IFRS Accounting

Staff paper

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Project	**Pollutant Pricing Mechanisms**
Topic	**Summary of feedback – national standard-setters**
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Purpose and structure

1. The purpose of this paper is to summarise feedback from national-standard setters responding to our questionnaire asking about the prevalence and significance of pollutant pricing mechanisms to the financial statements of IFRS reporters in their jurisdictions.

2. This paper is structured as follows:
   - (a) background information on the questionnaire (paragraphs 3-5);
   - (b) key messages (paragraphs 6-12);
   - (c) feedback summary;
     - (i) compliance schemes (paragraphs 14-29);
     - (ii) voluntary schemes (paragraphs 30-37);
     - (iii) entities that generate or issue credits (paragraphs 38-42);
   - (d) appendix A – list of respondents to questionnaire;
   - (e) appendix B – approaches observed in practice to account for compliance schemes.

Background information on the questionnaire

3. As part of horizon scanning activities the staff performed outreach with national standard-setters. A questionnaire was developed and distributed to members of the Accounting Standards Advisory Forum (ASAF).[1]

4. The questionnaire had three sections: compliance schemes; voluntary schemes; and entities that generate and issue credits. The questions were prepared to gather evidence about:

    (a) the prevalence of pollutant pricing mechanisms;

    (b) the types of entities affected by pollutant pricing mechanisms;

    (c) the significance of pollutant pricing mechanisms to the financial position, financial performance and cashflows of IFRS reporters;

    (d) the accounting issues arising from pollutant pricing mechanisms including whether there is diversity in practice or other deficiencies in accounting; and

    (e) the importance of information about pollutant pricing mechanisms to users of financial statements and whether any deficiency in the accounting adversely affects the usefulness of information.

5. We distributed the questionnaire in January 2024 and requested responses by the end of March. We received 20 responses, with regional groupings submitting individual responses from some of their members. The table below provides a breakdown of responses by geographical region. Appendix A provides the list of respondents.

Region	**Number of respondents**
Africa	1
Asia-Oceania	6
Europe	6
Latin America	5
North America	2

[1] Agenda Paper 10C, *Pollutant pricing mechanisms survey and questionnaire*, includes the questionnaire distributed to ASAF members

Key messages

6. Most respondents reported that some form of compliance scheme currently exists in their jurisdiction. Almost all respondents said that there are plans to either introduce new compliance schemes or expand the scope of existing schemes in their jurisdictions, suggesting that the prevalence of these schemes is increasing.

7. Although many respondents noted that the financial effects of compliance schemes on IFRS reporters is not significant at this time, they expect this to change as governments and jurisdictions continue to look for ways to meet their climate-related commitments.

8. Many respondents reported diversity in accounting for compliance schemes.

9. Most respondents said they believe the prevalence of voluntary schemes is increasing in their jurisdictions and they expect the financial effects of voluntary schemes to become more significant.

10. Some respondents said they have observed diversity in accounting for voluntary schemes.

11. Most respondents did not have enough information to estimate the number of IFRS reporters in their jurisdiction that generate or issue credits, but believe the number is low.

12. Some respondents noted that they are conducting or plan to conduct research on pollutant pricing mechanisms.

Feedback summary

13. The feedback below has been structured in the same way as the questionnaire, summarised as follows:

    (a) compliance schemes;

(b) voluntary schemes; and

(c) entities that generate or issue credits.

Compliance schemes

Prevalence and types of entities[2]

14. Most respondents reported that some form of compliance scheme currently exists in their jurisdiction. Most schemes described were cap-and-trade schemes, particularly amongst respondents from the European Union who noted that the EU ETS was the largest scheme in their jurisdiction.

15. Almost all respondents said that there are plans to introduce new compliance schemes, either for the first time or in addition to existing schemes. For example, the European Commission recently reformed the EU ETS framework by expanding its scope and introducing a new separate ETS.[3] Scope expansion is also planned in China, where the national ETS which covers the power sector and currently accounts for over 40% of the country's carbon dioxide emissions, is expected to be gradually expanded to cover an additional seven sectors.

16. Many respondents noted that compliance schemes cover entities in electricity and heat generation, energy-intensive industries including oil and gas, steel, chemicals and pulp, aviation, and manufacturing industries. Some also listed agriculture, mining and waste disposal as industries covered by compliance schemes.

17. A few respondents noted that mandatory participation was not industry specific but instead applied to any entity with annual emissions above a specified threshold.

[2] Summary feedback of questions 1.1, 1.3 and 1.5..

[3] Further information about the reforms to the EU ETS can be found here: EU ETS reforms

Significance[4]

18. Respondents provided mixed responses when asked whether the number of IFRS reporters in their jurisdictions participating in compliance schemes is significant:

    (a) A few indicated that the numbers were significant.

    (b) A few said the numbers were low or insignificant.

    (c) A few reported that there were no compliance schemes in their jurisdictions.

    (d) A few noted that they did not have this information or could not provide an estimate.

19. A few respondents provided an estimate of the percentage of listed entities participating in compliance schemes, which ranged between 7-12%.

20. Many respondents reported that the financial effects of these schemes did not appear to be significant to the financial position, financial performance and cash flows of the entities participating in compliance schemes. A few respondents commented that it was difficult to assess the significance of the schemes to the financial position, financial performance and cash flows because disclosures are limited. A few suggested that the limited disclosures could imply that the financial effects of the schemes are not material.

21. A few respondents reported that the approach used by an entity to account for the emissions allowances also determined how significant the financial effects were. Some of the accounting approaches result in little effect on the financial position or financial performance if credits are acquired for little or no cost and the entity holds sufficient credits to meet its obligations under the scheme. Paragraph 26 discusses the accounting approaches used in practice.

22. Some respondents reported that the effects of these schemes can be significant, but the significance depends on factors such as; the size of the entity, the level of excess

[4] Summary feedback of questions 1.2 and 1.4.

emissions produced by the entity, and the sector in which the entity operates. Entities operating in emissions-heavy sectors such as the energy and aviation were listed as those most affected.

23. One respondent shared the research they had conducted on ten IFRS reporters in the aviation industry. Of the seven who separately disclosed emissions trading certificates, the average amount of emissions trading certificates disclosed had increased from £79m in 2021/2022 to £234m in 2022/2023.

24. Some respondents said that they expect the financial impacts of compliance schemes to increase in significance as the number and scope of compliance schemes grows, carbon prices increase, and the number of allowances allocated for free is reduced.

Accounting diversity[5]

25. Although a few respondents noted that their jurisdictions have developed guidance, most respondents reported that there is no specific guidance in their jurisdictions on how to account for compliance schemes. As a result, many respondents reported that they have observed diversity in accounting for compliance schemes.

26. In the absence of guidance, respondents described various approaches used by entities in their jurisdictions to account for the rights and obligations arising from these schemes. Some noted that entities used the 'emissions rights' approach, some described entities using the 'government grant' approach, and some reported entities used the 'net liability' approach. [6] Appendix B provides a brief description of these approaches.

27. Some respondents provided evidence of the diversity observed. For example;

[5] Summary feedback of questions 1.6-1.9.

[6] The 'emissions rights' approach was the approach described in IFRIC *3 Emissions Rights* which was withdrawn because of concerns about accounting mismatches.

(a) One respondent reported that among the ten largest IFRS reporters in their jurisdiction who disclosed information about pollutant pricing mechanisms, there was diversity in the classification of emissions rights:

   (i) held for own use—they were classified as either inventory or intangible assets; and

   (ii) held for trading—they were classified as either derivatives or inventory.

(b) One respondent referred to a study which analysed the financial statements of 34 steelmakers, and found that of the 15 IFRS reporters, eight disclosed information about pollutant pricing mechanisms. For granted allowances, five recorded them at nil, and two at fair value (one did not disclose this information). For purchased allowances, almost all measured them at cost, however there was diversity in how they classified them – as either inventory or intangible assets.

(c) One respondent reported that they had conducted research using a sample of ten IFRS reporters in the aviation industry which showed that there was diversity in the classification and measurement of emissions allowances. Seven classified them as either inventory or intangible assets (two classified as current intangible assets and three as non-current intangible assets), and two expensed them (one did not disclose the classification basis). Eight measured them at cost, and one at fair value (one did not disclose the measurement basis).

28. Many respondents said it was difficult to assess whether the diversity in practice adversely affects the usefulness of the information provided to users. However, some respondents provided feedback from investors who expressed concerns about the lack of transparency, consistency, and comparability within industries and across sectors.

29. One respondent reported that they could not determine whether there was diversity in practice because information disclosed was limited, which, in their view, suggested that the financial effects were not yet material for many entities.

Voluntary schemes

Prevalence and types of entities[7]

30. Almost all respondents reported that IFRS reporters in their jurisdictions participate in the voluntary market, and that some form of voluntary scheme exists. When asked to describe the types of entities participating in voluntary schemes, respondents described entities in a wide range of industries including power generation, agriculture, forestry, transportation, mining, real estate, and finance. Some respondents noted they did not have the information to describe the types of entities.

31. Most respondents reported that the prevalence of voluntary schemes is increasing.

32. One respondent shared feedback from outreach with stakeholders. These stakeholders said that the prevalence and significance of both compliance and voluntary schemes is increasing and is likely to become more material in the short to medium term.

33. One respondent said that their research suggests that the prevalence of the use of voluntary credits increased rapidly for several years but had tapered off in recent years. This respondent cited the example of two large entities that had pulled back from the voluntary market and purchase of carbon offsets, shifting instead towards investing in infrastructure and technologies to reduce their carbon emissions.

Significance[8]

34. Respondents provided mixed responses when asked whether a significant number of IFRS reporters in their jurisdictions participate in voluntary schemes:

    (a) A few indicated that the numbers were significant.

    (b) A few suggested that the numbers were low but expected to increase.

    (c) A few noted that there was insufficient information available to determine this.

[7] Summary feedback of questions 2.1, 2.3 and 2.4.

[8] Summary feedback of questions 2.2 and 2.5.

35. Many respondents said that the financial effects of these schemes did not appear to be significant to the financial position, financial performance and cash flows of entities participating. However, some suggested that the financial effects can be significant for entities in certain industries like energy or agriculture. One respondent noted that stakeholders in their jurisdiction considered the financial effects of voluntary schemes to be increasingly important as target dates for net zero commitments approached. Some reported that they did not have the data to assess the financial effects.

Accounting issues[9]

36. Most respondents reported that voluntary schemes give rise to accounting issues that are difficult to resolve. Some noted that the issues were similar to those in the compliance market such as issues related to the classification of carbon credits, and measurement approaches. Other issues raised include:

    (a) determining whether an asset exists, and at what point it should be recognised;

    (b) determining whether an active market exists for valuing carbon offsets; and

    (c) determining whether a liability should be recognised in respect of a commitment to reduce carbon emissions.

37. Some respondents reported observing diversity in accounting for voluntary schemes. A few shared feedback from investors about the effect of this diversity. For example:

    (a) One respondent said they received complaints from investors about the transparency, consistency and lack of information provided by entities.

    (b) One respondent reported that their investor outreach indicated that voluntary pledges and commitments did not have a significant effect on investors' analysis. However, if these activities were to become more significant in the future, investors would prefer entities to account for similar commitments consistently.

[9] Summary feedback of questions 2.6-2.9.

Entities that generate or issue credits

Prevalence and types of entities[10]

38. Many respondents reported that they are aware of IFRS reporters in their jurisdiction that generate or issue credits. Most described a system where projects developed to reduce or remove greenhouse gas emissions are verified and certified by a third party. Some noted that credits created by these projects can be used to reduce or settle a compliance obligation.

39. When asked to describe the types of entities that generate or issue credits, respondents listed entities across various industries including energy generation, resource development, renewable energy, investment and private equity firms, real estate and agriculture.

Significance and accounting issues[11]

40. Most respondents could not provide an estimate of the number of IFRS reporters that generate or issue credits, many noting that there was insufficient information disclosed by entities to determine this. Most believed the number to be low, but that it was increasing.

41. Similarly, because of the insufficient information available, almost all were unable to determine the significance of the financial effects but estimated it to be limited.

42. Some respondents reported that issuing or generating credits gives rise to accounting issues that are difficult to resolve and had observed diversity in practice, particularly related to the treatment of costs of generating credits and whether they should be expensed or capitalised.

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[10] Summary feedback of questions 3.1-3.5.

[11] Summary feedback of 3.6-3.9.

Appendix A – List of respondents to the questionnaire

A1. We received responses from the following national standard-setters and regional bodies:

Region	#	Respondents
Africa	1	Pan African Federation of Accountants
Asia-Oceania	6	Individual responses from AOSSG members: • Australian Accounting Standards Board • Accounting Regulatory Department, PRC Ministry of Finance China • Accounting Standard Board of Japan • Hong Kong Institute of Certified Public Accountants • Korea Accounting Standards Board • New Zealand External Reporting Board
Europe	6	Autorité des norms comptables Accounting Standards Committee of Germany UK Endorsement Board EFRAG including individual responses from: • Denmark • Portugal • Norway
Latin America	5	Individual responses from GLASS members: • Argentina • Columbia • Costa Rica • Mexico • Panama
North America	2	Canadian Accounting Standards Board Financial Accounting Standards Board

Appendix B – Approaches observed in practice to account for compliance schemes

B1. In the absence of guidance, several approaches have developed in practice to account for the rights and obligations arising from participation in compliance schemes. The following table highlights the three main approaches.

	'Emissions rights' approach	'Government grant' approach	'Net liability' approach
Allowances or credits	Allowances or credits are recognised as intangible assets, initially measured at fair value and subsequently at either cost or fair value applying IAS 38 *Intangible Assets*.		Allowances or credits are recognised as intangible assets and measured initially and subsequently at cost. For granted allowances or credits this is usually a nominal amount.
Government grant	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 for Government Grants and Disclosure of Government Assistance*. The grant is recognised as a deferred income in the statement of financial position and subsequently recognised as income on a systematic basis over the compliance period.		Not applicable

	'Emissions rights' approach	'Government grant' approach	'Net liability' approach
Liability	A liability is recognised as emission are made and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, at the best estimate of the expenditure required to settle the present obligation.	A liability is recognised as emissions are made and measured based on the carrying amount of the allowances or credits held. If emissions exceed allowances or credits held, the liability is measured based on the market value of the allowances or credits needed to settle the liability for excess emissions.	A liability is recognised as emissions are made and measured based on the carrying amount of allowances or credits held. If the allowances or credits held are measured at nil and sufficient to cover actual emissions, then the liability is measured at nil. In addition, if the entity holds allowances or credits equal to the emissions liability the effect on the net assets is nil.