



4 July 2011

Mr. Hans Hoogervorst

Chairman

International Accounting Standards Board

30 Cannon Street

London EC4M 6XH

UNITED KINGDOM

Dear Hans,

Re: AOSSG's Preliminary Observations on IASB's Emissions Trading Schemes Project

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the Emissions Trading Schemes (ETS) project.

The AOSSG has 25 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macau, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam.

This comment letter has been drafted by the AOSSG ETS working group and reflects in broad terms the collective views of the AOSSG members. Individual members may also choose to make separate submissions that agree or disagree with aspects of this submission. The intention of the submission is to provide timely inputs to the IASB, while we acknowledge that it will take more time to come towards a due-process document.

The AOSSG's views on how to proceed with the project can be summarised as follows:

- Given the need for an authoritative standard on ETS, the IASB should allocate more resources on the project and accelerate the standard setting process.
- The IASB should expand the scope of the project so as to address issues in broad areas, *inter alia*, Cap and Trading Schemes, Baseline and Credit Schemes, Clean Development Mechanism project activities, and Certification of Renewable Energy and so forth.
- Taking into account the significant degree of variations in practice, more outreaching activities and field testings should be conducted world-wide including the Asia-Oceania region before standards are finalised.

To assist the IASB in advancing the project, we formulated the following preliminary observations for key issues, after conducting survey to limited membership and discussion afterwards.

Granted Allowances

(a) Assets related to allowances

We believe that intangible assets should be recognised when the entity substantively obtains control of the allowances. Some AOSSG members believe that an intangible asset should be

measured at fair value both initially and subsequently, while others believe that it should not be re-measured at fair value subsequently.

(b) Liabilities related to allowances

We do not believe that liabilities should be recognised when an entity receives granted allowances, because it does not incur present obligation solely upon the receipt of the granted allowances. Rather, liabilities related to the allowances should be recognised when the entity actually emits. Many AOSSG members believe that liabilities should be measured at fair value when the entity actually emits and remeasured at fair value subsequently.

(c) Concurrent deliberation on IAS 20 with the recognition of granted allowances as assets

We believe that the ETS project should be conducted concurrent with the revision of IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* to account for the corresponding credit of the granted allowances to be recognised as assets.

Purchased Allowances

We believe that purchased allowances should be recognised as assets when acquired, and measured in the same manner as granted allowances.

Certified Emissions Reductions under the Clear Development Mechanism

As the IASB has not undertaken extensive research on the accounting for Certified Emissions Reductions (CERs) under the Clean Development Mechanism (CDM), we encourage the IASB to address the issue, which are critical for the Asia-Oceania region. Having noted that there are two alternatives suggested on the nature of CERs: inventories or intangible assets, we recommend that the IASB undertake further research on this issue.

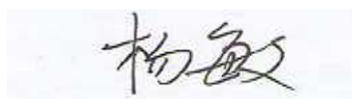
Our observations on respective issues are detailed in Appendix. The AOSSG has always hoped to participate in the process of setting a single set of high quality global accounting standards, and believes that the IASB finds our observations valuable.

If you have any queries regarding any matters in this submission, please contact us.

Yours Sincerely,



Ikuo Nishikawa
Chairman of the AOSSG



Yang Min
Leader of the AOSSG
ETS Working Group

Appendix

The AOSSG's Preliminary Observations on IASB's Emissions Trading Schemes Project

For convenience, we have summarised our understanding of the IASB's preliminary views, contrasted with the AOSSG's preliminary observations on them for respective topics.

1. Scope of ETS project

IASB: Scope of IFRIC 3 withdrawn in 2005 by the IASB was confined to Cap and Trading Schemes. In May 2008, the IASB tentatively decided to extend the scope of the ETS project to include all emissions trading schemes and tradable rights, including (a) the issue of accounting for all tradable emissions rights and obligations arising under ETS; and (b) the issue of accounting for activities that an entity undertakes in contemplation of receiving tradable rights in future periods. The IASB currently focuses on the Cap and Trading Schemes, and has not addressed the issue in accounting for Project-based Certificates and Renewable Energy Certificates etc.

AOSSG: With increasing awareness of global warming, many jurisdictions try to reduce emission by implementing ETS, CDM project activities, Pollution Rights Trading Mechanisms or Renewable Energy Certificates. Hence, the AOSSG recommends that the IASB consider all mechanisms stated above in order to address entire issues related to recognition and measurement of assets and liabilities related to ETS.

2. Recognition & Measurement of Granted Allowances

(1) Recognition & Measurement of Allowances

A) Recognition

IASB: Granted allowances fall into the definition of "asset", and should be recognised when an entity acquires these allowances.

AOSSG: The AOSSG stands on the same side with the IASB on this issue, but the timing of recognition requires further clarification. Since granted allowances are categorised as intangible assets acquired by way of government grants in accordance with IAS 38, the allowances should be recognised based on the requirements of IAS 20. IAS 20 requires that government grants shall not be recognised until (a) an entity will meet with the conditions attaching to them and (b) the grants is received. There is a question whether the entity should recognise these allowances when it actually receives them or when it has the right to receive them.

The AOSSG understands based on the conceptual framework that an entity should not recognise a resource as an asset until it has owned or controlled the resource that creates

benefits to flow into. Therefore, the AOSSG believes that the granted allowances should be recognised as assets when an entity actually controls the granted allowances.

B) Nature of the assets

IASB: Granted allowances should be assets, pending the analysis of their nature.

AOSSG: The AOSSG agrees with IASB's preliminary view, since granted allowances fall within the definition of intangible asset in IAS 38 (nonmonetary asset without physical substance).

Some believe that allowances should be treated as financial instruments. However, the AOSSG does not support the view, because (a) the granted allowances are neither equity instruments nor contractual rights to receive cash or other financial assets, which means they are outside the definition of financial assets in IAS 32; and (b) the allowances do not fall within the definition of derivative which includes "no initial net investment or significant less initial net investment than expected initial net investment required by other types of contracts with similar market volatility" and "future settlement".

In addition, a few AOSSG members believe that allowances should be recognised as inventories when an entity receives allowances with an intention to hold them for trading purposes, while it should be recognised as intangible assets when it intends to use them itself. One AOSSG member believes that allowances may be treated as raw materials (inventories) and included in the costs of goods sold when they are used up in the production process. However, these approaches may not produce useful information for users, because it is complex and it would reduce comparability between entities. Specifically, it would be difficult to demonstrate the entity's intention either for *trading* or *held for use* at initial recognition, and as intention often changes over time. Therefore, the AOSSG believes that allowances should be recognised as intangible assets.

C) Initial Measurement

IASB: Granted allowances should be initially measured at fair value.

AOSSG: In light of faithfully representing the economic value of controlled resources in the financial statements, the AOSSG agrees with the IASB's tentative decisions. However, if granted allowances are treated as deferred income, the fair value measurement may conflict with the current measurement requirements in IAS 20 which allows government grants to be initially measured at fair value or nominal amount. Therefore, the AOSSG suggests that the IASB revise IAS 20 simultaneously in order to ensure the consistency between them.

D) Subsequent Measurement

IASB: At its meeting in November 2010, it was decided that allowances should be required to be subsequently measured at fair value.

AOSSG: Some AOSSG members agree with the IASB's tentative decision which requires the

allowances to be measured subsequently at fair value, to be in line with the IAS 38. However, when some jurisdictions adopted IFRSs or converged their standards with IFRSs, they only incorporated the cost model to measure intangible assets. In order to avoid the conflicts between their standards and IFRSs, the AOSSG suggests revisiting IAS 38 to exclude granted allowances from its scope, and to require granted allowances to be subsequently measured at fair value.

Other members believe that the granted allowances should be initially measured at fair value but not be re-measured subsequently, because gains or losses from fluctuations of market value are not relevant to an assessment of performance of the entity that intends to use the allowances to offset its emissions, rather than sell them.

(2) Recognition & Measurement of Liabilities Related to the Allowances

A) Recognition

IASB: IFRIC 3, withdrawn in 2005, required an entity to recognise liabilities when there is need for the entity to submit the allowances to compensate the obligations from emission. However, in its recent meetings, the IASB tentatively decided to change the timing of recognition, so that the entity should recognise the liabilities when it receives the granted allowances.

AOSSG: The AOSSG does **NOT** agree with the IASB's tentative decision, and instead proposes that the related liability be recognised when actual emission incurs, given that the IASB's conceptual framework defines a liability as a current obligation with unconditional occurrence.

The AOSSG believes that, when the entity receives the granted allowances, there is no obligation to deliver when no emission incurs, therefore there is no current obligation. Moreover, the entity can avoid the obligation by ceasing its operation, or otherwise preventing emissions which creates uncertainty on the timing and amount of such obligation. Hence, the AOSSG considers that a reporting entity should not recognise the liability until actual emission incurs and it needs to deliver allowances to compensate for the emission, which creates a current obligation and eliminates the uncertainty of timing and amount.

B) Measurement

IASB: At its recent meetings, the IASB has reached the conclusion to measure the liability at fair value, in order to avoid mismatching of valuation models of the allowances and those of the liabilities.

AOSSG: Some AOSSG members agree to measure liability at fair value both initially and subsequently, aiming to avoid mismatching of valuation between allowances and liabilities. Other members believe that the liability should be measured based on the carrying amount of allowances on hand plus market value of any excess of emissions liability over the allowances at hand.

(3) Concurrent deliberation on the IAS 20 with the recognition of granted allowances as assets

IASB: Based on IFRIC 3, the entity should follow IAS 20 and recognise government grants as deferred income when it receives the allowances, and amortise the deferred income as income on a systematic basis. Since the IASB re-started the project, this issue has been discussed, but the final decision has not been made yet. Up to date, the IASB tentatively decided that the allocation of allowances creates an obligating event that meets the definition of a liability and should be recognised as such in the statement of financial position.

AOSSG: The AOSSG agrees with the principle of accounting treatment under IAS 20, but proposes further research on the nature of deferred income and the timing and method of recognition of government grants. The AOSSG hopes that the IASB will give holistic consideration to these issues in the process of the IAS 20 revision, including presentation of the gain in other comprehensive income. As mentioned in its Agenda Paper 10B for the September 2010 meeting, there may be alternative methods regarding accounting for gain, one of which is to defer it while the other is to present it in OCI.

(4) Presentation & Disclosure

IASB: At the joint meeting of the IASB and the FASB in November 2010, it's been proposed to present the net value of allowance asset after offsetting an allowance liability, but any tentative decision in the IASB has not been made yet.

AOSSG: Most AOSSG members **oppose** this proposal and instead propose separate presentation of the allowances and liabilities related to the allowances on the balance sheet to help users get more information.

Following are considered to be relevant as disclosure requirements in the notes:

- (a) The entity's involvement in ETS, risk assessment of climate change, and description of emission reduction strategy and allowance management;
- (b) Illustration of accounting policy and estimates;
- (c) Quantity and monetary value of granted allowances and purchased allowances, and quantity and monetary value of allowances used to compensate for emission activities; and
- (d) The possession and sale of CER.

3. Recognition and Measurement of Purchased Allowances

IASB: In the joint meeting of the IASB and the FASB in September 2010, this issue was raised and they have reached the conclusion that purchased allowances fall into the definition of assets and should be recognised as such, and the initial and subsequent measurement principles should be aligned with granted allowances.

AOSSG: The AOSSG believes that the purchased allowances meet the definition of assets;

thus should be measured initially at fair value. The subsequent measurement principles should align with granted allowances. However, an AOSSG member considers that the purchased allowances should be measured according to the cost model.

4. Accounting for CDM

Clean Development Mechanism (CDM) refers to the mechanism in the Kyoto Protocol which promotes emission obligated business entities in developed countries to cooperate with business entities in developing countries in order to reach a target of carbon dioxide emission reduction. Entities from developed countries could purchase Certification Emission Reductions (CERs) to compensate for their emission obligations.

IASB: The IASB has not launched any research on this issue yet.

AOSSG: The AOSSG recommends the IASB to accelerate study on CDM-related accounting to fill the vacuum in this area.

(1) Accounting treatments of CER Supplier

With respect to the accounting treatments of CERs suppliers, there are two proposals for the IASB's consideration while the AOSSG plans to conduct further research on this issue.

A) Recognition

Under the IASB's conceptual framework, the definition of an asset refers to a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. In regard to the CERs,

- (a) the entity will not acquire the CERs until it has taken some actions to reduce the emission and the emission reductions have been certified by U.N. CDM Executive Board, which indicates that CERs are a result of past events;
- (b) The entity has the ownership of CERs, which indicates that it controls the CERs;
- (c) The entity can sell CERs in the market and the economic benefits will flow to the entity, which indicates that the CERs can cause economic benefits to flow in.

Hence, CERs satisfy the definition of assets. Moreover, the inputs the entity has made to produce CERs are separately identifiable and the transaction price is specific, which means the cost and the valuation of CERs can be reliably measured. To summarise, the AOSSG suggests that CERs be recognised as assets.

The AOSSG members have different views on the nature of CERs. Some members think that CERs should be recognised as inventories for the following reasons:

- (a) CERs satisfy the definition of inventory. IAS2 defines "inventory" as assets held for sale in the ordinary course of business (finished goods), assets in the production process for sale in the ordinary course of business (work in process), and materials and supplies that are consumed in production (raw materials), since CERs is derived from operation of

- emission reduction and the purpose of holding CERs is to sell them after the certification,
- (b) The economic benefits of CERs can flow to the entity. There is a trading market available for CERs, and the transaction price can be identified, which indicates that CERs tradable with monetary prices would lead to actual economic benefits; and
 - (c) The cost of CERs can be measured on a reliable basis.

Other members believe that CERs should be recognised as intangible assets. A supporting reason is that CERs are not monetary, do not have physical substance and can be separately identified, which satisfies the definition of intangible asset according to IAS 38. Along with consideration that CERs can be traded in the same market as granted allowances and the effects of compensating the emission obligation is the same, indicates the same nature of the two items, and that CERs should be recognised as intangible asset in the same way as granted allowances. In addition, taking into account that the CERs are a kind of right to offset the obligation to deliver the allowances, not the tangible goods which actually exist, the entities should recognise the CERs as intangible assets, according to the accounting of patents, concessions and licences. Moreover, the costs and the expenses that the entities bear in the process of acquiring the CERs may not be reliably measurable.

AOSSG: The AOSSG leans towards opting for recognition of CERs as intangible assets. Given the uncertainty of CER production and certification, the AOSSG recommends that an entity should recognise CERs when the entity expects the emission reduction can be certified and the economic benefits can flow to the entity, otherwise it should recognise CERs when the U.N. Executive Board issues the certificate.

B) Measurement

AOSSG:

If CERs are recognised as inventories, the entity could apply initial and subsequent measurement in accordance with IAS 2.

If CERs are recognised as intangible assets, the entity could initially classify the CERs as the intangible assets acquired by way of a government grant in accordance with IAS 38, measure CERs at fair value, and apply the revaluation model for the subsequent measurement (Paragraph 85 and 86, IAS 38) with no amortization.

The AOSSG recommends that CERs be measured at fair value both initially and subsequently.

C) Revenue from CERs Sale

AOSSG:

If CERs are recognised as inventories, the entity should apply IAS 18 to account for them as income. On the other hand, if CERs are recognised as intangible assets, the entity should apply IAS 38 to account for them as gains or losses.

In addition, as required by U.N. CDM Executive Board and some authorities in developing countries, proportionate fees are collected from CER transactions as management benefits of

the UN and the country where the entity takes part in CDM. This portion should be recognised as liabilities rather than revenue.

The AOSSG proposes that the revenue from CERs be accounted for based on the requirements regarding disposals of intangible assets in IAS 38.

(2) Accounting of CER Buyers

The AOSSG proposes that CER buyers use the same accounting treatments as the entities that purchase allowances.