not create a present obligation. Only when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets does the entity have a present obligation.

Future operating costs / exit or disposal cost obligations

5. Future operating costs or costs expected to be incurred under an exit or disposal plan are similar to the promise to pay allowances in that the related outflows are dependent on an entity’s future actions.

6. Future operating costs or costs expected to be incurred under an exit or disposal differ from a promise to pay allowances in that the related outflows do not result from a contract with a third party. That means the related outflows are not the result of an exchange transaction. On the other hand, in a voluntary scheme, the entity assumes the promise to pay allowances in exchange for the membership in the scheme and the allocation of allowances.

Regulatory actions (View 2)

Topic	Reference	Application of View 2
Regulatory liabilities	**IASB ED *Rate-regulated Activities*** 'An entity shall recognise […] a regulatory liability for its obligation to refund previously collected amounts and to pay a specified return when it has the obligation to decrease rates in future periods as a result of the actual or expected actions of the regulator.' [paragraph 8]	Regulatory actions (eg as result of previously collected amounts) create the obligating event. A regulatory action creates an unconditional obligation to refund previously collected amounts. (Depending on the circumstances, there may be uncertainty as to timing and amount of refund.)
	FASB ASC Topic 980 *Regulated Operations* [formerly FASB Statement No. 71 *Accounting for the Effects of Certain Types of Regulation*] 'A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by amortizing the gain or other reduction of net allowable costs over those future periods and reducing rates to reduce revenues in approximately the amount of the amortization. If a gain or other reduction of net allowable costs is to be amortized over future periods for rate-making purposes, the regulated enterprise shall not recognize that gain or other reduction of net allowable costs in income of the current period. Instead, it shall record it as a liability for future reductions of charges to customers that are expected to result.' [paragraph 11c]	

Regulatory liabilities

7. A regulator's action (that creates a regulatory liability) is similar to a contract in a voluntary scheme in that the associated consequences are dependent on an entity's future actions. Specifically, the consequences are dependent on an entity's conducting its regulated activities in the future.

8. A regulator's action differs from a promise to pay allowances in that the outcome of a regulator's action is less influential to an entity's future actions. This is because a regulator's action aims at refunding specified amounts to an aggregate customer base. A promise to pay allowances does not provide such a strong cause-and-effect relationship. Although there is an expectation about the amount of allowances to be paid under the contract, the entity can influence that amount by its future actions (eg by installing technologies to abate emissions).

9. A regulator's action also differs from a promise to pay allowances in that a regulator's action, typically, does not result in a (direct) outflow from resources of the entity. This is because a regulatory liability reflects a refund to a customer base via decreased future rates (and not via direct cash refunds). On the other hand, in a voluntary scheme, the promise to pay allowances results in an outflow of resources (allowances) from the entity.

Contingent rentals (View 2)

Topic	Reference	Application of View 2
Liability for contingent rentals	**Discussion Paper *Leases*** 'The boards' preliminary view is that the assets and liabilities recognised by the lessee should reflect the obligation to make contingent rental payments. The obligation to pay rentals is unconditional and hence meets the definition of a liability. Only the amount that will be paid is uncertain. […] However, some board members think that the treatment of contingent rental payments should depend on the nature of the contingency to which the payment is linked. They think that when payment is linked to usage or the performance of the lessee, the obligation to pay rentals should exclude the contingent element.' [paragraph 7.12]	The lease contract creates the obligating event. As of that point, the obligation to make payments is unconditional. Only the amount of contingent rental payments is uncertain.

Contingent rentals versus promise to pay allowances

10. A performance or usage based lease contract is similar to a contract in a voluntary scheme in that the resulting outflows are dependent on an entity's future actions. Only if the entity uses the leased item will it make lease payments under the lease contract. In a voluntary scheme, only if the entity emits will it make payments under the contract.

11. A lease contract differs from a contract in a voluntary scheme in the structure of payments. In a lease contract, the lessee typically pays cash (or cash equivalents) in exchange for the right of use. In a voluntary scheme, a member pays allowances in exchange for emitting. Importantly, allowances paid in a voluntary scheme, to a large extent, can be viewed as a payback of allowances that the member received at inception of the contract. The payment structure in a lease contract only includes payback features if the lease (a) is a sale and leaseback arrangement or (b) includes upfront payments by the lessor to the lessee (which is not typical). Participation in a voluntary scheme, to some extent, can be viewed as a sale and leaseback arrangement. When an entity

enters a voluntary scheme the entity (a) sells its ability to freely emit and (b) simultaneously leases back the right to emit. In exchange for the right to emit, the entity promises to pay one allowance for each unit of emissions. This can be seen as similar to a lease contract with performance or usage based rental payments.

Written non-compete agreement (View 1 or View 2)

<table>
<tr><th>Topic</th><th colspan="2">Reference
Conceptual Framework project</th><th>Conceptual Framework analysis supports…</th></tr>
<tr><td rowspan="4">Written non-compete agreement</td><td colspan="2">IASB AP 2
September 2009
Performance does not include avoiding actions. Covenants not to compete do not create claims. Covenants associated with debt agreements do not create claims (but of course the debt itself is a claim). Laws prohibiting certain actions do not create claims, but violating the law may create a claim by the statutory authority for a fine or remedial actions.</td><td>View 1
A breach of the non-compete agreement creates the obligating event. Until a breach occurs, no claim exists because the entity can avoid the payment of damage by its future actions.</td></tr>
<tr><td colspan="2">IASB AP 14b, FASB memo 70B
December 2007</td><td rowspan="3">View 2
The agreement not to compete creates the obligating event. As of signing the non-compete agreement, the entity has an unconditional obligation to pay damage if it breaches the non-compete agreement. The probability that the entity breaches the non-compete agreement does not affect the existence of a present obligation but affects its measurement (amount of liability may be low if probability to breach the contract is low).</td></tr>
<tr><td>IASB definition</td><td>FASB definition</td></tr>
<tr><td>A present obligation of the entity: Obligor has unconditional contractual promise.
Arising from past events: The obligation arose at the date the contract was entered into.
Settlement of which is expected to result in an outflow of [economic] resources: The obligation is to be settled by refraining from undertaking the specified business or activity, which can result in reduced cash inflows, or (if it breaches the non-compete agreement) cash outflows to obtain release from promise or to pay</td><td>Probable future sacrifices of economic benefits …to transfer assets or provide services to other entities in the future: A requirement to refrain from undertaking specified business or activity, which can result in reduced cash inflows, or (if it breaches the non-compete agreement) cash outflows to obtain release from promise or to pay damages to other party.
Arising from present obligations of a particular entity: The requirement is borne by the entity.
As a result of past transactions or</td></tr>
</table>

	damages to other party.	*events*: No different from "arising from past events" in the IASB definition.	

Non-compete agreement

12. A non-compete agreement is similar to a promise to pay allowances in that the resulting outflows are dependent on an entity's future actions. In a non-compete agreement, an entity pays damages to the counterparty if it breaches the non-compete agreement. In a voluntary scheme, an entity pays allowances to the scheme administrator if it emits.

13. A non-compete agreement differs from the promise to pay allowances in the likelihood of an outflow to the counterparty over the live of the contract. A writer of a non-compete agreement promises to refrain from undertaking an activity (ie competing). Hence, it is unlikely that the writer of the contract pays damage to the counterparty (as result of a breach of contract). A member in a voluntary scheme does *not* make a promise to refrain from undertaking an activity (ie emitting). Instead, the entity enters the scheme with the expectation that it will emit (and pay one allowance per emission). Most likely, the entity will take into consideration its expected future emissions and hence, outflows when it agrees on an allocation of allowances with the scheme administrator.

Contractual promise to keep an advertiser's name on a stadium

<table>
<tr><th>Topic</th><th colspan="2">Refeerence
Conceptual Framework project</th><th>Conceptual Framework analysis supports…</th></tr>
<tr><td rowspan="3">Stadium naming

(Contractual promise to keep an advertiser's name on a stadium for a period of five years)</td><td colspan="2">IASB AP 11d, FASB memo 74d
June 2008</td><td rowspan="3">View 2

Contractual promise to keep an advertiser's name on a stadium creates the obligating event. The obligation to permit the acquirer to name the stadium (and the obligation to provide the stadium) is unconditional. Only the amount of outflow is uncertain.</td></tr>
<tr><td>IASB definition</td><td>FASB definition</td></tr>
<tr><td>A present obligation of the entity: Unconditional contractual promise to provide benefits—which is capable of resulting in cash outflows. In order to remove the obligation an outflow of cash would probably be necessary.
Arising from past events: The obligation arose at the date the contract was entered into.
Settlement of which is expected to result in an outflow of [economic] resources: The obligation is to be settled by delivering the service of continuing to name the stadium (or repaying cash) or forgoing alternative cash inflows.</td><td>Probable future sacrifices of economic benefits …to transfer assets or provide services to other entities in the future: Delivery of service (or repayment of cash) or forgoing alternative cash inflows.
Arising from present obligations of a particular entity: The requirement is borne by the entity.
As a result of past transactions or events: No different from "arising from past events" in the IASB definition.</td></tr>
</table>

Stadium naming

14. The stadium naming example is similar to a voluntary scheme in that an entity gives up a right when it enters into the contract. In the stadium naming example, the entity gives up the right to put a name on its stadium. In a voluntary scheme, the entity gives up the right to freely emit.

15. The promise to keep an advertiser's name on the stadium differs from the promise to pay allowances in that an entity, typically, can not influence the outflows related to the stadium naming by its future actions. For example, the promisor incurs costs of installing the customer's name on the stadium and ongoing maintenance costs. In a voluntary scheme, the outflows that result from the promise to pay allowances are dependent on an entity's future actions. The entity could, for example, influence its future emissions and, hence the outflows under the contract by installing technologies that produce less emissions.

Contract to deliver future music recordings

<table>
<tr><th>Topic</th><th colspan="2">Conceptual Framework analysis</th><th>Conceptual Framework analysis supports…</th></tr>
<tr><td rowspan="3">Written contract to deliver future music revenues from the sale of copies of existing recordings[1]</td><td colspan="2">IASB AP 14b, FASB memo 70B
December 2007</td><td rowspan="3">View 2:
The contract to deliver future music revenues from the sale of existing recordings creates the obligating event. As of signing the contract, the obligation to deliver future music revenues from the sale of existing recordings is unconditional. Only the amount of future revenue to deliver is uncertain.</td></tr>
<tr><td>IASB definition</td><td>FASB definition</td></tr>
<tr><td>A present obligation of the entity: Obligor has unconditional contractual promise.
Arising from past events: The obligation arose at the date the contract was entered into.
Settlement of which is expected to result in an outflow of [economic] resources: The obligation is to be settled by providing cash outflows as a result of the sale of copies of the existing recordings or in order to secure release from the promise.</td><td>Probable future sacrifices of economic benefits …to transfer assets or provide services to other entities in the future: Cash outflows are required as a result of the sale of copies of the existing recordings or in order to secure release from the promise.
Arising from present obligations of a particular entity: The requirement is borne by the entity.
As a result of past transactions or events: No different from “arising from past events” in the IASB definition.</td></tr>
</table>

[1] The Conceptual Framework concluded identically on a contract to deliver future music revenues from the sale of copies of **future** recordings. The Conceptual Framework team did not address in their analysis whether, and to what extent, the outflow is contingent on an entity’s future actions. For example, the Conceptual Framework team did not distinguish whether the future music revenues (a) will be generated from an existing catalogue that has been distributed or (b) require additional selling efforts by the writer of the contract.

Contract to deliver future music revenues

16. A contract to deliver future music revenues and a contract in a voluntary scheme are similar in that the outflows from the contracts are dependent on an entity's carrying out specified activities in the future (ie selling of music or emitting).

17. A contract to deliver future music revenues and a contract in a voluntary scheme differ in the trigger that causes the outflow from the contract. In a contract to deliver future music revenues, the outflow is triggered by the revenue that an entity generates. In a voluntary scheme, the outflow is triggered by the operations that an entity conducts. However, the outflow in both contracts is dependent on the level of an entity's activities. If a stable correlation between an entity's revenue and its operations exists, a revenue-based trigger translates into an operations-based trigger and vice versa. (Emissions trading schemes typically assume a stable correlation between an entity's output and the related emissions when setting up allocation plans.)