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IFRS Today

Our series on the most topical issues in financial and sustainability reporting

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PODCAST TRANSCRIPT

Emissions schemes | Green initiatives in the airlines industry

James

Hello, and welcome to IFRS Today.

To drive the move to a greener economy, corporations across many different sectors have announced net-zero carbon commitments. This brings both challenges and opportunities as businesses embark on new arrangements and operational changes to hit their net-zero targets.

In this episode – the first in a new series on the impact of this transition on financial reporting – we'll look specifically at green initiatives in the airlines industry.

We'll run through some key financial reporting considerations under IFRS® Accounting Standards. I'm joined by Irina Ipatova, an associate partner from KPMG International Standards Group, and Mark Wrigglesworth, an audit partner from KPMG in the UK.

Mark, Irina – Firstly, why is the shift to net zero so important for both preparers and users of financial statements?

Mark

Well, James, the transition to a net-zero economy is a fundamental shift in how companies do business in a similar way to the emergence of the Internet in the 1990s. The impact of this shift is a real focus for users. We're starting to see the emergence of new goods and services, as well as changes in the way existing products we use in our everyday lives are delivered in a greener way.

Air travel is a great example of that and what we'll talk about today. The challenge is determining how these arrangements driving the net-zero economy should be accounted for. The accounting guidance is really trying to play catch-up.

Irina – What guidance exists and how have KPMG firms started to think about how that guidance should be applied?

Irina

As you mentioned, Mark, we are seeing a shift to greener behaviour and a significant rise in voluntary green schemes. This triggers an increased number of accounting questions. I have to say, emissions schemes are not something entirely new. Mandatory schemes aiming to cap pollution have been used in different countries for a very, very long time.

But the green schemes are something new and the accounting questions are different. I have to admit, unfortunately there are no specific requirements in the IFRS Accounting Standards, and this topic is not on the active agenda of the standard setter. It's just on the reserve list. What does it mean? It means that we need to help our teams and clients to determine the appropriate accounting for their specific schemes.

This will ensure that users receive relevant and comparable information, and that's what we're busy doing now. I will share some of our thinking as part of this podcast series.

James

Okay. So let's talk now about some of the impacts on airlines. Mark, what are the key green initiatives that you're seeing in the airlines industry?

Mark

Well, James, the types of green initiatives we see fall into two brackets. Firstly, the use of sustainable aviation fuel (or SAF, as it's commonly known) to reduce CO2 emissions. And secondly, a variety of third-party carbon-offsetting services are now starting to emerge.

Irina

That's very interesting, Mark. Let's see if the financial reporting considerations are the same for these two initiatives. The critical first step in determining the appropriate accounting is to understand the terms of the arrangement and the rights and obligations of the parties.

James

Okay, Irina, let's start with the sustainable aviation fuel initiatives. Mark, can you tell us a bit more about these?

Mark

Sure, James. Airlines are using greener alternatives to traditional jet fuel. They pay a premium for it, but it generates around 80 percent less CO2 than normal jet fuel. It generates a carbon reduction – what we will refer to in the rest of this discussion as carbon credits – although there may be other terms such as offsets commonly used. Airlines use sustainable aviation fuel to help meet their carbon targets or certain legal or regulatory obligations related to carbon emissions, depending on the jurisdiction.

Irina

Mark, I think we'll need to go into a bit more detail here. So I'm going to ask you some questions. Do airlines use the carbon credits themselves or do they offer them to customers?

Mark

Well, Irina, both. Let's look at the two scenarios. In the first, an airline is required to use a specific amount of SAF, or does this voluntarily, and claims the related carbon credits itself. In the second scenario, if an airline uses SAF voluntarily, it may also decide to offer separately the related carbon credits or offsetting services to its customers for a fee.

Having said that, regardless of whether carbon credits are a separate offering in the contract, passengers are likely to pay a higher price for their travel – if an airline uses SAF based on the current price of SAF. Although I have to say, the market for SAF supply is still very much evolving.

Irina, looking at the first scenario in which an airline uses carbon credits itself but charges a higher price for the ticket, what would be the accounting outcome there?

Irina

I think, Mark, that in this case the airline will simply recognise a higher cost of providing the service. If you ask me why? Because carbon credits are not a separate offering in the contract and they are not transferred to the customer. The customer benefits only from a transportation service. So carbon credits would not be considered a separate performance obligation.

This will be the case even if the airline charges a so-called 'fuel premium' and potentially shows this premium separately to the ticket price.

Mark

Thanks, Irina. That's very clear. Moving on to the second sustainable aviation fuel scenario in which airlines offer separately its own carbon credits or offsetting services to customers. Let me explain how these arrangements work and why customers are keen to purchase such credits. As you mentioned earlier, Irina, many companies are making net-zero commitments and are keen to reduce their carbon footprint.

One way to do this is to acquire carbon credits or offsetting services. Such companies would normally use carbon credits or offsetting services for the purposes of their sustainability reporting. We're also expecting to see an increasing number of climate conscious individuals paying extra to offset $CO2$ from air travel.

Irina

So Mark, do airlines usually offer carbon credits or offsetting services only together with the flight?

Mark

Not necessarily, Irina. Companies could also purchase them separately in bulk through existing supplier arrangements.

Irina

And are there specific registration and certification requirements for carbon credits that relate to the use of sustainable aviation fuel?

Mark

Well, that differs from country to country and regulatory regimes. In some countries, batches of SAF are registered in a national database and/or subject to certain certifications. There may also be some sort of third-party verification. In the UK, for example, all batches of SAF are registered with the UK Department of Transport and certain certifications are generated. So there is documentation associated with each production batch, which provides an audit trail.

Now, you may be wondering, Irina, how the accounting analysis of this scenario differs from the first one. What do you think?

Irina

You know, Mark, in short, it does. Where SAF credits are transferred to customers, most considerations point to a separate performance obligation for three reasons. First, carbon credits are a separate offering in the contract and may be sold separately from the transportation service. Second, the customer can also purchase similar carbon credits or offsetting services from another airline. And third, the customer purchases the carbon credits to achieve their net-zero commitment and can benefit from carbon credits by using them in their sustainability reporting.

So what are the additional considerations? If carbon credits or offsetting services are transferred to the customer at the same time as the flight, then the overall accounting outcome may be similar to the scenario where the airline does not offer the SAF credits separately. Conversely, if the timing of the transfer differs, for example, because carbon credits are effectively issued for a customer to claim the benefit at a time different from the flight, then revenue related to carbon credits or offsetting services may be recognised separately.

James

Thanks, Irina. So that covers green initiatives around sustainable aviation fuel. Let's move on to the second green initiative we said we'd look at, namely third-party carbon-offsetting services. How do these work, Mark?

Mark

Well, James, this is fairly simple. In this case, an airline may, for example, offer a service which reduces flight emissions through other projects that are designed to reduce CO2 elsewhere, such as reforestation or a renewable electricity project. Customers could purchase a third party's carbon credits or offsetting service either as part of their travel or separately in bulk. The airline may provide some sort of certification specifying who issued the credits, their number and whether the carbon credits have been claimed on the customer's behalf.

In some jurisdictions, it may be possible that third-party carbon credits – if they're not used – could be sold to another party, although most companies purchase those to meet their own net-zero commitments. Irina, what would be the accounting considerations in this scenario?

Irina

I think, Mark, that similar to the previous scenario with carbon credits arising from the use of sustainable fuel, most considerations are likely to point to a separate performance obligation here as well. However, what's different is that in some cases an airline may act as an agent rather than a principal in relation to third-party offsetting services. So further analysis of the specific facts and circumstances would be required.

So what does the airline need to consider? It will need to consider if it can influence the pricing, whether it has inventory risk and whether it obtains control of the third-party carbon credits or offsetting services before passing them to the customer. And if the airline acts as an agent, then it would recognise only its net commission from the service rather than the gross amount of revenue.

James

Thank you both. So it does sound like there's a lot going on in the airlines industry in relation to green initiatives. When it comes to IFRS accounting, I'm interested to know what each of you would suggest as a key takeaway point for listeners.

Mark

Well, James, I would say that understanding the terms of the arrangement and the rights and obligations of the parties is critical. To do this, industry specialists need to work really closely with their accounting colleagues and auditors to get this right. Irina, what would you add?

Irina

Mark, I fully agree. I would add that this is a fast-emerging area and stakeholders are keen to better understand the related impacts on the company and its performance. So relevant and meaningful disclosures are absolutely key.

James

Interesting. I'm sure that would be really useful for preparers and users considering the financial reporting implications of these arrangements. In future episodes, we'll be exploring green arrangements in other sectors and accounting for carbon credits that they generate. As our thinking develops in this area, we'll continue to share it. I hope you'll join us for the next episode.

Thank you!

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