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EU ETS Carbon Accounting Report Launch

Co-Hosted by
Welcome Remarks

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President & CEO
IETA
EU ETS Carbon Accounting Report Launch

Moderator:

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European Policy Director
IETA

Presenters:

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Partner, National & Global Accounting
PwC

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Partner, Capital Markets and Accounting
PwC
Emissions trading systems: The opportunities ahead

Report Launch Event
October 2021
Emissions trading systems: The opportunities ahead

"If the EU ETS is to be used as a template for carbon markets around the world, it will be necessary to have an internationally recognised way to account for carbon allowances. This will give investors and stakeholders clarity on how companies are faring on their path to net zero."

Report consists of two parts:

• Accounting for carbon emissions
• Survey results and current accounting best practices
Financial reporting: Impacts of climate change

**Physical risks**
- Severe weather events such as hurricane, fire, flood
- Effects of rising temperatures including sea level rise and changes in global weather patterns

**Transitional impacts**
- Changes in legislation and policy to decarbonise the economy
- Shift in consumer preferences towards sustainable products
November 2019: IASB In Brief

"IFRS Standards and climate-related disclosures"

November 2020: IASB Educational Material

"Effects of climate-related matters on financial statements"

01 Impairment of non-financial assets
02 Financial instruments
03 Recoverability of other assets
04 Provisions and contingent liabilities
05 Fair value measurements
06 Emissions trading schemes
07 Insurance liabilities
08 Disclosures about judgments and assumptions
Interplay between financial and non-financial reporting

ESG Disclosure
- Entities report ESG information:
  - Targets?
  - Planned changes to business?

Financial reporting
- Consistency of Assumptions with ESG reporting:
  - Fair value measurement.
  - Impairment assumptions.
  - Useful lives of assets.
  - Useful amongst others…

MD&A / Management Commentary
- Provide context to the financial statements and ESG?
- Telling a consistent story?
- Focussing on material issues?
Pollutant Pricing
Mechanism
Accounting
A growing area of focus

Emissions trading: A quick refresh

- Designed to encourage reductions in emissions by introducing a ‘carbon price’
- Credits must be surrendered to cover emissions
- May permit purchase of additional credits or trading of credits

Why the renewed focus?

- Rising value of carbon credits
- Increased importance of carbon credits in economics of investment decisions
- Greater focus on ESG reporting
<table>
<thead>
<tr>
<th>Technical references</th>
</tr>
</thead>
<tbody>
<tr>
<td>No specific accounting standard that deals with accounting for emissions trading schemes</td>
</tr>
<tr>
<td>IFRIC 3 was intended to address the accounting in this area but was withdrawn in 2005.</td>
</tr>
<tr>
<td>IASB potential project - Pollutant pricing mechanisms</td>
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<td>“Emissions trading systems: The opportunities ahead”</td>
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## Accounting for emissions credits

<table>
<thead>
<tr>
<th></th>
<th><strong>Asset and government grant accounting</strong></th>
<th><strong>Liability accounting</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full market value</strong></td>
<td>Initially measured at market value</td>
<td>Remeasured based on market value of allowances at each period</td>
</tr>
<tr>
<td></td>
<td>Might be remeasured</td>
<td></td>
</tr>
<tr>
<td><strong>Initial market value</strong></td>
<td>Initially measured at market value</td>
<td>Measure liability for credits on hand at carrying amount of those credits and liability in excess of credits on hand at market value</td>
</tr>
<tr>
<td></td>
<td>Might be remeasured</td>
<td></td>
</tr>
<tr>
<td><strong>Nominal amount</strong></td>
<td>Initially measured at nominal amount</td>
<td>Only liability in excess of allowances on hand is remeasured at market value</td>
</tr>
<tr>
<td></td>
<td>(usually nil)</td>
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</tbody>
</table>
Accounting for forward purchases or sales of emission allowances

- IFRS 9 Considerations
  - Net settleable contracts
  - Own Use exception
  - Hedge Accounting?
The Voluntary Carbon Market

Rapid Growth

Accounting?

Taskforce on Scaling Voluntary Carbon Markets
Key survey findings – participants

- Global survey from September 2020 to January 2021 of companies participating in the EU ETS
- There were 25 complete responses to the survey.
- To ensure that the survey results were presented on the basis of consistent activities, we excluded three companies that indicated they use EU ETS only for trading purposes from the analysis.
Key survey findings – granted and purchased allowances

Too many different reporting methods

Among the 25 respondents, four different ways were used to account for granted and purchased allowances and three different ways to value granted allowances.

Exhibit 1: Balance sheet recognition for granted allowances

Question: Where are granted allowances initially recognised on the balance sheet?

- Intangible fixed assets
- Inventory
- Other
- Debtors

Source: PwC and IETA survey, September 2020 to January 2021

Exhibit 2: Valuing allowances

Question: At what value are granted allowances initially recognised on the balance sheet?

- At nil value
- At fair value at date of receipt, with opposite entry recognised as deferred income on the balance sheet
- Other

Source: PwC and IETA survey, September 2020 to January 2021

Exhibit 3: Balance sheet recording for purchased allowances

Question: Where are purchased allowances recorded on the balance sheet?

- Intangible fixed assets
- Inventory
- Other
- Debtors

Source: PwC and IETA survey, September 2020 to January 2021
Key survey findings - obligations

Companies used five different ways to measure the allowance:

Exhibit 4: Initial measurements of emission allowances

Question: How is the obligation for emissions initially measured?

6 At carrying value for allowances already granted/purchased, with the balance valued at the prevailing market price

6 No obligation is recognised unless there is a shortfall, with the balance valued at the prevailing market price

4 At carrying value for allowances already granted/purchased and at the relative contract price for allowances to be purchased under forward purchase contracts, with the balance valued at the prevailing market price

4 Other

2 No obligation is recognised unless there is a shortfall, at the relative contract price for allowances to be purchased under forward purchase contracts with the balance valued at the prevailing market price

Source: PwC and IETA survey, September 2020 to January 2021
Key survey findings – lines in the income statement

And entered them on four different lines on the income statement:
Key survey findings – lack of standardisation

These different reporting methods are causing nearly half of respondents to be concerned about the lack of standardised reporting and its effects.

45% of respondents raised concerns that there is no single accounting treatment for emissions credits, which leads to a lack of comparability in emissions accounting.

“Lack of consistent accounting guidance in this area is causing significant diversity in practice.”

Compliance officer, large energy company
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Thank you
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