

THE LANDFILL ALLOWANCE TRADING SCHEME (LATS)

Trading and Accounting

1. How are the accounting practices under LATS managed?
2. How do local authorities obtain information on the availability of allowances for purchase or sale?
3. How does the scheme work in terms of trading?
4. How robust is the assumption that 68% of waste arising in England is biodegradable?
5. What are the VAT exemption limits on allowance trading?
6. Due to the reconciliation period, authorities may have to purchase allowances or receive income from the sale of allowances for the last financial year in the current financial year – how should they account for this?
7. Will the process of trading require authorisation by the Financial Services Authority under Financial Services Act?
8. Do WDAs have access to the list of trading officers?
9. What is the scope for non-monetary trading?
10. Should waste disposal authorities (WDAs) employ the services of brokers?

TRADING & ACCOUNTING

1 How are the accounting practices under LATS be managed?

Defra and HM Treasury have been working with The Chartered Institute of Public Finance and Accountancy (CIPFA) to develop the accounting for landfill allowances. HM Treasury has explored a number of options and developed a preferred approach. DCLG was involved in the discussions and was prepared to consider making regulations to avoid any unintended effects of the accounting treatment on council finances, to date this has not proved necessary. Defra continues to ensure that CIPFA, the LGA and the Accounting Standards Board (ASB) are involved in developing the solution before consulting publicly on any necessary accounting Regulations.

2 How do local authorities obtain information on the availability of allowances for purchase or sale?

Information about surpluses, or shortages of allowances in future years, resides with WDAs who are best able to predict their own level of diversion from landfill as part of their waste strategies. Information on the total level of future surpluses or shortages comes from communicating and forward trading with other WDAs. This is facilitated through the internet bulletin board on the LATS Register and elsewhere through brokers acting on behalf of WDAs.

Once authorities have written or reviewed their municipal waste management strategies they can look to the forward market to ensure that there are

allowances to buy (at a price which is below their marginal cost of diversion from landfill) in the years where authorities plan to, and that there is demand for allowances (at a price above their marginal cost of diversion) in the years that they plan to sell. If there are surplus allowances in the year an authority plans to sell, or excess demand in a year an authority plans to buy, it may be beneficial for authorities to revise their plans for investment to match this. By matching up future demand and supply, the forward market provides a mechanism to reduce the risk of surpluses or shortages of allowances in any one year.

3 How does the scheme work in terms of trading?

Transferring landfill allowances (through trade or otherwise) is not mandatory. The advantage of transferring allowances is that it helps to overcome the fact that different WDAs will face different additional costs of diversion from landfill depending on their particular circumstances. For example, WDAs with comparatively low additional diversion costs will have an incentive to divert as much BMW from landfill as possible, selling their surplus allowances to WDAs that face higher costs of diversion. Conversely, authorities with comparatively high diversion costs might choose to continue with lower cost landfilling, using the money it saves from the cheaper disposal option to purchase the necessary quantity of allowances.

If an authority wishes to buy or sell allowances it may choose to advertise on the LATS Bulletin Board, so that other authorities are aware that allowances are available/required. The Bulletin Board is available within the LATS Register website at <http://lats.defra.gov.uk>. Authorities wishing to respond to a notice on the LATS Bulletin Board should contact the authority that has submitted the notice directly to negotiate the sale of allowances. Defra endeavours to post all notices submitted on the website within 48 hours of receipt by Defra, subject to approval by a Defra administrator. Notices will not be posted onto the website if the content does not relate to the sale or purchase of landfill allowances. This website will also display a transfer log, which will list the number of allowances traded and their price but not the specific authorities concerned.

Alternatively, an authority may wish to contact other authorities directly to see if they are interested in a trade or use a broker to make arrangements. To ensure that authorities get the maximum benefit from using the Scheme and to demonstrate Best Value, authorities are advised to look for trading opportunities across the country and not just within their region.

WDAs may also choose to use brokers to make arrangements for trading, although there is no requirement in the Scheme to do so. Brokers can act as intermediaries, linking buyers and sellers. Brokers are not able to hold landfill allowances themselves, as the Scheme is not intended to be speculative. If an authority chooses to use a broker, it can also give the broker access to the authority's accounts on the electronic register if it wishes to do so.

(Refer to **Guidance on Trading, Borrowing and Banking Landfill**

Allowances on the Defra website at www.defra.gov.uk/environment/waste/localauth/lats/allowance.htm **section c – Transfer of allowances)**

4 How robust is the assumption that 68% of waste arisings in England is biodegradable?

Research carried out by the Environmental Agency (EA) suggests varying percentages of biodegradable municipal waste are present in municipal waste. For the purposes of monitoring, the percentage is deemed by the Landfill Allowance and Trading Scheme (England) Regulations 2004 to be 68%. The Agency will carry out further research regularly to identify if there is significant variance from the 68% figure in England. If the biodegradable content varies significantly from 68%, then the EA will inform the Government of their findings. It is possible that in the future this percentage will need to be revised for use with LATS.

5 What are the VAT exemption limits on allowance trading?

HM Customs and Excise have confirmed that allowances traded for cash will be outside the scope of VAT. However, the trading of allowances for nonmonetary consideration (e.g. allowances exchanged for a supply of services) could be taxable. Arrangements between public bodies are treated as non-business activities and are outside the scope of VAT unless there is potential for distorting competition. Distortion of competition arises when similar services are provided by both private companies and public authorities. Therefore if allowances are exchanged for a supply of services that could be provided by the private sector, VAT will be payable. In such cases, if arrangements between public bodies were not treated as business activities and included VAT, the provision of the services by the public authorities would always undercut similar services provided by the private sector.

(Refer to **Guidance on Trading, Borrowing and Banking Landfill Allowances** on the Defra website at www.defra.gov.uk/environment/waste/localauth/lats/allowance.htm **section i – Value Added Tax (VAT)**)

6 Due to the reconciliation period, authorities may have to purchase allowances or receive income from the sale of allowances for the last financial year in the current financial year – how should they account for this?

Feedback from Finance Officers suggested that income from trades during the reconciliation period can be accounted for in the year the income is received and that it does not have to be estimated and allowed for in the previous year's accounts.

7 Does the process of trading require authorisation by the Financial Services Authority under Financial Services Act?

Financial markets are regulated, where provided for in the Financial Services and Markets Act 2000 (FSMA), by the Financial Services Authority (FSA).

The issue of how the FSMA will be interpreted in relation to trading of landfill allowances is ultimately a matter for the courts. Prior to legal precedent being set, it is therefore not possible to give definitive guidance on how the FSMA will be interpreted for landfill allowance trading. Crucially, the individual circumstances of each party and the nature of its intended trades will effect the extent to which it is regulated. Participants in the LATS are therefore advised to seek their own legal advice. The information provided below by the FSA should therefore be treated as indicative only.

Trading for immediate (spot) delivery of landfill allowances will not ordinarily require authorisation by the FSA since a landfill allowances is not a specified investment. However, trading for forward physical delivery, i.e. a contract under which delivery is to be made at a future date at a price agreed when the contract is made, can be a specified investment and thus trading may require authorisation. There is currently an exclusion which suggests that if the contract is made for commercial and not investment purposes then it will not constitute a regulated activity. The distinction between commercial and investment purposes is not clearly defined and caution is advised if relying on this exclusion. Caution is also advised in relation to trading derivatives. Participants should seek their own specialist advice on these issues.

(Refer to **Guidance on Trading, Borrowing and Banking Landfill Allowances** on the Defra website at www.defra.gov.uk/environment/waste/localauth/lats/allowance.htm **section h – Financial regulation**)

8 Do WDAs have access to the list of trading officers?

A contact list (subject to the agreement of each individual) within the secure LATS Register giving the details for each authority's trading officer is available in order to facilitate the process of contacting other authorities.

9 What is the scope for non-monetary trading?

Non-monetary trading will add an extra degree of flexibility to the scheme by allowing waste disposal authorities to use allowances to pay for services rendered by another authority for example. The majority of responses to the consultation felt that non-monetary trading would add a welcome flexibility to the scheme and will allow waste disposal authorities to meet their targets in the most cost effective manner. A significant number on non-monetary trades has already taken place.

10 Should waste disposal authorities (WDAs) employ the services of brokers?

Each WDA can make its own decision about whether or not to use brokers as there is no requirement within LATS to do so. The Waste and Emissions Trading Act 2003 does not allow brokers to hold allowances themselves. Allowances can only be held by WDAs. However, brokers can act as intermediaries, using their experience and expertise to link buyers and sellers and to negotiate the price of allowances for each trade. The use of brokers is not compulsory, but a WDA may use brokers to make arrangements for trading its allowances if it chooses to do so. Brokers are likely to charge commission on each transaction they complete and this will vary between brokers.