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Australian Accounting Standards Board

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Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Wayne

Clarification of measurement of liabilities under IAS 37 in the context of ETSs

We are writing to seek clarification of the IFRS Interpretation Committee's position on an aspect of measuring liabilities under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We note that the issue has previously been discussed in IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* and (the now withdrawn) IFRIC 3 *Emission Rights*.

IFRIC 1, paragraph BC3, notes that IAS 37 requires provisions to be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. Thus in regard to changes in liabilities addressed by IFRIC 1, when the effect of a change in estimated outflows of resources embodying economic benefits and/or the discount rate is material, that change should be recognised based on a current value measurement of those liabilities involving the application of a current market-based discount rate.

IFRIC 3, paragraph BC24, reflected the then IFRIC's view that the obligation to deliver allowances for past emissions would normally be measured at the present market price of the number of allowances required to cover emissions made at the balance sheet date and noted that this view arose from paragraph 36 of IAS 37, which requires a provision to be measured at the 'best estimate of the expenditure required to settle the present obligation at the balance sheet date'.

Based on the above, our understanding is that the amount required to settle an obligation at the balance sheet date should reflect current values, being the amount that an entity would rationally pay to settle the obligation or transfer it to a third party.

However, there is some published evidence of divergent practice around the world in recognising and measuring emission liabilities[1]. Some of that evidence suggests variable application of IAS 37. In particular, a mixed measurement approach has been adopted by some entities for measuring emission liabilities in which the value of the emission

1 See for example, *Accounting for Carbon*, The Association of Chartered Certified Accountants (UK), 2010 and *Trouble-Entry Accounting – Revisited, Uncertainty in accounting for the EU Emissions Trading Scheme and Certified Emission Reductions*, PricewaterhouseCoopers (PwC) and International Emissions Trading Association (IETA), 2007.

obligation is based on the carrying value of allowances already granted (which may be recognised at a nil value) and the purchase price of other allowances. Where the allowances granted or purchased are insufficient, the balance of the liability is measured at the prevailing market price of allowances. Other entities have adopted a current value measurement basis for the entire emission liability. Incidentally, paragraph BC25 of IFRIC 3 guarded against such a treatment by noting that the cost of allowances (or their initial fair value, if issued for less than fair value) was not the amount that the participant would rationally pay to settle its obligation, rather, the amount required to settle an obligation at the balance sheet date would reflect current values. IFRIC 3 also noted that liabilities are measured independently of how those liabilities would be funded.

Although the evidence referred to above relates to the divergent practices developed in regard to measuring liabilities in the context of ETSs, we believe the issue is relevant to how to account for liabilities under IAS 37 more broadly. We think the issue may also have raised concerns in other jurisdictions internationally that would need to apply IAS 37 in recognising and measuring liabilities, whether in the context of ETSs or otherwise.

We are aware that the IFRS Interpretations Committee has transferred the issue of accounting for ETSs to the IASB, which has a planned research project to deal with it in a comprehensive way. This letter is written with a view to seeking confirmation from the Committee on the previous positions taken in various IFRICs in regard to measurement of liabilities under IAS 37. The confirmation sought is of a general and fundamental nature and is in the context of existing IFRS. It should not be seen only as an ETS-specific issue although it could be beneficial to jurisdictions that have such schemes in operation or planned.

The clarification would also provide a context for those who are developing approaches for accounting for ETSs for possible consideration by the IASB (eg. the French standard setter ANC, EFRAG) and those developing approaches under existing IFRSs (i.e before any IASB developments on the topic of ETS).

We have written before about Australian carbon tax in relation to IFRIC 21 *Levies* but we may also face the prospect of an ETS. This letter is written in relation to the latter as a separate matter.

If you require further information on the matters raised above, please contact me or Ahmad Hamidi (ahamidi@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO