

# Accounting for GHG Allowances under Japanese accounting standards

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## The purpose of this study

The purpose of this study is to consider  
accounting for GHG allowances under  
Japanese accounting standards from  
theoretical standpoint.

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## 1 • Points(1)

Are GHG allowances  
financial instruments?

Measurement – at what price?

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## 1 • Points(2)

Should treatment of GHG allowances  
purchased or received at nil cost be  
consistent in the balance sheet?

Are GHG allowance-based derivatives  
financial assets?

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## 2• Conclusions(1)

GHG allowances are non-financial instruments.

Measurement - entry price

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## 2• Conclusions(2)

The treatment of GHG allowances purchased or received at nil cost should be consistent in the balance sheet.

GHG allowance-based derivatives are non-financial assets.

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### 3 • Are GHG allowances financial instruments?(1)

- GHG allowances are  
**non-financial instruments**
- GHG allowances are not financial assets  
but operating assets (non-monetary assets),  
application of IAS No.38 *Intangible Assets*

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### 3 • Are GHG allowances financial instruments?(2) *-Our theoretical background-*

- Subjective goodwill

(Edwards&Bell(1961), Feltham&Ohlson(1995), Saito(1995), Kasai(2000))

#### Difference between value-in-use and market price

When managers use assets and earn some profits characteristic of their company, the assets have Subjective goodwill.

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### 3 • Are GHG allowances financial instruments?(3) *-Our theoretical background-*

Saito(1995),Kasai(2000)

Assets are classified into 2 types  
according to whether they have subjective  
goodwill or not.

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### 3 • Are GHG allowances financial instruments? (4) *-Our theoretical background-*

- **Operating activities of business**  
**Operating assets have subjective goodwill**  
) value-in-use > market price ( value-in-use > market price)
- **Financial activities of business**  
**Financial assets have no subjective goodwill**  
) value-in-use = market price  
( perfect competitive market hypothesis)

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3• Are GHG allowances  
financial instruments? (5)  
- Our theoretical background -

Are GHG allowances financial assets?

It depends on whether they have  
subjective goodwill or not.

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3• Are GHG allowances  
financial instruments? (6)

-Does GHG allowances have subjective goodwill?-

- **GHG allowances have subjective goodwill**

because . . .

- They are used in various ways

(Ex. Some entity may use them for compliance purposes

Other entity may use them for trading purposes)

their value-in-use are different from company to company

value-in-use market price

) GHG allowances are not financial assets but operating  
assets. application of IAS No.38(intangible assets)

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### 3 • Are GHG allowances financial instruments? (7)

*-Application of IAS No.38-*

- GHG allowances are similar to **fishing licences** or **import quotas** in character.

GHG allowances may correspond to **Intangible Assets (IAS No.38)**.

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### 3 • Are GHG allowances financial instruments? (8)

*-Application of IAS No.38-*

IAS No.38 Para.7

*“An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.”*

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### 3 • Are GHG allowances financial instruments? (9)

*-Application of IAS No.38-*

IAS No.38 Para.8

*“Common examples of items encompassed by these broad heading are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.”*

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### 4 • Measurement *-at what price?-(1)*

- Initial measurement    entry price
- Subsequent measurement
  - benchmark    historical cost
  - allowed alternative    revalued amount

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## 4 • Measurement *-at what price?-(2)*

- Initial measurement  
entry price

because GHG allowances are operating assets (intangible assets)

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## 4 • Measurement *-at what price?-(3)*

- Subsequent measurement  
<Benchmark treatment> historical cost

IAS No.38 Para.63

*“After initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses.”*

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## 4 • Measurement -at what price?-(4)

- Subsequent measurement

<allowed alternative treatment>    revalued amount

IAS No.38 Para.64

*“After initial recognition, an intangible asset should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortisation and any subsequent accumulated impairment losses.”*

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## 4 • Measurement -at what price?-(5)

revalued amount

entry value or exit value?

difference between operating assets and financial assets  
in revalued amount

↓ { • operating assets    entry value  
     • financial assets    exit value

entry value

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## 5 • Should treatment of GHG allowances purchased or received at nil cost be consistent in the balance sheet?(1)

- Treatment of GHG allowances purchased or received at nil cost should be consistent in the balance sheet.



Both allowances purchased and received at nil cost have subjective goodwill (the same characteristics).

- Measurement • • entry (market) value

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## 5 • Should treatment of GHG allowances purchased or received at nil cost be consistent in the balance sheet?(2)

Accounting for GHG allowances received at nil cost is relevant to accounting for donation.

<accounting for donation>

donated assets are measured at entry market price

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## 5• Should treatment of GHG allowances purchased or received at nil cost be consistent in the balance sheet?(3)

<Journal>

Dr.	GHG allowances × ×	Cr.	Donated capital × ×
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entry (market) value

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## 6• Are GHG allowance-based derivatives financial assets? (1)

### GHG allowance-based derivatives (contracts to buy or sell GHG allowances)

They are commodity-based derivative.

They are not financial assets on the ground of JWG(2000).

the reason for on-balance sheet

- popular theory contract accounting(Ijiri1980)
- this study “GHG allowances with condition precedent”

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## 6• Are GHG allowance-based derivatives financial assets? (2)

*-commodity-based derivatives-*

- GHG allowances are operating assets.  
They belong in **the same category as commodity**.  
GHG allowance-based derivatives are commodity-based derivatives.

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## 6• Are GHG allowance-based derivatives financial assets? (3)

*-commodity-based derivatives-*

According to JWG(2000), a commodity-based derivative doesn't meet the definition of a financial instrument.

(JWG(2000) *basis for Conclusions 2.14(e)*)

**GHG allowance-based derivatives are non-financial assets.**

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## 6• Are GHG allowance-based derivatives financial assets? (4)

*-commodity-based derivatives-*

However, JWG(2000) also says  
when commodity-based derivatives are settled net by a financial instrument, they should be accounted for in the same manner as financial instruments.

*(JWG(2000) Draft Standard 2 (a))*

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## 6• Are GHG allowance-based derivatives financial assets? (5)

*-the reason for on-balance sheet-*

• the reason for on-balance sheet

popular theory contract accounting (Ijiri(1980))



expansion of accounting recognition  
(based on delivery    based on contract)

Viewed in this light, GHG allowance-based derivatives can be recognized **only** by introducing contract accounting.

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## 6• Are GHG allowance-based derivatives financial assets? (6)

*-the reason for on-balance sheet-*

•this study

GHG allowance-based derivatives can be taken as “GHG allowances with condition precedent”.



Viewed in this light, they can be recognized without introduction of contract accounting.

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## 7• summary(1)

GHG allowances are non-financial instruments.

Measurement - entry price

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## 7 • summary(2)

The treatment of GHG allowances purchased or received at nil cost should be consistent in the balance sheet.

GHG allowance-based derivatives are non-financial assets.

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