



Project **Emissions Trading Schemes**

Topic **Cover Memo**

Purpose

1. The staff have prepared 3 papers (the Agenda Papers) for the joint meeting. The staff will present 2 papers that outline the critical issue in the Emissions Trading Schemes project; the recognition of assets and liabilities for the allocation in a cap and trade scheme. The third paper is provided for information only and thus will not be presented. The third paper provides a brief description of the other main issues in the Project that will be discussed at future board meetings.
2. The Agenda Papers are as follows:
 - (a) IASB AP 10A/FASB AP 6A: **Recognition of assets in a cap and trade scheme**
 - (b) IASB AP 10B/FASB AP 6B: **Existence and recognition of liabilities for the allocation in a cap and trade scheme**
 - (c) IASB AP 10C/FASB AP 6C: **Issues to be discussed at future board meetings**

Background information

3. The Agenda Papers do not include detailed information about the basic mechanics of emissions trading schemes. Descriptions of the mechanics and the different types of emissions trading schemes with examples are included in the draft research paper written by former IASB Industry Fellow, Nikolaus Starbatty. The IASB will publish the paper as a Staff Research Paper in the next few months.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

IASB/FASB Staff paper

This paper will reflect the views of Niko and not those of the IASB. Before it is published, this paper is available as Agenda Paper 10A in the observer notes of the May 2009 IASB meeting¹. This paper was presented for information purposes only.

Previous discussions by the boards

4. Below is a table setting out a brief summary of the issues and when they were discussed by the boards:

Date	Board discussion	Topic	Decisions
May 2010	IASB	Staff Research Paper written by Niko Starbatty	The Board did not make any decisions at this meeting, but provided Niko with comments on the paper.
December 2009	IASB	Right to receive future allowances in a cap and trade scheme	The Board did not make any decisions at this meeting. The Board members did indicate that a voluntary and a statutory scheme are quite similar.

¹ May 2009 IASB observer notes for Emissions Trading Schemes:
<http://www.ifrs.org/Current+Projects/IASB+Projects/Emission+Trading+Schemes/Meeting+Summaries/IASB+May+2010.htm>

IASB Agenda paper 10/ FASB Agenda paper 6

IASB/FASB Staff paper

Date	Board discussion	Topic	Decisions
November 2009	Joint meeting	Whether, and when there is a liability in a voluntary cap and trade scheme	The boards did not make any decisions at this meeting. The boards indicated a preference for a view that an entity can have an obligation before it emits.
March 2009/April 2009	IASB/FASB	Initial accounting in a cap and trade scheme for allowances received from the scheme administrator and the corresponding obligation	<p>The IASB tentatively decided:</p> <p><i>Allowances received 'free of charge' from the scheme administrator should be</i></p> <ul style="list-style-type: none"> ▪ recognised as assets. ▪ initially measured at fair value. <p><i>Corresponding obligation to the allowances received 'free of charge' should be</i></p> <ul style="list-style-type: none"> ▪ recognised as a liability. Although there was disagreement as to why there is a liability and what is the nature of the present obligation². ▪ initially measured at the fair value of the allowances received. <p>The FASB did not reach any conclusions on the initial accounting for cap and trade schemes. The FASB directed the staff to complete more research.</p>

² Many Board members expressed the view that the obligation to comply with a condition that must be met, or an obligation to reduce emissions.

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IASB/FASB Staff paper

Date	Board discussion	Topic	Decisions
October 2008	Joint meeting	Accounting for the receipt of allowances in a cap and trade scheme and a baseline in a baseline and credit scheme.	The session was educational and no decisions were made.
May 2008	IASB	Scope	<p>The Board decided that the scope of the project will address the accounting for:</p> <ul style="list-style-type: none"> ▪ all tradable emissions rights and obligations arising under emissions trading schemes, and ▪ activities related to emissions trading schemes such as certified emissions reductions (CERs).
December 2007	IASB	Re-activated work on emissions trading schemes	<p>The Board re-activated work on this project because there has been a void in authoritative guidance in this area since the withdrawal of IFRIC 3 <i>Emission Rights</i>. It appears that considerable diversity in practice has arisen.</p> <p>The Board decided to limit the scope of the project to the issues that arise in accounting for emissions trading schemes.</p>

Issues to be discussed at future board meetings

5. Appendix A includes a diagram that outlines the important questions and decisions in a cap and trade scheme. The issues of recognition of assets and liabilities for the allocation are only the first issues for which the staff will seek decisions.

IASB/FASB Staff paper

6. The staff believe that the boards can reach tentative decisions on the issues of recognition in AP 10A/6A and AP 10B/6B without discussing the other issues identified in Appendix A. In fact, the staff believe that tentative decisions on the issues of recognition are necessary for the discussion of the future issues. In particular, determining whether a liability for the allocation exists and identifying the nature of any such liability will help frame the boards' future discussion of measurement of the assets and liabilities. Furthermore, it is essential to understand the specific elements that should be recognised prior to discussing the presentation issue of netting.
7. In the light of those comments, any tentative decisions by the boards on the issues of recognition may need to be redeliberated by the boards at any time.

Next steps

8. The staff plan to discuss the other main issues (see AP 10C/6C) in the project at the joint board meetings as follows:

Date	Topic (see AP 10C/6C)
October 2010	i) Measurement of the assets and liabilities ii) Emitting; how it interacts with the liability for the allocation;
November 2010	iii) Presenting the assets and liabilities net (netting ³) iv) Right to receive a future allocation v) Baseline and credit schemes
December 2010	vi) Other issues

³ We have used this term to distinguish this concept from the mechanics of emissions trading schemes. This concept is the same as described as offsetting in paragraph 42 of IAS 32 *Financial Instruments: Presentation* and Topic 210-20 *Offsetting*.

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9. The staff believe it is necessary to obtain tentative decisions on all of the main issues during this time to be able to meet the target publication for an exposure draft on Emissions Trading Schemes in Q3 2011.

Terminology

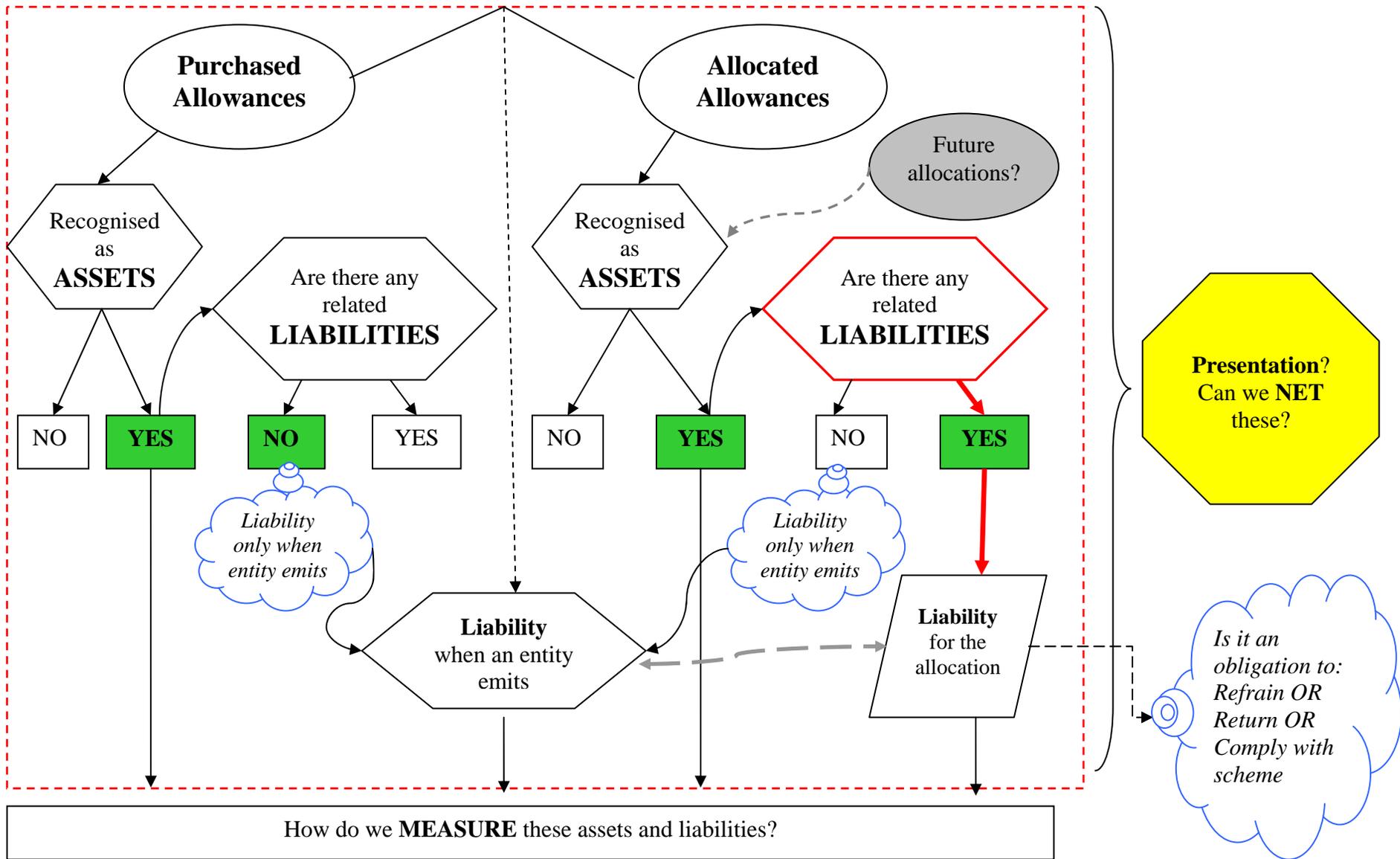
10. A number of terms used throughout the Agenda Papers are specific to emission trading schemes. Appendix B includes a list and staff's working definition of terms used throughout the Agenda Papers. Appendix B is not meant to provide the specific drafting for those definitions, nor is it meant to provide a comprehensive list of definitions that may be required.

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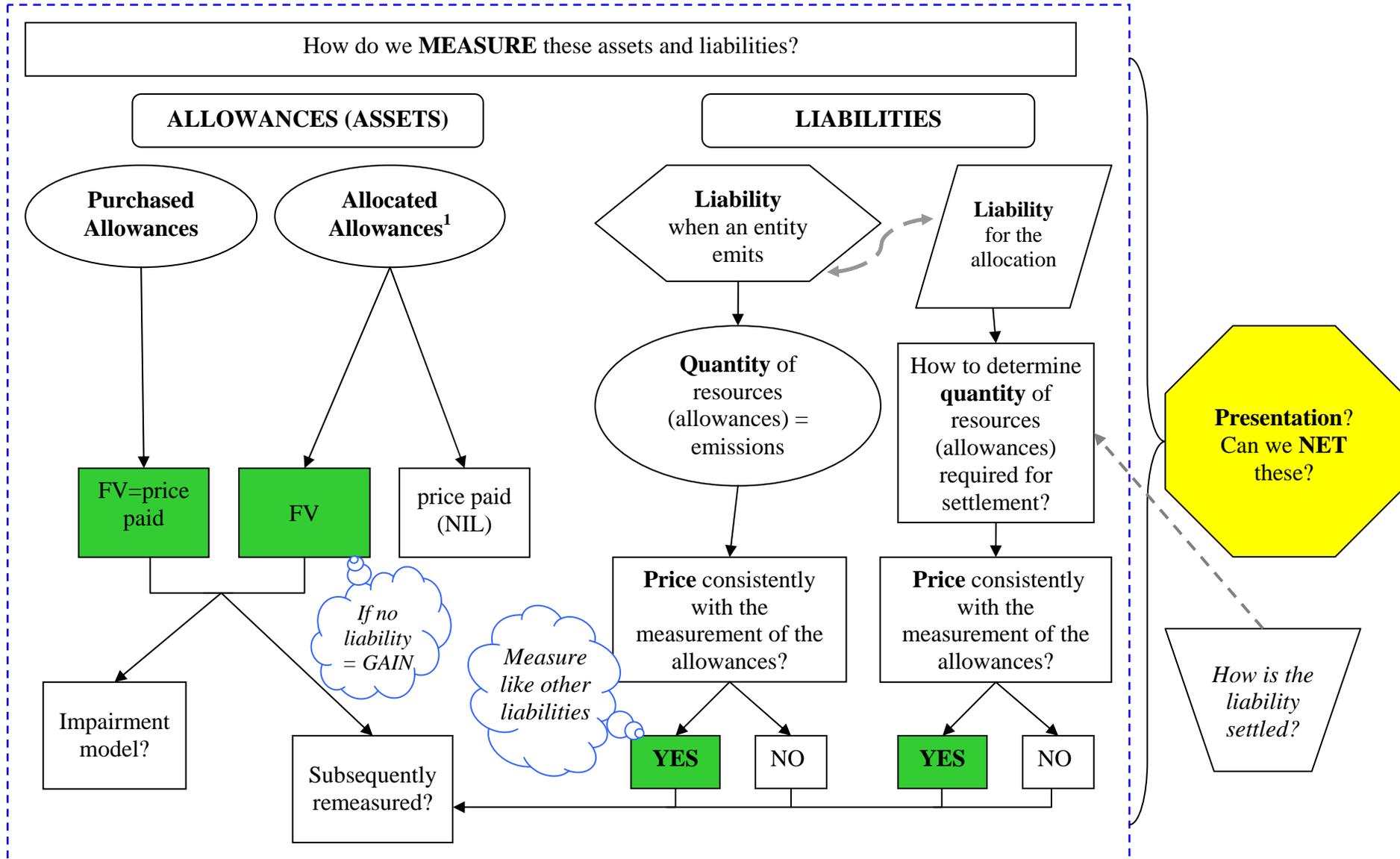
Appendix A
Outline of main issues

CAP & TRADE SCHEMES

IASB/FASB Staff paper



IASB/FASB Staff paper

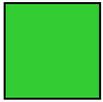


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¹ For simplicity, the staff omitted measurement issues for future allocations. Measurement issues for future allocations will be discussed if they are recognised as assets.

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Description of main symbols



Green shaded box; staff's recommendation



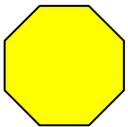
Cloud shape; provides a description of alternatives or results



Red shape or line; main project hurdle



Grey dashed line; the interaction of issues must be considered



Yellow octagon; an overall issue to be considered



Large red dashed box; contains recognition issues



Large blue dashed box; contains measurement issues

Appendix B

Terms used throughout the Agenda Papers

- B1. A number of terms used throughout the Agenda Papers are specific to emission trading schemes. Commonly used terms and staff's working definitions of these terms are as follows:
- (a) allocate the granting or providing of allowances to entities (who are scheme participants) from the scheme administrator. These allowances are provided to entities for no monetary consideration.
 - (b) allowances a certificate used in a cap and trade scheme to offset a unit of emissions. Allowances are freely tradable in markets that are generally well established. Allowances can be allocated to the entity by the scheme administrator (for no monetary consideration) or can be purchased (in the market or through auction).
 - (c) baseline an individual upper limit of total units of emissions assigned to an emitting source as part of a baseline and credit scheme.
 - (d) baseline and credit scheme a type of emissions trading scheme that establishes an overall limit on total units of emissions. The overall limit is implemented by assigning individual limits on emissions to specific sources of emissions (eg a factory) in the form of baselines. At the end of the compliance period, the source is issued credits for the difference between actual emissions and its baseline (if it emits below the baseline). (One credit is issued for each unit of emissions.) For every unit of emissions above its baseline, the source must provide the scheme administrator with credits.
 - (e) cap and trade scheme a type of emissions trading scheme that establishes an overall cap (ie a limit) on total units of emissions for particular pollutants for all entities combined. The overall cap therefore establishes the total number of allowances in circulation. The allowances create a trading mechanism that is used to carve up the overall limit between entities. Entities must return an allowance to the scheme administrator for every unit of

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emissions.

- (f) **clawback** a rule in a cap and trade scheme that requires an entity to return previously allocated allowances upon closure of the facilities for which the allocation was provided.
- (g) **credit** a certificate used in a baseline and credit scheme to offset units of emissions (similar to an allowance). Credits are issued to emitting sources for the differential between a baseline and actual emissions when the source emits below the assigned baseline. The issued credits are freely tradable in markets.
- (h) **commitment period** an administrative period over which the scheme administrator will apply the defined total cap or limit on units of emissions. For administrative purposes, the commitment period will often comprise a number of compliance periods. The commitment period is defined differently by each scheme, but may be tied to a specific period defined, for example, by the Kyoto Protocol.
- (i) **compliance period** a defined time period (often an annual period) for reporting emissions. At the end of a compliance period, entities are required to report their total units of emissions and 'settle' any obligations under the scheme by surrendering allowances or credits to the scheme administrator.
- (j) **statutory scheme** an emissions trading scheme imposed by the law. Participation in the scheme is mandatory if an entity wishes to conduct the business to which the scheme applies.
- (k) **voluntary scheme** an emissions trading scheme that is not a statutory scheme. An entity agrees to the terms of the scheme upon entering the scheme. Once an entity has joined a scheme, the entity's participation is generally governed by contract and may no longer be 'voluntary'.