

Considerations for Sustainability Reporting in Worldwide Accounting Standards

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28th November 2020

Table of Contents

I. Introduction.....	3
II. Current Methods for Sustainability Reporting.....	4
II-A. Accounting for Organization Using Less.....	5
II-B. Accounting for Organization Using More.....	5
III. Observations from EU ETS Accounting Principles.....	7
IV. Learnings from the EU ETS System.....	8
V. Conclusion.....	9
VI. Final Suggestion for Stage 1.....	10

I. Introduction

The IFRS Foundation has initiated a Consultation for the future of Sustainability Accounting as a Standard in global financial accounting. It is indeed, a current requirement that the exponentially increasing greenhouse gases and environmental pollutants, including the dangerous and poisonous gases that are emitted to the air we breath, is somehow better managed to ensure our own best survival.

As the world develops and more people from more countries, start using cars where previously they may not have had access, consume more electricity, when previously they may not had the availability and consume food and beverages that require more energy in its preparations, the expending of global energy resources has indeed increased. There is a correspondingly increased need for energy resources such as coal, that is crucial for making steel, that is then used to make bridges and buildings through to daily utensils; crude oil, that is then used to drives vehicles and trucks to transport goods and humans; and other minerals and natural resources that requiring extraction from source to then make its further downstream products that has wide usage, such as gold, iron ore and bauxite. Indeed, to reduce any dependencies on such products, with an increasing demand, is a big change in the natural living of persons in their respective societies, retrospectively.

However, to meet this gap of having good and clean air, and to also keep the personal and national income from such natural resources going, alternative sources of energy such as wind power, solar power and hydrogen as sources of energy has been researched and several prototypes and commercialized products are now available in the market. Whilst wind power has had a high uptake in the European markets, with the windmills finding their place on the hill tops and previous farm lands, the amount of energy that can consistently be derived from this source, is still inadequate to completely be able to replace other sources of energy. Technically, wind power is still unviable for the production of good quality steel, that the world critically needs and is indeed dependent upon. Similarly, solar power, whilst replacing energy produced from coal and hydro-electricity projects, is still insufficient in being able to cover all geographic areas where there is not much sunlight or has inclement weather pattern for a dependable production of replacement energy.

With this background and common understanding, the IFRS would have to develop a standard for accounting that appropriately and adequately reflects, with material objectivity, a process to identify, quantify and report the Sustainability standards for financial reports that would be adoptable worldwide in an equitable manner.

II. Current Methods for Sustainability Reporting

Whilst all countries, with respect to the signed accords such as the Paris Accord, have started implementing regulations and equivalent processes, that adhere to reducing green house gases, its efficiency and applicability has still some distance to cover, especially when applied to countries who are also economically developing. Sometimes, when the country develops at a rate that is higher than the targeted emission reduction standard, the net emission may still increase, as if the country has not adopted any strategy or has failed in its signing of such accords. Hence, it does come in the way of the development strategies for countries especially in Asia and Africa, and even developed countries such as Australia, where there is a fast pace of economic development, that either to meet the emission standards and put a cap on the number of cars and vehicles sold, or to pursue the impetus of economic development and make as many persons economically better equipped such as with a car or electricity in the house, as a seriously contentious decision. Often such contention may also lead to serious other consequences such as political instability or hyper-inflation of the economy and in depth recessions, as the fiscal policies would become inherently inconsistent and ambiguous with the signed and applicable agreements and treaties. Hence, for nations that are such affected, a selected and limited applicable standard for Sustainability Reporting maybe made available as opposed to the highly developed standards and processes such as those already implemented in the European Union through its Emissions Trading System.

Indeed, the Emission Trading System is the most developed in the world, as far as being applicable to Accounting Standards are considered. Here, a highly defined Cap and Trade System, where an organization is given an allowance by the administration to be able to emit green house gases, is used and monitored by the organization for its operations. If the organization is using less than its allotted allowances, it can 'sell' the allowance to another organization that is using more than its allowance. Hence, in terms of accounting this provides a complete realization of the economic fundamentals that would be used and applied, such as Allowances and market pricing of Greenhouse Gases, to then be used for reporting on Sustainability.



Figure 1 : Schematic Representation of EU ETS

In such a System, there is a clear financial advantage for the Organization that is using less Carbon Emissions, and indeed forms a clear Asset for the Organization – that it is reducing the Carbon Emissions. Similarly, it is a Liability, or Payables for the Organization that is increasing or using more than the Cap provided by the Allowances by the Government. Hence, in the European Union, a Double Entry Accounting can be applied with such clear objectives.

II-A. Accounting for Organization Using Less

Ledger Entries

<u>Debit</u>	<u>Credit</u>
Cash from Selling Allowance (A)	Forwarding of Allowances (B)

Profit and Loss Statement

Earnings Before Taxation, Depreciation and Amortization = \$ xVal

Earnings Adjusted to Carbon Emission Trading (EUETS) = \$xVal + A

Balance Sheet

Increase in Assets = Cash

Decrease in Liabilities = Allowances

Hence, it is observed that the Liabilities in the form of Allowances provided by the Government to each Organization, can be converted to Cash Asset, if the Organization gets rid of this liability by reduced emission of greenhouse gases.

II-B. Accounting for Organization Using More

Ledger Entries

<u>Debit</u>	<u>Credit</u>
Obtaining Allowances (A)	Cash for Allowances (B)

Profit and Loss Statement

Earnings Before Taxation, Depreciation and Amortization = \$ xVal

Earnings Adjusted to Carbon Emission Trading (EUETS) = \$xVal - B

Balance Sheet

Increase in Assets = Allowances

Decrease in Liabilities = Cash

Hence, it is observed that the Liabilities in the form of Allowances provided by the Government to each Organization, can be converted to an Asset, when purchased for the operations of the Organization as a going-concern, and the Organization pays cash for such a purchase. Also, in this scenario, in a Standardized Accounting Principle, such Cash would be a reducing liability for the Organization.

III. Observations from EU ETS Accounting Principles

It can be observed from the above example, that for Organizations using Less :

- a. The provided Allowances are a Liability from Government
- b. Allowances can be converted to Asset
- c. Cash is an Asset

Also, for Organizations using More :

- a. The provided Allowances are an Asset from the Government
- b. Assets can be increased with Cash
- c. Cash is a Liability

Hence, the value of Cash in the EU by virtue of the ETS, is a fundamental consideration for the Accounting Books, as to its interpretation as an Asset or a Liability, depending on whether the Organization is using More or Less of the allowed concessions by the Government.

The above fundamental is a critical factor for developing fiscal and economic policies for a nation and indeed for the whole of the European Union as a single market. Understandably, the European Central Bank is using currency liquidation as a policy, to manage such risks, and therefore, it maybe considered that the EU ETS system would introduce fundamental questions of the nature of Cash in Accounting Systems, that would have an impact on the developing fiscal and monetary policies of the Central Bank.

Moreover, the future of an Organization that is dependent on this ETS System, becomes dependent on whether and how much greenhouse gases it emits, that may well be beyond its natural control, depending on other environmental factors, that would overall, and fundamentally, affect the nature of Cash for the Organization – cumulatively causing a fiscal crises for the nation. For stable economic and financial condition, a definitive and constant derivation for the nature of Cash would be required both for the Organization and the country of its operations.

IV. Learnings from the EU ETS System

However fundamentally flawed, the EU ETS system may still provide some insights into the challenges posed by Carbon Trading as a sustainable system in itself for worldwide adoption. Understandably, the European Union, can express more concern for greenhouse gases, as it has limited amount of natural energy resources for national accounts, importing most such utilities. Still, for a worldwide acceptable Accounting Standards in Sustainability would require:

- a. A non-fiscal impacting assessment Standard
- b. Clearer Definition of the Asset Class for Allowances
- c. Better evolved mechanism for exchange of Cash for Allowances

V. Conclusion

A method to report on Sustainability of Organizations as a part of going concern assessments is a true and valid initiative that is in the best interest of mankind. However, an economically risk-free option has to be identified that would agree with the existing consensus and principles of financial management. Whilst some Accounting Standards suggest depreciation of Long Lived Assets (IAS 36 and ASC 360), such depreciation against a Government provided Allowance, may be insufficient economic re-adjustment that best preserves the economics and reduces the risks of recessions or financial meltdowns.

A possible suggestion is to initially, only include the data for carbon emissions in financial statements for organizations worldwide. Thereafter, as per the policies and regulations of specific jurisdictions, a better analysed solution can be developed. To firstly understand that greenhouse gases are dangerous and causes harm to mankind, should firstly find a place in the financial statements. Thereafter a financial and accounting standard, be it as a Government Allowance in Credits, or incentives to adopt better technology, can be adopted per individual countries. Here, IFRS can provide a new Accounting Standard for such adjustments in financial Accounting, that meets all such customized implementations.

VI. Suggestions for Stage 1

As the first Stage for greenhouse reduction, all Publicly Listed Companies Worldwide should include a Statement on the Carbon Emissions from its operations. This can be represented in terms of Tonnes of Emission, and would not need any further monetary or Cash equivalency or conversions in such Statements.

It is suggested that the Balance Sheet that provides financial information for the Organization be the appropriate placement for such a Statement. Inclusively, each individual reader of the financial statement for the Organization can make their own estimate, depending on their market of reference, for adjusting and discounting the associated Assets, Liabilities and final adjusted Profits of the Organization. Accordingly, the price for the Organization in the global market would also face such similar adjustments, providing an incentive for the Organization to decide accordingly.