MINUTES

To:	Board
From:	Emissions Team (Debbeler, x353)
Subject:	Minutes of Emissions Trading Schemes Board Meeting of November 18, 2009
Date:	December 15, 2009

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue an Accounting Standards Update.

<u>Topic</u>: Rights and obligations in voluntary schemes

<u>Basis for Discussion</u>: FASB Memos 4, 4A, 4B

<u>Length of Discussion</u>: 7:15 a.m. EST to 8:15 a.m. EST

<u>Attendance</u>:

Board members present:	FASB: Herz, Linsmeier, Seidman, Siegel, Smith IASB: Tweedie, Cooper, Danjou, Engström, Finnegan, Garnett, Gélard, Gomes, Kalavacherla, Leisenring, McConnell, Smith, Yamada, Zhang
Board members absent:	None
Staff in charge of topic:	Starbatty
Other staff at Board table:	FASB: Golden, Stoklosa, Mills, Kuhaneck, Debbeler IASB: Teixeira, Clark
Outside participants:	None

Summary of Decisions Reached:

The boards discussed the accounting for emissions cap and trade schemes. The meeting focused on schemes with voluntary participation (voluntary schemes), which involve contracts between knowledgeable and willing parties.

The boards discussed the application the definitions of an asset and a liability in the FASB Concept Statements and in the IASB Framework to a voluntary scheme. The boards focussed their discussion on two views on when liabilities arise in such a scheme:

- View 1 is that an entity's actual emissions are the obligating event in a voluntary scheme. An entity does not incur a present obligation, and hence a liability, until it has emitted. Until emissions have occurred, the entity can take action that enables it to avoid delivering allowances.
- View 2 is that entering into the membership contract is the event that creates a liability (the obligating event). By signing the membership contract, the obligation to pay allowances is unconditional.

The staff did not ask the boards to make any decisions at this meeting, but did seek advice as to which view had the stronger initial support. Both boards indicated a preference for view 2.

Next steps

The boards will discuss accounting models for emissions trading schemes (both voluntary and statutory) in the first quarter of 2010.

Objective of Meeting:

The objective of this meeting was to discuss voluntary schemes in order to give the staff some idea of where the boards were leaning on this topic. The boards were not asked to make any decisions at this meeting. The objective of this meeting was reached.

Matters Discussed and Decisions Reached:

Staff Comments

1. Mr. Starbatty summarized the tentative decisions so far. The IASB has decided tentatively that allowances received for free from the government should be recognized as assets measured at fair value. The IASB also tentatively decided that by receiving allowances from the government, an entity incurs an obligation, which should be recognized as a liability and measured at fair value. The FASB has not reached any tentative decisions.
2. Mr. Starbatty stated that the staff are not asking the boards to make any decisions at this meeting in light of their different starting points. Instead, the staff will ask the boards questions that shall provide guidance in developing accounting guidance in emissions trading schemes.
3. Mr. Starbatty stated that the papers being discussed today address the items exchanged when an entity becomes a member of a voluntary scheme. One of the papers includes examples comparing the issues related to emissions trading schemes to other accounting literature. Mr. Starbatty noted that these examples are not meant to be exhaustive.
4. Mr. Starbatty noted that the most contentious accounting issue is whether a present obligation exists before the entity has actually emitted. The papers for this meeting present two alternative views. View 1 states that a member's actual emissions create the obligating event, and that until emissions have occurred, the member can avoid the outflow of allowances by its future actions. View 1 is consistent with the accounting for asset retirement obligations in Statement 143 (FASB Accounting Standards Codification™ Topic 410, Asset Retirement and Environmental Obligations), and with International Accounting Standard 37, *Provisions, Contingent Liabilities, and Contingent Assets*,. View 2 states that the membership contract creates the obligating event, and that as of signing the membership contract, the obligation to pay allowances is unconditional and only the amount of allowances due remains uncertain. View 2 is consistent with the accounting for business combinations in Statement 141(R) (FASB Accounting Standards Codification™ Topic 805, Business Combinations), and in International Finanical Reporting Standard 3, *Business Combinations*.

5. Mr. Starbatty stated that the staff believe the differences between the views arise from differing units of account. View 1 uses the allowances received as the unit of account for recording the asset, and uses the actual emissions as the unit of account for recording the liability. This results in a timing difference in View 1 between the asset and the liability being recorded. View 2 creates a liability before the entity has emitted, resulting in consistent timing as to when the schemes create assets and liabilities.
6. Mr. Starbatty asked the board for their comments.

Board Comments

7. The boards did not vote on this issue, nor did they reach any tentative decisions. However, they identified which board members would initially support each view. The IASB was 10-4 in favor of View 2. The FASB was 4-1 in favor of View 2, but the dissenting board member expressed some limited support for View 2.
8. Mr. Tatsumi asked for clarification of the amounts recorded when allowances are received, especially under View 1. Mr. Starbatty noted that the paper does not address measurement, but also noted that the income statement discrepancy – the timing mismatch – will be bigger if you follow View 1.
9. Mr. J. Smith stated that he thinks the entity entering into a voluntary emissions trading scheme has a service obligation which could be measured either at fair value or at the value of the consideration exchanged. He analogized the obligation present in emissions trading schemes to selling a royalty or entering into a noncompete agreement.
10. Mr. J. Smith also stated that he thinks an entity entering into this arrangement becomes "worse off". Mr. J. Smith stated that he did not think an entity would receive allowances equal to its actual emissions, and he thought that the entity would need to incur costs to lower emissions to that level or pay a penalty for exceeding the limit. Mr. Leisenring questioned why entities would enter the voluntary schemes if they were distinctly worse off by doing so. Mr. Danjou noted than an entity must expect some benefit from a voluntary scheme or else the entity would not enter that scheme, and that an entity couldn't be purely "worse off" by entering the scheme. Mr. Danjou noted that an entity might be "worse off" when a mandatory scheme begins. Mr. Kalavacherla stated that he thinks entities enter voluntary schemes as a

result of social pressure, because they want to demonstrate to stakeholders that they are being environmentally responsible and because they want to be prepared if and when a statutory scheme is enacted. Mr. Kalavacherla stated that he does not think that most entities will make money from entering into a voluntary scheme, regardless of their intentions.

11. Mr. Leisenring noted that he did not perceive a difference between accounting under voluntary or statutory (ie mandatory) schemes. Mr. Leisenring expressed support for View 1. He stated that he thinks View 2 is inconsistent with the recognition criteria in IAS 37, and noted that he thinks View 2 would accrue for contamination that has yet to occur, which he does not support doing. He asked a general question related to the example in the memo about whether, under View 2, the entity would be liable for the amount of granted allowances or for the expected units of pollution on day 1. He noted that this issue is not relevant if View 1 is adopted.
12. Mr. Leisenring also expressed concern that the obligation in View 2 is not firm. He stated that he thinks the receipt of allowances isn't an obligating event, and noted that if an entity receives allowances and then doesn't emit, that entity is not obligated to do anything.
13. Mr. Gélard agreed with the conclusions drawn by applying IAS 37, but stated that he supported View 2. He stated that he did not know whether or how to prioritize one portion of existing literature over another, besides just relying on personal preference in accounting treatments.
14. Mr. Herz stated that he prefers to consider the arrangement as a whole and determine the best way to portray the economics of that arrangement. Other board members, including Mr. L. Smith, Mr. Danjou, Mr. Zhang, and Mr. Cooper, agreed.
15. Mr. Herz noted that a literal application of the concepts would result in the entity recording an asset and a gain upon receipt of the allowances, but stated that he did not believe that represented the economics of the transaction. He stated that he did not think that View 2 violated the concepts statements, and agrees that the analogy to business combinations is appropriate.
16. Mr. L. Smith expressed concern about the analogy to existing business combinations literature, and stated that he does not think that the boards need to justify their position with an analogy if they agree on a particular accounting treatment. Mr.

Linsmeier agreed with Mr. L. Smith that the analogy to business combinations might be a "stretch". He stated that the obligations related to consideration in a business combination are much more clear than the obligations related to emissions schemes. Mr. Herz supported the analogy to existing business combinations literature. Mr. Herz stated that he did not think that the valuation of the firm would change the day after they received the allowances, and that he does not think there is an economic gain on day 1. Mr. Herz stated that he thinks if the entity takes a gain upon receipt of the allowances, the entity has created a short position for future emissions.

17. Mr. Linsmeier expressed some support for View 1 because it better captures the obligations in the contract.
18. Mr. Clark highlighted an issue with future instalments of the schemes. If an obligation or liability is recognized under View 2, it is unclear how long that liability should extend. In a voluntary scheme, the entity could estimate either for the current period (usually a year) or perhaps until the end of the contractual agreement. In a statutory scheme, recognition beyond only the current period would be difficult to estimate. (The staff have decided to present some of the issues related to future instalments at the December meeting.)
19. Mr. Zhang stated that he thinks there is a liability but would prefer not to call it a performance obligation.
20. Mr. Kalavacherla recommended looking at the net obligation of the entire contract, and booking the net position of that arrangement. He stated that he thinks that often this net position will be zero afer an entity has entered into the arrangement. He stated that he does not think the assets and liabilities should be presented gross. He would only accept a day 1 gain or loss to the extent of a net position, for example, if more allowances were granted than the entity expected to emit or vice versa.
21. Mr. Gomes agreed with Mr. Leisenring and expressed support for View 1.
22. Mr. Yamada expressed support for View 2, subject to the concern about future instalments expressed by Mr. Clark previously.
23. Mr. Cooper stated that he thinks View 2 is closer to reflecting the underlying economics, but added that it is not perfect. He noted that there are still measurement issues to be dealt with in View 2, particularly related to the liability's measurement basis and the length of the scheme.

24. Ms. Seidman expressed support for View 2. She noted that the boards should clarify that if an entity receives more allowances than it expects to have emissions, a net asset should be recognized.
25. Mr. Garnett stated that he thought it was helpful to consider the voluntary scheme separately from a statutory scheme because the voluntary scheme results from a business decision. He stated that he would recognize the liability ratably over the period as the entity emits.
26. Mr. Finnegan expressed support for View 2. He stated that he thinks the contract gives rise to a liability in the same way an insurance contract or a lease does. He added that measuring the liability would be more complicated. He agreed with Mr. Cooper that View 2 is not the perfect answer, but that it is preferable in that it provides more decision-useful information.
27. Ms. McConnell stated that she thinks View 1 is the appropriate accounting treatment based on existing accounting literature. She noted that she is undecided as to which view will produce the better information for financial statement users. She suggested that disclosure might be more appropriate for providing information about the scheme and the entity's plans for dealing with that scheme. She noted that she thinks if the entiy plans to continue producing, then they are going to emit, which makes it difficult to measure the liability especially in a statutory scheme.
28. Sir Tweedie stated that he supports View 2. He agreed with Mr. Herz that it was appropriate to consider how the value of the entity would change as a result of entering the scheme. He analogized to conditional grants, where a condition is satisfied before a gain can be recognized.

<u>Follow-up Items</u>:

None.

<u>General Announcements</u>:

None.