ESMA
European Securities and Markets Authority

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PUBLIC STATEMENT

Clearing the smog: Accounting for Carbon Allowances in Financial Statements

I. Objective

This Statement intends to:

- Take stock of the **different accounting approaches observed** to date in the financial statements of European listed issuers regarding carbon pricing programmes (specifically, compliance carbon allowances as defined in Section IV).
- Encourage issuers to **consider which IFRS Accounting Standards**[1] could be used to account for carbon allowances in their financial reporting (Section VI and VII).
- ⇨ Provide **disclosure recommendations to enhance decision usefulness for users** by promoting transparency of the information included in the financial statements with respect to carbon pricing programmes, in which an issuer is engaged (Section VIII and IX).

This Statement does not prescribe a method according to which carbon allowances should be accounted for in the financial statements, but rather reinforces **ESMA's prior calls and recommendations for increasing transparency and decision usefulness for users**. The Statement **aims to raise issuers' awareness** regarding a topic whose relevance in corporate reporting has increased in recent years and is expected to continue to gain further attention as the targets set out in the 2015 Paris Agreement draw closer and **issuers may need to consider carbon allowances to compensate greenhouse gas (GHG) emissions**. Its contents should be considered in light of **materiality**.

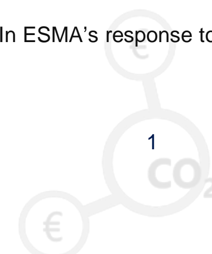
II. Background

Across various recent publications, the European Securities and Markets Authority (ESMA) has highlighted that issuers may need to consider the impacts of how climate-related matters are accounted for in financial statements prepared in accordance with IFRS Accounting Standards and urged issuers to provide robust related disclosures. Among the topics addressed in such prior publications, ESMA has called for increased attention to the accounting and financial reporting ramifications that stem from issuers' efforts to reduce GHG emissions in conjunction with their response to targets set out under the Paris Agreement, to local regulations and requirements, and/or to stakeholder pressures.

This growing demand for carbon mitigation has given rise to the development and availability in the market of a variety of carbon pricing schemes and instruments. ESMA has observed that their use is increasing as more issuers across different industries are entering into schemes. While their potential impact in financial reporting may be limited at the moment, it is expected that this situation will soon change considering that the number of available free allowances are likely to reduce in the near future and that the prices for carbon allowances are increasing at a fast pace.

The variety of schemes and instruments coupled with the absence of an IFRS Accounting Standard that specifically applies to such schemes[2] has led to different practices emerging from the application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Carbon pricing programmes and specifically carbon allowances may impact several line items in the statement of financial position, the statement of profit and loss and other comprehensive income and the statement of cash flows. Therefore, **ESMA calls for transparency on accounting policies used** to enable users of financial information to understand (i) **how issuers are recognising, measuring and presenting such schemes in financial statements**, (ii) the **current and future impacts of such schemes**, and (iii) how issuers are **progressing on their journey to net zero**.

[1] IFRS Accounting Standards are developed by the International Accounting Standards Board (IASB).
[2] ESMA notes that the IASB has a project on pollutant pricing mechanisms that is currently on its 'reserve list'. In ESMA's response to the IASB Agenda consultation, ESMA considered that this project should be prioritised.



III. A, B, CO_2: the carbon alphabet soup

Carbon pricing programmes have developed (and may continue to develop) in many shapes, forms and sizes, and the terminology associated with them often combines and mixes different definitions, concepts and classifications (e.g., credit, offset, allowance, etc.). For the purposes of this Statement:

Carbon pricing programmes refer to instruments representing i) a permission to emit one ton of carbon dioxide (CO_2) in a specified time period, or ii) a tradeable credit generated through emissions reductions or carbon removal measures or projects, representing one ton of CO_2 reduced or removed[3]. Carbon pricing programmes are certified by governmental bodies (compliance market) or independent verifiers (voluntary markets), have a unique serial identifier, and are issued, tracked and cancelled within an electronic registry.

Compliance Carbon Pricing Programmes		Voluntary Carbon Pricing Programmes	
Mandatory participation by certain issuers[4]		*Voluntary strategies to reduce GHG emissions by certain issuers, not stemming from a legal requirement*	
Emission allowances, rights, or permits	Associated with emission trading schemes (ETS), such as the cap-and-trade model of the European Union ETS (EU ETS). Certain issuers are awarded emission allowances equal to a cap of allowable emissions, which are thereafter tradeable.	**Carbon offsets**	Carbon pricing programmes not for compliance purposes and non-fungible due to a high level of diversity in voluntary programmes' terms and conditions (type of CO_2 reduction/removal project, independent verifier, timing & location of reduction/removal activities, tradeable vs. non-tradeable, etc.)

Focus of statement "Carbon allowances"

While the definitions above are simplified, ESMA highlights the importance of distinguishing between carbon mitigation instruments classified as compliance and voluntary carbon pricing programmes (for instance, because this classification may play a role as to whether certain carbon allowances, credits or offsets can be recognised as assets). **Issuers should carefully analyse the contractual features of the carbon pricing programmes they have entered or plan to enter and any other requirements or regulations to which the issuer (its industry or sector) may be subject**. Different contractual features and instruments may entail different accounting treatments and may impact financial statements differently.

IV. Scope

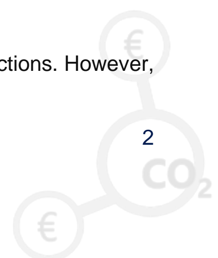
This Statement focuses on **compliance carbon pricing programmes and specifically emission allowances, rights and permits (hereafter, carbon allowances).** This choice of scope results from the fact that the most prevalent carbon pricing programme currently observed in the European context relates to the EU ETS, a compliance carbon pricing programme.[5] The EU ETS is the largest carbon market and features mandatory participation by certain issuers, along with an obligation to settle emission liabilities using emissions allowances, rights or permits. Specific to the EU ETS is the setting of a cap on the overall awarded emissions, allowances or rights, a permission to trade such allowances or rights and the existence of an active market.

This Statement does not specifically address:

- Accounting practices that arise directly in relation to voluntary market programmes.
- Other mandatory compliance programmes, such as green or renewable energy certificates (RECs).

Nevertheless, to assist issuers in developing their accounting policies on mandatory and voluntary carbon pricing programmes not addressed in this Statement, ESMA includes, in section V, **some accounting considerations** and, in section VIII and IX, **recommendations regarding disclosures**.

[3] Definition based on EU ETS Handbook Glossary for *Credits* and *Emission Allowances*.
[4] In addition, ESMA acknowledges that there are other mandatory compliance programmes such as RECs in some jurisdictions. However, these programmes are not issued to represent an emission reduction or removal of CO_2 equivalent.
[5] For further information, please check: https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en

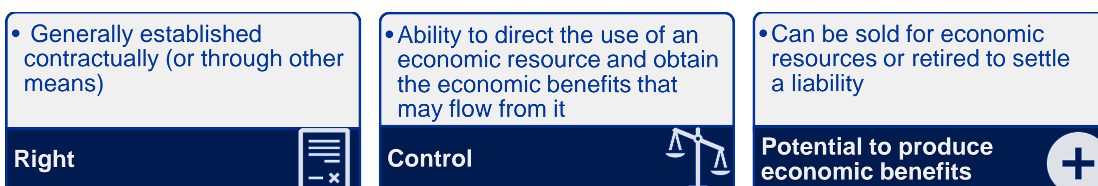


V. General considerations: aspects to consider when developing accounting policies regarding carbon pricing programmes under IFRS Accounting Standards

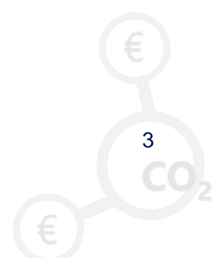
As mentioned above, when developing accounting policies to account for carbon programmes in accordance with IAS 8[6], issuers need to consider their own specificities and circumstances, together with the characteristics of the carbon programmes entered into. Furthermore, **disclosures are essential** for users of the financial statements to enable them to understand the impact of the carbon pricing programmes on issuers' financial performance and position. When performing such assessment, ESMA recommends that issuers consider, among other factors, the following:

1. Do carbon programmes give rise to rights that meet the definition of assets under IFRS Accounting Standards?
2. Does the issuer incur an obligation to acquire carbon allowances by entering into carbon pricing programmes?
3. Do the carbon allowances give rise to different types of asset? Does the nature of the asset affect whether and when the asset is recognised and how it is measured?
4. Do liabilities need to be recognised in the financial statements and when?
5. What is the appropriate measurement policy for carbon pricing programmes? What is the best estimate for provisions arising from carbon pricing programmes?
6. Which income or expenses do the carbon pricing programmes generate? At which point should gains and losses (income and expenses) be recognised?
7. How should cash flows related to carbon pricing programmes be classified in the cash flow statement?
8. What disclosures are needed to enable a user of the financial information to understand the impact of the carbon pricing programmes?

One fundamental question that should be considered when assessing how to account for such programmes in the financial statements is whether the carbon credits or allowances effectively meet the definition of an asset, or whether they should be considered an expense (this in particularly relevant in the context of voluntary carbon pricing programmes). The IFRS *Conceptual Framework* identifies an asset of an entity as a **present economic resource controlled by the entity as a result of past events**. ESMA notes that this definition incorporates three main criteria:



[6] In light of the absence of a specific IFRS Accounting Standard dealing with this topic.



VI. Observed current accounting practices on carbon allowances

The following subsections provide a high-level overview of the **current accounting approaches most frequently observed regarding carbon allowances** by national enforcers and ESMA during enforcement and regulatory activities conducted in recent years. Nevertheless, ESMA is aware that, in the absence of an IFRS Accounting Standard specifically addressing these transactions, issuers have adjusted those approaches to cater for the specificities of their carbon allowances, and the guidance developed by other standard setters and related literature. The following diagram maps out the most commonly observed practices when accounting for carbon allowances (on the asset side), **at initial recognition** in accordance with **paragraphs 10 to 12 of IAS 8**:

1 **Unit of account**
Is the carbon allowance a separate unit of account?
When the carbon allowance is not part of the cost of another good or service, it is a separate unit of account[1]

2 **Asset Recognition**
Should an asset be recognised?
When an asset is recognised, determine which standard to use.
If not, expense as incurred.

3 **Held for use**
Is the carbon allowance purchased/granted to be typically held for use?[2]

3 **Held for trading**
Is the carbon allowance purchased to be typically held for trading?
[Broker-trader entities]

4 **Inventory Accounting**
Is the awarded or purchased carbon allowance to be sold in the ordinary course of business or to produce products/services to fulfil contracts with customers?
Debit: IAS 2 *Inventories*
Credit: Cash (if acquired) **or** Deferred income (if awarded & recognised at fair value)

4 **Intangible Asset Accounting**
Is the carbon allowance transferable or tradeable, held to settle a liability stemming from CO_2 in the ordinary course of business?
Debit: IAS 38 *Intangible Assets*
Credit: Cash (if acquired) **or** Deferred income (if awarded & recognised at fair value)

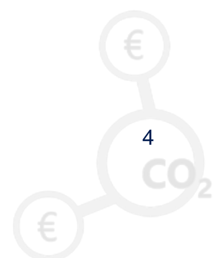
4 **Other Standards to Consider**
Consider the **first box** on **page 7.**

[1]When the carbon credit is purchased together with other goods or services (is part of the cost of such other goods or services), the carbon credit may not be accounted for separately. I.e. it may be accounted for as part of the good or services acquired.

[2]Most issuers measure the awarded allowances at cost (which is usually nil). In those cases, there is no impact of the allowances in the primary financial statements at initial recognition. This impact only materialises when issuers need to acquire allowances to compensate the CO_2 emissions produced.

ESMA is aware that, within the accounting treatments identified above, diversity in practice on how to recognise, measure, present and disclose carbon allowances still exists. The following set of tables illustrates the two accounting treatments observed most frequently in practice. ESMA highlights that, although there is currently no specific guidance in IFRS Accounting Standards to deal with this topic, issuers **should apply the accounting policies chosen consistently over time, across similar carbon pricing programmes and primary financial statements** and **should only change** them if these changes result in financial statements providing **reliable and more relevant information**[7].

[7] Paragraph 14 of IAS 8.



➔Inventories Approach (inventories + liability)

IFRS Accounting Standards referred to by issuers:

- ⇨ IAS 2 *Inventories*
- ⇨ IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

Issuers in practice disclose that they apply this approach when:

- ⇨ Carbon allowances are **held for sale in the ordinary course of business.**
- ⇨ Carbon allowances are held with the intent of being used in the **production process** (for example, in producing carbon-neutral products).

ESMA notes that, however, if the issuer holds carbon allowances only for (i) capital appreciation or (ii) trades carbon allowances **outside the normal course of business**, these do not meet the definition of inventory.

IAS 2 specifies that inventories need to be measured at the lower of cost and net realisable value.

With regards to the cost of carbon allowances, the observed practice is that when allowances are received as grants, they are recorded at nominal amount (in most cases, nil); when purchased, they are initially recognised at cost. Subsequently, they may be measured first-in-first-out (FIFO) or on a weighted average basis. ESMA also observes that some issuers measure carbon allowances awarded for free at fair value, with the difference between fair value and cost of allowances classified as a government grant under IAS 20 (deferred income) on the statement of financial position (see *Approach B* in the table).

What is the observed impact on the financial statements?

	Statement of financial position		Statement of profit or loss and other comprehensive income	Statement of cash flows
Asset side	**Purchased carbon allowances** Inventory asset (initial recognition measured at cost; subsequently cost or net realisable value, if lower).		➔ Revenue when carbon allowances are sold. ➔ Expensed as cost of goods sold when used or sold. ➔ If Approach B for awarded carbon allowances applied, the deferred income (government grant) is released to net against the expense when emissions are produced.	Purchases and sales of carbon allowances are presented as part of operating activities.
Asset side	**Awarded carbon allowances (free)**[8]			
Asset side	*Approach A*: Inventory asset measured at cost (nil).	*Approach B*: Inventory asset measured at fair value at initial recognition, subsequently at (deemed) cost.		
Liability side	No corresponding entry as inventory asset is recorded at nil.	Deferred income at initial recognition, (corresponding to government grant).		
Liability side	**Is there an obligation connected to the carbon allowances?**		➔ If Approach A, expensed only when CO_2 emissions exceed the carbon allowances held. ➔ If Approach B, expensed as CO_2 emissions are produced.	
Liability side	*Approach A*: A provision/liability is recognised at market value only to the extent that **emissions occur exceeding** the carbon allowances held.	*Approach B*: A provision/liability is recognised at the carrying amount of the allowances at hand **or** market value for the allowances at each period end that would be required to cover any excess emissions (i.e., actual emissions in excess of allowances on hand) produced.		

The observed practice is that issuers usually measure the provision and liability at the carrying amount of the carbon allowances already held (regardless of whether the carbon allowances were obtained for free or were purchased) **or** at the market value of carbon allowances at each period end that would be required to cover actual emissions[9].

[8] For carbon allowances awarded for free, this Statement distinguishes between two approaches observed (*Approach A* and *Approach B* in the table), which depend on whether the asset (whether inventory or an intangible) is initially recorded at fair value or not. When fair value is used, the observed practice is that issuers subsequently consider the fair value of the carbon allowances awarded for free to be the cost of the awarded carbon allowances and adjust it in case of impairment.

[9] For further information, please also consider section VII of this Statement.

➔Intangible Assets Approach (intangibles + liability)

IFRS Accounting Standards referred to by issuers:

- ⇨ IAS 38 *Intangible Assets*
- ⇨ IAS 20

Issuers in practice disclose that they apply this approach when:

- ⇨ A carbon allowance that is transferable or tradeable is held to settle a liability stemming from GHG in the ordinary course of business.

Observed practice is that if issuers do not determine that the assets are inventory, the carbon allowances may be considered to fit the IAS 38 definition of intangible assets, insofar as they may be deemed as non-monetary assets that are identifiable (wherein they are separable and can be sold, exchanged or transferred), have no physical form, and are resources controlled by the issuer. Recognition of the carbon allowances as intangible assets can only occur if it is probable that the expected future economic benefits that are attributable to the asset will flow to the issuer and that the cost of the asset can be measured reliably.

IAS 38 measurement requirements specify that intangible assets are measured initially at cost and subsequently carried at cost less accumulated amortisation and impairment losses (if any). The observed practice is that, for example when carbon allowances are received as grants, these are recorded at nominal amount (in most cases, nil); when purchased, these are initially recognised at cost. Carbon allowances are not usually amortised. ESMA also observes that some issuers measure carbon allowances awarded for free at fair value, with the difference between fair value and cost of allowances classified as a government grant under IAS 20 (deferred income) on the statement of financial position (see *Approach B* in the table).

According to IAS 38 when there is an active market, issuers could elect to use the revaluation model, however, ESMA has not observed this measurement option being often used in relation to carbon allowances.

<table>
<tr><th colspan="5">What is the observed impact on the financial statements?</th></tr>
<tr><th colspan="3">Statement of financial position</th><th>Statement of profit or loss and other comprehensive income</th><th>Statement of cash flows</th></tr>
<tr><td rowspan="3">Asset side</td><td colspan="2">Purchased carbon allowances
Intangible asset (measured at cost).</td><td rowspan="4">➔ Gains or losses if carbon allowances are sold (not revenue).
➔ If Approach B for awarded carbon allowances applied, the deferred income (government grant) is released to net against the expense when emissions are produced.</td><td rowspan="7">Purchases and sales of carbon allowances are presented as part of investing activities.</td></tr>
<tr><td colspan="2">Awarded carbon allowances (free)</td></tr>
<tr><td>Approach A: Intangible asset measured at cost (nil).</td><td>Approach B: Intangible asset measured at fair value at initial recognition), subsequently[10] at (deemed) cost.</td></tr>
<tr><td rowspan="3">Liability side</td><td>No corresponding entry (i.e., no government grant).</td><td>Deferred income at initial recognition, (corresponding to government grant).</td></tr>
<tr><td colspan="2">Is there an obligation connected to the carbon allowances?</td><td rowspan="2">➔ If Approach A, expensed only when CO_2 emissions exceed the carbon allowances held.
➔ If Approach B, expensed as CO_2 emissions are produced.</td></tr>
<tr><td>Approach A: A provision/liability is recognised at market value only to the extent that emissions occur exceeding the carbon allowances held.</td><td>Approach B: A provision/liability is recognised at carrying amount of the allowances at hand or market value for the carbon allowances at each period end that would be required to cover any excess emissions (i.e., actual emissions in excess of carbon allowances on hand) when emissions are produced.</td></tr>
</table>

The observed practice is that issuers usually measure the provision and liability at the carrying amount of the carbon allowances already held (regardless of whether the carbon allowances were obtained for free or purchased) **or** at the market value of carbon allowances at each period end that would be required to cover actual emissions.[11]

[10] See Footnote 8.
[11] For further information, please also consider section VII of this Statement.

VII. Other standards to consider

Carbon allowances, whether or not recognised as assets or liabilities, can impact several areas of financial reporting, including but not limited to (i) fair value measurement of assets, (ii) impairment of non-financial assets, (iii) provisions, contingent liabilities, (iv) financial instruments or (v) revenue recognition. The following boxes provide snapshots of some high-level considerations to take into account:

1. IAS 2 and IFRS 13 *Fair Value Measurement*
2. IAS 36 *Impairment of Assets*
3. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
4. IFRS 9 *Financial Instruments*
5. IFRS 15 *Revenue from Contracts with Customers*

Broker-trader entities specific considerations

Applicable standards

⇨ IAS 2 ⇨ IFRS 13

ESMA notes that when the issuer is a broker-trader entity and the carbon allowances are held for trading (i.e., the issuer actively trades carbon allowances with the main intent of selling them short-term for profit arising from price movement or changes in trader's margin), the IAS 2 broker-trader exemption may apply. In such instances, issuers may consider measuring the carbon allowances at fair value less costs to sell with changes in fair value recognised in the statement of profit or loss. In measuring carbon allowances at fair value in accordance with IFRS 13, issuers should consider the characteristics of the carbon allowances that market participants would take into account when pricing the carbon allowances at measurement date. If the inputs issuers use to measure the fair-value of carbon allowances are other than observable prices in an active market, issuers may need to categorise the resulting fair value using level 2 or level 3 of the IFRS 13 fair value hierarchy and disclose the necessary information.

How should carbon allowances be considered in impairment testing?

Applicable standard

⇨ IAS 36

When carbon allowances are recognised as intangible assets, they are within the scope of IAS 36 for impairment testing, whereby the recoverable amount is determined as the higher of value in use and fair value less costs of disposal. In addition, ESMA notes that the value in use for carbon allowances may be assessed at the level of the cash-generating unit (CGU) to which the carbon allowances belong (e.g., an operation identified as a CGU for impairment testing, against which the carbon allowances is meant to be redeemed).

ESMA also highlights that issuers should consider carbon allowances when testing CGUs for impairment. Notably, where CO_2 allowances need to be acquired to offset carbon emissions, issuers may need to consider such costs when determining the value in use of CGUs.

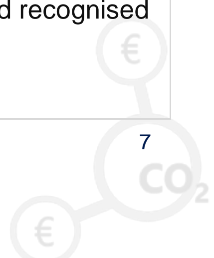
Is there an obligation connected to carbon allowances?

Applicable standard

⇨ IAS 37

ESMA highlights that compliance carbon allowances may trigger, for example, provisions:

- When the issuer emits CO_2 for which the issuer has received CO_2 allowances for free and recognised them at market value in the statement of financial position, or
- When the issuer emits more CO_2 than the annual allowable threshold.



IAS 37 sets out the conditions to consider for determining the existence of (and requirement to recognise) an obligation, which could apply to issuers in the context of a failure to comply with the requirements of the compliance carbon pricing programmes. IAS 37 requires an issuer to recognise a provision when:

- The issuer has a present obligation (legal or constructive) arising from a past event.
- There is a probable outflow of resources embodying economic benefits that will be required to settle the obligation. ESMA notes that a provision may need to be recognised if an issuer faces an obligation that it needs to settle by paying cash, delivering carbon allowances, or purchasing/generating carbon allowances for a specified period.
- The issuer can determine a reliable estimate of the amount of the obligation.

ESMA highlights the recent IFRS IC agenda decision on Climate-related Commitments (IAS 37 Provisions, Contingent Liabilities and Contingent Assets).[12]

The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation (in ESMA's view, usually, this should be the current market price of the carbon allowances required or the carrying value of the carbon allowances already held that will be used to offset the CO_2 emissions) at the end of the reporting period.

ESMA understands that certain sectors or activities may be subject to specific legal requirements, which may affect the accounting treatments of carbon allowances. Therefore, when assessing whether and when a liability needs to be recognised in the financial statements, issuers should also consider any constructive or legal obligations connected to the sector of activity in which they operate.

What to consider when carbon allowances underlay derivative contracts?

Applicable standard

⇨ IFRS 9

ESMA notes that when issuers enter into contracts/commitments to buy/sell carbon allowances with net settlement features, they may fall within the scope of paragraph 2.6 of IFRS 9. In such cases, issuers need to account for the contracts of purchasing or selling carbon allowances as derivatives at fair value through profit or loss unless they meet the own use scope exemption in IFRS 9 or they are used for hedging purposes (in the latter case hedge accounting rules may apply). Moreover, at the inception of the contract, issuers may decide to irrevocably designate the own use contracts as measured at fair value through profit or loss.

In this respect, ESMA highlights that the own use exemption set out under paragraph 2.4 of IFRS 9 may be met in instances where, for example, an issuer purchases allowances to offset its own emissions (the issuer purchases carbon allowances to meet its expected own usage requirements).

What to consider when carbon allowances are sold?

Applicable standards

When an asset is recognised as inventory:

⇨ IFRS 15 (including for broker-trader entities using the IAS 2 exemption)

When an asset is recognised as an intangible asset:

⇨ IAS 38

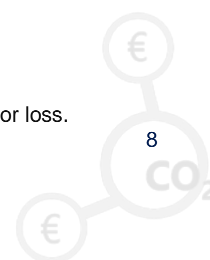
ESMA notes that when IAS 2 is applied to account for the carbon allowances, the issuer should generally apply IFRS 15 to recognise the revenue when such allowances are sold or when the products produced or services are rendered.

When IAS 38 is applied to account for the carbon allowances:

- The issuer should recognise either a gain or a loss from the sale (IAS 38, paragraph 113).
- If the issuer follows a revaluation model, the cumulative revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realised (IAS 38, paragraph 87).[13]

[12] IFRS - IFRIC Update March 2024

[13] Please note, however, that the transfer from revaluation surplus to retained earnings should not be made through profit or loss.



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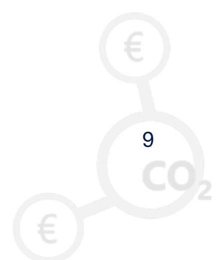
VIII. Clearing the smog: disclosure recommendations

The following disclosure recommendations should be considered by issuers as examples of what may need to be included in the financial statements to enable a comprehensive understanding of how carbon allowances currently impact and may impact the issuer's financial statements in the future. These disclosures should be considered **in light of their materiality** (from both a quantitative and qualitative perspective)[14]. These recommendations apply to compliance and voluntary carbon pricing programmes.

- ✓ Issuers should provide **information on the accounting policies** used for the recognition, measurement, and presentation of carbon pricing programmes. Given the lack of specific IFRS Accounting Standard to account for such schemes, issuers should consider the disclosures required by IAS 1 about the accounting policies developed[15]. When issuers hold carbon allowances/credits, the notes should include information on (i) the **main terms and nature of such schemes** to enable users to understand the risks, opportunities and main differences between the schemes or instruments used, (ii) whether the programmes are **compliance or voluntary** programmes and, in case of the latter, where applicable, any **judgements** used to support the recognition of assets in the financial statements.
- ✓ Where applicable, issuers should consider the requirements in IAS 1 regarding **judgements and major sources of estimation uncertainty**. In this respect, issuers should consider disclosing the CO_2 prices (and sources) used in estimations[16]
- ✓ When the measurement of carbon allowances is based on internal assumptions, issuers may need to provide information in the financial statements regarding **the main assumptions used, as well as sensitivity analyses** with respect to those main assumptions and the related impacts[17].
- ✓ **Depending on the standards** applied by issuers (IAS 2, IAS 38, IFRS 9, IAS 20, etc.), issuers will need to **provide the specific disclosures** required by such standards.
- ✓ Disclosures should specifically explain how these allowances **impact the financial performance, financial position, and cash flows**, indicating which line items in the financial statements are affected. Where applicable, any differences and impacts arising from different measurement bases arising in different jurisdictions should also be highlighted (e.g. EU ETS vs UK ETS)[18] .In particular, disclosures should include information on:
  - o **material gains and losses** (income and expenses) recognised in the statement of profit and loss and other comprehensive income or material cash flows in the statement of cash flows, for instance, when issuers sell CO_2 allowances (this is particularly relevant if these were obtained for free).[19]
  - o how the CO_2 allowances were taken into consideration in **cost of sales expenses**.[20]
  - o **material non-cash transactions** pertaining to investing activities[21] in a way that provides all the relevant information about these transactions and activities.
- ✓ Whether the carbon allowances were purchased or awarded, **issuers are encouraged** to provide **quantitative disclosures** on the amount of carbon allowances owned and/or owed (for instance quotas from previous years), acquired, consumed, or sold and on the useful life of the certificates together with other key terms.
- ✓ Issuers should disclose the **measurement basis and sources** (whether the price of carbon allowances are based on internal or external sources). In case the issuer accounts for such programmes as inventories, the issuer should disclose whether it uses the FIFO or weighted average method[22].
- ✓ Where applicable, issuers **are encouraged to disclose quantitative assumptions** used about carbon allowances or certificate prices for GHG emissions **in impairment testing** in particular when assessing the value-in-use of CGU(s). Where relevant, such disclosures may need to be accompanied by sensitivity analyses[23].
- ✓ Where relevant, issuers should disclose **if provisions have been recognised** to account for CO_2 allowances that need to be purchased to comply with commitments (either in the year-end or interim reports) and how those provisions have been measured[24].

[14] IASB, IFRS Practice Statement 2: Making Materiality Judgements,14 September 2017
[15] Paragraphs 117 to 117E of IAS 1.
[16] Paragraphs 122 to 125 of IAS 1.
[17] Paragraphs 112, 125 to 129 of IAS 1.
[18] Paragraph 31 of IAS 1.
[19] Paragraphs 85 and 86 of IAS 1, Paragraphs 13,16 and 21 of IAS 7
[20] Paragraph 36, 38 and 39 of IAS 2
[21] Paragraph 43 of IAS 7.
[22] Paragraphs 117 and 125 of IAS 1 and paragraph 36 of IAS 2.
[23] Paragraph 134 of IAS 36.
[24] Paragraphs 14 and 85 of IAS 37.



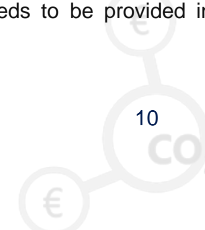
IX. Connectivity: bridge with the European Sustainability Reporting Standards (ESRS)

Consistent treatment of climate-related matters across the annual financial report is a key element in mitigating the risk of greenwashing and in presenting a well-balanced, cohesive story. ESMA continues to call for consistency between the assumptions used in estimations and measurements related to climate matters and the information provided across the different sections of the annual financial report.

Issuers should carefully and consistently connect the information that is provided with respect to carbon allowances in the financial statements with the disclosures required under the ESRS[25].

Sustainability statement	Financial statements
ESRS requirement E1-7 – *GHG removals and GHG mitigation projects financed through carbon credits*, paragraph 56(b), requires that the issuer disclose in its sustainability reporting the amount of GHG emission reductions or removals from climate change mitigation projects outside its value chain it has financed or intends to finance through any purchase of carbon credits. When disclosing this information in the sustainability report, issuers must consider including, if applicable: • the total amount of carbon credits outside the issuer's value chain verified against recognised quality standards and cancelled in the reporting period, and • the total amount of carbon credits outside the issuer's value chain planned to be cancelled in the future and whether they are based on existing contractual agreements or not. In instances where the issuer may have made public claims of GHG neutrality involving the use of carbon credits, explanations shall be provided to inform users of the sustainability statement whether (i) these claims are accompanied by GHG emissions reduction targets, (ii) the reliance on carbon credits in relation to such claims do not impede or reduce the possibility of meeting GHG emission reduction targets (or where applicable, net zero target) and information about the credibility and integrity of the carbon credits used. Issuers should disclose information concerning the "quality" of carbon credits, highlighting the risks related to the environmental integrity of such credits that may lead issuers to reassess their climate neutrality claims (for instance, risks that carbon credits obtained in the past have been overestimating GHG emission reductions or that the permanence of such reductions has been undermined by other events, such as wildfires). Removal types of carbon credits may also be used for neutralisation of the residual GHG emissions in relation to net zero targets, in which case, their use must also be disclosed.	In line with and in consideration of applicable requirements in IFRS Accounting Standards, accounting for carbon allowances in the financial statements should be consistent and coherent with disclosures provided in relation to carbon allowances elsewhere in the annual financial report, most notably in the sustainability statement. The information provided in the financial statements should be specific and useful to the understanding of the financial statements, and not merely a repetition of the contents provided in the sustainability report. ESMA reiterates that disclosures should explain how these programmes impact an issuer's financial performance and financial position, indicating which line items in the financial statements are affected and, where applicable, any differences and impacts across different jurisdictions. When material, issuers should also consider providing a reconciliation in the notes to the financial statements between any quantitative disclosures made in relation to CO_2, by relevant scopes, in the financial statements and the sustainability statement.

[25] ESMA notes that the definition of carbon credits in ESRS 1 includes, amongst others, awarded and purchased carbon allowances from mandatory and voluntary programmes). Therefore, issuers may need to consider if further information needs to be provided in the sustainability statement.



X. Next Steps

- ⇨ ESMA urges **issuers** to consider the **recommendations** in this Statement (sections VIII and IX) when accounting for and disclosing information about carbon allowances that they have entered or plan to enter into. ESMA equally urges **supervisory bodies and auditors** to consider the **messages outlined** in this Statement when supervising and auditing the 2024 annual financial reports.
- ⇨ These recommendations should be considered by issuers in light of their **materiality and relevance** for the specificities of the carbon pricing programmes in which the issuer participates.
- ⇨ ESMA and enforcers **will continue to monitor**:
  - **Standard-setters' work** in this area;
  - The **progress of issuers** with respect to accounting for carbon allowances in their IFRS financial statements and documenting practices as they evolve, and;
  - Whether **further guidance to** the market is necessary addressing the accounting for compliance or voluntary carbon pricing programmes.

Helpful References

ESMA Publications	
ESMA32-63-193237008-1793	European common enforcement priorities (ECEP) for 2023 annual financial reports, 25 October 2023
ESMA32-193237008-8269	ESMA Report on 2023 Corporate reporting enforcement and regulatory activities, 26 March 2024 ⇨ *Section 3.2.3.2 Assessment of Compliance with ESMA's 2022 ECEP: Climate-related matters*
ESMA32-1283113657-1041	The heat is on: Disclosures of Climate-Related Matters in the Financial Statements, 25 October 2023

Abbreviations and Acronyms

CO_2	Carbon dioxide
ESMA	European Securities & Markets Authority
ESRS	European Sustainability Reporting Standards
ETS	Emissions trading schemes
EU	European Union
FIFO	First-in first-out
GHG	Greenhouse gases
IFRS	International Financial Reporting Standards
REC	Renewable energy certificates

Disclaimer

This Statement is intended as educational material. The information included in this statement does not constitute guidelines, best practices, or illustrations of a single approach on how to recognise, measure or present the impact of carbon pricing programmes in an issuer's financial statements prepared in accordance with IFRS Accounting Standards. The statement outlines information on potential accounting paths solely to the extent that such information could be considered informative and understandable. Given the lack of an IFRS Accounting Standard specifically addressing this topic, this statement also includes detailed recommendations on disclosures to enhance decision usefulness of users of the IFRS financial statements.

Issuers remain ultimately responsible for compliance with principles in IFRS Accounting Standards.