International Accounting Standards Board®

Press Release

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IFRIC issues guidance on accounting for greenhouse gas emissions and scope of leasing standard

The International Financial Reporting Interpretations Committee (IFRIC)* has today released two Interpretations—IFRIC 3 *Emission Rights* and IFRIC 4 *Determining whether an Arrangement contains a Lease*.

IFRIC 3 specifies the accounting for companies participating in government schemes aimed at reducing greenhouse gas emissions. It requires companies to account for the emission allowances they receive from governments as intangible assets, recorded initially at fair value. It also requires companies, as they produce emissions, to recognise a liability for the obligation to deliver allowances to cover those emissions.

IFRIC 4 gives guidance on determining whether arrangements that do not take the legal form of a lease (eg some take-or-pay contracts) should, nonetheless, be accounted for in accordance with IAS 17 *Leases*. It specifies that an arrangement contains a lease if it depends on the use of a specific asset and conveys a right to control the use of that asset.

Introducing IFRIC 3, Kevin Stevenson, IFRIC Chairman, said:

> Until now there has been no consensus on how emission control schemes that use marketable allowances should be accounted for. This Interpretation fills that gap by explaining how accounting standards should be applied to such schemes. The guidance is timely because one such scheme—the European Union's Emissions Trading Scheme—starts next year.

Mr Stevenson noted that in the medium term the IFRIC intends to revisit the accounting in IAS 38 *Intangible Assets* for some readily tradeable intangible assets (such as some emission allowances). He explained that the requirements of that standard had constrained the IFRIC

* The IFRIC is the interpretative arm of the International Accounting Standards Board (IASB).

in developing its Interpretation but that it would not have been possible to amend the standard in time for 2005.

On IFRIC 4 he commented:

> This Interpretation explains that the requirements of the IASB's leasing standard have wider applicability than just those agreements described as leases. Elements of some supply and outsourcing agreements may now need to be treated as leases. In finalising this Interpretation the IFRIC has responded to those constituents who were concerned about the differences between the draft Interpretation and similar requirements of the IFRIC's US counterpart, the Emerging Issues Task Force. As a result, the main requirements of the Interpretation are now the same as the US requirements.

Subscribers to the IASB's Comprehensive Subscription Service can view the Interpretations from the secure online services area of the IASB's Website (www.iasb.org).

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NOTES TO EDITORS

About IFRIC 3 *Emission Rights*

1 In the light of the Kyoto agreement, several governments have, or are in the process of developing, schemes to encourage reductions in greenhouse gas emissions. The Interpretation focuses on the accounting to be adopted by participants in a ‘cap and trade’ scheme, although some of its requirements might be relevant to other schemes that are also designed to encourage reduced levels of emissions and share some of the features of a cap and trade scheme.

2 Typically in cap and trade schemes, a government (or government agency) issues rights (allowances) to participating entities to emit a specified level of emissions. (The government may issue the allowances free of charge or the participant may be required to pay for them). Participants in the scheme are able to buy and sell allowances and therefore, in many schemes, there is an active market for the allowances. At the end of a specified period, participants are required to deliver allowances equal to their actual emissions.

3 The Interpretation specifies that:

- rights (allowances) are intangible assets that should be recognised in the financial statements in accordance with IAS 38 *Intangible Assets*.

- when allowances are issued to a participant by government (or government agency) for less than their fair value, the difference between the amount paid (if any) and their fair value is a government grant that is accounted for in accordance IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

- as a participant produces emissions, it recognises a provision for its obligation to deliver allowances in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This provision is normally measured at the market value of the allowances needed to settle it.

About IFRIC 4 *Determining whether an Arrangement contains a Lease*

4 In recent years arrangements have developed that do not take the legal form of a lease but which convey rights to use assets in return for a payment or series of payments. Examples of such arrangements include:

- outsourcing arrangements;
- telecommunication contracts that provide rights to capacity; and
- take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services.

5 The Interpretation specifies that an arrangement that meets the following criteria is, or contains, a lease that should be accounted for in accordance with IAS 17 *Leases*:

(a) Fulfilment of the arrangement depends upon a specific asset. The asset need not be explicitly identified by the contractual provisions of the arrangement. Rather it may be implicitly specified because it is not economically feasible or practical for the supplier to fulfil the arrangement by providing use of alternative assets.

(b) The arrangement conveys a right to control the use of the underlying asset. This is the case if any of the following conditions is met:

(i) the purchaser in the arrangement has the ability or right to operate the asset or direct others to operate the asset (while obtaining more than an insignificant amount of the output of the asset).

(ii) the purchaser has the ability or right to control physical access to the asset (while obtaining more than an insignificant amount of the output of the asset).

(iii) there is only a remote possibility that parties other than the purchaser will take more than an insignificant amount of the output of the asset and the price that the purchaser will pay is neither fixed per unit of output nor equal to the current market price at the time of delivery.

About the IFRIC

6 The IFRIC first met in February 2002. It comprises 12 voting members (all part-time) drawn from a variety of countries and professional backgrounds, and it meets about nine times a year under a non-voting chairman. The IFRIC's principal role is to consider, on a timely basis within the context of International Financial Reporting Standards and the IASB *Framework*, accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment. In developing Interpretations, the IFRIC works closely with similar national interpretation committees.

About the IASB

7 The IASB, based in London, began operations in 2001. It is funded by contributions collected by its Trustees, the IASC Foundation, from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations. The 14 IASB members (12 of whom are full-time) are drawn from nine countries and have a variety of professional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. In pursuit of this objective, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world.

8 A Deloitte & Touche study indicates that 92 countries will either require or permit the use of IFRSs for publicly traded companies beginning in 2005. The 92 countries include Australia, the member states of the European Union, and Russia. At present, some 35 countries require the use of international standards for all domestic listed companies, six other countries require the use of international standards for some companies, and many countries base their national practices on international standards. In September 2002 the IASB and the US standard-setter, the Financial Accounting Standards Board, reached an agreement to work towards the convergence of existing US and international practices and the joint development of future standards. Recently, the IASB and the Accounting Standards Board of Japan agreed to initiate discussions to eliminate differences between IFRSs and Japanese standards