

Agenda Item 9: Emissions Trading Schemes

IPSASB Meeting

December 8-11, 2015

Toronto, Canada

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Objective of this Session

- Provide direction on development of an Emissions Trading Schemes (ETSs) consultation paper.

Background

- Previous IPSASB meetings:
 - September—Directions on accounting approaches and develop background paper on public policy perspective.
 - March and June 2015—Directions on symmetry, accounting approaches, link to ETS public policy, CP structure, etc.
- Task Based Group: Aracelly Mendez, Angela Ryan, Fabienne Colignon and Martin Koehler
- IASB Collaboration: IASB Staff—Jane Pike. IASB education session in October. (See Appendix A)

Overview of Issues

1. IPSASB project's approach, given IASB developments
2. Draft background paper on public policy objectives (agenda item 9.2)
3. Accounting options (descriptions and evaluations) and linkage between economic impacts and accounting treatments (agenda item 9.3)

Issue 1 IPSASB Project and IASB Developments

- IASB developments since June discussion:
 - IASB education session in October 2015
 - Next IASB discussion could be in January or February
 - Project linked to IASB Conceptual Framework (elements)
 - Staff considering wider set of “pollutant pricing mechanisms” (PPMs)
- Uncertainty over timing of IASB project

Issue 1 IPSASB Project and IASB Developments

Staff and TBG considered three options:

- Option 1—IPSASB discussions continue (March, June 2016)
- Option 2—Defer discussions until September 2016:
 - Project remains active
 - Staff and TBG work on accounting issues, monitor IASB developments and provide input
- Option 3—Temporary halt to IPSASB project:
 - No further discussions until IASB's discussion paper is issued

Issue 1 IPSASB Project and IASB Developments

- Recommendation—Option 1, Continue, IPSASB discussions in March, June, etc.
- TBG members expressed strong support for Option 1:
 - Build on foundation of IPSASB's 2015 discussions and maintain project momentum
 - Provide direction for collaboration with IASB staff; and
 - Staff research and IPSASB discuss:
 - Economic substance of different types of ETSs and other interventions (e.g. carbon taxes);
 - Governments' experiences with different emission reduction interventions (case studies, examples)

Action Requested

1. IPSASB asked to:
 - a) Note that IASB project's next steps are linked to IASB Conceptual Framework; and
 - b) Confirm recommendation to continue IPSASB discussions (Option 1)

Issue 2 Background Paper—Public Policy Objectives

- Agenda Item 9.2—Draft public policy paper
- Background to the draft paper :
 - Version 1 reviewed by IPSASB in September (Appendix C)
 - Revisions directed
 - TBG reviewed revised paper and proposed changes
 - Paper's structure revised and more coverage included
 - Joint paper concept discussed with IASB staff

Issue 2 Background Paper—Public Policy Objectives

- Agenda item 9.1's Appendix B provides detail on proposed revisions
- Brief overview:
 - a) Widen, deepen descriptions of different types of ETSs;
 - b) Extend descriptions of other interventions; include comparisons between ETSs and other interventions; and
 - c) Include descriptions of different countries' interventions

Issue 2 Background Paper: Development

Paragraph 26(b) asks for IPSASB direction on:

- i. New order for interventions; discuss ETSs last
- ii. In–depth coverage for all four interventions, include country specific examples
- iii. Focus on four main interventions and on characteristics relevant to development of accounting options; and
- iv. Exclude coverage of accounting options

⇒ *Does IPSASB support paper's direction?*

Issue 2 Background Paper—Public Policy Objectives

- Joint paper concept:
 - a) IPSASB and IASB staff work together on paper's development
 - b) Both boards review draft paper, as part of its development and/or as a meeting paper for ETS (PPM) discussions
 - c) Possible publication of paper as a joint IASB–IPSASB paper

Issue 2 Background Paper—Public Policy Objectives

- Joint paper concept:
 - IASB staff discussed idea with IASB subcommittee
 - IASB staff open to a joint *internal* document
 - Difficult to do joint *publication* (IASB debate on types of publication, including “staff papers”)
 - *Important:* Stay concise, stay focused on differences with accounting implications

⇒ *Does IPSASB support the joint paper concept?*

Action Requested

2. The IPSASB is asked for direction on the draft background paper. Should the paper be:
- Developed as proposed in Appendix B, including the specific points highlighted in paragraph 26(b); and
 - Turned into a joint IPSASB–IASB paper with staff from both boards contributing to and reviewing the paper’s development?

Issue 3 Accounting Options and Economic Impacts

- Agenda Item 9.3 provides draft descriptions of the following four accounting options:
 - Approach 1, *Emission Notes (Financial Liability)*
 - Approach 2, *Emission Licenses (Intangible Asset)*
 - Approach 3, *Pollutant Pricing Mechanisms—Rights and Obligations*
 - Approach 4, *Emission Limits (Taxes and Contingencies, formerly Approach 3, Revenue)*

Issue 3 Accounting Options and Economic Impacts

- Other accounting options may be identified through:
 - IASB developments
 - Comparisons of different types of emission reduction interventions
 - Economic impact considerations

Issue 3 Accounting Options: Descriptions, Evaluations

Expand descriptions of accounting options?

- Explore (describe) impact of different simplifying assumptions (worked examples); and
- Link options to economic impact of different interventions

Evaluation of accounting options: widen the focus?

- Economic substance and/or future proofing,
- Relationship to existing IPSASs, applicable GFS reporting guidelines, and/or accounting for similar interventions (e.g. fishing quotas)

Issue 3 Accounting Options: Economic Impacts

- “Economic impacts” of each government intervention:
 - Cash flow impacts; and
 - Creation of rights, resources and obligations.
- Check this approach to “economic impact”:
 - Other types of economic impact that should be included? (e.g. include a broader approach to benefits arising from emission reductions)

Issue 3 Economic Impacts: Table 1 Administrator

Intervention	Negative cash flows	Positive cash flows	Resources, rights and obligations	Comparison with Other Interventions
Command and control	Cost (implement, administer)	Fees for permits penalties for non-compliance	Rights to charge, fine, and enforce	Carbon tax and ETS also enforce compliance.
Results-based financing (RBF)	Cost (implement, administer); funds -projects	None	Right to project work (service performance)	<i>ETS link:</i> RBFs can generate EAs
Carbon tax	Cost (implement, administer)	Tax revenue	Right to enforce	<i>ETS link:</i> Can have threshold; only emissions above taxed
ETS	Cost (implement, administer)	Transfer fees (and sales) for EAs on initial issuance	Rights over EAs (resource). Rights to EAs as emissions occur. Right to enforce.	<i>Carbon tax:</i> Can use to raise funds <i>RBF:</i> ETS may allow RBFs to generate EAs

Issue 3 Economic Impacts: Table 2, Participants

Intervention	Negative cash flows	Positive cash flows	Resources, rights and obligations	Comparison Other Interventions
Command and control	Payments for permits, upgrades, etc.	None	None	Carbon tax and ETS also enforce compliance.
Results-based financing (RBF)	Cash spent on the project	Receive grant or payment for projects	Right to funds for projects, earn EAs, or both; obligations to carry out project	<i>ETS link:</i> Some RBFs generate EAs
Carbon tax	Tax payments	None	Obligations to pay taxes	<i>ETS link:</i> Scope to have a threshold so that only emissions above are taxed.
ETS	Fees for EAs, costs to change operations	Possibly sell EAs	Rights to emit (EAs); obligation to surrender EAs	<i>Carbon tax:</i> Potential for fund-raising similar to carbon tax

Issue 3 Accounting Options: One preferred? One not supported?

⇒ *Which option do IPSASB members prefer? (Is there any option that has little, if any, support?)*

- Four accounting options:
 - Approach 1, *Emission Notes (Financial Liability)*
 - Approach 2, *Emission Licenses (Intangible Asset)*
 - Approach 3, *Pollutant Pricing Mechanisms—Rights and Obligations*
 - Approach 4, *Emission Limits (Taxes and Contingencies, formerly Approach 3, Revenue)*

Action Requested

3. Provide comment and views on:
 - (a) Accounting options: Descriptions and evaluations (agenda paper 9.3);
 - (b) Preferred accounting option; and
 - (c) Economic impacts for each intervention and linkage between (i) interventions, (ii) economic impacts and (iii) accounting treatments.

Next Steps

- Provide issues paper to IPSASB's March 2016 meeting
- Revise background paper (public policy objectives, interventions)
- Accounting options:
 - Revise descriptions and evaluations (e.g. improve linkage between economic impacts and accounting options)
 - Monitor IASB developments for other accounting options

Approach 1, *Emission Notes (Financial Liability)*

Step 1 Administrator creates EAs (EAs are like currency)

Dr EAs asset (inventory)

Cr Gain on asset creation (nil value, initial cost)

Step 2 Administrator transfers EAs (start of compliance period)

Dr Expense

Cr Liability (notes (like currency) issued)

Approach 1, *Emission Notes (Financial Liability)*

Step 3 Emissions occur (during compliance period)

Dr Right to receive EAs

Cr Revenue

Step 4 EAs received back (end of compliance period)

Dr Liability (notes returned)

Cr Right to receive EAs

Approach 1, *Emission Notes (Financial Liability)*

Step 1 Administrator creates EAs

EAs: Asset? *Conceptual Framework:* Control ✓ Past event ✓
Resource ✓ (Yes, ability to generate cash flows)

Step 2 Administrator transfers EAs (start of compliance period)

EA currency liability? *Conceptual Framework:* Present
obligation? outflow of resources?

Obligation to accept back EAs: Present obligation? (Participants do not have obligation to submit EAs.) What is outflow of resources?

Approach 1, *Emission Notes (Financial Liability)*

Step 3 Emissions occur (during compliance period)

Right to receive EA: Asset? *Conceptual Framework*: Control ✓

Past event ✓ Resource?

Able to generate cash flows? Service potential?

Step 4 EAs received back (end of compliance period)

Logically follows from step 2, with “tidy” extinguishment of the liability (outstanding notes) and the asset (right to receive EAs)

Approach 2, *Emission Licences (Intangible Asset)*

Step 1 Administrator creates EAs (EAs are **intangible assets**)

Dr EAs asset

Cr Gain on asset creation (nil value, if at cost)

Step 2 Administrator transfers EAs (start of compliance period)

Dr Expense (Depends on book value, transfer “price”)

Cr **EAs (intangible assets)**

Approach 2, *Emission Licences (Intangible Asset)*

Step 3 Emissions occur (during compliance period)

Dr Right to receive EAs

Cr Revenue

Step 4 EAs received back (end of compliance period)

Dr EAs

Cr Right to receive EAs

Approach 2, *Emission Licences (Intangible Asset)*

Step 1 Administrator creates EAs

EAs: Asset? *Conceptual Framework*: Control ✓ Past event ✓
Resource ✓ (Yes, ability to generate cash flows)

Step 2 Administrator transfers EAs (start of compliance period)

EA Asset extinguished: Control over asset transferred to participant

Approach 2, *Emission Licences (Intangible Asset)*

Step 3 Emissions occur (during compliance period)

Right to receive EA: Asset? *Conceptual Framework*: Control ✓

Past event ✓ Resource?

Able to generate cash flows? Service potential?

Step 4 EAs received back (end of compliance period)

What happens now? Impair EAs down to zero?

Issue: Are EAs assets, after they are issued?

Approach 3, *Pollutant Pricing Mechanisms—Rights and Obligations*

- Symmetry with IASB approach (from June IASB meeting)

Step 2: **Participants** receive EAs for free:

Dr EAs asset

Cr **Government grant liability**

Step 3: During period, participants emit pollutants

Dr **Expense (emissions related)**

Cr Liability to submit EAs to administrator

Dr Government grant liability

Cr **Revenue** from government grant

Approach 3, *Pollutant Pricing Mechanisms*

Participant	Administrator (Step 1: Create EAs)
Step 2: Participants receive EAs: Dr EAs Cr Government grant liability	Step 2: Dr Govt grant asset Cr EAs
Step 3 Emissions occur: Dr Expense (emissions) Cr Liability to submit Eas Dr Government grant liability Cr Revenue (govt. grant)	Step 3: Dr Right to receive EAs Cr Revenue Dr Expense Cr Govt. grant asset
Step 4: Submit EAs Dr Liability to submit EAs Cr EAs	Step 4: Dr EAs Cr Right to receive EAs

Approach 3, *Pollutant Pricing Mechanisms*

Step 1 Administrator creates EAs

Dr EAs

Cr Gain on asset creation (nil value, initial cost)

Step 2 Administrator transfers EAs (start of compliance period)

Dr Government grant asset

Cr EAs

Approach 3, *Pollutant Pricing Mechanisms*

Step 3 Emissions occur (during compliance period)

Dr Right to receive EAs (as emissions occur)

Cr Revenue

Dr Expense (spread over period; transfer)

Cr Government grant asset

Step 4 EAs received back from participants

Dr EAs

Cr Right to receive EAs

Approach 3, *Pollutant Pricing Mechanisms*

Step 1 Administrator creates EAs

EAs: Asset? *Conceptual Framework:* Control ✓ Past event ✓
Resource ✓ (Yes, ability to generate cash flows)

Step 2 Administrator transfers EAs (start of compliance period)

EA grant: Asset? *Conceptual Framework:* Resource? What
does this asset represent?

Control of EAs has fully transferred.

Participants will recognize expense for
obligation to submit EAs (see Step 3)

Approach 3, *Pollutant Pricing Mechanisms*

Step 3 Emissions occur (during compliance period)

(a) Right to receive EAs: Asset? *Conceptual Framework*: Control ✓

Past event ✓ Resource?

Able to generate cash flows? Service potential?

(b) “Transfer expense” spread through compliance period

Step 4 EAs received back (end of compliance period)

What happens now? Impair EAs down to zero?

Issue: Are EAs assets, after they are issued?

Approach 4, *Emission Limits (Taxes and Contingencies)*

Focus on cash received from transfer or sale of EAs

Step 1 Administrator creates EAs (EAs are not recognized as assets)

No accounting entries

Step 2 Administrator transfers EAs (start of compliance period)

Dr Cash from transfer/sale

Cr Tax revenue received in advance

Approach 4, *Emission Limits (Taxes and Contingencies)*

Step 3 Emissions occur (during compliance period)

No accounting entries

Step 4 EAs received back (end of compliance period)

Dr Tax revenue received in advance

Cr Revenue (tax)

Approach 4, *Emission Limits*: Disclosure of Contingencies

- **Participants** disclose contingent asset or contingent liability
 - Contingent asset if expect to emit *less* than EAs received
 - Contingent asset if expect to emit *more* than EAs received
- **Administrator** discloses contingencies—two options
 - Option A: *Symmetry*: Contingency to reflect position for whole group of participants; expect to exceed cap or expect to stay beneath cap?
 - Option B: No contingency

Approach 4, *Emission Limits (Taxes and Contingencies)*

Step 1 Administrator creates EAs, which are not recognized as assets:

- Are EAs assets? Resource ✓ control ✓ past event ✓
- EAs only a device to create an ETS, with Administrator's charges a separate issue?

Step 2 Administrator transfers EAs; recognizes cash and tax revenue received in advance:

- Should an expense for decrease in EAs be recognized?
(From step 1: No asset, no expense)