

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Ottawa, Canada

Meeting Date: December 2-5, 2013

Agenda Item 3

For:

☒ Approval

☐ Discussion

☐ Information

Emissions Trading Schemes

Objective(s) of Agenda Item

1. The objective of the session is to approve the project brief on Emissions Trading Schemes, which in the Consultation Paper development phase will be a joint project with the International Accounting Standards Board.

Material(s) Presented

Agenda Item 3.1 Draft Project Brief

**INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS
BOARD****PROJECT BRIEF AND OUTLINE****1. Subject—Emissions Trading Schemes**

- 1.1 This project will develop requirements and guidance on accounting for emissions trading schemes (ETS). The project will consider accounting for both administrators¹ and participants in ETS. It is proposed that the project is a joint project with the International Accounting Standards Board (IASB). The IPSASB would expect to lead on the requirements and guidance relating to public sector administrators of statutory ETS.
- 1.2 Existing IPSASs do not address the accounting for ETS. IFRSs also do not specifically address accounting for ETS. The International Financial Reporting Interpretations Committee (the IFRIC) issued IFRIC 3, *Emission Rights*, in December, 2004. IFRIC 3 addressed the accounting for the rights and obligations arising from participation in the European Union's (EU) ETS. Its scope did not include all types of ETS. The IFRIC concluded that, on the basis of existing IFRS pronouncements, allowances issued to participants under the EU scheme were intangible assets and should be accounted for in accordance with IAS 38, *Intangible Assets*, and that such assets should be measured at fair value. IFRIC 3 was withdrawn in June 2005. This was largely because the limited level of trading in EU scheme allowances meant that the need for accounting guidance had become less pressing. Withdrawal of IFRIC 3 was intended to allow a more comprehensive approach to accounting issues related to ETS to be developed by the IASB, rather than because the accounting specified in IFRIC 3 was considered defective.
- 1.3 The IASB initiated a project on ETS in late 2007 and this subsequently became a joint project with the Financial Accounting Standards Board. Considerable work was carried out and a staff research paper was developed and discussed by the IASB in 2010. This paper outlined the main types of scheme and identified a number of key accounting issues, particularly the measurement of obligations to emit by participants in receipt of allowances and baselines. In November 2010, the project was deferred until after the IASB's agenda consultation. Alison McManus of IASB Staff gave a presentation on accounting for ETS at the IPSASB's March 2012 meeting. In May 2012 the IASB added ETS to its research agenda.
- 1.4 While acknowledging that there are a number of variants, the IASB draft research paper identified and discussed the characteristics of two main types of ETS: (i) cap and trade schemes and (ii) baseline and credit schemes. In a cap and trade scheme, a central administrator (typically a 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 the distribution of 'emission allowances'. The cap, and therefore the allowances, will normally be below the actual levels of emissions currently being made by entities, thus creating scarcity and making allowances valuable. Allowances in cap and trade schemes can be traded.

¹ The term "administrator" is used rather than "grantor". Administrators issue allowances in cap and trade schemes and "caps" and "credits" in baseline and credit schemes

- 1.5 In a baseline and credit scheme the administrator allocates the cap in the form of baselines. The baseline provides an entity a right to emit up to a specified level. The baselines are assigned to a specific emitting source and, unlike allowances in cap and trade schemes, cannot be traded. The trading mechanism is introduced at the end of the reference period, when the administrator issues tradable 'credits' to entities that have emitted below their baseline. Conversely, the administrator requires entities that have emitted above their baseline to provide credits. This mechanism imparts scarcity and gives rise to a market.
- 1.6 Schemes may be further segmented into statutory or non-statutory schemes. Statutory schemes are government imposed and require mandatory participation of entities that emit greenhouse gases. Non-statutory schemes are voluntary in nature. Because of its remit the IPSASB's primary focus is on statutory schemes. However, non-statutory schemes will be covered from a participant's point of view. The IASB staff paper identified a number of statutory and non-statutory schemes.
- 1.7 In the Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, the IASB considered when present obligations and liabilities arise for the recipients of allowances in cap and trade schemes in the context of obligations where the requirement to transfer economic resources is dependent on the occurrence one or more future events that depend on the reporting entity's future actions. The IASB has not formed a view on when liabilities arise where the requirement to transfer an economic resource. The IASB has, however, rejected the view that obligations must be strictly unconditional in order for a present obligation and a liability to exist.
- 1.8 Many governments have introduced ETS in order to reduce greenhouse gas emissions in their jurisdictions. In a number of cases this was in response to, or related to, the Kyoto Protocols, which were ratified in 2005 with a first commitment period covering 2005-2012 (the United States did not ratify the Protocols and Canada withdrew in 2011). The second commitment period is for 2013-2020, although this has not been legally ratified. Under the Kyoto Protocol, 37 industrialized countries and the European Union committed themselves to binding targets for greenhouse gas emissions.
- 1.9 A government could set up, and be the administrator of, a scheme which involves it issuing permits or allowances to emit to participants of the scheme, facilitate a trading mechanism for the permits or allowances and reconcile the surrender of permits or allowances at the end of the commitment period. A public sector entity could also be a participant in a scheme where it is an emitter of greenhouse gases. This project includes in its scope the accounting treatment for both types of transactions or other events.
- 1.10 The project will also consider whether obligations under the Kyoto Protocol and other international treaties or accords could give rise to a liability of a national government.
- 1.11 There are certain similarities with the IPSASB's approach to service concession arrangements. In the service concession arrangements project the IPSASB developed requirements and guidance for administrators of concession arrangements. The IPSASB adopted an approach that was underpinned by the control model and "mirrored" the requirements for operators in IFRIC 12, *Service Concession Arrangements*. While symmetrical approaches are not always feasible and may not always be desirable, the approach sought to minimize misalignments between operators' and administrators' accounting.

2. Project Rationale and Objectives

- 2.1 Guidance on how to account for ETS from the perspective of an administrator appears limited. The New Zealand Treasury has developed accounting policies for ETS for the consolidated New Zealand Government Financial Statements and the New Zealand Controller and Auditor General has produced guidance on the operation and accounting and auditing of ETS. The development of accounting requirements will enhance the global consistency and comparability of resources and obligations related to ETS in the financial statements of public sector entities
- 2.2 For private sector entities that are participants in an ETS there are a number of accounting models that are currently in use. This diversity in practice was one of the reasons that the IASB and the FASB initiated a joint project on this topic and why the IASB has a Research Project in its Work Plan. By analogy, a public sector entity that is a participant in a scheme could select one of these accounting models. The IPSASB should also include the accounting treatment for participants in an ETS in order to avoid diversity of accounting treatments for public sector entities.

(a) Issues identified

- 2.3 There are a number of issues that will need to be considered in this project. These issues include:

Administrators

- Do Kyoto Protocol Units (also known as assigned authorized units (AAUs) under the New Zealand scheme) issued to national governments under the Kyoto Protocol meet the definition of an asset?
- If Kyoto Protocol Units are an asset what is the nature of the asset and how should they be measured?
- Do obligations of national governments under the Kyoto under the Kyoto Protocol and other international treaties or accords give rise to liabilities?
- Do allowances (baselines) to emit that are issued to participants without charge give rise to an expense and liability of the administrator? If so, how should such liabilities be measured and at what point does the expense/liability arise?
- Does revenue arise when participants surrender allowances to the administrator? If so, what is the timing of the recognition of such revenue?

Participants

- Are allowances and baselines assets of the participant entity?
- How should such assets be measured both at initial recognition and subsequently? Does the manner in which the participant entity acquired the allowances -purchased or allocated at no cost by the administrator-affect measurement?
- When should a liability be recognized for emissions in excess of allowances or baseline-actual or expected basis?
- Should the presentation of assets and liabilities be on a gross, net or linked basis?

(b) Objectives to be achieved

- 2.4 The ultimate objective of the project is to issue one of more IPSASs on ETS covering both public sector administrators and public sector participants.
- 2.5 The intermediate objective is to produce a Consultation Paper. The Consultation Paper will identify the main statutory ETS schemes and their key characteristics, the main accounting issues and the viable options for accounting treatments and presentation for ETS. It will provide preliminary views where IPSASB is able to formulate such views.

(c) Link to IFAC and IPSASB Strategic Plans

i. Link to IPSASB Strategy

- 2.6 One of the IPSASB's continuing strategic priorities for the period 2012–2014 is public sector critical projects. These include both public sector specific and IFRS convergence projects. The proposed project is a hybrid. The development of requirements and guidance for public sector administrators of statutory ETS is a public sector specific project. The development of an accounting treatment for public sector entities that are participants in an ETS is likely to be an IFRS convergence project, although the project will consider whether there are any issues specific to public sector participants.

ii. Link to IFAC Strategic Plan

- 2.7 The IFAC Strategic Plan for 2011–2014 includes two strategies that are relevant. The first is IFAC's commitment to the development, adoption and implementation of international standards, including those for the public sector. The second is an enhanced focus on public sector financial reporting. Developing requirements and guidance for ETS supports both strategies.

3. Outline of the Project

(a) Project Scope

- 3.1 The scope of this project is to determine the appropriate accounting treatment for the:
- 3.1.1 Administrators of an ETS; and
- 3.1.2 Participants in an ETS.

(b) Key Issues

- 3.2 A number of key issues are set out below. The list is not exhaustive.

Key Issue #1—Scope of the schemes covered by the project?

- 3.3 The IASB identified two main types of scheme- cap and trade schemes and baseline and credit schemes (see paragraph 1.4 of Section 1). The project will consider whether there are other types of ETS that should be within the scope of the project such as command and control schemes.

Key Issue #2—At what point do present obligations and liabilities arise for administrators and participants and how should liabilities be measured?

- 3.4 A key issue is to determine when present obligations and liabilities arise for both administrators and participants under schemes within the scope of the project (see paragraph 2.3 of Section 2)

Key Issue #3—When do assets arise for administrators and participants and how should assets be measured?

- 3.5 A key issue is to determine when asserts arise in the schemes within the scope of the project and how those asserts are measured

Key Issue #4—What disclosures should be required?

- 3.6 A key issue is what disclosures should be required for administrators and participants taking into account the qualitative characteristics and constraints on financial reporting

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 It has been agreed that the first phase will be a joint project with IASB. At present ETS is on the IASB's research agenda and there is little likelihood of it being moved to the active agenda in advance of a further consultation on the IASB's Work Plan.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 The project is linked to the Conceptual Framework projects of both the IASB and the IPSASB, particularly the definitions of an asset and a liability and the timing of present obligations where obligations are conditional on future events, which are dependent on an entity's future actions. Dependent upon the outcome of the ETS project, there may be implications for several IPSASs, including IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* and IPSAS 31, *Intangible Assets*. As the project develops, potential implications for other IPSASs may also be identified. At this stage (May 2013), there are no IASB pronouncements that are relevant to this project.

(c) Other—Government Finance Statistics

- 4.3 The IPSASB has recently reaffirmed the importance of reducing differences with the statistical basis of reporting where appropriate with the publication of a Consultation Paper, *IPSAS and Government Finance Statistics Reporting Guidelines*. This project will consider requirements and guidance on accounting for ETS under the statistical basis of reporting for both administrators and participants. It will assess whether there are opportunities for reducing differences in accounting treatments.

5. Development Process, Project Timetable and Project Output

(a) Development Process

- 5.1 The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) Project timetable

Major Project Milestones	Expected Completion
Present draft Project Brief	December 2013
Undertake further research on types of schemes (January 2014–March 2014)	
Discussion of issues and development of a Consultation Paper (CP) (April 2014–December 2014)	
Approve CP (6 month comment period)	December 2014
Review of responses to CP and development of an Exposure Draft (June 2015–March 2016)	
Approve ED (4 month comment period)	March 2016
Review of responses to ED and development of a IPSAS	
Approve Final IPSAS	Late 2016/Early 2017

(c) Project output

- 5.2 The initial output will be a Consultation Paper. Following analysis of the responses to the Consultation Paper an Exposure Draft (s) will be developed. The ultimate output will be an IPSAS (or IPSASs).

6. Resources Required

(a) Task Based Group

- 6.1 A Task Based Group will assist in providing information on the broad range of ETS, to evaluate accounting options and to oversee the project.

(b) Staff

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) Factors that might add to complexity and length

- 6.3 Factors that might add to the complexity and length of the project include:

6.3.1 Joint working with IASB will facilitate a high quality product and reduce the likelihood of differences in accounting treatments that are not justified on public sector grounds, but will require detailed planning, coordination and communication.

6.3.2 The wide range of ETS and the extent to which they can be classified in a manner that provides meaningful information for users;

6.3.3 The relative lack of existing guidance on ETS, in particular guidance relating to administrators; and

6.3.4 The interaction between this project and the development of the Conceptual Framework. .

7. Important Sources of Information

7.1 Potential sources of information regarding ETS include:

7.1.1 The draft IASB Staff Research Paper developed and discussed in 2010.

7.1.2 The Financial Statements of the Government of New Zealand.

7.1.3 Controller and Auditor-General of New Zealand. *The Emissions Trading Scheme-Summary Information for Public Entities and Auditors.*

7.1.4 Parliament of Australia, Issues Paper, Emissions Trading Schemes Around the World (2012)

7.1.5 The Government Finance Statistics Manual (2001) (revision expected shortly).

7.1.6 The System of National Accounts (SNA) 2008.