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VIDEO TRANSCRIPT

IFRIC agenda decisions – Climate-related commitments

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Hello, I'm Brian O'Donovan. I'm Global IFRS and Corporate Reporting Leader at KPMG and I'm a member of the IFRS Interpretations Committee – the IFRIC. In its March meeting, the Committee voted to finalise its agenda decision on climate-related commitments. That's the one about the circumstances in which a company would recognise a provision for the costs of fulfilling a commitment to reduce or offset its greenhouse gas emissions.

Now, this agenda decision has attracted a huge amount of interest since it was published as a draft last year. So let's run through what the final version does and doesn't say.

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 percent before 2029. Secondly, that it will offset its remaining emissions from 2029 onwards by buying and retiring carbon credits. And let's assume the company has no legal obligation to do this.

The issue is – Should the company recognise a provision when it makes this public statement? Well, the Committee confirmed that the company would apply a two-part test under IAS 37[1], the IFRS accounting standard that deals with provisions.

[1]IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Is there is a constructive obligation?

The first part of the test is whether the company's statement has created a constructive obligation.

Now, a 'constructive obligation' is an existing concept in IAS 37. You can see it described on the slide and we actually use this concept in lots of other contexts. It's a really important part of the analysis because if the company's statement does not create a constructive obligation, then the company will not recognise a provision.

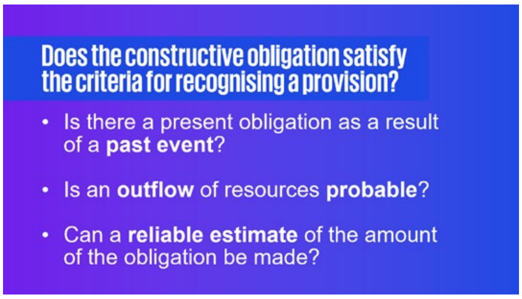
The Committee confirmed that a company can create an obligation through a public statement, but assessing whether this is the case will require judgement.

The Committee noted that actions a company takes that publicly affirm its intentions can help assess whether an obligation exists. The Committee also noted that this assessment may need to be revisited from one reporting date to the next. However, because this is a judgement, the Committee did not – it could not – conclude definitively on whether a particular statement creates a constructive obligation. This will be a matter for management to consider on a case-by-case basis.

The Committee also considered whether we could include indicators in the agenda decision to help management make this judgement. But we held back from doing this, as the Committee is not permitted to add to the requirements of IFRS Accounting Standards.

Should a provision be recognised?

The second part of the test is whether the company recognises a provision for its constructive obligation.



The company will recognise a provision if the obligation meets all three of the criteria in IAS 37, which you can see on this slide. The key to the first criterion is identifying the past event. For example, if a company commits to offset specific emissions it makes in the future, then emitting pollutants will generally be the past event. This means that even if all the other criteria are met, the company will recognise a provision only when it emits the pollutants in the future.

The key to the second criterion is identifying the outflow. In the case of the commitment to offset specific emissions, the company plans to buy and retire carbon credits. Some Committee members – including me – could have spent all day discussing how to account for carbon credits. However, that's not the question the Committee was asked, and the agenda decision quite rightly doesn't try to answer it.

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

What did the Committee conclude?

So the Committee concluded that in this specific fact pattern the company may create a constructive obligation when it makes its statement. Remember, that's a matter of judgement. But the company will not recognise a provision at that date. In the future, if it emits pollutants from 2029 onwards, it may well recognise the provision then, if all of the other criteria continue to be met.

That's what the agenda decision does say. The agenda decision does not discuss additional factors to consider when assessing whether a public statement creates a constructive obligation. That's because that would have added to the requirements in IAS 37. And it doesn't get into the accounting for carbon credits – however vital and important that topic is – because that's not the question the Committee was asked to address.

Next steps

The Committee voted to finalise the agenda decision, but that's not the end of the story. The Trustees of the IFRS Foundation will consider whether the Committee has complied with its due process before the IASB [International Accounting Standards Board] can be asked whether it has any objections. The earliest the agenda decision can be published is probably April.

In the meantime, here at KPMG, we'll continue to work on this and related issues to try and flesh out what companies need to do at the practical level to make the judgements and assessments IAS 37 requires. So watch this space!

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