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EFRAG  
Françoise Flores  
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16. Sitzung IFRS-FA am 16.05.2013  
16\_02a\_IFRS-FA\_ETS\_DCL

Berlin, 3. Mai 2013

B-1000 Brussels

Dear Françoise

### **EFRAG Draft Comment Paper: Emissions Trading Schemes**

On behalf of the Accounting Standards Committee of Germany, I am writing to comment on the Draft Comment Paper *Emissions Trading Schemes* (hereinafter the “DCP”) issued by the European Financial Reporting Advisory Group (EFRAG) in December 2012.

We acknowledge that a variety of potential accounting policies and related interpretations for IFRS has been discussed in context of the European Emissions Trading Scheme and therefore our view and feedback does not object to the idea to carry out related research to improve existing IFRS. Hence we consider EFRAG’s de lege ferenda discussion in the DCP as a step in the right direction and as a reasonable starting point for further research by the IASB. Reflecting the issues addressed in the DCP by EFRAG, we believe it is even more important, future research activities also include a review of current reporting practice and identify existing problems for users when analysing financial statements.

We believe it is important to have a robust set of principle-based IFRS covering a wide range of transactions rather increasing the number of standards that address on a case-by-case basis specific transactions in specific business environments. In this light we do not support the view of a need for specific accounting guidance for Emissions Trading Schemes. We think accounting policy for Emissions Trading Schemes should be addressed within the scope of existing IFRS. Furthermore, in reaching out to German preparers on the DCP we

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learned that best practice guidance was developed in accordance with existing principles in current IFRS and this guidance is applied by major companies.

We noticed that the DCP especially focuses on the distinction of different accounting policies for Emissions Trading Schemes arising from different business models. In our view the proposed distinction between a “trading approach” and a “compliance approach” seems reasonable and we support such a segregation that already exists in IAS 2 *Inventories* and other IFRSs. However, we think the distinction criteria between a trading portfolio and a compliance portfolio of emission allowances should not primarily focus on the amount or the number of transactions relating to granted or purchased emission allowances as indicated in the DCP. We think it is more reasonable to link the distinction to entity’s risk management for emission allowances. A trading approach should not be forced by systematic transactions and sales in light of effective (working) capital management and other treasury activities, including the sale of excess of emission allowances by the entity, without increasing its risk exposure for future cash flows to redeem emission allowance to authorities.

We provide our detailed comments relating to the questions in the DCP with further information in appendix attached. If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely

*Liesel Knorr*  
President



## Appendix

Rn.28: Do you agree that specific accounting guidance is needed? Please explain why.

Rn.29: Do you agree with the arguments presented above? Should any other arguments be included?

We agree with EFRAG's view that emission allowances are intangible assets as defined in IAS 38 *Intangible Assets* and do not represent financial instruments. However, we believe IAS 38, similar to IAS 16 *Property, Plant and Equipment*, was developed in the light of reflecting entity's "infrastructure" of resources to run business activities and depicting entities long-term assets that are not part of the working capital used in the entity's normal operating/production cycle.

In reaching out to German entities we received a unanimous feedback that emission allowances are considered as short-term assets and managed as resources similar to other physical inventories in context of production and construction process and related greenhouse gas emissions. Purchase of emission allowances are not considered as typical capital expenditures. Therefore they consider accounting for emission allowances in accordance with IAS 2 *Inventories* is appropriate.

We also think it is more appropriate to consider emission allowances in context of inventories for business activities that cause greenhouse gas emission and the participation in the Emissions Trading Scheme. Hence, we think there is room for improvements in the long-standing IAS 2 and update the requirements to cover short-term intangible assets that are consumed in the normal operating/production cycle.

In the same way we think there should be clarifications relating to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* relating to the



questions arising from free allowances, especially whether the current options for measurement and presentation in IAS 20 should be retained. Furthermore, we see the necessity for improving the accounting guidance and the underlying concept of liabilities, especially if the liability depends on future activities of the entity.

We believe these improvements and clarifications in IFRS should not be developed solely on the basis for Emissions Trading Schemes. Therefore we do not agree with a need for specific accounting guidance and think that general, more principal based improvements should be made that can be applied to any Emissions Trading Scheme. We noticed that the DCP only addresses the cap and trade model in its current format and legal structure in Europe. We would like to highlight that not all Emissions Trading Schemes may be implemented in the European way as a cap and trade model. Furthermore, we also notice an ongoing political debate for potential changes to the structure of the European Emissions Trading Scheme to improve its effectiveness.

Rn.39: Do you agree with the analysis of information needs of users for each business model?

Rn.40: Do you agree that this should result in different accounting requirements?

From a general perspective, we agree that different nature of activities and related transactions should result in the necessity of considering different accounting requirements for an appropriate depiction of the entity's financial position and performance. Therefore, we would support EFRAG's consideration of having differing accounting requirements for emission allowances. We also believe this thinking is already part of IASB's consideration when developing new standards and requirements for transactions and events that affect the entity's financial position and performance.

Rn.56: Do you agree that free allowances should be measured at fair value at inception, this fair value being their deemed cost?



Rn.57: If not, what arguments detailed above do you not find convincing? How do you respond to them?

Rn.70: Which of the above options [for the counter entry as deferred income, OCI gain, or Day-1 gain in profit or loss] would you support? Please explain why.

Rn.88: Do you agree or disagree with EFRAG's proposal on the subsequent measurement of assets and liabilities? Please explain why

We think EFRAG needs to provide more information and explanation on its view because it is not clear to us whether these proposals in the DCP are considered as specific rules for free allowances in context of the European Emissions Trading Scheme. Especially we would like to get a better understanding whether the proposal for initial measurement and presentation at fair value as deemed cost should be applied to all government grants in the future or whether these proposals are considered exceptionally on the fact that the free allowances in the European Emissions Trading Scheme are tradable and an active market exists.

We do not form a view on these questions in this comment letter. Many issues relating to these questions will be part of a more fundamental debate in the ongoing revision of the Conceptual Framework project.

Rn.77: Do you agree that the liability should not be derecognised before the entity surrenders the rights to the Regulator (i.e. surrendering rights affects the entity's financial position and is not solely a compliance exercise)?

We do agree with EFRAG's view that the entity should not derecognise the liability before the entity surrenders the rights to the authority.



Rn.76: Do you agree that in a compliance model an entity should not offset the asset and the liability separately, because separate presentation provides more relevant information?

Rn.78: Do you agree that the entity's value changes with the act of emitting and that settling the obligation to the Regulator has economic value? Do you agree that balance sheet presentation is relevant to users?

We agree with the view that presentation in financial statements is important to achieve the overall objective to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.

It is not fully clear to us from the explanation in the DCP, how the argumentation of the term "economic value" is linked with the prediction of future cash flows in a compliance approach of a business model. It is our understanding from the DCP that in a compliance scenario the entity generally does not consider to generate additional cash flows from emission allowances. Hence, we see merits for the argumentation that the presentation should only focus on the depiction of the additional cash flows as outcome of the entity's participation in the Emissions Trading Scheme.

Rn.102: Which of the above alternatives [to classify trading and compliance portfolio] would you support? Please explain why.

The DCP states in paragraph 92 "*EFRAG believes that an entity that engages in systematic transfers or sales out of the compliance portfolio should not be allowed to apply the compliance accounting model described above*". We question this view and this kind of distinction between trading and compliance and would not support it without further clarification.



In our view the compliance approach should not be linked primarily to the amount or number of transactions. It would be more reasonable to link the distinction to the entity's risk management for emission allowances. Systematic transfers or sales in light of effective (working) capital management without increasing risk exposure on future cash flows to redeem emission allowance should not result in the application of a trading approach. This would also include selling any excess of emission allowances on systematic basis.

Rn.107: Which of the above alternative approaches would you prefer and why?

Currently, the IASB already lists on its research agenda future project activities relating to Emissions Trading Schemes as the result of the IASB agenda consultation. We think this is an appropriate approach, considering that this research activity will include thorough analyses of issues that exist in current reporting practice from a user perspective and will result in a corresponding research paper.

At this stage we believe it would be premature to start the development of amendments for IFRSs. We also think the mechanism for narrow scope amendments to existing IFRSs is not an appropriate alternative. Many issues discussed in the context of Emissions Trading Schemes address fundamental questions about concepts and assumptions underlying IFRS. Some of these concepts will also receive special attention for potential changes in the ongoing Conceptual Framework project by the IASB. As mentioned above, we also think developing a specific IFRS for emission allowances is not desirable. Improvements and clarifications should be made within the scope of existing IFRSs.