

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

L Amended

Committee: IAASB Consultative Advisory Group

Meeting Location: London

Meeting Date: September 20-21, 2007

Proposed Project **Assurance Engagements on Carbon Emissions Information**

Objectives of Agenda Item

To comment on the proposed project “Assurance Engagements on Carbon Emissions Information.”

Project Status

The IAASB Steering Committee has considered a draft project proposal on this topic, upon which this paper is based, and has agreed that a revised proposal should be prepared for consideration by the IAASB. The revised project proposal is scheduled to be considered by the IAASB at its December 2007 meeting.

Sustainability Experts Advisory Panel

The proposed project has the support of the IFAC Sustainability Experts Advisory Panel (SEAP). The IFAC Board set up SEAP in 2004 to serve the IAASB and the Professional Accountants in Business (PAIB) Committee. SEAP’s 15 members (see Appendix) communicate by e-mail rather than holding physical meetings. Roger Simnett, formerly a public member of IAASB, is the chair of SEAP.

SEAP does not have authority to issue documents in its own right, but is expected to both:

- Respond to technical matters referred to it by the IAASB or PAIB, and
- Be proactive in keeping IAASB and PAIB Committee informed of relevant technical matters and making appropriate recommendations.

Other IFAC committees are also aware of SEAP and may interact with it from time to time.

Project outline

PROJECT OUTPUT

1. A new International Standard on Assurance Engagements, ISAE 34xx, “Assurance on Information about Carbon Emissions.”
2. In developing the ISAE, the project task force will seek to use as a base the following documents developed by a joint US/Canadian task force:

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- AICPA Statement of Position (SOP) 03-2, *Attest Engagements on Greenhouse Gas Emissions Information*.
- CICA Practice Guide, *Engagements to Audit GHG Emissions Information*.

ISSUE IDENTIFICATION

3. Sources such as the Stern Report¹ and the report of the Intergovernmental Panel on Climate Change² have highlighted the overwhelming scientific evidence that “*climate change presents very serious global risks, and it demands an urgent global response.*” Stern notes that climate change “*is the greatest and widest-ranging market failure ever seen,*” and concludes that “*the benefits of strong and early action far outweigh the economic costs of not acting.*” The primary focus of the actions recommended by Stern is a shift to low-carbon energy systems.
4. A major step toward reducing carbon emissions is the development of “cap and trade” schemes, in which a central authority sets a limit, or “cap,” on carbon³ emissions and entities in the scheme are given tradable credits (allowances) that represent the right to emit a specific amount of carbon. The total amount of credits cannot exceed the cap, thereby limiting total emissions to that level. Entities that pollute beyond their allowance must either buy credits from those who pollute less than their allowance, or face penalties. In effect, the buyer is being fined for polluting, while the seller is being rewarded for having reduced emissions. Thus, entities that can easily reduce emissions will do so, and those for which it is harder will buy credits. The rationale behind such schemes is to provide market incentives for emission reductions to take place where the cost of the reduction is lowest.
5. The robustness of such schemes is subject to the rigor with which emissions are measured, which in turn is affected by the measurement criteria and the assurance systems used.
6. The ratification of the Kyoto Protocol’s “cap and trade” approach to carbon emissions by all but two of the world’s developed countries (Australia and the USA) has added significant impetus to the development of regional, national and international carbon markets. In recent years, numerous carbon trading schemes have commenced, including the EU Emissions Trading Scheme⁴, Japan’s Voluntary Emissions Trading Scheme, the New South Wales Greenhouse Gas Reduction Scheme⁵, and the Chicago Climate Exchange.⁶ Governments currently exploring further trading schemes include Australia⁷, and the UK⁸.

¹ “Stern Review on the Economics of Climate Change” www.sternreview.org.uk.

² “Climate Change 2007: The Physical Science Basis” www.ipcc.ch

³ While the term “carbon” is used here, different schemes may regulate different greenhouse gases (GHGs). Carbon dioxide (CO₂) is the major GHG. Other GHGs (e.g., methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, perfluorocarbons and chlorofluorocarbons) are often measured as carbon dioxide equivalents (CO₂-e).

⁴ ec.europa.eu/environment/climat/emission.htm

⁵ www.greenhousegas.nsw.gov.au/

⁶ www.chicagoclimatex.com

⁷ www.dpmmc.gov.au/emissionstrading/index.cfm

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7. While a primary use of carbon emissions information is to facilitate carbon trading schemes, other uses are also evident, including:
- Disclosure by entities seeking to become “carbon neutral,” e.g., News Corporation: “Our carbon footprint last year was 641,150 tons. ... Today, I am announcing our intention to be carbon neutral, across all our businesses, by 2010”⁹.
 - Disclosure in entities’ sustainability reports, e.g., the leading criteria for sustainability reporting, the GRI Guidelines, include “Total direct and indirect greenhouse gas emissions by weight” as a core indicator.
 - Disclosure in accordance with regulatory requirements, e.g., ~~around 4000 Australian facilities from a wide range of industry sectors are required to report annually for disclosure in the National Pollutant Inventory~~ the Australian government has drafted legislation to establish a national framework for reporting greenhouse gas emissions, abatement actions and energy consumption and production by corporations from July 1, 2008.
 - Voluntary carbon registers, e.g. the Carbon Disclosure Project at www.cdproject.net, which is “the largest repository of corporate greenhouse gas emissions data in the world.”
 - As a basis for imposing carbon taxes, e.g., Sweden, Finland, the Netherlands, and Norway have introduced carbon taxes.

RATIONALE FOR IAASB TO UNDERTAKE THE PROJECT

8. There is a great deal of variation in the way current carbon trading schemes assure the data used to establish rights and obligations. It is expected that over time, a global trading scheme will emerge, either through global “regulation” like the Kyoto Protocol, or through individual schemes allowing credits to be traded with other schemes¹⁰. The evolution of a global trading scheme will require a global approach to assurance.
9. IFAC member bodies and accounting firms, rather than the IAASB, will be liaising with policy makers on the form of verification/audit/assurance that particular schemes should

⁸ The UK Emissions Trading Scheme, which commenced in 2002, ended in December 2006. The UK government is now consulting on a new scheme, the “Carbon Reduction Commitment” (CRC). Announced in May 2007, the CRC will apply mandatory emissions trading for large commercial and public sector organizations (including supermarkets, hotel chains, government departments, and large local authority buildings). www.defra.gov.uk/environment/climatechange/trading/index.htm

⁹ Rupert Murdoch, Chairman and Chief Executive Officer, News Corporation, May 9, 2007

¹⁰ “A workable global emissions trading scheme is likely to evolve slowly through a patchwork of linked national and regional schemes. A single comprehensive global emissions trading scheme in which all countries participate under the same rules would deliver least-cost global abatement. Unfortunately, it is unlikely to be achievable in the foreseeable future, not least because of the loss of sovereignty that would be involved. It is more realistic to envisage a global regime emerging through informal and formal linkages between national and regional emissions trading schemes and other arrangements.” Report of the Prime Minister’s Task Group on Emissions Trading, Australia, February 2007. <http://www.pmc.gov.au/publications/emissions/index.cfm>

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require. However, in the absence of a generally accepted international standard, it is difficult for them to argue that the global accounting profession stands ready to offer a solution. As a recent report by PricewaterhouseCoopers “Building Trust in Emissions Reporting” (February 2007) noted:

Currently...the industry is a long way from a crystal clear set of requirements for verification competences in emissions reporting supply chains... This can result in misunderstandings over the value of the verification outcome, with an expectation gap between what an individual verifier actually assures and what the other actors in the reporting chain assume. This increases the risk of errors and abuse and could undermine trust in the schemes. A new global set of generally accepted emissions verification standards need to be established to address these concerns

10. The need for consultation on assurance mechanisms is evident in recent consultations, e.g.:
 - In “Meeting the Energy Challenge – A White Paper on Energy” (May 2007), the UK Department of Trade and Industry notes that “the approach to monitoring, reporting and verification/audit” is one of four key areas for further consideration during consultation.
 - In their response to a recent proposal by the Australian National Environment Protection Council, the three Australian IFAC member bodies noted “that there appears to have been little consideration of the requirement for independent assurance (verification) of any data prepared in accordance with such a framework. It is essential that data being reported in accordance with the framework is credible – for which equally rigorous and robust assurance requirements are needed.”
11. While some international standards have been developed by private organizations (e.g., ISO 14064-3), these standards are not necessarily freely available, and have not been developed in accordance with the rigor of the IAASB due process, or in the context of the related documents applicable to professional accountants (e.g., ISQC 1, the International Framework for Assurance Engagements, and ISAE 3000).
12. There is a need for timely development of an ISAE dealing specifically with carbon emissions to provide a proper reference point as a global trading scheme evolves. While a global scheme may appear to be some way off, a global assurance standard is needed in the short to medium term so that it can be referenced in national and other schemes and thus evolve as the global standard in time.

KEY ISSUES TO BE ADDRESSED

Suitability of Criteria

13. Different trading schemes use different sets of criteria, which can, and do, vary in certain significant respects, e.g., how they address the various methods of “offsetting” including tree-planting, energy efficiency projects and the like. Some criteria have been developed for application across schemes also¹¹, and can be used along with those specified for a scheme,

¹¹ Such as the WBCSD/WRI protocols for company and project GHG accounting, and ISO 14064 parts 1 & 2 for GHG measurement & reporting

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particularly where the criteria specified for the scheme are silent on an issue. Given that they are currently being used for assurance engagements, and the fact that actual trades are being made based on data generated according to these criteria, it is expected that a number of these sets of criteria will display the characteristics of suitable criteria (relevance, completeness, reliability, neutrality and understandability). The ISAE will provide guidance on how these characteristics should be applied to determine whether a particular set of criteria is suitable. Further, the task force will consider whether the ISAE should specifically name any particular sets of criteria that have achieved general acceptability, perhaps as examples in the text

Using the Work of an Expert

14. The ISAE will need to give attention to the need for the engagement team to access specific expertise in the evolving legal/regulatory/trading market environment; the physical processes by which carbon emissions are generated, reduced, avoided or removed (e.g. sequestration); the methods available to quantify, monitor and report on carbon emissions and the uncertainties around these methods; and the determination of appropriate carbon emission boundaries.

Level of Assurance

15. The task force will consider whether both “reasonable assurance” and “limited assurance” engagements should be covered by the ISAE. This will be addressed, in part, by evaluating the content of assurance requirements and reports for existing emissions trading schemes. In this regard, AICPA SOP 03-2¹² states “while a review-level service relating to an entity's GHG inventory is permissible under existing attestation standards, it is most likely that the market will ultimately demand an examination-level service. Accordingly, this SOP provides guidance only on an examination-level service.” A similar approach is likely for the IAASB project.

Evidence Gathering Procedures

16. The ISAE should include specific guidance on the risk factors professional accountants should consider when obtaining assurance on carbon emissions, and on the nature, timing and extent of further procedures.

Form and content of the assurance report

17. The ISAE should aim to bring a degree of consistency to the form and content of assurance reports on carbon emission disclosures. Consistency of reporting (in addition to consistency of work effort) is particularly important in evolving areas of assurance to ensure expectation gaps are avoided to the extent possible.

IMPLICATIONS FOR ANY SPECIFIC PERSONS OR GROUPS

18. Apart from SEAP, who will be consulted at key stages as the project develops, and IFAC Member Bodies and regional groups (in particular FEE) who have requested the IAASB to

¹² AICPA Statement of Position (SOP) 03-2, *Attest Engagements on Greenhouse Gas Emissions Information*.

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undertake a sustainability-related project, certain non-accounting groups are likely to be affected. For example, (i) the ISO, which has produced a standard on the validation and verification of greenhouse gas assertions; and (ii) regulators, such as those in Alberta, Canada, who are proposing a regulation for carbon emissions that would call for companies' carbon emission reporting to be verified by either registered engineers or public accountants.

Action Requested

The IAASB CAG is asked to discuss the potential project outlined in this paper, and to comment on the desirability of the IAASB undertaking this project and on the identified issues.

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Appendix

Members of SEAP – September 2006

	Firm or other	Active in member body	Other relevant affiliations – current and past	Region
Roger Simnett (Chair)	Academia	ICA and CPA Australia	IAASB independent member	Oceania
Peter Wong	Ex Deloitte	Hong Kong ICPA	<ul style="list-style-type: none"> GRI Board IFAC Board 	Asia
Roger Adams	ACCA	ACCA	<ul style="list-style-type: none"> GRI Board AccountAbility Technical C'tee 	UK
Alun Bowen	KPMG	ICA England & Wales	<ul style="list-style-type: none"> Business in the Community in Wales KPMG Global Sustainability Services 	UK
Nancy Kamp-Roelands	EY	Royal NIVRA (Netherlands)	<ul style="list-style-type: none"> FEE Sustainability Group NIVRA Standard Setting Group on Sus. Assurance UNCTAD-ISAR corporate responsibility indicators GRI Environmental Indicators AG 	Europe
Alan Willis	CICA	Canadian ICA	<ul style="list-style-type: none"> GRI Verification WG GRI Reporting as a Process WG AICPA/CICA Sustainability Task Force 	Canada
Lars-Olle Larsson	PwC	FAR (Sweden)	FEE Sustainability Group	Scandinavia
Susan Todd	Solstice Sustainability Works Inc		<ul style="list-style-type: none"> AccountAbility practitioner GRI Social Indicators Advisory Group 	Canada
Robert Langford	ICAEW	ICA England & Wales	<ul style="list-style-type: none"> FEE Sustainability Group GRI Boundaries WG GRI Indicators WG 	UK
Beth Schneider	Deloitte	American ICPA	AICPA/CICA Sustainability Task Force	US
Takeshi Mizuguchi	Academia	Japanese ICPA	Advisory Committee of GRI Forum Japan	Asia
Maria Fatima Reyes	Consultant	Philippines ICPA	<ul style="list-style-type: none"> PICPA's Env. Accounting C'tee UN Division for Sus. Development's Experts WG on EMA 	Asia
Johan Piet	TranspaRability BV	Royal NIVRA (Netherlands)	<ul style="list-style-type: none"> FEE Sustainability Group AccountAbility Technical C'tee 	Europe
Preben Soerensen	Deloitte	FSR (Denmark)	AccountAbility Technical C'tee	Scandinavia
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