Financial Implications of Direct Bank Lending and Carbon Emissions Trading: Analysis and Recommendations for the Governmental Accounting Standards Board

Introduction

Fifteen Evans School MPA students recently participated in an inaugural “Deep Dive” capstone seminar. The seminar focused on the financial implications of two recent state and local policy developments: growth in direct bank lending to municipalities and the advent of sub-national carbon emissions markets. A direct bank loan is when a state or local government circumvents the traditional municipal bond market and borrows money directly from a lender. Sub-national carbon emissions exchanges, such as those recently launched in California and proposed in Washington State, could generate billions in new state government revenue by attaching fees to the right to emit carbon. Both these developments will affect the financial health of many state and local governments. However, at the moment it is not clear how these developments should be reflected on state and local governments’ financial statements.

The seminar’s mandate was to advise the Governmental Accounting Standards Board (GASB) on how to fill this information gap. The GASB is a quasi-governmental body that sets accounting rules for US state and local governments. It is the crucial link between the more than 20,000 governments that prepare financial statements according to its rules and the taxpayers, investors, and other stakeholders who use those statements to hold those governments accountable.

The direct bank lending analysis focused on two main questions: How many governments have taken out direct bank loans and how many are expected to in the future? And what concerns do investors, credit rating analysts, and others have about direct bank lending, and how might new disclosures in financial statements speak to those concerns?
The emissions trading analysis focused on two different questions: How have private companies and governments in other countries accounted for the financial impact of emissions trading? And are US emissions trading markets sufficiently well-developed to support “fair value” accounting of emissions credits on governments’ financial statements?

During an intensive ten week quarter, the students assembled a multifaceted analysis of these questions. They compiled an exhaustive review of the relevant academic and practitioner literatures. They interviewed more than 50 key GASB stakeholders. They also produced original empirical analysis from several sources of administrative data. Professor Justin Marlowe supervised.

On March 17, 2015, the students briefed the GASB and submitted reports that will inform the Board’s future discussions in this area. This paper is a short summary of the key findings and recommendations presented in those reports. If the Board decides to create new accounting standards in either of these areas, the students’ research will have directly impacted fiscal policy on these crucial emerging areas.

Accounting Implications of Direct Bank Lending to Governments

Overview of the Direct Bank Loan Market
The market for loans directly from financial institutions to governmental entities is often referred to as direct loans, direct bank loans, or direct bank placements (DBP). Perhaps one of the most significant challenges with direct bank loans is the lack of disclosure requirements associated with these loans in borrowers’ financial statements.

When a government seeks to issue a bond in the capital markets, that bond is considered to be a public offering and is subject to Securities and Exchange Commission (SEC) Rule 15c2-12. This law requires the issuer to disclose the price, interest rate, loan terms, and other material information in a publicly-available official statement. These bond disclosures are posted to a Nationally Recognized Municipal Securities Information Repository (NRMSIR) or the Electronic Municipal Market Access (EMMA) website and are reviewed by retail investors, large institutional investors, credit ratings agencies, and other entities seeking information on the issuer’s financial position. The disclosures made in official statements are critical to assigning credit ratings, investor decisions, and market transparency.
Governmental entities issuing DBPs are not subject to public disclosure requirements when taking on debt in the form of direct bank loan. As privately-offered loans, these products do not meet the definition of a municipal security under the SEC rules, and, therefore, are exempt from Rule 15c2-12. Although these bank loans may share many of the same terms and conditions and security pledges as outstanding bonds, these terms can easily go undisclosed.

While the amount of a loan must be included in an entity’s comprehensive annual financial report, the report may exclude important covenants or loan terms that could have a material effect on the entity’s debt profile, financial position, or ability to repay existing bondholders.

The increased trend in DBP started after the collapse of bond insurance in 2008. Governments began to hedge the risk associated with variable rate debt – also known as variable rate demand obligations or “VRDOs” – by entering into fixed-variable rate swaps. These swaps allowed governments to pay effective interest rates lower than prevailing market rates. These variable rate transactions usually required “liquidity support” in the event that investors moved their money away from VRDOs. Liquidity support for many of these VRDOs began to expire in 2010 and 2011, at which point banks refinanced many of them as DBP to reduce their risk associated with supporting VRDOs (Jacobs, et. al 2011). These refinancing activities were the catalyst for substantial growth in the DBP market.

DBPs offer governments many advantages, but the lack of transparency and available data on DBPs makes it difficult for the public to determine which governments are involved in the DBP market. The questions before the GASB are whether the DBP market is large enough and the transparency issues substantial enough to warrant new accounting rules.

Size of the Direct Bank Loan Market Today
Although determining the true size of the overall market for DBPs is difficult, data from federal commercial banking regulators, the California Debt and Investment Advisory Commission (CDIAC), and the Washington State Auditor suggest the market is large and growing. In addition, independent analyses of market data indicate large increases in the size of the direct loan municipal market (Breckenridge Capital Advisors 2014). In the fourth quarter of 2014, data showed Federal Deposit Insurance Corporation (FDIC)-insured institutions held $131 billion in direct loans from states and political subdivisions in the U.S., the largest amount ever reported.
Analysts at S&P estimated the market for direct bank loans could account for as much as 20 percent of municipal debt in a January 2015 white paper on DBP in 2014 (Bodek 2014). S&P also reported that analysts had examined 404 direct loans for which they had received disclosure documents in 2014, with a par amount of $15.8 billion (Buswick 2015). Note that not all loans evaluated in 2014 were originated in 2014, as some were from prior years.

The California Debt and Investment Advisory Commission, the state’s clearinghouse for all public debt issuance, aggregates data on all public debt issued in California. In 2009, the first year in which data are available for the “Loan from a bank or other institution” debt category, public borrowers in the state issued only seven direct loans for a total par value of $40 million. By 2014, par value of direct loans had increased by more than 2000 percent, with 62 issuances for a total par of $869 million (CDIAC 2015).
In January 2015 alone, public borrowers in California engaged in seven direct bank loans for a total par value of $285 million, or 17 percent of all public debt issued in the state that month. In previous years, direct loans did not account for more than 1.5 percent of total public debt issued in the state.

In Washington State, our analysis of public financial data provided by the Washington State Auditor’s Office suggests DBPs are also increasing. In 2009, 25 public borrowers in Washington reported a total ending balance of $76.2 million in direct bank loan debt. By 2013, the last year for which full data are available, 346 public borrowers reported a total ending balance of $336.9 million in direct loan debt. Note that Analysts at the Washington State Auditor’s office indicated the categories “Notes payable” and “LID notes payable with commitments” are likely direct bank loans, although some direct bank loans may also be coded in the “Miscellaneous” category. We omitted the “Miscellaneous” category from this analysis in the interest of a conservative estimate of the market. “Ending balance” is the total liability reported by the issuer at the end of the fiscal year, in nominal dollars.
In nominal dollars, the ending balance of direct loans increased by 342 percent from 2009 to 2013. As a percentage of total public debt issued in Washington State, direct loans accounted for 0.42 percent in 2009, but increased to 1.17 percent in 2013, according to Schedule 9 of Liabilities data proved by the Washington State Auditor. The percentage of issuers engaging in direct bank loans increased from less than 5 percent of all issuers to 2009 (25 out of 521), to 28 percent of all issuers (346 out of 878).

All indications suggest this market is going to grow, but perhaps not rapidly.

**Costs and Risks for Governments that Use Direct Bank Loans**

Governments generally face two costs when issuing bonds: the cost of obtaining the bond (e.g. issuance costs), as well as reporting costs related to disclosure. The cost of issuing a bond varies depending on the size of the issue and the complexity of the structure. An interview with the budget director of a large urban county in the Pacific Northwest disclosed that issuance costs generally amount to two percent of the bond sale amount. This figure includes underwriter fees, legal fees, and staff time, to name a few.

Obtaining a direct bank loan requires significantly lower transaction costs, as the
use of an underwriter is not needed, and the staff time involved in securing the loan requires a fraction of the overall process and timeline for obtaining a traditional municipal bond. Due to the variability in bond issuances, it is difficult to precisely estimate how much money municipalities are spending on the indirect and direct costs associated with obtaining bonds. Additionally, the lack of available information for direct bank loan disclosures makes it very challenging to determine the associated costs for the DBP market.

The disclosure standards associated with the traditional bond market were established to protect investors by offering a clear picture of the issuer’s financial position. These disclosures include debt obligations, an entity’s ability to pay the bond, and terms and conditions that have the potential to impair the rights of other bondholders, among other key pieces of information.

Direct borrowing by municipalities introduces risk and uncertainty by limiting the amount of information readily available to the public regarding a government’s debt portfolio. Lack of information increases risk as well as the cost of borrowing from financial institutions based on risk and return theories. Bank loans change the debt profile of governments, making it more difficult for credit rating agencies to accurately rate the quality of governments’ public debt issuances. In May of 2014, S&P threatened to cut the rating of governments’ debt issues if they did not disclose their direct bank loans (Municipal Market Advisors 2014). By not disclosing these direct bank loans, credit rating agencies are unable to accurately assess a government’s ability to repay its outstanding debt and also assess a government’s fiscal health.

To understand a government’s financial position and their relative credit risk, the impact of all debt, including bank loans, must be analyzed. Financial report users are concerned with some of the risks that bank loans can bring forth, and detailed disclosure in the notes would assist in analyzing this risk. A conversation with a representative of CDIAC noted that disclosure within the financial reports would not entirely soothe the concerns of investors. Investors are concerned not only with reporting and disclosure within financial statements, but also prior disclosure, similar to the disclosure requirements for bonds in SEC Rule 15c2-12.

**Accounting and Financial Reporting Challenges**

Accountability is the cornerstone of all financial reporting in governments. Annual financial statements provide a record of all public activities. Financial statements provide a retrospective look into the efficiency and execution of policy goals that
have been outlined in government budgets; therefore, accountability and transparency are important policy considerations. Inter-period equity is an important component of accountability. In the context of direct bank loans, consideration should be given to the ability of the government in future years to meet a debt obligation, as well as to comply with certain terms and conditions that can be found in loan agreements.

Governments’ financial reporting plays a key role in meeting the needs of financial statement users (GASB 1987). Since the users of a government’s financial reports are diverse, users’ needs may also vary. The type and amount of information disclosed in the financial statements should be based on the most common needs of these users (GASB 1987). Investors and creditors who lend or participate in the lending process, as well as the legislative and oversight officials who directly represent the citizens, would be the primary users of financial statements. Generally, users employ the information disclosed in the financial statements to assess a government’s accountability or to make an independent credit assessment for a wide variety of reasons.

**Investors and Creditors**

Direct bank loans increase the outstanding debt of a government, and might pose a risk to a government’s credit record and influence a government’s capability to meet their obligations as they come due. Therefore, investors and creditors should have access to all important provisions of the direct bank loan that a government is engaged in, in order to assess a loan’s risks and impacts.

Some provisions of a direct bank loan might lead to liquidity concerns for the investors. For example, the maturity and amortization of the bank loan, the extraordinary prepayment terms, as well as the put/call options are related to the risks that a government might encounter in paying back its debts. Thus, the disclosure of these kinds of clauses would contribute to overall transparency and an efficient market for direct bank loans. Providing this information could provide investors and creditors a better understanding of the existing and future financial resources, actual and contingent liabilities, as well as the debt condition of a government. Also, investors and creditors could use this information to assess the government’s ability to continue offering resources for debt service in the future, which helps the people who have invested or plan to invest in the government’s bonds make relevant decisions.
**Legislative and Oversight Officials**

In addition to investors and creditors, both legislative and oversight officials should have access to the information related to the direct bank loans in order to accurately assess the overall financial condition of the government. This could include debt structure and funds available for appropriation (when developing capital and operating budgets), and program recommendations. Legislators are usually concerned with the level and sources of resources so as to see whether the resources are used in accordance with appropriations (GASB 1987). Direct bank loans are one of the sources of revenue that a government could obtain, which would impact its overall financial condition. Therefore, information concerning the direct bank loans, specifically the general terms of the loan, source of repayment, and the information about the amount of additional debt and its impact on overall debt position, could help legislators make important assessment of the government’s financial condition and decisions concerning resource allocation.

**Conclusion and Recommendations**

Our analysis of available data, conversations with market participants, and review of existing literature revealed an unmet need for disclosure of direct loan terms. An absence of disclosure guidelines has led to disparate reporting standards and a lack of market transparency, which contradicts the GASB’s mission of greater accountability in public sector financial reporting. We recommend the GASB consider some of these items for disclosure in local government financial statements:

- Amount of the loan and impact on overall debt position,
- Purpose of the loan,
- Source of repayment,
- Interest rate and conditions under which it would change,
- Cross-default provisions, acceleration clauses, “most favored nation” clauses, and other terms or covenants that may impair the rights of existing bondholders, and
- General loan terms (including maturity date, payment dates, lender, and amortization schedule).

Disclosure of each of these items in annual financial statements has the potential to increase transparency with regard to direct bank loans, particularly for users seeking a more holistic understanding of an entity’s long-term liabilities. Although disclosure of these items within the financial statements may not satisfy stakeholders demanding timely disclosure of loans, it would support the need for uniform disclosure and standard reporting in this quickly growing market.
Accounting Implications of Carbon Emissions Trading

Background
At the time of writing, there are two major emissions trading programs active in the United States. In New England, the Regional Greenhouse Gas Initiative (RGGI) is a multistate carbon market primarily aimed at curbing emissions from large single source emitters. In RGGI states, these emitters are, for the most part, coal fire power plants, and the market has generally remained relatively small. On the other coast, California is currently running an emissions exchange that is primarily contained to that one state. In 2007, the Western Climate Initiative was proposed as a sweeping carbon market that would include many states in the western US but was ultimately defeated in every state’s voting body save California. The resulting program is mostly based on the WCI’s proposed legislation and does include some elements from Quebec, Canada.

The challenge of integrating carbon emission mitigation strategies with economic realities has led many governments at both the national and state level to the solution of emissions trading markets. Governments and regulating bodies can use carbon markets as a strong source of revenue and private entities can find investment opportunities in well-structured carbon markets. These factors taken together allow for a convergence of environmental policy goals and economic advantages. Emissions trading schemes, also referred to as carbon markets, emissions markets, cap and trade systems, or right to pollute systems, are an attempt by government regulators to reconcile the often disparate goals of commercial ventures and environmental protection. In a typical emission trading scheme, a government actor will set an overall amount of polluting emissions they deem allowable in their jurisdiction. Upon arriving at this amount, they will begin distributing allowances or credits that represent the right for entities to produce and emit a predetermined amount of carbon dioxide, sulfur dioxide, or other greenhouse gas product.

These allowances are surrendered to the regulating body at a predetermined time, usually annually, and typically also have a set expiration date to prevent hoarding of excess allowances. Over time, the total emission limit is typically lowered so as to achieve a net reduction in total emissions. Depending on the system in question, allowances can be allocated free of cost to emitters, sold at auction, distributed at a reserve price, or some combination of these methods. When prices for allowances are higher, there is stronger pressure to emit less and
thus greater environmental gains are achieved.

While it greatly varies from scheme to scheme, emitters who bear the responsibility of obtaining and surrendering emission allowances can be legally required to play a part in the system, can opt into the scheme’s coverage, or can be outside non-emitting parties seeking to take advantage of the secondary market. This secondary market is the trade half of cap and trade. Within the limits set by the regulating body, entities both large and small are allowed to trade their emissions allowances at whatever rate the market will bear. Outside investors can obtain credits with the intent to resell them later at a profit or simply retire the credits from circulation in order to help reduce greenhouse gas emission. While the accounting for these private entities who either consume or invest in emission credits is somewhat straight forward, the regulating government bodies face a very different and unique set of account challenges.

**Current Disclosure Practices**

Current GASB standards do not have any specific requirements for emission trading programs. Aside from the potential challenges discussed in the case on Massachusetts. However, existing GASB financial statement disclosure requirements work well for disclosing the emission trading programs in terms of the income statement impact. These requirements are mainly established by existing GASB statements, including Statements No. 34, No. 38 and No. 54, and they meet the characteristics of relevance, understandability, comparability, timeliness, consistency, and reliability. Disclosure from the perspective of balance sheet impact is discussed in other parts, such as the unused allowances.

California’s cap-and-trade program took effect in early 2012. Based on its Cap and Trade Auction Revenue Expenditure Plan, the proceeds are used for multiple purposes including clean transportation and energy efficiency.\(^1\) Therefore, we can infer that revenues of some governmental funds (Transportation Fund and Environmental and Natural Resources Fund) may be partly contributed by cap-and-trade proceeds. However, none of the currently held emission allowances are recognized on the governmental fund balance sheet and none of the relevant activities are disclosed by California’s Comprehensive Annual Financial Report (CAFR).

According to its 2013-2014 Budget Act, $500 million from the designated fund would be loaned to its general fund and $100 million will be repaid according to the Governor’s budget (California Legislative Analyst’s Office 2014). Nothing

---

\(^1\) Portions of this section are adapted from “Carbon Accounting Challenges: Are you Ready?” Deloitte Center for Energy Solutions 2009 (Washington, DC).
Financial Implications of Direct Bank Lending and Carbon Emissions Trading

directly related with the cap-and-trade program was shown on California’s CAFR in 2012 and 2013. However CAFR mentioned the proposed repayment of the cap-and-trade loan in 2014-2015. Since California hasn’t published its CAFR for fiscal year 2014, we may expect this inter-fund transfer to be shown on the coming report.

Among the RGGI member states, only Massachusetts has disclosed direct information about its emission allowance program on its CAFR. As stated in the Regional Investment of RGGI CO2 Allowance Proceeds, 2012 report, the total cumulative fund generated from RGGI allowances up to 2012 was $984,763,052. $93,100,000 of this total was transferred to the general funds by some states (RGGI 2012).

Accounting and Financial Reporting Challenges

In our assessment, carbon markets present four main challenges to government financial accounting and reporting. Here we detail each of those concerns.

Valuation of Carbon Allowances

There is inherent volatility in the price of carbon. This uncertainty creates two main issues. The first and most obvious issue is that price fluctuations of allowances impact investor confidence. The second issue is that price volatility impacts the cost of production for private industry significantly. Regulated firms are subject to the greatest risk exposure considering past market variability. Governmental bodies additionally stand to sustain large variations in asset and liability accounts depending on their allowance valuation methods.

There are two main allowance methods originally proposed by the International Accounting Standards Board’s (IASB) International Financial Reporting Interpretations Committee (IFRIC). In December of 2004 these organizations proposed that allowances are to be accounted for as intangible assets subject to the following definitions:

• At cost (nominal amount), or the value of the allowance at the time of procurement or,
• Fair value, or the current value of the allowance on an active market.

While there is a general agreement on the use of fair-value accounting methods, there has been little research into the particular valuation methodologies that should be used when valuing carbon allowances. In accordance with prior GASB guidance, a fair-value accounting mode requires a government to determine “the
principal (or most advantageous) market for” the carbon allowance to be measured. Considering the data used in fair-value accounting (depending on the level of accounting) this would entail determining the market with the most accurately quoted market prices, quoted prices for similar assets or liabilities, interest rates and yield curves, or credit spreads.

Level 1 accounting appears to be the most advantageous because it provides the most accurate representation of an asset’s fair value. In order to accurately measure assets using the Level 1 method, a governmental entity must first determine the most accurate valuation method. IFRS 13 describes three valuation approaches (IFRS 13 B5–B33): the market approach, the income approach, and the cost approach. As the IFRS implies, in order to accurately use a market-based valuation method, an active market must first be identified from which a transaction price paid for an identical or a similar instrument can be used to value the carbon allowance.

However, current markets are likely not stable enough to justify the use of Level 1 fair-value accounting. Furthermore, the external factors accounting for wide variations in prices on secondary carbon markets can be limited to a few factors, such as:

- **Introduction of new renewable energy policies:** Any added subsidies to state or federal policies that offer incentives for the large emitters regulated under emissions trading systems (ETS) to install renewable energy sources have the potential to quickly and greatly reduce a firm’s carbon footprint. In response, many firms may need to purchase allowances to offset their carbon outputs, and those purchases can have a drastic effect on the spot price of carbon in the secondary markets, such as ICE, that governments use in determining their fair-value accounting.

- **Vintage retirement:** As one vintage of carbon allowances is retired and a new vintage is released most ETSs are structured to reduce the amount of available allowances as vintages progress. In preparation for this, ETSs assume firms will account for the rising cost of allowances as they become scarcer with each vintage.

- **Economic recessions:** Immediately after its inception, the EU ETS allowance spot price on secondary markets “fell from almost 30€/tCO2 in mid-2008 to less than 5€/tCO2 in mid-2013” (Koch 2014). There has been a dearth of research attempting to explain the factors leading to this sudden collapse of the EU ETS allowance price. While the factors listed above arguably have a large effect on prices within secondary markets, most of the research to come out in
recent years have pointed to the Great Recession of 2008, which began in the
US, as the primary driver of the EU ETS price collapse.

Unused Credits and Amortization
In both of the carbon market models observed in the United States, RGGI and
California, suppliers have and often exercise the ability to hold onto credits. That
is, after the closing of an auction, some credits may remain in the possession of the
government. Often, these credits are purposefully withheld to be sold at a later
date, either to companies who could not afford the original price or to correct
inaccurate pollution estimates. The California Air Resources Board also sets aside a
certain number of credits for allowance price containment reserves and a voluntary
renewable electricity program. Carbon credits in most models have a set period of
time in which they must be “used”, a shelf life. After that time, they lose their value
and their ability to count towards a company’s compliance within the carbon offset
model.

In the markets that exist today, carbon credits expire after a period of time whether
or not they have been used. Credits are also not required to be used on purchase,
but are rather “held” until the emitter reaches a certain level of pollution. As a
credit loses remaining time for use, it also loses its value to the emitter who must
pollute at a certain level in order to use it. If not, the credit retires and counts sim-
ply as a loss on the part of the emitter. As market prices change and credits move
through the market with varying life spans remaining, setting a standard for valua-
tion is imperative for knowing how much an older credit is worth. This will enable
governments to properly account for their value if we do treat carbon credits as an
asset on balance sheets.

Governments may decide to purposefully hold onto a carbon credit until it retires.
Retirement normally refers to the purposeful withholding of a carbon credit until
it reaches its expiration date. In this way, governments can force emitters to reduce
pollution by denying them the option to purchase and allowing the credits to reach
full maturity without ever being placed on the market. There is also precedent of
purchasers other than the government holding onto credits until retirement, hop-
ing to force emitters into reducing their greenhouse gas emissions.

Using fair-value accounting would accurately track the loss of value over time of
carbon credits. However, this would require stable markets that react to external
price factors. In the absence of a traditional market, setting up an amortization
schedule may be the best way to track the loss of value over time. For example,
each quarter a carbon credit would drop in value. The asset would lose value on a balance sheet and the sale price would lessen.

**Investing Carbon-Related Revenue**

With the growth of emissions trading markets, it will undoubtedly become necessary for governments to consider how to manage and account for this new source of revenue. When revenue is recurring and is specifically earmarked for a predetermined purpose, a trust fund is one tool governments have to manage these funds. There are certainly advantages to using trust funds: Namely, more protection for these funds from the regular budgeting process and the ability to have a government engage in long term financial planning. There are, however, inherent weaknesses in trust funds that could be exacerbated in trusts that are incorporated through trading-based revenue.

The inherent weakness of trust funds is that by having revenue and appropriations that are indirectly controlled by legislatures, there is a level of disconnect from the voting populace over how their money is being spent. At the same time, trust funds are also not fully immune from the regular appropriations process despite their financial status. In essence, those who create funds can also undo them and create a false sense that these funds are more protected than they really are. Lastly, there is great differentiation in how trusts are reported and how transparent they are (Patashnik 1997).

These inherent shortcomings of government trusts may not require any new reporting requirements if those trusts are long established and their funds allocated from a predictable source of revenue. However, emissions-based trusts may need to be held to a different standard. Trusts in this financial space are established from revenue earned from a new emerging market that is prone to great fluctuation in value and pricing. More robust and streamlined disclosure requirements may be needed to ensure that bond purchasers have the best

**Governments as Emitters**

The bulk of this report addresses financial reporting standards for governments as regulators. However, many public utilities and transportation agencies may find value in understanding and possessing standards as emitting entities. The struggles associated with this type of financial reporting have been well documented within the corporate sector, and these lessons should help address concerns for governmental entities as emitters.
**Offsets and Renewable Energy Credits (REC)**

Emission trading schemes are not the only newly developed program to address environmental concerns. The growth of emission trading has also given rise to carbon offset markets, in which entities purchase carbon allowances and hold them to prevent emitters from purchasing the allowances. Renewable energy credits (RECs) are another popular government program. RECs provide emitters with incentives such as tax credits and grants in exchange for investing in renewable energy, and therefore decreasing their carbon use. Any proposed financial accounting standards pertaining to emission trading schemes may want to consider the implications these rules may have on these other programs.

**Conclusion and Recommendations**

As these markets evolve and mature, the management and accounting for corresponding revenue within the program proceed funds will become of considerable importance. California’s cap-and-trade program raises $500 million per year, RGGI generated over $90 million in the most recent 2014 auction, and if passed, Washington State is estimated to raise up to $4 billion per year by 2030. States have thus established trust funds for proceeds. These funds may not require additional disclosure, but recent events suggest that funds such as these are often used to balance budgets and routinely ignore their stated purposes. California’s cap-and-trade proceed funds of $500 million were recently loaned to the state’s general fund. Current disclosure requirements for these funds are inconsistent and not always easily accessible.

Public utilities and transportation agencies represent a large percentage of emitting entities, and it may be in GASB’s best interest to consider establishing accounting standards for governments, as emitters. Many recommendations appear to conclude similar treatment for governments as regulators, but there are inherent differences that must be addressed. As previously mentioned, emitters view emission credits in a much less consistent context as regulators, which could cause confusion when determining the type of asset that the credit may be. Another unique aspect for emitters is the need to determine how many emission credits will be required for the current compliance period. Estimates are a popular option in practice, but measurement at a specific point in time may provide greater consistency.

The findings of this report attempt to provide GASB with direction to next steps required to determine accounting standards for emission trading schemes. Treatment of these programs appear to be repeatable for a number of similar programs, and consistency appears to suggest these markets are well established, enduring,
and in need of accounting standards.
References


