International Financial Reporting Standards

GPF meeting, 6 November 2014
Agenda paper 4A

Emissions Trading Schemes

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Purpose of this session

- Provide background information on:
  - A common type of emissions trading scheme: the ‘cap and trade’ scheme.
  - The main accounting issues identified to date.
  - Common accounting policies applied in practice.
- Seek input from GPF members about their practical experiences and any additional accounting issues that they have identified.

Agenda

1. **Where are we in the project?**

2. **Background on ETS**
   - Agenda Paper 4B provides background information on common types of emission trading schemes.

3. **What are the main accounting issues?**
   - Including questions to GPF members

Where are we in the project?

- Early stages
  - staff research: identifying the development of schemes and current accounting practices
  - IASB has not yet issued a document for comment
- Previous project (2005-2010)
  - Began after the issue (2004) and withdrawal (2005) of IFRIC 3 *Emission Rights*
  - IASB made some tentative decisions about cap and trade issues but these will need to be revisited
  - Many issues were not discussed, eg
    - baseline and credit schemes
    - right to future allocations
  - Suspended in 2010

Agenda

1. Where are we in the project?

2. Background on ETS

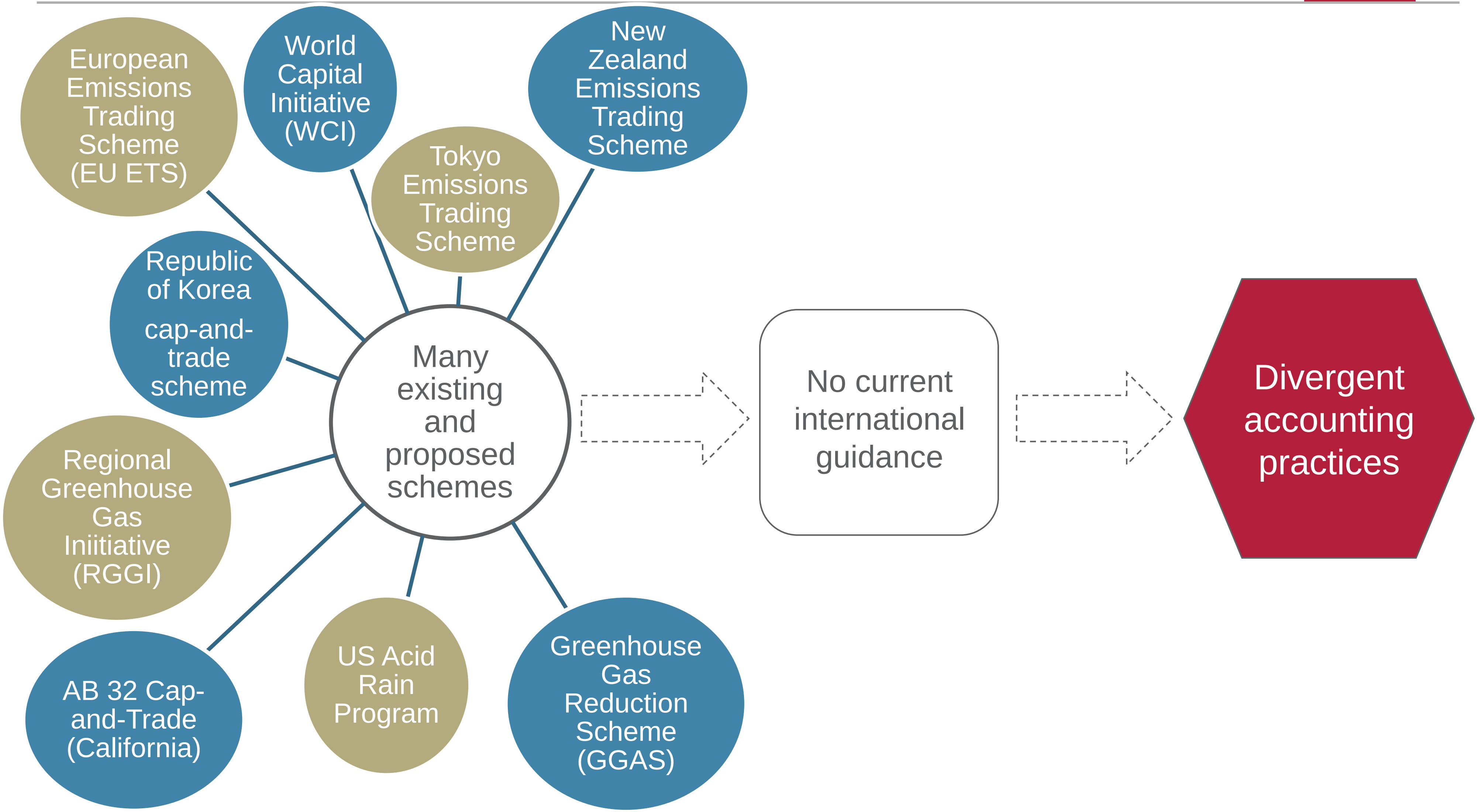
- Agenda Paper 4B provides background information on the types of emission trading schemes.

3. **What are the main accounting issues?**
   - **Including questions to GPF members**

Growth of emissions trading schemes

- Climate change is a critical issue
- More jurisdictions developing some form of emissions reduction policy
- Emissions trading schemes a common solution

Current accounting practices



Main types of schemes - Cap & trade vs Baseline & credit – see Agenda Paper 4B

	Cap & trade	Baseline & credit
Overall cap (emissions target)	Units of emissions (eg tonnes of CO_2) that may be released within commitment period	
Implementation of overall cap	Allocation or auction of allowances to individual emitters up to overall cap	Baselines are assigned to individual emitters up to the overall cap Credits issued only if emissions are below baseline at end of the year
Trading mechanism	Allowances are tradable	Credits are tradable, baseline is not
Remittance obligation	Allowances covering ***total*** emissions	Credits covering emissions in ***excess*** of baseline

Agenda

1. Where are we in the project?
2. Background on ETS

3. What are the main accounting issues?

– Including questions to GPF members

What are the main accounting issues?

- What ***elements*** should an entity recognise in its financial statements for emissions trading schemes?
  - – Allowances – are they assets?
  - – What are the obligations/liabilities – when do they arise?
  - – When do you ***recognise*** the assets and liabilities?
  - – How do you ***measure*** the assets and liabilities?

Do allowances meet the definition of an asset?

Conceptual Framework: asset—a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

- The tradable instruments (allowances)
  - are allocated free of charge or auctioned
  - have market value
  - can be traded or retained and used to settle obligation

As a result of deliberations on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, issued in July 2013, the IASB tentatively decided to refine the definition of an asset to be "a present economic resource controlled by the entity as a result of past events".

What do you think?

Fact pattern

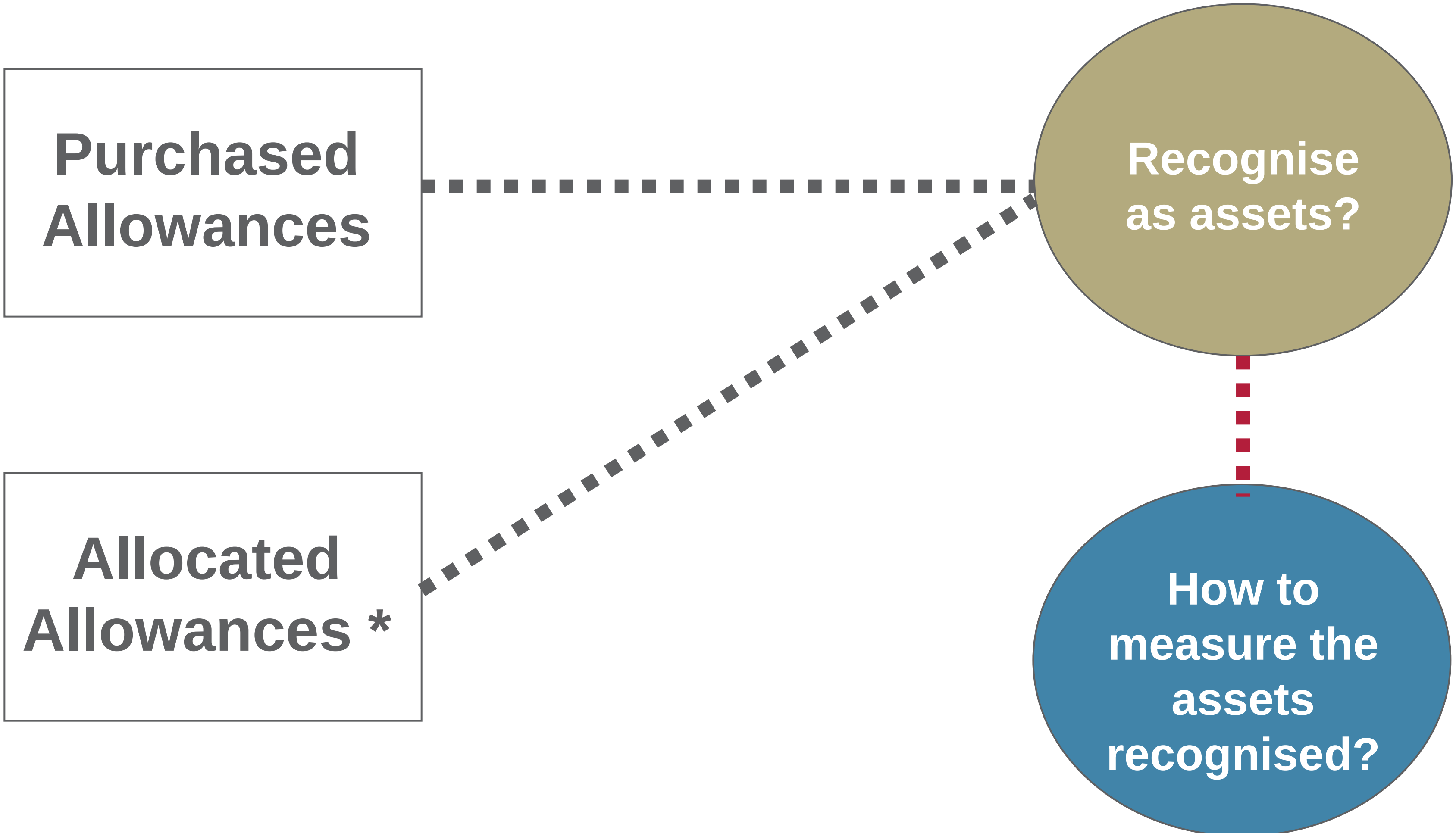
On 01/01/20x0 government allocates, free of charge to domestic carbon emitters, tradable allowances to emit 75% of their cumulative past 3 years' carbon emissions over next 3 years.

Allowances immediately trade in a deep and liquid market.

If emitter stops production it keeps the benefits of the allowances received.

Question 1 for GPF members
Does A have an asset at 01/01/20x0?

Cap and trade scheme – asset recognition



*received from the scheme administrator free of charge

Cap and trade - what are the obligations?

Conceptual Framework: liability—a present obligation of the entity arising from past events, the settlement of which is expected result in an outflow from the entity of resources embodying economic benefits.

- An obligation to submit allowances equivalent to the volume of pollutants emitted in the period
  - – no obligation to emit
  - – no obligation to return unused allowances

As a result of deliberations on the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, issued in July 2013, the IASB tentatively decided to refine the definition of a liability to be "a present obligation of the entity to transfer an economic resource as a result of past events".

What do you think?

Fact pattern

On 01/01/20x0 government allocates, free of charge to domestic carbon emitters, tradable allowances to emit 75% of their cumulative past 3 years' carbon emissions over next 3 years.

Allowances immediately trade in a deep and liquid market.

If emitter stop production it keeps the benefits of the allowances received.

Question 2 for GPF members
Does A have a liability at 01/01/20x0?

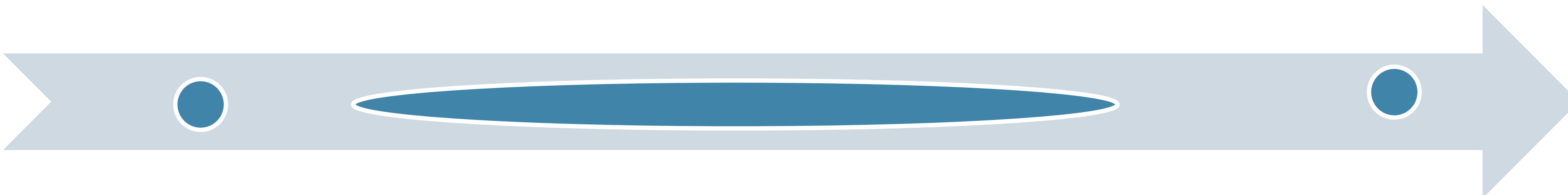
IFRIC 3 *Emission Rights*

- Issued Dec 2004, withdrawn June 2005
- Cap and trade schemes give rise to:
  - An asset for allowances held (IAS 38 *Intangible Assets*)
    - Initial measurement at fair value
    - Maybe revalued through OCI
    - Subject to impairment testing (IAS 36 *Impairment of Assets*)
  - A government grant (IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance)*
    - Initially recognised as deferred income in the balance sheet.
    - Subsequently recognised as income on a systematic basis over the compliance period
  - A liability (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).
    - Obligation to deliver allowances equal to emissions that have been made
    - Measured at best estimate of expenditure required to settle present obligation at balance sheet date.

Cap and trade – accounting mismatches

Asset recognised when allowances received

Liability settled at end of compliance period



Obligation to remit allowances arises as emissions occur

Observed accounting policies are designed to minimise accounting mismatches caused by differences in the timing and measurement of assets and related liabilities

Current accounting approaches (See Appendix A of Agenda Paper 4B)

	Approach 1	Approach 2	Approach 3
Initial recognition of allocated allowances	Recognise and measure at market value at date of issue; corresponding entry to government grant.		Recognise and measure at cost, which for allocated allowances is nil.
Initial recognition of purchased allowances	Recognise and measure at cost.		
Subsequent measurement 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

Current accounting approaches (continued)

	Approach 1	Approach 2	Approach 3
Recognition of liability	Recognise liability when incurred (ie as emissions are produced).		
Measurement of liability	Liability is measured based on the market value of the number of allowances at each period end that would be required to cover actual emissions.	Liability is measured based on: • the carrying amount of allowances on hand at each period end to be used to cover actual emissions 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).	

Further questions for GPF members

Question 3 for GPF members
Is your organisation a participant in a cap and trade scheme? If so, how does it account for the rights and obligations created by the scheme (current approach 1, 2, 3 or another approach)?

Question 4 for GPF members
Is your organisation a participant in a baseline and credit or other type of scheme? If so, how does it account for the rights and obligations created by the scheme?

Question 5 for GPF members
What accounting issues, in addition to those identified in this presentation, do you think are relevant to address in the project?

Project information

- **Project page:** http://go.ifrs.org/Emissions-Trading-Schemes

Project contacts:

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Thank you


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