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Kevin Stevenson
Chairman
International Financial Reporting Interpretation Committee

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Kevin,

Comments on IFRIC D1 "Emission Rights"

The Accounting Standards Board of Japan (ASBJ) is pleased to comment on IFRIC D1 "Emission Rights". The International Issues Standing Committee of ASBJ has considered this issue as a liaison standard setter and has reached to a view different from the proposal of D1. We hope that our comment will contribute to the discussion in both IFRIC and IASB.

Best Regards,

Masayoshi Ogiwara

International Issues Standing Committee
Technical Manager, Accounting Standards Board of Japan

1. We disagree with the proposal of the Exposure Draft. We believe that an allowance initially granted by the government free of charge should be recognised as an asset at cost, that is, zero, and provisions should be recognised for an excess of actual emissions over allowances, in accordance with IAS 37.

2. The proposed treatment is likely to cause mismatch between income and expense when an allowance granted is recognised as an asset at fair value. The Exposure Draft proposes that a participant should recognise deferred income corresponding to an allowance granted by the government free of charge, in accordance with IAS 20. However, we note that IASB is considering the revision of IAS 20 and there is possibility that it will be required to recognise government grants as income when granted. If the notion of deferred income is eliminated from IAS 20, the proposed Interpretation will lead to significant distort of periodic profit or loss. Considering the possibility of such revision, we cannot agree with the proposal depending on IAS 20.

3. Even if the notion of deferred income is retained in IAS 20, the proposed treatment may result in mismatch between income and expense due to fluctuations in market value. While an expense is measured based on fair value of allowances for each period, corresponding income is measured based on the initial value of allowances. Whether a participant adopts the benchmark treatment or the alternative treatment in IAS 38, measurement of income and expense would be inconsistent, because in either case the increase of fair value of allowances will not be recognised in profit or loss.

4. The Exposure Draft proposes that a participant should recognise an allowance as an asset and an obligation to deliver it as a liability, on the ground that each item has independent existence and meets the definition of assets and liabilities, respectively (paragraph BC 5). However, we believe that there is inseparable linkage between the allowance and the obligation, because the allowance granted to a participant in a cap and trade scheme is accompanied by the obligation to deliver it according to the actual emission expected in the business activities. In other words, a participant is placed in a position similar to a forward contract to sell, in which the volume of future actual emission is an underlying. We believe that, in order to reflect the economic substance of the scheme, allowances granted should be treated as linked together with the future delivery obligations. Although an allowance can be sold at market on its own, to sell it before the end of its compliance period is similar to broker's activities intended for generating a profit from fluctuations in market price. Such a transaction that is considered exceptional for a participant should not be the cornerstone of accounting for emission rights.

5. Paragraph BC 5 of the Exposure Draft raised some other basis for the proposal, including (1) a number of different allowances may be used to settle its obligation, (2) granted allowances should be accounted for consistently with purchased allowances,

and (3) the offset requirements of IAS 32 are not met because there is no right of offset between the allowances and the obligation to deliver them. However, we do not believe those rationales are valid. As to (1) above, it only means that allowances of different types can be used for settling the obligation to deliver an allowance through translation based on a certain rule and it cannot be a reason for requiring recognition of an asset. As to (2) above, recognition of a purchased allowance as an asset is compatible with the notion of a net asset, because purchases of allowances are generally intended for the fulfilment of the obligation to deliver allowances. And as to (3) above, the offset requirements in IAS 32 need not be necessarily met because allowances and obligations are not financial instruments. We believe they can be reported at the net amount if a participant has an intention to set off them at the end of the compliance period.

6. A participant incurs obligations to deliver allowances to meet actual emissions or pay a penalty to the government when actual emissions go over allowances. We believe that an excess of actual emissions over allowances meets the definition of liability because it is a present obligation of a participant arising from past events, the settlement of which is expected to result in an outflow from its resources embodying economic benefits. However, a participant should recognise provisions in accordance with IAS 37 because it is a liability of uncertain timing or amount during the compliance period. A participant should recognise a liability at the end of the compliance period, and derecognise them together with allowances when the actual amount of emissions are certificated by a proper organisation.

7. Although a participant can obtain cash or cash equivalents when it sells allowances at market during the compliance period, a participant cannot be released from an obligation to deliver allowances equal to actual emission arising from its business activities during the compliance period. We believe that proceeds on sales of allowances during its compliance period should be recognised as a liability until the end of the compliance period, because such proceeds correspond to the future delivery obligation, except for the case where it is clear that a participant will not incur delivery obligations, for instance, in the case where a participant has discontinued its operations. Such a liability should be derecognised at the end of the compliance period.

8. We agree with the proposal that the accounting of brokers for emission rights is excluded from the scope. A participant to the scheme has different nature from a broker because it does not generally intend to generate a profit from fluctuations in market price.

Accounting entries in accordance with our proposal
- Extracted from Illustrative Example of D1

On the first day of the year –IE 6

Company A received allocation of allowances free of charge.

No enrty

At the end of the first six months –IE 7 and 8

No entry

At the end of the year- the end of the compliance period

Company A recognised provisions corresponding to the excess of actual emissions over allowances during the compliance period.

Dr. Expense 4.5
Cr. Provisions 4.5

Company A purchased an additional 500 tones of allowances at 9 per tonne.

Dr. Intangible asset (allowances) 4.5
Cr. Cash 4.5

Company A recognised liability at the end of compliance period.

Dr. Provision 4.5
Cr. Liability 4.5

Company A set off allowances and obligations after certification.

Dr. Liability 4.5
Cr. Asset 4.5

If Company A sell allowances during the compliance period, the following accounting entry will be made.

Dr. Cash x
Cr. Liability x

The liability shall be set off together with purchased allowances or derecognised and transferred to income at the end of the compliance period, except the case Company A clearly will not incur the obligation to deliver allowances equal to emissions.

	D1 Proposal		Our proposal	
At the end of six month	Summary P/L		Summary P/L	
	Income	(55)	Income	0
	Expense	66	Expense	0
	Net Loss	11	Net Loss	0
At the end of the year	Summary P/L		Summary P/L	
	Income	(120)	Expense	4.5
	Expense	112.5	Net Loss	4.5
	Expense（write down）	12		
	Net Loss	4.5		