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VIDEO TRANSCRIPT

IFRIC agenda decisions – Climate-related commitments

Brian O'Donovan
KPMG Global IFRS Leader and IFRS Interpretations Committee member

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

In its November meeting, the Committee discussed accounting for climate-related commitments – specifically, the circumstances in which a company recognises a provision for the costs of fulfilling a commitment to reduce or offset its greenhouse gas emissions.

This was a very engaged and topical Committee discussion with implications for any company that has made a net zero or similar commitment.

Climate-related commitments

In the fact pattern considered by the Committee, a company publicly states – firstly – that it will reduce its greenhouse gas emissions by 60% before 2029 – and – secondly – that it will offset its remaining emissions from 2029 onwards by buying and retiring carbon credits. This is a fictional case – but lots of companies are making commitments of this nature.

The issue is – should the company recognise a provision when it makes this public statement?

The Committee discussed a two-part test that the company would apply under IAS 37, the IFRS Accounting Standard that deals with provisions.

Is there is a constructive obligation?

The first part of the test is whether the company's statement has created a constructive obligation. IAS 37 is explicit that a company can create an obligation through, for example, stating that it will accept certain responsibilities.

But not every public statement creates this kind of obligation. Management will need to consider whether its public statement is sufficiently specific to create a valid expectation that the company will fulfil its commitment. If this is not the case, then the company will not recognise a provision. This will be a matter of judgement.

If, and only if, there is a constructive obligation – then the company moves on to the second part of the test.

Should a provision be recognised?

The second part of the test is whether the company recognises a provision for its constructive obligation. This will be required if the obligation meets all three of the following criteria.

The first criterion is whether the obligation arises from a past event. For example, the company has stated – today – that it will offset emissions it generates in the future – from 2029 onwards. The past event for this part of the commitment is not the company's statement, it's the emission of greenhouse gases from 2029 onwards. This means the company will recognise a provision for this part of its commitment – but only from 2029 onwards.

The second criterion is whether it is probable that an outflow of resources will be required to settle the obligation. One subtle but very important point here is that spending money to buy a valuable asset – for example, energy-efficient machinery – is not (in net terms) an outflow. So the company's plans to invest in new assets to reduce emissions by 60% before 2029 will not result in a provision. However, retiring valuable carbon credits to offset future emissions – and receiving nothing in return – is an outflow.

The third criterion is whether the company can make a reliable estimate of the amount it will need to spend to settle the obligation. This criterion will usually be met – except in what IAS 37 calls 'extremely rare cases'.

What did the Committee conclude?

Pulling this together, the Committee concluded that the company uses judgement to determine whether its public statement creates a constructure obligation. This applies to its commitment to reduce emissions by 60% before 2029 – and to its commitment to offset emissions from 2029 onwards.

If the company does have a constructive obligation, then it applies the three recognition criteria. For the commitment to reduce emissions by 60% before 2029, a key consideration is that investing in new, energy-efficient assets is not a (net) outflow, so the company does not recognise a provision for this. The commitment to retire carbon credits to offset future emissions is an outflow that will result in a provision – but only from 2029 onwards – when the company generates the emissions it has committed to offset.

Next steps

The Committee agreed to issue a **tentative** agenda decision – it will be open for comment until early February. So take a look. See if you agree with the Committee's conclusion – and whether you want to comment.

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