IFRS Today

Our series on the most topical issues in financial and sustainability reporting

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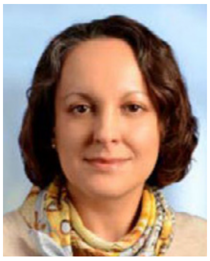

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PODCAST TRANSCRIPT

Emissions schemes | How do voluntary green schemes work?

James

Hello and welcome to a new episode of KPMG's Emissions podcast series in which we explore emerging trends in emissions and green schemes and the related financial reporting impacts under IFRS® Accounting Standards.

I'm joined today by Irina Ipatova, an associate partner in the International Standards Group, and Alison McManus, a Canadian firm partner and member of KPMG's Global Revenue and Provisions Topic Team.

Irina – in our previous podcast, you mentioned a significant rise in voluntary green schemes and an increasing number of financial reporting questions on the accounting for these schemes.

Irina

That's right, James. Governments and companies are progressing towards their net-zero emissions targets and we are seeing a shift to greener behaviour and a rise in voluntary schemes. We're also seeing a significant increase in challenging questions. I have to say this is largely driven by the absence of specific requirements under IFRS Accounting Standards. It is critical that we explore here the different schemes and understand their terms and conditions to determine the appropriate accounting.

Today, we will look at some of the voluntary schemes highlighting three things:

- first, what types of arrangements we see in practice that may generate green carbon credits;
- second, how carbon credits are certified and registered; and
- third, how they can be used.

We will also highlight some general financial reporting considerations which may be relevant for both companies that generate carbon credits and companies that acquire to use them.

Let's start with looking at why these schemes are voluntary. I have to say, unlike mandatory schemes in which a polluting company needs to limit its emissions or pay for an excess, voluntary schemes are designed to drive greener behaviour. Usually there is no regulatory requirement to participate in such a scheme. So let's explore the types of arrangements that may generate green carbon credits.

Allison – What voluntary schemes are you seeing in practice?

Allison

Well, we've seen a variety of different schemes, but let's start with the basics.

Voluntary schemes are typically designed to create or generate certificates. These certificates can be referred to as carbon credits or sometimes carbon offsets. And the carbon credits are meant to certify that through its activities, a company has reduced or removed a specific amount of carbon from the atmosphere. And the schemes themselves can be managed by independent bodies or government bodies. And these schemes will often have different rules and regulations. In addition, the activities that companies complete to reduce or remove their emissions can vary quite significantly as well.

Now, these differences and variations are the reason why you mentioned before, Irina, that we need to understand the terms and conditions of each scheme to be able to determine the financial reporting implications, because each scheme can be different.

Irina

Okay. So can you give us some real life examples of companies or activities that are creating credits?

Allison

Of course. Here are three more common examples that I've seen in practice.

One is in the agricultural industry where farmers will adopt more sustainable practices to reduce their carbon footprint. This could be through soil improvement or soil carbon storage (which also might be referred to as carbon sequestration).

In the developing world, I've seen something related to cooking where the people adopt a better technology to use for their everyday activities – such as cooking or heating – to reduce or limit the amount of greenhouse gases released into the atmosphere.

My third example is trees – planting or growing trees – which we know naturally captures and stores carbon dioxide. Now, in addition to these three examples, I've also seen other processes in different industries that aim to capture and store carbon – for example, into old mines and even injecting it into cement.

Irina

Wow, even into cement? So what about certification and registration? Who determines how a company's green activity translates into carbon credits?

Allison

Well, I mentioned before that each scheme is managed by a different body. So it is these bodies that create these carbon credits and set the rules for certifying the credits. But, as I mentioned, each scheme or arrangement operates a bit differently, and this will be a theme as we go through our discussion today. For example, there might be different metrics to track how emissions are reduced or removed and how many credits will be created from that reduction or removal.

Now, also some assurance might be required to certify that the company complied with the terms of the scheme before carbon credits can be created. And for financial reporting purposes we tend to focus more on this mechanism for creating credits because this often raises a question as to whether something needs to be accounted for.

And in terms of registering the credits once they are created, we've seen a number of different processes here as well. And I know, Irina, you talked about some on the podcast for sustainable aviation fuel. However, the one I wanted to highlight today is the one that I see more often, which is that of a single carbon credit that has a unique identifier, like a serial number that is being issued by the requisite body to a company that has met the requirements of the scheme.

Now these credits remain in the central registry of the body that created or issued the credit, but are recorded as being owned by the company.

Irina

That's very interesting. And how can a company use the credits?

Allison

Well, continuing our theme, there's a lot of variation here as well, and it really does depend on the scheme or arrangement, which is back again to the importance of understanding the information about the scheme.

One of the more common things we see in the market for voluntary schemes is an ability to sell these carbon credits to third parties. Now the third parties may then choose to retire these credits, which means that they can't be sold again or used by anyone else.

And companies often decide to retire these credits in order to state that in their sustainability reports that they have offset their emissions, thereby reducing their overall or net emissions.

Other scenarios that I've seen, the third parties may want to purchase these credits to settle regulatory liabilities. That is a case where an obligation is imposed by a government on their emissions.

Of course, if the company that created or generated these credits chooses not to sell them to a third party, then the company itself could retire the credits or potentially use them to settle their own regulatory liabilities.

Irina

Thank you, Alison. This gives us a very insightful overview. I have to say, it sounds like voluntary schemes differ, but I do wonder if the financial reporting considerations and the approach to the analysis may be similar for different types of schemes.

Allison

Yes, indeed. You're correct. Some of the high-level considerations would be relevant for all schemes and specifically: whether carbon credits are a separate unit of assessment or unit of account; whether they meet the definition of an asset; and, of course, which IFRS Accounting Standard to apply.

Irina

I do agree. I also think that a company would need to consider what to do on initial recognition. For example, when to recognise carbon credits and at what amount, how to account for them subsequently and what to do on disposal or retirement.

James

Thanks Irina, and thank you, Alison. That's all very interesting. It's pretty clear that this is a complex area and I think what you've just talked about has given us a really good overview of how voluntary green schemes like these can work. It certainly sounds like the financial reporting around this could present a few challenges. And not just for companies generating the carbon credits, but also for the companies purchasing them.

We'll cover this in more detail in future. But for now, thanks for listening and stay tuned!

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