## Case 11-1

## Polluter Corp.

Polluter Corp. (the "Company"), an SEC registrant, operates three manufacturing facilities in the United States. The Company manufactures various household cleaning products at each facility, which are sold to retail customers. The U.S. government granted the Company emission allowances (EAs) of varying vintage years (i.e., the years in which the allowance may be used) to be used between 2015 and 2035. Upon receipt of the EAs, the Company recorded the EAs as intangible assets with a cost basis of zero, in accordance with the Federal Energy Regulatory Commission (FERC) accounting guidance for EAs. The Company has a fiscal year end of December 31.

As background, in an effort to control or reduce the emission of pollutants and greenhouse gases, governing bodies typically issue rights or EAs to entities to emit a specified level of pollutants. Each individual EA has a vintage year designation. EAs with the same vintage year designation are fungible and can be used by any party to satisfy pollution control obligations. Entities can choose to buy EAs from, and sell EAs to, other entities. Such transactions are typically initiated through a broker. At the end of a compliance period, participating entities are required to either (1) deliver to the governing bodies EAs sufficient to offset the entity's actual emissions or (2) pay a fine.

The Company currently emits a significant amount of greenhouse gases because of its antiquated manufacturing facilities. The Company plans to upgrade its facilities in 20X4, which will decrease greenhouse gas emissions to a very low level. On the basis of the timing of the upgrade, the Company currently anticipates a need for additional EAs in fiscal years 20X0–20X4. However, upon completion of the upgrade, the Company believes it will have excess EAs in fiscal years subsequent to 20X4 because of reduced emissions as a result of the upgrade.

The Company currently has forecasted the updates to its facilities will cost approximately $15 million. As the Company operates in a capital intensive industry, analysts and investors focus on a number of important ratios and measures, including working capital, capital expenditures, cash flows from operations, and free cash flow. As a result, the board of directors and management provide forward-looking guidance on these ratios and measures and expend great effort managing these results in light of the Company's operational needs.

The Company entered into the following two separate transactions in fiscal year 20X0, which will impact the Company's results as presented in the statement of cash flows, which the Company prepares under the indirect method.

1. To meet its need for additional EAs in fiscal years 20X0–20X4, on April 2, 20X0, the Company spent $3 million to purchase EAs with a vintage year of 20X2 from Clean Air Corp.

2. In an effort to offset the costs of the April 2, 20X0, purchase of 20X2 EAs, the Company sold EAs with a vintage year of 20X6 to Dirty Chemical Corp. for $2 million.

**Required:**

1. What is the appropriate classification in the statement of cash flows in the Company's December 31, 20X0, financial statements for its purchase of 20X2 EAs from Clean Air Corp.?

2. What is the appropriate classification in the statement of cash flows in the Company's December 31, 20X0, financial statements for its sale of 20X6 EAs to Dirty Chemical Corp.?

3. If the Company reported its results pursuant to IFRSs rather than U.S. GAAP, how would the Company record the purchase and sale of its EAs differently?