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Paris, April 30, 2013

Comment Paper Emissions Trading Schemes

Dear,

We are writing to you with respect to your Draft Comment Paper Emissions Trading Schemes.

Since 2005 (first application of IFRS), GDF SUEZ (hereafter "GDFS") has dealt with CO2 accounting and, as a multinational company, had to face with different mechanisms such as EUA, CER, ERU over different jurisdictions. Therefore we question the need for a specific standard or interpretation on such a narrow issue. Particularly, we have developed a robust guidance (explained in our financial statements) on the basis of existing standards dealing with commodities.

Furthermore, on one hand the classification issue is not crucial from our point of view (inventory or intangibles?). On the other hand, it is key for the utility sector to represent the substance of the business together with the corresponding P&L impacts. GDFS has always applied strong and robust principles/documentation to account for its emissions allowances in substance, i.e. Emissions Trading Schemes are managed as a commodity and it is key for us to record the cost through P&L as part of the cost of goods sold.

We would be happy to share with you our strong experience on emission allowances accounting.

Kind regards

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No. 28: Do you agree that specific accounting guidance is needed? Please explain why.

GDFS does not believe that a specific accounting guidance is needed. We instead think that the IASB should focus on broad principles including improvement of the framework since the latter could help in solving, among others, the Emission Trading Scheme issue.

Furthermore, those general principles help in accounting for **in substance** specific or complex transactions that large quoted groups (like GDFS) are achieving. In other words, a principle-based approach should not lead to the issuance of a separate project/standard each time a specific or complex transaction occurs.

No. 29: Do you agree with the arguments presented above? Should any other arguments be included?

We note that EFRAG believes that "it is not possible to draw a perfect analogy to inventory, because the rights are not physically consumed during the production process and the entity can complete production without obtaining the emission rights first". However, utility companies effectively manage their emission allowances as any other commodities without any difference. Indeed, the emission allowance exposure is part of the hedge of the energy margin. For example, a gas-fired power plant is managed as a clean spark spread option, i.e. the power station will run if and only if the price of the power is greater than the price of the fuel and the CO₂. When an entity is hedging the value of its power station, it will conclude (forward) transactions on power, gas and CO₂. In conclusion, emission allowance is managed as a commodity (cost of goods sold) and should be accounted for accordingly.

Since 2005, GDFS has always applied IAS 2 and IAS 39 guidance to account for emission allowances transactions.

Note 1: Summary of Significant Accounting Policies (extract from the GDFS consolidated financial statements)

Under European Directive 2003/87/EC establishing a greenhouse gas (GHG) emissions allowance trading scheme within the European Union, several of the Group's industrial sites were granted GHG emission rights free of charge. Under the Directive, each year the sites concerned have to surrender a number of allowances equal to the total emissions from the installations during the previous calendar year. Therefore, the Group may have to purchase emissions allowances on pollution rights markets in order to cover any shortfall in the allowances required for surrender.

As there are no specific rules under IFRS dealing with the accounting treatment of GHG emissions allowances, the Group decided to apply the following principles:

- *emission rights are classified as inventories, as they are consumed in the production process;*
- *emission rights granted free of charge are recorded in the statement of financial position at a value of nil;*
- *emission rights purchased on the market are recognized at acquisition cost.*

The Group records a liability at year-end in the event that it does not have enough emission rights to cover its GHG emissions during the period. This liability is measured at the market value of the allowances required to meet its obligations at year-end.

No. 39: Do you agree with the analysis of information needs of users for each business model?

No. 40: Do you agree that this should result in different accounting requirements?

GDFS believes that EFRAG should not refer about different accounting treatment depending on the "business model" of an entity. Rather, the economics of a transaction (= **management purpose**) should be considered when determining the accounting treatment in substance.

This wording issue being pointed out, we are really surprised that this question arises since the accounting treatment depending on the management purpose is fundamental in IFRS and applied for any commodity transactions, i.e. how should a commodity contract be accounted for in accordance with IAS 39 (for example, does a gas purchase contract qualify for (1) own use, (2) trading or (3) hedge accounting) ?

In conclusion, even if the emission allowances are not financial assets in accordance with the definitions of IAS 39, it is key to consider IAS 39 guidance when recognising and measuring emission allowances¹. Particularly, own use transactions should be accounted for as such when they meet the "normal sale and purchase" requirements (i.e. the economics / management purpose should drive the accounting treatment).

No. 56: Do you agree that free allowances should be measured at fair value at inception, this fair value being their deemed cost?

No. 57: If not, what arguments detailed above do you not find convincing? How do you respond to them?

No. 70: Which of the above options would you support? Please explain why.

Emission allowances are commodities that should be accounted for in accordance with IAS 2, i.e. at cost except for broker-trader inventory that should be measured at fair value.

Specifically on the allowances received for free, these are economically to be considered as grants and should then be accounted for as such in accordance with IAS 20, i.e. the recognition of these grants should not lead to a day-one P&L gain (= matching principle between costs and revenue). Again we consider allowances as an element of production accounted for as cost of goods sold therefore booking a day-one P&L gain does not reflect the economic substance of the free allowances which have been provided to the industry for an interim "education" period.

No. 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?

No.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)?

No. 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?

EFRAG (§ 71) notes that "the economic linkage should not result in derecognition of the asset and liability, because the entity will **surrender control of the rights** and be relieved of the liability only when the emission rights will be transferred and only when the rights are surrendered to the authority, respectively".

From our perspective, if the emission allowances have been "flagged/consigned" (i.e. the management purpose of the entity – through an adequate documentation – is to economically consume the benefit of the allowances in the production/generation process), the entity does no longer control the economic benefits resulting from this asset. While the framework [Framework 4.4] specifies that "an asset is a resource controlled by the entity from which future economic benefits are expected to flow the entity", we believe that there is a mix-up between economic linkage / control of economic benefits and legal title (ownership).

We note that EFRAG's analysis is right to the extent that there is no "flag" or "consignment" of the emission allowances, i.e. the entity has kept the possibility to use the available certificates in another way. In such a situation, an accrual should be recognised depending on the CO₂ emitted while the emission allowance is still recognised in inventory.

¹ IAS 2 already refers to IAS 39 for broker-trader inventory (i.e. they should be measured in accordance with IAS 39).

Furthermore, we do not understand why such economic link is used to justify the subsequent measurement of the liability (EFRAG §79c).

As a conclusion, we have been emphasizing above the need to consider the economics and management purpose of a transaction when accounting for it:

- Emission allowances are managed as any other commodities and should be accounted for as such (IAS 2);
- The framework does not specify that "physical" consumption prevails to consider that the economic benefits embodied in an asset have flown to the entity². Rather, when an emission allowance has been "designated" as being consumed, the entity does no longer control the economic benefits of the asset. Therefore the asset should be derecognized or depreciated;
- The management purpose designation for a transaction or a certificate is a matter of documentation (= internal control) and available IFRS guidance should be used (IAS 39).

No. 88: Do you agree or disagree with EFRAG's proposal on the subsequent measurement of assets and liabilities? Please explain why.

As a consequence of the classification of emission allowances as inventories, they should be recognised and measured as such.

Any accrual should be recognised in case of a shortage (excess of emissions over available allowances) and measured at its best estimate (market price or at the price of forward contracts if the cost of production has been hedged).

No. 102: Which of the above alternatives would you support? Please explain why.

Utility companies are facing this issue more globally with respect to their commodity transactions ("IAS 39 documentation" issue), i.e. emission allowances have no specific features different from gas, power or coal.

We agree with EFRAG that strong internal controls should be put in place and changes of management purpose should not occur (e.g. from own use certificate to "trading" certificate). In that respect, we agree with EFRAG that selling the excess is not a change in the business model but it is simply an adjustment to the actual emissions.

Documentation should be made at inception and criteria to account for the emission allowances as "own use" or "trading" should be met throughout the life of the allowance.

No. 107: Which of the above alternative approaches would you prefer and why?

The IASB has classified "Emission Trading Schemes" within the context of their feedback statement to the IASB agenda consultation 2011 in December 2012 as a priority research project.

As we have emphasised above, no new standard is needed but transactions should be accounted for using strong and robust IFRS principles. This approach will also allow to account for other types of certificates (e.g. CERs/ERUs) which are not different from EUAs in respect of the issues raised in the EFRAG paper.

² If an entity sells a turbine to a customer and the latter decides that it should be given for safekeeping in the warehouse of the entity, the latter could nevertheless decide to sell it again to another customer. The turbine is still physically present (i.e. it has not been transferred) but the entity does no longer control the economic benefits embodied in the asset.