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IFRS Today

Our series on the most topical issues in IFRS® Standards and financial reporting

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"If your company is facing new, climate-related laws or regulations, it's vital that you understand the key principles highlighted in this case. They will help you understand whether you have an obligation."

VIDEO TRANSCRIPT

IFRIC agenda decisions – Does an emissions scheme create an obligation?

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Hello – I'm Brian O'Donovan – I'm a partner at KPMG and I'm a member of the IFRS Interpretations Committee – the IFRIC.

In its February meeting, the Committee considered whether an emissions scheme that applies to automotive companies creates an obligation that meets the definition of a liability. If your company is facing new, climate-related laws or regulations, it's vital that you understand the key principles highlighted in this case. They will help you understand whether you have an obligation.

Negative low-emission vehicle credits

In the fact pattern considered by the Committee, the government sets annual targets for companies that produce or import vehicles. If you produce or import vehicles with average emissions below the target, well that's great news – you receive positive credits. However, if you produce or import vehicles with average emissions above the target, well, you receive negative credits. If you have negative credits for a calendar year, you are required to eliminate that negative position.

The question is whether a negative credit position creates an obligation that meets the definition of a liability under IAS 37, the provisions standard.

Now, for a simple emissions scheme, the answer to that question is usually a simple yes, but this case is more complicated. In particular, there's more than one way to eliminate a negative position. You can buy positive credits from other companies; you can surrender positive credits you earn in the future; you might submit a remedial plan. And if you fail to eliminate a negative position, well, the government can impose sanctions – it might restrict your access to the market – but it doesn't fine you. There's no direct financial penalty.

So, if there are multiple possible outcomes and no direct financial penalty, do you have an obligation?

Well, the Committee concluded that a company with negative credits does have an obligation, unless accepting the sanctions is a realistic alternative. That obligation is a legal obligation because it arises from the operation of law. If a company decides it doesn't have a legal obligation – perhaps it believes it can live with the sanctions – it also considers whether it has a constructive obligation: whether it has through its own actions or past public statements created an obligation for itself.

Next steps

The Committee agreed to publish a tentative agenda decision. It's in the February **IFRIC Update**, and it's available for comment up to mid-April. Take a look – see what you think. Perhaps you want to comment.

In addition, please do take a look at KPMG's **Climate change resource centre**. It includes great resources on this and many other financial statement issues.

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