Emerging Economies Group meeting

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Project: Pollutant Pricing Mechanisms
Topic: Update on horizon scanning
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Purpose of this session

• Provide EEG members with an update on horizon scanning activities in relation to pollutant pricing mechanisms

• Seek feedback on the prevalence of pollutant pricing mechanisms in your jurisdiction and your views on whether the IASB should prioritise a project on this topic
Information for participants

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   • What are pollutant pricing mechanisms?
   • Compliance market
   • Voluntary market

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What are pollutant pricing mechanisms?

Mechanisms, also known as ‘schemes’, designed to achieve a reduction of greenhouse gases (GHG) through the use of tradable emissions allowances or carbon credits.

**Compliance market**
- Established and regulated by governments
- Emissions trading schemes (ETS) are used as a means to limit GHG emissions
- Participation is mandatory for entities covered by the ETS

**Voluntary market**
- Operates outside of the compliance market
- Enables carbon emitters to offset emissions by purchasing carbon offsets on a voluntary basis
- A project-based system is used, where carbon offsets are created through the development of projects that remove or reduce GHG emissions from the atmosphere
Compliance market

Two main types of compliance schemes exist:

**Cap-and-trade scheme**
- Overall cap set on total volume of GHG emissions that can be released during a specified commitment period
- Overall cap is then allocated across participants by distributing or selling allowances. Over time cap is reduced
- Participants must remit allowances to cover GHG emitted

**Baseline and credit scheme**
- Total emissions are not fixed, instead a baseline is established that serves as a limit on the emissions for participating entities
- Participants may emit up to the level of the baseline without incurring additional costs
- Credits are issued to entities that have reduced emissions below baseline level
Voluntary market

Two main types of voluntary schemes exist:

Avoidance/Reduction

• Carbon offsets are generated by measuring GHG emissions that were avoided or reduced as a result of implementing a project
• Examples include renewable energy projects, energy efficiency improvements, waste management initiatives

Removal/Sequestration

• Carbon offsets are generated by measuring the amount of GHG emissions removed by a project by means of afforestation, reforestation or carbon capture and storage technologies
• Examples include forestry projects which capture carbon, and direct air capture and storage technologies which use chemicals to trap carbon from the air
Compliance market – diversity in accounting
Three approaches observed in practice

<table>
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<th>‘Emissions rights’ approach*</th>
<th>‘Government grant’ approach</th>
<th>‘Net presentation’ approach</th>
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| • Allowances or credits are recognised as intangible assets and initially measured at fair value  
  • As emissions are made, a liability is recognised and measured in accordance with IAS 37  
  • Any difference between the amount paid for allowances or credits and their fair value is accounted for as a government grant applying IAS 20 | • Accounting is similar to the ‘Emissions rights’ approach except the liability is measured based on the carrying amount of the allowances or credits held  
  • If emissions are in excess of the allowances or credits held the liability for the excess is measured based on the market value of those allowances or credits | • Allowances or credits are recognised as intangible assets measured at cost (for granted allowances or credits this is usually a nominal amount)  
  • As emissions are made a liability is recognised and measured based on the carrying amount of allowances or credits held  
  • If the entity holds allowances or credits equal to the emissions liability the effect on net assets is nil. |

*This approach was the approach required by IFRIC 3 Emissions Rights which was withdrawn because of concerns about accounting mismatches
Voluntary market – accounting considerations

Are carbon credits assets?

Things to consider:
• Control: Can the entity direct the use of the carbon credits and obtain the economic benefits that flow from them?
• Potential to produce economic benefits: can the entity sell the credits or use them to settle an emissions liability?

Intangible assets or inventory?

Inventory:
• If held for sale in ordinary course of business or if considered supplies to be consumed in production process
Intangible assets:
• If it is probable that the future economic benefits will flow to the entity and costs can be measured reliably (excludes credits that meet inventory definition)

How should they be measured?

Inventory:
• At the lower of cost and net realizable value. If they have similar economic characteristics to commodities they may be measured at fair value through profit or loss (broker-trader)
Intangible assets:
• Using either the cost model or the revaluation model if an active market exists
Added to reserve list

Feedback received
Respondents ranked PPM as high priority, but not as high as other projects

Prevalence increasing
Many stakeholders have suggested that the IASB should now prioritise a project on PPM

Horizon scanning
Staff are performing research and engaging with stakeholders to understand current landscape

Current stage
IASB meeting
Present results of horizon scan at a future IASB meeting
Accounting Standards Advisory Forum
Preliminary survey results – compliance schemes

As part of our horizon scanning, we asked ASAF members to complete a survey about pollutant pricing mechanisms in their jurisdiction.

Most respondents stated that some form of compliance scheme exists in their jurisdiction.

Almost all respondents noted that there are plans to introduce new schemes in the future.

About half of respondents indicated that they are aware of diversity in practice or other deficiencies in the accounting for compliance schemes.
Almost all respondents indicated that IFRS reporting entities in their jurisdiction participate in the voluntary market.

More than half of respondents noted that the prevalence of voluntary schemes is increasing.

More than half of respondents indicated that these schemes give rise to accounting issues that are difficult to resolve.
Questions for EEG members

• Do you have any comments or questions on the IASB’s horizon scanning activities?

• How prevalent are pollutant pricing mechanisms in your jurisdiction?

• Do you think the IASB should prioritise a project on pollutant pricing mechanisms?
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