Guidance on carbon accounting and the net UK carbon account

Updated: December 2009
Introduction

1. A carbon accounting system is required under the Climate Change Act 2008 ("the Act")¹ to determine compliance with the carbon budgets and targets in the Act. While the Act establishes the basic requirements for the system, secondary legislation is required to establish the details. A carbon accounting system is particularly necessary because, in addition to the UK's own domestic emissions, carbon units purchased from or sold overseas through emissions trading also need to be accounted for.

2. In addition, the carbon accounting system will help meet the requirements in the Act to produce an annual statement, providing details of UK emissions and the net UK carbon account for the year in question. The Carbon Accounting Regulations 2009 therefore put in place provisions for ensuring the net UK carbon account can be calculated on an annual basis to meet this requirement. The Act also requires the publication of a final statement for the budgetary period which will be used to determine whether or not a carbon budget has been met, and the Carbon Accounting Regulations 2009 ensure this statement is produced accurately and transparently.

3. This paper explains some of the key aspects of the carbon accounting system with reference to the provisions of the Act and the Carbon Accounting Regulations 2009, as amended by the Carbon Accounting (Amendment) Regulations 2009 ("the Regulations").² This paper was originally published in April 2009 alongside a summary of responses to a public consultation on carbon units, the net UK carbon account and carbon accounting, which took place between October 2008 and January 2009.³ This version is an update published to coincide with the laying of the Carbon Accounting (Amendment) Regulations 2009, which will come into force on 1st January 2010.

4. As stated in the consultation document, we consider it is highly likely that the carbon accounting rules will need to be amended to take account of changes for the period after 2012. This includes a new international framework for tackling climate change and a revised approach to the EU Emissions Trading System (EU ETS).

5. We do not therefore consider it is possible to establish rules now which will remain fully applicable into the post-2012 period. We have, however, aimed to ensure that the carbon accounting system being established can, as far as possible, be retained in future budgetary periods.

Department of Energy and Climate Change
Updated: December 2009

³ The summary of responses and details of the consultation are available from: www.decc.gov.uk/en/content/cms/consultations/carbon_account/carbon_account.aspx
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The net UK carbon account

6. Section 27 of the Act defines the “net UK carbon account”. In short, this is what we compare against the carbon budgets to determine whether we are meeting them.

7. The net UK carbon account is calculated by first taking net UK emissions for a given period, using data from the UK national emissions inventory report. This comprises aggregate gross emissions from sources in the UK, including emissions from land use, land use change and forestry (LULUCF), which are then adjusted to take into account removals by sinks associated with LULUCF activity.

8. This gives net UK emissions, which are adjusted to account for the amount of carbon units which have been brought in from overseas by Government and others to offset UK emissions (“credits”), and UK carbon units which have been disposed of to a third party (“debits”).

9. The net UK carbon account must not exceed the carbon budget at the end of each budgetary period. Figure 1 below sets out how the net UK carbon account will be calculated.

Figure 1: Calculating the net UK carbon account
10. The Regulations establish the rules for determining and accounting for the amount of carbon units which may be credited to, and must be debited from, the net UK carbon account. The Regulations also establish the types of units which may be counted as credits and debits.

11. This information is used to compile the annual statement of emissions, and final statement for the budgetary period, required by Sections 16 and 18 of the Act respectively.

12. The Regulations are explained in more detail below, with reference to relevant sections of the Act.
Regulation 3: Eligible carbon units

13. Section 26 of the Act requires the Government to make regulations specifying the types of unit which are to be considered carbon units for the purposes of the Act. Regulation 3 fulfils this requirement.

14. As proposed in the consultation, the units listed below are the only units to be designated as carbon units for the purposes of carbon accounting in the first budgetary period. Each of these are recognised by the United Nations Framework Convention on Climate Change (UNFCCC) under the Kyoto Protocol and the Marrakech Accords and/or the EU Emissions Trading System (EU ETS). Each unit represents one tonne of CO₂-equivalent (tCO₂e).

Assigned Amount Units (AAUs)
- An accounting unit issued by developed countries which have agreed under the Kyoto Protocol to reduce their emissions to target levels below their 1990 emissions (“Annex 1 countries”). These are the basic currency used to track emissions under the Kyoto Protocol.
- Each Annex 1 country has an amount of AAUs to cover emissions during the 2008-2012 commitment period. The number of AAUs issued represents the emissions cap for that country under the Kyoto Protocol; it is based on a country’s emissions in 1990 (the baseline) adjusted to reflect its Kyoto obligations.

Certified Emissions Reductions (CERs)
- A credit from Kyoto Clean Development Mechanism (CDM) projects, issued by the CDM Executive Board.
- CDM enables countries with Kyoto commitments to invest in project-based emission reduction activities in developing countries. The amount of CERs issued corresponds to the amount of emissions which have been prevented by the project.

Emissions Reduction Units (ERUs)
- Credits from Kyoto Joint Implementation (JI) projects issued by the host country by converting either AAUs or removal units (RMUs).
- JI allows Annex 1 countries to jointly implement emission reduction projects with the investing country being able to “credit” the reductions against their own Kyoto obligations. The amount of ERUs issued corresponds to the amount of emissions which have been prevented by the project.

Removals Units (RMUs)
- A Kyoto unit representing a net removal of greenhouse gases from the atmosphere through land use, land use change or forestry activities. RMUs are issued by the Kyoto Annex 1 country in which the reduction occurs.
European Union Allowances (EUAs)

- Allowances issued to EU ETS participants by respective EU Member States. Each Member State sets an overall ‘cap’, approved by the European Commission, on the total amount of emissions allowed from all the installations covered by the scheme in their territory.
- The cap is converted to EUAs, which themselves are converted from a Member State’s AAU. The EUAs are then distributed to participants in the scheme in relation to their EU ETS obligations.

15. There are a number of benefits in recognising these units in the carbon accounting system. The units described above are recognised under the Kyoto Protocol and/or the EU ETS and have been subject to rigorous international scrutiny to assure their quality. They have been defined clearly and in detail, ensuring their rigour in terms of “verifiability” (i.e. that the emissions reductions they represent are certain to have occurred) and, for baseline-and-credit-schemes such as CDM, “additionality” (i.e. that the emissions reductions they represent would not otherwise have occurred had the credit-generating activity not taken place).

16. This approach also ensures the carbon accounting system established under the Act is compatible with the existing systems at EU and UN level, which will ensure both simplicity and compatibility as these units may be used to meet both international and domestic obligations.
Regulations 4 and 5: Mechanism for crediting units

17. Regulations 4 and 5 establish the mechanisms by which units may be counted as credits towards carbon budgets.

18. Regulation 4 requires the Government to open a “credit account” in the UK registry. The registry is the system set up in the UK to administer the carbon accounting system under the existing EU and UN frameworks, recording the issuance, transfer, cancellation, retirement and banking of carbon units. The credit account, which was created in the UK Registry in October 2009, is the dedicated route through which carbon units can be credited voluntarily to the net UK carbon account. The regulation establishes a mechanism for returning carbon units which have been transferred into the credit account in error to the account from which they were originally transferred. Any other carbon units can only be removed in order to be cancelled – this fulfils the requirement in Section 27(4) of the Act that units counted as credits cannot be used to offset any other emissions.

19. Regulation 5 sets out the process by which carbon units may be counted as credits. Any person may transfer carbon units to the credit account but they will only be counted as credits towards the net UK carbon account if a UK Minister makes a declaration to that effect.

20. This regulation also places a duty on UK Ministers to consult the devolved administrations in the event that the UK Minister is not minded to count as a credit a unit which a devolved administration has transferred into the credit account. The rationale here is that such a decision might affect the interaction between any regional carbon accounting systems and the net UK carbon account.

21. A carbon unit may not be counted as a credit if it has been used to offset emissions which are not from sources in the UK (e.g. units which have been bought to offset emissions from international aviation), because those emissions are not covered by the targets and budgets in the Act. In addition, regulation 5 prevents removal units (RMUs) issued by the UK being counted as credits. This is because counting these units as credits would lead to double counting under the complex international rules on how RMUs are issued. In practice, it is very unlikely that these units will be issued before the end of the period for calculating whether the carbon budget has been met; this provision simply puts beyond doubt that RMUs issued to the UK may not be counted as credits.

22. The crediting mechanism is shown in Figure 2 below.

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4 RMUs issued by other countries may be counted as credits or debits as RMUs are defined as carbon units in Regulation 3.
Figure 2: Crediting mechanism under Regulations 4 and 5

- Carbon unit transferred to the credit account
  - Has the unit been transferred to the credit account in error?
    - Yes → Unit is returned to its originating account
    - No
      - Is the unit declared a credit by a UK Minister?
        - Yes → Unit is counted as a credit towards the net UK carbon account and is cancelled in accordance with regulation 8
        - No
          - Was the unit transferred to the credit account by a Devolved Administration?
            - Yes → The Devolved Administration in question must be consulted before a final decision is made
            - No → Agreement reached not to declare the unit
          - Agreement reached that the unit was transferred to the credit account in error
Regulation 6 (as amended): Accounting for the EU Emissions Trading System (EU ETS)

23. Regulation 6, as amended by the Carbon Accounting (Amendment) Regulations 2009,\(^5\) establishes the mechanism to account for credits and debits as a result of the operation of the EU ETS during the first budgetary period. Under this mechanism, at the end of the first budgetary period (which coincides with the end of the second phase of the EU ETS), the contribution of the EU ETS towards the net UK carbon account will correspond to the level of the cap, which is the right approach to take in a capped trading system.

24. During the budgetary period, if EU ETS participants in the UK collectively exceed the UK cap, the amount of emissions in excess of the cap must be considered as a credit, as operators must have bought units from overseas to cover these emissions. If on the other hand EU ETS participants in the UK collectively reduce their emissions below the UK cap, then the difference between reported emissions from the EU ETS sector and the cap must be considered a debit, as operators must have sold or retained excess units which are not required to cover emissions in the UK.

25. In order to determine whether units should be credited to or debited from the net UK carbon account each year, Regulation 6 compares the number of allowances surrendered with “the annual allocation”. The starting point for this calculation is the total amount of allowances to be allocated by the UK in the period 2008-2012, whether for free, by auction/sale or via the new entrant reserve (1,228,109,497 allowances)\(^6\), less those allowances relating to installations in Gibraltar which are outside the scope of the Act (941,956 allowances). This gives 1,227,167,541 allowances as the total UK allocation, which is then divided as set out in the table below.

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual allocation(^7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>245,991,207</td>
</tr>
<tr>
<td>2009</td>
<td>245,294,083</td>
</tr>
<tr>
<td>2010</td>
<td>245,294,083</td>
</tr>
<tr>
<td>2011</td>
<td>245,294,084</td>
</tr>
<tr>
<td>2012</td>
<td>245,294,084</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1,227,167,541</td>
</tr>
</tbody>
</table>

\(^5\) SI 2009/3146; available from: [www.opsi.gov.uk/si/si2009/uksi_20093146_en_1](http://www.opsi.gov.uk/si/si2009/uksi_20093146_en_1)


\(^7\) The annual allocation for 2008 is the same as the incorrect number included in the original regulations, and higher than in subsequent years, because the regulations cannot be amended retrospectively. The allocations for 2009 and 2010, and 2011 and 2012 are different (by one unit) because allocations must be a whole number and the total allocation for 2009 to 2012 is not divisible by four.
26. Whilst on an annual basis the effect of the EU ETS may be either a credit to, or a debit from, the net UK carbon account, at the end of the first budgetary period the contribution of the EU ETS towards delivering the carbon budget will equate to the level of the cap.

27. For 2008 the calculation was completed by 15 June 2009, and for 2009 and the remaining years of the budgetary period the calculation must be completed by 31 May in the year following that to which it relates. This timeframe matches the EU ETS timetable, where results for each year are made available in April the following year.

28. The calculation of whether an amount of units are to be credited or debited in each year as a result of the operation of the EU ETS is summarised in Figure 3 below.

Figure 3: Mechanism for calculating each year whether an amount of carbon units should be credited to or debited from the net UK carbon account as a result of the operation of the EU ETS

- What is ‘the annual allocation’?
  - In 2008 it is 245,991,207 units
  - In 2009 and 2010 it is 245,294,083 units
  - In 2011 and 2012 it is 245,294,084 units

The sum of these annual allocations equals the total UK allocation, 1,227,167,541 units.

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For 2010, for example, the calculation must be done by 31 May 2011.
Regulation 7: Debiting units

29. Regulation 7 sets out the process and timing for calculating, in each year, whether an amount of carbon units must be debited from the net UK carbon account. Debits arise where Government disposes of carbon units, for example by selling them to another country or other third party. These units need to be debited, and the net UK carbon account increased accordingly, as the recipient can use the units to offset their own emissions and it would lead to double-counting if they were also available to offset UK emissions.

30. To ensure we are able to calculate the net UK carbon account each year, we propose checking at the end of each year whether the UK holding of carbon units is less than the previous year’s holding. If it is, and if it is also below the original allocation of units given to the UK under the Kyoto Protocol, we must have disposed of units in the meantime. The units will be debited from the net UK carbon account to reflect this.

31. “The UK holding of carbon units” means the amount of units held in the following UK Registry accounts:
   • the UK’s national retirement account, where the UK retires AAUs annually in accordance with Kyoto Protocol obligations; and
   • the Party Holding Account where the UK’s AAUs were initially issued.

The holding is also deemed to include the total UK allocation under the EU ETS, regardless of where these are held at the time, as these units are simply UK AAUs which have been converted into the EU allowances (EUAs), the EU ETS “currency”.

32. If the UK holding of carbon units at the end of one year (“year x”) is less than it was at the end of the previous year (“year x-1”), and if it is also less than “the relevant share of the UK assigned amount” (the total amount of AAUs issued to the UK under the Kyoto Protocol, less an amount representing the allocation to the UK’s Crown Dependencies and Overseas Territories), an amount of units must be debited from the net UK carbon account.

33. The amount to be debited will be calculated as follows:
   • If the UK holding of carbon units in year x-1 was less than the relevant share of the UK assigned amount, the amount to be debited will equate to the difference between the UK holding of carbon units in year x and the UK holding of carbon units in year x-1.
   • If the relevant share of the UK assigned amount is less than the UK holding of carbon units in year x-1, the amount to be debited will equate to the difference between the UK holding of carbon units in year x and the relevant share of the UK assigned amount.
34. In respect of 2008, where there is no previous year’s holding of carbon units to refer to, the approach will simply be to compare the UK holding of carbon units in 2008 with the relevant share of the UK assigned amount.

35. The process for debiting is summarised in Figure 4 below.
Regulation 8: Cancelling units

36. Under the Act the Government may set more demanding domestic targets than those required under the international framework (i.e. for the 2008–2012 budgetary period, the Kyoto Protocol) – this means we could meet our international target and still have carbon units left over in the UK registry. Section 27(5) of the Act requires the carbon accounting regulations to make provision for calculating the difference between our international obligations and domestic targets, and ensure that any additional units are not made available to offset emissions in the UK or provided to other countries to offset their emissions. Regulation 8 provides the mechanism, following the end of the budgetary period, for calculating and cancelling the units to put them beyond use.

37. The starting point for the calculation is the UK’s assigned amount issued under the Kyoto Protocol, adjusted to exclude non-UK emissions from relevant Crown Dependencies and Overseas Territories. From this, an amount of units representing the level of the carbon budget is subtracted. This gives the difference in stringency between our Kyoto target and the level of the carbon budget. Two further adjustments are required to calculate the number of units that need to be cancelled.

38. First, an adjustment must be made to account for the difference between the UK’s net land use, land use change and forestry (LULUCF) emissions as calculated under the Kyoto Protocol and as calculated under international carbon reporting practice. The UK reports LULUCF activities in the UK national emissions inventory report following guidelines produced by the Intergovernmental Panel on Climate Change (IPCC). The figures from this will be used to assess our progress towards the UK’s domestic targets and will feed into the baseline that is used to determine our carbon budgets. However, only a subset of these LULUCF activities fed into the baseline that was used to determine the UK’s Kyoto target and are eligible for compliance with that target. In order to calculate the difference in stringency between the UK’s Kyoto target and the first carbon budget we therefore need to reconcile the difference in the way net LULUCF emissions are calculated under the two methodologies.

39. We propose to make an adjustment to the budget equivalent to the difference in net emissions from LULUCF reported under the Kyoto methodology and under the IPCC methodology for the period 2008-2012.

40. Second, the number of carbon units placed in the credit account and declared as credits towards the net UK carbon account in the course of the budgetary period must be subtracted. This is because units in the credit account must be cancelled, in accordance with Regulation 4, and
therefore are counted towards the total number of units to be cancelled under Section 27(5) of the Act.

41. Regulation 8 requires the Secretary of State, between 1 January 2013 and 15 May 2014, to ensure that this calculation has been done, and a corresponding amount of units have been cancelled. This is to ensure they cannot be used to offset emissions in future periods. Regulation 8(4) provides that if any units have not been cancelled by 15 May 2014, an equivalent amount of carbon units will be debited from the net UK carbon account on 16 May 2014. The timing required ensures that the calculation and cancellation must be performed ahead of the deadline for producing the final statement to Parliament of the net UK carbon account for the first budgetary period (31 May 2014).

42. This process will not have any adverse effect on the mechanism in regulation 7 for calculating whether an amount of debits must be made during the budgetary period as the amount to be cancelled will be calculated after the end of the budgetary period.

43. The methodology for calculating the amount of units which must be cancelled under this section of the Act, including the LULUCF adjustment, is summarised in Figure 5 below.
Figure 5: Calculating the additional amount of carbon units which must be cancelled under Section 27(5) of the Act

This diagram is based on the equation in Regulation 8 for calculating the additional amount of carbon units to be cancelled:

$$A = B - C - D + E + F - G$$

Where:
- **A** is the additional amount of carbon units to be cancelled;
- **B** is the relevant share of the UK assigned amount;
- **C** is the level of the carbon budget;
- **D** is the amount of carbon units cancelled in accordance with Regulation 8(2);
- **E** is the amount of carbon units cancelled under Regulation 8(2) in relation to which no declaration was made under Regulation 5(2)(b);
- **F** is the net amount of emissions of targeted greenhouse gases to the atmosphere due to land use, land use change and forestry activities in the United Kingdom during the 2008–2012 budgetary period, calculated in accordance with international carbon reporting practice; and
- **G** is the net amount of emissions of targeted greenhouse gases to the atmosphere due to land use, land use change and forestry activities in the United Kingdom during the 2008–2012 budgetary period, calculated in accordance with Articles 3.3 and 3.4 of the Kyoto Protocol.

Please note this is an illustrative example and does reflect all possible scenarios. For example, there may also be debits from the net UK carbon account which affect the calculation of the net UK carbon account, and the difference between IPCC and Kyoto LULUCF emissions (F – G) may be a positive or negative amount. However, the equation above will apply in all circumstances.
Regulation 9: Register of transactions

44. Regulation 9 establishes a duty on Government to maintain a register of transactions to track the movement of carbon credits and debits within the registry, and to provide details of units which are cancelled. This provision was not consulted on but has been included in response to the calls for maximum transparency in the carbon accounting system.

45. The information required in the register is broadly what we’d expect to collect and retain in the course of performing the duties required under regulations 5 to 7, as well as for the process of calculating and cancelling the units under regulation 8.

46. This information will also help provide the basis of the annual and end-of-budget statements of net UK emissions and holdings of carbon units required under the Act, described in the following section.
Annual statement of emissions

47. Section 16 of the Act requires that an annual statement of emissions must be produced, which contains both UK emissions data and information regarding the net UK carbon account as set out in the table below.

<table>
<thead>
<tr>
<th>UK emissions data</th>
</tr>
</thead>
<tbody>
<tr>
<td>• UK emissions, UK removals and net UK emissions for each greenhouse gas.</td>
</tr>
<tr>
<td>• Explanation of the methodology used to measure or calculate these figures.</td>
</tr>
<tr>
<td>• Whether these figures represent an increase or decrease compared to figures for the previous year.</td>
</tr>
<tr>
<td>• The aggregate amount for the year of UK emissions, UK removals and net UK emissions of all greenhouse gases.</td>
</tr>
<tr>
<td>• The amount of net UK emissions of carbon dioxide in 1990, and the amount of net UK emissions of the other greenhouse gases for the base year for that gas.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Information regarding the net UK carbon account</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The total amount of carbon units that have been credited to or debited from the net UK carbon account for the year</td>
</tr>
<tr>
<td>• Details of the number and type of these units.</td>
</tr>
<tr>
<td>• The net UK carbon account for the year.</td>
</tr>
</tbody>
</table>

48. The annual statement of emissions must be laid before Parliament by 31 March in the second year after that to which it relates – i.e. the statement of emissions for 2008 must be published by 31 March 2010. The UK emissions data required will be sourced from the UK’s national emissions inventory reports, and the information regarding the net UK carbon account will be gathered as a result of regulations 4 to 9.

49. The timeframe for publication of the statement is to maintain consistency with the timeframe for compiling and submitting the UK’s inventory reports to the European Commission and United Nations Framework Convention on Climate Change (UNFCCC) – final emission figures are submitted to the UNFCCC in April in the second year following the year in question.9

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9 This means emissions data for 2008 will be submitted to the UNFCCC in April 2010, for example.
50. Our intention is that this approach will ensure the annual statements of emissions will contain the most up-to-date and accurate information available on the UK’s net emissions, using the same systems and data as for the emissions inventory which is required under the UNFCCC. This will help ensure transparency about progress towards meeting the targets and budgets established under the Act, and better enable Parliament and the public to hold the Government to account.

**Final statement for budgetary period**

51. Section 18 of the Act requires the publication of a statement for the whole budgetary period, which will be used to determine whether the carbon budget for a period has been met. The Act requires the statement to be published not later than 31 May in the second year following the end of the budget – the final statement for the first budget period must therefore be published by 31 May 2014.

52. The statement must contain the following information:
   - information on UK emissions, UK removals and net UK emissions for the budgetary period, based on the annual reports provided in the section 16 reports;
   - the total number of carbon units credited to or debited from the net UK carbon account for the budgetary period, giving details of those units;
   - the amount of the net UK carbon account for the budgetary period as a whole.

53. The final statement must also state whether the “borrowing” provision in section 17 of the Act has been used and the amount borrowed. It must also state the level of the carbon budget for the period – this will be the level of the budget as originally set, adjusted to account for any borrowing, or adjustment made to the level of the budget under section 21.

54. This statement will therefore provide all the information necessary to determine whether the budget has been met (i.e. whether the net UK carbon account does not exceed the level of the budget).

55. If the carbon budget has not been met, the statement must explain why not. This requirement is supplemented by the duty in section 19 of the Act which requires, in the event that a carbon budget is not met, the Government to lay before Parliament a report setting out proposals and policies for making up for the excess.

56. The plan must be laid before Parliament as soon as reasonably practicable after the final statement for the budgetary period is published. This will ensure as much clarity and transparency as possible as to how we’ll get back on track – this is particularly important as the next budgetary period will already be underway once the final statement is published.
Timeline

57. The diagram below sets out the annual and end-of-budget requirements for the first budgetary period resulting from the Carbon Accounting Regulations, the reporting requirements in the Act and existing commitments under the international framework and EU ETS. Together, these elements will ensure we are able to calculate the net UK carbon account each year.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAU</td>
<td>Assigned Amount Unit</td>
</tr>
<tr>
<td>CDM</td>
<td>Clean Development Mechanism</td>
</tr>
<tr>
<td>CER</td>
<td>Certified Emission Reduction</td>
</tr>
<tr>
<td>ERU</td>
<td>Emission Reduction Unit</td>
</tr>
<tr>
<td>EUA</td>
<td>European Union Allowance</td>
</tr>
<tr>
<td>IPCC</td>
<td>Intergovernmental Panel on Climate Change</td>
</tr>
<tr>
<td>JI</td>
<td>Joint Implementation</td>
</tr>
<tr>
<td>LULUCF</td>
<td>Land use, land use change and forestry</td>
</tr>
<tr>
<td>RMU</td>
<td>Removal Unit</td>
</tr>
<tr>
<td>UNFCCC</td>
<td>United Nations Framework Convention on Climate Change</td>
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