STAFF PAPER

16—17 July 2015

Accounting Standards Advisory Forum

Project	**Pollutant Pricing Mechanisms (formerly Emissions Trading Schemes)**		
Paper topic	Cover note		
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Introduction

1. In January 2015, the IASB decided to take a fresh approach to looking at how to account for pollutant pricing mechanisms.

2. In its June 2015 meeting, the IASB will consider the following papers, which were numbered 6A and 6B for the IASB meeting but have been renumbered as papers 7A and 7B for this ASAF meeting:

   (a) Agenda Paper 6A/7A *Why do we need a fresh approach?* This paper highlights some of the difficulties encountered in earlier approaches to the issue, which tried to fit emission allowances and the related obligations created by the mechanisms into existing Standards.

   (b) Agenda Paper 6B/7B *Comparison of possible approaches—a simplified example*. This paper provides a simple numerical example of a typical cap-and-trade type of emissions trading scheme (ETS). It shows how different accounting approaches produce different results in the statements of financial position and profit and loss and other comprehensive income. The approaches outlined represent some common approaches used in practice. The purpose of the paper is to demonstrate the accounting entries and resulting financial statement line items that have developed in the absence of specific guidance in IFRS.

3. The agenda papers are provided to the Accounting Standards Advisory Forum (ASAF) members for background information. The questions related to the advice that we are seeking from members of the ASAF are contained with this cover note.

Background

4. As noted in Agenda Paper 6A/7A, the nature of the allowances created for use in cap-and-trade ETS have some unique characteristics that make them difficult to classify within the existing categories of assets in IFRS. Consequently, some of the accounting treatments outlined in Agenda Paper 6B/7B that have been proposed or applied in practice since the withdrawal of IFRS Interpretation 3 *Emission Rights* (IFRIC 3) reflect different preferences in classification. The accounting approaches outlined in Agenda Paper 6B/7B also reflect different preferences towards treating allowances and related liabilities as separate items or considering them together as a 'natural hedge'.

5. At this time, we are looking for the ASAF to express non-binding, free-thinking ideas as a first step to developing our thinking about which possible accounting models could be developed for consideration in a Discussion Paper about this project. We do not want the ASAF's thinking to be restricted by existing Standards or past efforts or analysis.

6. Although the staff are interested in hearing ASAF members' views about any preferences they have for the accounting approaches outlined in Agenda Paper 6B/7B, the approaches contained in that paper are not intended to be used as a list of options. They are intended as a starting point for discussion to enable the staff to analyse views about the advantages and disadvantages of various approaches. Other approaches may be more appropriate.

7. The journal entries and summary financial statement presentation items focus on Entity 1 of the examples. This is a very simple example in which, for the first year of the scheme, the entity receives free-of-charge from the government the number of allowances equal to the volume of pollutants that it emits during the year. Consequently, when the first compliance year is considered in isolation, there is no net gain or loss related to that compliance year. However, the fact

pattern indicates that Entity 1 will receive fewer allowances from the government in the following and subsequent years. As a result, if the entity continues to emit the same volume of pollutants in future years, it will have a shortfall of allowances and will need to take some sort of action to mitigate this exposure.

8. The paper contains further examples, which are intended to draw out further issues to demonstrate a wider view of the economic effects of the ETS.

Questions for the ASAF

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1. Do members of the ASAF have a preference for any of the approaches demonstrated in the examples in Appendix C of Agenda Paper 6B/7B or another approach? If so, why? 2. Do you have any comments about the nature of any of the assets or liabilities that you think should be reported? 3. Do you suggest any alternative approaches? 4. Do ASAF members have any further comments on the accounting issues identified through Entity 1 and any further examples discussed that the staff should consider in a future paper to be brought to the IASB?

Next steps

9. At this stage, we are looking at generating thought-provoking ideas and possible approaches. The staff will then analyse any possible models that the IASB would like to explore in more detail through the Discussion Paper. This analysis will involve comparison to the concepts in the *Conceptual Framework* and the existing requirements of IFRS.