

# report

Paper CL 06 02-12

Committee	CIPFA/LASAAC
Venue	CIPFA, Robert Street, London
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Subject	Accounting for the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme

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The purpose of this report is to seek the views of CIPFA/LASAAC members regarding the changes that will be required to the Code of Practice on Local Authority Accounting for 2012/13 Code Update in relation to the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme.

## 1 Introduction and Background

- 1.1 CIPFA/LASAAC last considered the accounting treatment of the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme in detail at its meeting following the July - September 2010 consultation on the 2011/12 Code ie in October 2010. An extract of the report that was considered at that meeting is included at Appendix 1 for information. The 2011/12 Code set out in the Foreword that no provisions were included in the 2011/12 Code as a result of the Spending Review announcement about the CRC Energy Efficiency Scheme. This was carried forward into the 2012/13 Code due to the potential uncertainties in the Scheme.
- 1.2 CIPFA/LASAAC will be aware that 2011/12 is the first year that participating authorities will incur liabilities under the Scheme. The latest draft of the amendments to the Code in relation to the CRC Energy Efficiency Scheme that best fits the Scheme as it currently operates that was considered by CIPFA/LASAAC in October 2010 is also attached to this report at Appendix 2.
- 1.3 The Scheme is currently in its introductory phase (which will last until 31 March 2014). The introductory phase will require retrospective purchase of CRC allowances which are required to be surrendered to the CRC Registry by 31 July following the end of (for Scheme purposes) the first reporting year. It is anticipated that there will be two sales of the allowances by the government a year. The Treasury has issued draft regulations<sup>1</sup> in relation to the sales of allowances. The draft regulations can be viewed at:

[http://www.decc.gov.uk/en/content/cms/emissions/crc\\_efficiency/crc\\_efficiency.a.spx](http://www.decc.gov.uk/en/content/cms/emissions/crc_efficiency/crc_efficiency.a.spx)

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<sup>1</sup> DRAFT The CRC Energy Efficiency Scheme (Allocation of Allowances for Payment) Regulations [2012]

CL 4-02-12 sets out that the Simplification commentary issued by DECC has confirmed that the second phase of the Scheme will not be a “cap and trade” scheme. It has been confirmed that the proceeds from sale of allowances will also not be recycled.

- 1.3 CIPFA/LASAAC may also be aware that the Local Authority Accounting Panel (LAAP) has issued detailed application guidance on the recognition of the liability for the CRC Energy Efficiency Scheme as CIPFA/LASAAC was of the view that accounting for the liability was covered by the existing provisions of the Code. A draft of the Bulletin was circulated to CIPFA/LASAAC members for comments in December 2011. The LAAP Bulletin, LAAP 91 – *Accounting for the Carbon Reduction Commitment (CRC) Energy Scheme in 2011/12* is available on the CIPFA website at: [http://www.cipfa.org.uk/pt/pt\\_details\\_1.cfm?news\\_id=61658](http://www.cipfa.org.uk/pt/pt_details_1.cfm?news_id=61658).
- 1.4 The draft of the Scheme at Appendix 2 sets out that the Scheme is accounted for in accordance with IFRIC 3 *Emission Rights*. CIPFA/LASAAC will be aware that the IFRIC was withdrawn in 2005. However, it should be noted that at the time of the withdrawal of IFRIC 3, the IASB affirmed that IFRIC 3 is an appropriate interpretation of existing IFRSs for accounting for the EU Scheme (the European Emission Trading Scheme). It should be noted that Emissions Trading Schemes currently remains as a project on the IASB agenda. However, the project is paused and the IASB will consider whether the project will remain on the agenda as part of its agenda consultation process. It is anticipated that this will be in the first half of 2012
- 1.5 Authorities will need to account for the purchase of allowances in 2012/13 financial year. Some of these allowances might be purchased prospectively for 2012/13 financial year.

## 2 The Proposed Amendments to the Code

- 2.1 The current draft of the proposed amendments to the Code in Appendix 2 classifies the allowances as current intangible assets. Under the draft the liability was to be accounted for as a provision in accordance with the Code’s adoption of IAS 37. In the light of the need to consult on the proposed amendments to the 2012/13 Code in the 2012/13 Code Update CIPFA/LASAAC may consider it opportune to revisit the principles established in October 2010.

### **Classification of the Purchased Allowances**

- 2.2 The draft of the Code in Appendix 2 follows the recommendations of the withdrawn IFRIC 3 which required allowances of this nature to be accounted for as an intangible asset. This is because the allowances are “identifiable non-monetary asset without physical substance”. The current draft in Appendix 2 also classifies the allowances as current intangible assets.
- 2.3 At its meeting on 7 October, FRAB discussed the accounting arrangements for the CRC scheme to be incorporated into the FReM. FRAB agreed that allowances should be classified as intangible assets within the scope of IAS 38, and classified as either current or non-current depending on whether they were to be held for less than or more than 12 months. This decision was informed by decisions made by the IFRIC; albeit as noted above the IFRIC has been withdrawn. The report and the minutes of the meeting in question are available on the following link:

[http://www.hm-treasury.gov.uk/prs\\_frab\\_meetings\\_071010.htm](http://www.hm-treasury.gov.uk/prs_frab_meetings_071010.htm)

However, in addition, it is important to note that the Code, following the requirements of IAS 38, scopes out intangible assets “held for sale in the ordinary course of business” from the provisions of Section 4.5 of the Code.

- 2.4 It is necessary therefore to consider whether authorities will hold the allowances for sale in the ordinary course of business. It is possible, particularly in the early phases of the Scheme, that authorities will only hold the allowances for compliance purposes and, although they may sell them, will not purchase them for the purpose of trading. In these circumstances the authority would be able to classify the asset as an intangible asset and treat the assets as either current or non-current in accordance with the requirements of the Code.
- 2.5 If authorities do hold the allowances for the purpose of trading, they should classify the assets as inventories and account for the allowances in accordance with section 5.1 of the Code. This is more akin to the treatment set out in the Exposure Draft of the 2011/12 Code. Appendix 3 therefore accommodates an approach which permits the allowances to be classified as current assets or intangible assets (either current or non-current). **CIPFA/LASAAC is invited to consider this issue and whether or not it considers that the Code should allow for the option of authorities purchasing the allowances for trading purposes.**
- 2.6 The draft of the Code at Appendix 2 has the assets classified as current (intangible) assets. It might be useful to review this particular aspect of the proposed treatment whilst considering the accounting requirements of the Scheme. It should be noted that it is possible that the allowances will not meet the definition of a current intangible asset and should therefore be classified as a non-current intangible asset. As discussed in previous meetings it is also possible that if the assets are accounted for as a non-current intangible asset they will be brought into the definition of capital expenditure under the capital control regime. It is suggested that the Secretariat discusses this issue with the various administrations across the UK. This treatment of the allowances as potentially both current and non-current intangible asset is also covered in the proposed amendments to the Code in Appendix 3. **CIPFA/LASAAC’s views are sought on this issue.**

### **The Accounting Treatment of the Liability**

- 2.7 As noted above LAAP has provided detailed application guidance on the Code’s provisions on the accounting treatment of the liability. Appendix 1 sets out the issue raised by the consultation responses to the consultation on the 2011/12 Code that as the market price and number of allowances required will be known at the date the accounts are authorised for issue, the uncertainty inherent in a provision may not exist. Appendix 4 of this report sets out an extract of a report to LAAP in relation to this issue. The final recommendations from the Secretariat to LAAP (on 31 January 2012) are extracted below.

“The Bulletin therefore maintains the obligation as a provision at the reporting date. We accept that in 2011/12 it is likely to be relatively easy to estimate the obligation/liability. However, it has been retained as a provision because:

- even though it is unlikely that there will be a significant market for the sale of allowances, participants will be able to sell and purchase allowances from other participants in the Scheme;

- whilst authorities are required to surrender allowances they are not compelled to purchase them from the Environment Agency, although it is likely they will do so;
- authorities may chose (e.g. for cashflow purposes) not to buy allowances to cover the obligation and instead incur penalties (it is recognised that this may not be an economic decision as the penalties are high);
- whilst the obligation exists at the reporting date, authorities do not possess the allowances and are not at the reporting date obligated/committed to purchase them from the Environment Agency,
- It should be noted that the commentaries set out above relate only to the accounting requirements in relation to the provision and are not in any form recommendations on an authority's approach to the Scheme."

2.8 **CIPFA/LASAAC is invited to consider whether or not for clarity for practitioners it wishes to propose amendments to the Code to explicitly set out the accounting arrangements for the liability.** The previous drafts of the Code accounted for the liability as a provision and this is reflected in the draft amendments set out in Appendices 2 and 3.

#### **Penalties under the CRC Energy Efficiency Scheme**

2.9 Appendix 2 retains the treatment of penalties under the Scheme. The Scheme includes numerous penalties some of which might not be covered within the draft of the Code in Appendix 2. This has therefore been amended to refer to examples of instances where penalties might be incurred. Appendix 3 does not include a proposed amendment relating to penalties under the Scheme as arguably this is covered by Section 8.2 of the Code. **CIPFA/LASAAC is invited to consider whether or not it wishes to include stipulations in the Code in relation to penalties for the CRC Energy Efficiency Scheme.**

#### **Landfill Allowance Trading Scheme (LATS) England and Scotland**

2.10 CIPFA/LASAAC will also note that the drafts include amendments to the Landfill Allowances Trading Scheme in accordance with the Secretariat's comments in relation to the consultation on the 2011/12 Code in Appendix 1. It is acknowledged that the Scheme will be withdrawn for English authorities after the 2012/13 scheme year in England. The accounting treatment would therefore be clarified for the final year of the Scheme. In addition it currently appears that the provisions of the Code need to be retained for Scottish local authorities even though the Scheme is suspended in Scotland. **CIPFA/LASAAC's views are sought on this issue.**

### **Recommendation**

CIPFA/LASAAC is asked consider the report and the drafts of the proposed amendments to the Code in relation to the accounting treatment of the CRC Efficiency Scheme.

## Extracts from CL 04- 10 11

## Accounting for Carbon Reduction Commitment Allowances

[NOTE: A number of changes (including the removal of income from recycled allowances) were announced in the Comprehensive Spending Review. A revised section, and list of points for consideration, will be presented at the meeting.]

Question	Current	Intangible	No Comment
3 Should allowances be recognised as current assets or as intangible assets?	18 (67%)	0 (0%)	9 (33%)

Question	Agree	Disagree	No Comment
4 Do you agree that a liability and an expense should be recognised as energy is consumed?	18 (67%)	2 (7%)	7 (26%)
5 Do you agree that income from recycled allowances should be recognised as it becomes receivable?	20 (74%)	0 (0%)	7 (26%)

The following issues of principle were raised:

Issue	Secretariat Response
<p>Respondents to both the Code consultation and the parallel FReM consultation generally supported the approach of classifying allowances as current assets unless they were intended to be held for more than 12 months.</p> <p>At its meeting on 7 October, FRAB discussed the accounting arrangements for the CRC scheme to be incorporated into the FReM. FRAB agreed that allowances should be classified as intangible assets within the scope of IAS 38, and classified as either current or non-current depending on whether they were to be held or less than or more than 12 months. This decision was informed by decisions made by the IFRIC, albeit these decisions have not lead to an interpretation being issued. It was felt that until the IASB consider the issue further, and there is further information regarding the impact on entities, no departure from the standards should be incorporated.</p>	<p>The Secretariat proposes requiring classification as current intangible assets. This will ensure that there are no circumstances in which the purchase of allowances will fall within the capital control regime.</p> <p><b>CIPFA/LASAAC is asked for its views as to whether it is appropriate for the Code to exclude allowances from the definition of 'capital expenditure' in this manner, or whether the matter should be left for government regulation.</b></p> <p>Classification of the allowances as current intangible assets will result in revaluation gains and losses normally being taken to the Revaluation Reserve. It is acknowledged that this may result in a mismatch between the income and expenditure recognised in the Comprehensive Income and Expenditure Statement, although this is not expected to have any significant budgetary impact (the difference being the timing of the recognition of</p>

Issue	Secretariat Response
	<p>reevaluation gains in respect of allowances not used in year).</p> <p>Classification and measurement of the allowances as current intangible assets means that the treatment of CRC allowances is not consistent with the treatment in the Code for the Landfill Allowance Scheme in England and Scotland.</p>
<p>One respondent to the FReM consultation suggested the liability should be recognised as a creditor rather than a provision.</p>	<p><b>CIPFA/LASAAC is asked for its views on the classification of the liability. As the market price and number of allowances required will be known at the date the accounts are authorised for issue, the uncertainty inherent in a provision may not exist.</b></p>
<p>A number of respondents asked for clarification of the timing of recognition of the liability and the expense.</p>	<p>The Code currently requires recognition “as energy is used”, which could imply recognition throughout the year, potentially at different market rates. It is proposed to add the following sentence to the end of paragraph 2.4.2.12 to clarify that recognition of the expense at the end of the year would be acceptable.</p> <p>“The requirements of this paragraph can be met by recognising the liability and expense for the financial year at the end of the reporting period, measured at the market price of the number of allowances required as at 31 March in the relevant year.”</p> <p><b>Does CIPFA/LASAAC agree with this approach? Will this cause any problems for government returns (eg CLG quarterly reporting)?</b></p>
<p>One respondent suggested that the Code should recognise the possibility of authorities selling allowances.</p>	<p>New paragraph 2.4.2.13 added:</p> <p>“Where an authority sells allowances, it shall derecognise the assets, and recognise any gain or loss on disposal in Surplus or Deficit on the Provision of Services.”</p>
<p>One respondent asked whether assets and liabilities should be netted off as with pensions.</p>	<p>Netting off should not take place, as this will not provide meaningful information regarding an authority’s performance or position as at the reporting date. The following sentence has been added to</p>

Issue	Secretariat Response
	<p>paragraph 2.4.4.1:</p> <p>“Assets and liabilities, and income and expenditure shall not be netted off against each other.”</p>
<p>A number of respondents suggested that the income from recycled allowances should be treated as grant income.</p>	<p>Agreed; words “as grant income” added to paragraph 2.4.2.14 (2.4.2.13 in the Exposure Draft)</p>
<p>One respondent commented that the section of the Code covering the Landfill Allowance Trading Scheme needed reviewing.</p>	<p>The Secretariat concurs with this view, and has updated the section to bring the treatment in line with the treatment for the CRC scheme (in practice, this relates to the valuation of assets).</p> <p><b>CIPFA/LASAAC is asked for its views on whether it supports changing the accounting requirements for LATS to bring it in line with the treatment being proposed for the CRC scheme.</b></p>