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Re: Draft Comment Paper – Emission Trading Schemes

Dear Françoise,
We are pleased to have the opportunity to provide our comments in order to contribute to the Draft Comment Paper (DCP) on "*Emission Trading Schemes*" issued in December 2012.

With regard to the IASB going forward as raised in EFRAG's DCP, we think that it would be useful for the national standard setters to cooperate and develop a guidance or a basis for a future standard for the ER accounting.

Whilst we agree with the description of the trading model we have some concerns about the so-called compliance model:

1. the free ER received and the ER purchased do not represent a stable patrimonial resource for the entity, increasing its value, instead, they result as an avoided cost of production arising from the legislation that should impact the balance sheet only for accrual reasons. Therefore, instead of forcing the analysis on the recognition of an asset we should pay attention to the revenue recognition. In determining the compliance model we believe that we should start from analysing the nature of the ER;

2. following the economic approach a liability is therefore recognised only if there is a shortfall or if the entity has recognised the ER as assets because they were acquired.

The appendix of this letter reports the replies to the specific questions raised in the DCP and further detail about OIC's position. We think that the ER assigned free to the entity are different from the ER acquired by the entity and, therefore, in the answers below we have highlighted the distinctions between these two cases.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò
(Chairman)

APPENDIX

The OIC's response to the specific questions raised in the DCP.

Questions to constituents

28 Do you agree that specific accounting guidance is needed? Please explain why.

29 Do you agree with the arguments presented above? Should any other arguments be included?

We agree that a specific accounting guidance is needed due to the particular nature of the ER that makes it difficult to define a specific accounting treatment within the current framework. This lack of guidance has caused the creation of different accounting practices among preparers and therefore this affects the comparability of financial statements.

Regarding the analysis presented in your Comment Paper, we are unsure if the first question to be addressed should be whether the ER give rise to the recognition of assets. The analysis should start from the economic nature of the rights. The ER allow the entity not to incur in any penalties therefore they represent an avoided cost of production.

So, the analysis should be performed by looking at what effects the overall event has on the entity and what real costs are incurred. For further detail about the accounting treatment that we suggest, please see the reply on the question raised in paragraphs 56-57 of the DCP.

Questions to constituents

39 Do you agree with the analysis of information needs of users for each business model?

40 Do you agree that this should result in different accounting requirements?

We agree that different information should be given to users in the trading model and in the compliance model.
However, we have some concerns on the accounting for the ER under the compliance model.
We think that to determine the right measurement criteria under the compliance model it would be more appropriate to distinguish between the free allowance of the ER and the purchased one. In the latter case we agree that the acquisition cost gives the best evidence of the value of the ER but we disagree with the measurement criteria proposed for the free allowance.

Questions to constituents

56 Do you agree that free allowances should be measured at fair value at inception, this fair value being their deemed cost?

57 If not, what arguments detailed above do you not find convincing? How do you respond to them?

We agree that the act of emitting is the real obligating event. However, it is necessary to note that for the emission covered by the ER assigned for free by the authority, this obligating event is already satisfied.
Take the following examples: an entity enters into a contract and has to pay a debt with raw materials that have a book value of zero; in this way the company does not recognize any liability. If it pays the debt with a fixed number of equity instruments held it cannot derecognize the asset and recognize the liability. If it has to buy the asset to pay for the liability it recognizes a liability at the fair value of the asset.

Coherently with the nature of the ER of avoided cost, a recognition of free allowances, that would determine a recognition of revenue, is not appropriate since the correlated cost is not recognised. We also think that the simultaneous recognition of asset and liability increases complexity.

Question to constituents

70 Which of the above options would you support? Please explain why.

The question of paragraph 70 relates to the other side of the entry if free allocations are initially measured at fair value. Having said that we do not consider appropriate the recognition at fair value, we are not convinced about EFRAG's proposed model. In fact, we think that the appropriate respective entry side of the free allocation is neither a deferred income nor a credit to OCI nor a day-1 gain.

Questions to constituents

76 Do you agree that in a compliance model an entity should not offset the asset and the liability separately, because separate presentation provides more relevant information?

77 Do you agree that the liability should not be derecognised before the entity surrenders the rights to the Regulator (i.e. surrendering rights affects the entity's financial position and is not solely a compliance exercise)?

78 Do you agree that the entity's value changes with the act of emitting and that settling the obligation to the Regulator has economic value? Do you agree that balance sheet presentation is relevant to users?

With regard to the questions of paragraph 76 and paragraph 78, we think that in a compliance model a separate representation does not provide relevant information to the users. Having said that we do not agree with the recognition of an asset for the ER, we disagree with the sentence in paragraph 73 of EFRAG's DCP ("*Emission rights have economic value and holding them or not, trading them and being liable to surrendering what is being held affects the entity's financial position. Appropriate presentation and measurement of such information is relevant to users in helping them evaluate the economic events that have taken place and base their predictions for future cash flows.*"). In fact, we think that in a compliance model ER should not have economic value for the entity and should not affect its financial position. It would only affect it if the ER are sold at a higher value than the corresponding liability.
Therefore, since the free ER and the acquired ER are an avoided cost of production arising from the legislation, they should impact the balance sheet only for accrual reasons and we support an economic approach for their accounting.

Question to constituents

88 Do you agree or disagree with EFRAG's proposal on the subsequent measurement of assets and liabilities? Please explain why.

With regard to the question of paragraph 88, we think that the proposed model is too complex, too onerous for the entity and the (potential) economic benefit for the users does not justify the cost that the entity would incur in implementing it.

Question to constituents
102 Which of the above alternatives would you support? Please explain why.

In line with paragraph 101, we agree that systematic transfers or sales may invalidate the compliance model.

We note that often marginal optimization selling occurs in practice to adjust the previous entity's estimates about its gas emission. So, the selling of the surplus of the ER acquired does not create particular conceptual problems and does not lead to the loss of the own use exemption because the objective of the entity remains to be in compliance with the legislative requirements.

Question to constituents
107 Which of the above alternative approaches would you prefer and why?

With regard to the possible options for the IASB's steps when it will decide to resume its project on Emission Trading, we do not agree with the following alternative approaches suggested in the EFRAG's DCP:

- start a research project;
- develop a standard; or
- have the IFRS IC work on an interpretation.

In fact, we note that the IASB in the past demonstrated to be unable in resolving the issue efficiently and, therefore, we think that a cooperation among the National Standard Setters could lead to an accounting model's agreement. An agreement about the accounting model may potentially remove the uncertainty about the accounting treatment and safeguard the comparability of the financial statements.