

Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

5 February 2024

Dear Mr Mackenzie

Invitation to comment: Tentative Agenda Decision – *Climate-related Commitments (IAS 37)*

1. The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS Accounting Standards for use in the UK and therefore is the UK's National Standard Setter for IFRS Accounting Standards. The UKEB also leads the UK's engagement with the IFRS Foundation on the development of new standards, amendments and interpretations. This letter is intended to contribute to the Foundation's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended international accounting standards undertaken by the UKEB.
2. There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS.¹ In addition, UK law allows unlisted companies the option to use IFRS and approximately 14,000 such companies currently take up this option.²
3. We welcome the opportunity to provide comment on the IFRS Interpretations Committee's (the Committee) Tentative Agenda Decision (TAD) *Climate-related Commitments (IAS 37)*. In developing this letter, we have consulted with stakeholders in the UK, including preparers of accounts, accounting firms and institutes, academics and users of accounts.

¹ UKEB calculation based on London Stock Exchange Group (LSEG) and Eikon data, May 2023. This calculation includes companies listed on the Main market as well as on the Alternative Investment Market (AIM).

² UKEB estimate based on FAME (company information in the UK and Ireland produced by the Bureau Van Dijk, a Moody's analytics company), Company Watch financial analytics and other proprietary data.

4. The UKEB responds to the Committee's TADs in limited circumstances, taking into consideration factors such as the degree of impact on UK companies, disagreement with the analysis or the usefulness of the explanations and clarifications. We are responding to this TAD in view of its impact on UK companies.
5. Our outreach to UK stakeholders and our own research has clearly identified an expectation gap in reporting climate-related risks. Users of accounts report concerns that material climate-related risk disclosures and net zero commitments in company reports often appear disconnected from the accompanying financial statements. This was also noted by Committee members themselves at their November 2023 meeting.
6. Whilst this TAD goes some way to closing that expectation gap, UK stakeholder feedback suggests that in isolation it is unlikely to fully address it. We consider that further work is needed to address those wider concerns but note that this is outside the remit of the Committee. We therefore expect to write separately to the IASB to set out these concerns.
7. The remainder of this letter focuses on the technical analysis in the Committee's TAD.
8. Overall, we agree with the technical analysis and the Committee's conclusion in the TAD. We therefore encourage the Committee to finalise the agenda decision. However, we have identified some amendments that in our view would enhance clarity and help reduce the risk of unintended consequences.
9. Our detailed responses and recommendations are set out in the Appendix to this letter. Our main recommendations are as follows:
 - a) The identification of the triggering action/event that gives rise to a present constructive obligation as a result of a past event is a crucial part of the analysis and it is essential that this part of the TAD is as clear as possible. The technical analysis as currently drafted in the TAD does not discuss the requirements in paragraph 17 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Feedback from UK stakeholders suggests that this paragraph can lead to uncertainty about the point at which a present obligation arises. We consider the TAD would be more helpful if it were to include in the analysis a reference to the requirement in paragraph 17, clarifying that paragraphs 17 – 19 of IAS 37 are to be considered in combination. (See paragraphs A5-A7 of the Appendix)
 - b) There is a risk that the technical analysis in relation to 'probable outflow of resources' (e.g. exchange vs transfer of resources) could be viewed as going beyond the existing requirements and guidance in IAS 37. We recommend limiting the analysis as far as possible to the existing text of IAS 37. (See paragraphs A8-A9 of the Appendix)

- c) We also recommend the Committee proposes the 'probable outflow of resources' assessment (as per b) above) to the IASB for consideration and potential standard setting, as part of the ongoing IASB project *Provisions – Targeted Improvements*.

10. If you have any questions about this response, please contact the project team at UKEndorsementBoard@endorsement-board.uk.

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix A: IFRS Interpretations Committee – Tentative Agenda Decision: *Climate-related Commitments (IAS 37)* – detailed recommendations

- A1. The UKEB agrees with the IFRS Interpretations Committee's (the Committee) overall conclusion in the Tentative Agenda Decision (TAD): *Climate-related Commitments (IAS 37)*. However, we have some recommendations on the drafting of the analysis in the TAD, and these are set out below. The aim of the recommendations is to enhance clarity and reduce the risk of unintended consequences.

Does the constructive obligation satisfy the criteria for recognising a provision?

- A2. In an effort to provide a simple, concise and clear technical analysis accessible to all stakeholders, including non-accountants, and to reduce the risk of unintended consequences, we recommend that the TAD analyses the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* only to the extent specifically needed in responding to the questions in the submission request. Additional analysis (for example addressing aspects of the provision recognition criteria that in this fact pattern do not need to be addressed) could impair clarity and increase the risk of potential diversity in practice. For example, see A9(a) below.
- A3. When setting out in the TAD the recognition criteria in paragraph 14 of IAS 37 we recommend complementing the analysis stating that '*If there is no present obligation (i.e. the recognition criterion paragraph 14(a) is not satisfied), the entity need not consider whether recognition criteria in paragraph 14(b) and 14(c) are satisfied. Similarly, when recognition criterion 14(a) is satisfied but criterion 14(b) is not satisfied, recognition criterion 14(c) does not need to be considered*'. This would provide additional clarity on the overall approach required and would frame the level of detail needed in the TAD in analysing the provision recognition criteria.
- A4. If an entity has concluded that a constructive obligation has been created, the next step is to assess whether such constructive obligation is '*present*' and '*as a result of a past event*'. This is a crucial part of the analysis and we consider that an explicit statement to this effect in the TAD would be helpful, emphasising the requirement in IAS 37 for the obligation, legal or constructive, to be a '*present*' obligation and leading in to the next part of the analysis.

Present obligation as a result of a past event

- A5. The technical analysis as currently drafted in the TAD does not discuss the requirements in paragraph 17 of IAS 37. Feedback from UK stakeholders suggests that this paragraph can lead to uncertainty about the point at which a present obligation arises. We consider the TAD would be more helpful if it were to include in the analysis a reference to the requirement in paragraph 17, clarifying that for the analysis in the TAD paragraphs 17 – 19 of IAS 37 are to be considered in combination. That is, when assessing whether the entity has no realistic alternative to settling the obligation created by the event (as per IAS 37 paragraph 17) it is also necessary to assess whether the obligation exists independently of an entity's future actions (IAS 37 paragraph 19).
- A6. We recommend that the Committee makes its determination independently of non-mandatory accompanying material in IFRS Accounting Standards, such as the Illustrative Examples accompanying IAS 37.
- A7. In addition, regarding the entity's commitment to reduce its current greenhouse gas emissions by at least 60% by 20X9 (referred to in this document as '**Commitment 1**'), we recommend avoiding the statement that the entity 'will never' have a present obligation. This is to recognise the possibility that, for example, an executory contract could become onerous. Alternatively, the TAD should state explicitly the overriding assumption that contracts will not become onerous.

Probable outflow of resources

- A8. For purposes of consistency throughout the document and adding clarity, we recommend adding the words '*present*' and '*as a result of a past event*' in the second sentence in this section: 'The Committee concluded that if the commitment described in the fact pattern creates a **present** constructive obligation for the entity **as a result of a past event**'. This additional precision would be helpful to emphasise that (i) it is not sufficient for there to be an obligation – the obligation must be present and as a result of a past event and (ii) that the assessment of the second recognition criterion is required only when the first criterion is fully met.
- A9. IAS 37 does not explain what is meant by 'outflow' and it is not explicit whether this recognition criterion refers to an exchange or a transfer of resources or whether the relevant outflow can be gross or must be net. Stakeholder feedback indicates that there are different ways in which this recognition criterion could be interpreted given the lack of guidance in IAS 37, and given the acknowledgement in the TAD that in some circumstances an asset may be recognised when a provision is recognised. To avoid the risk of going beyond the requirements of IAS 37 and of potential unintended consequences, therefore, we recommend limiting the analysis, as far as possible, to the existing text of the Standard.

- a) **Commitment 1:** Given the first criterion is not met, an assessment of the second recognition criterion for this commitment is not required. We recommend omitting paragraph a.³ to avoid confusion and the potential risk of unintended consequences.
- b) Regarding the entity's commitment to offset its remaining emissions in 20X9 and thereafter, by buying carbon credits and retiring them from the carbon market (referred to in this document as '**Commitment 2**'), an entity is unlikely to take such actions without expecting some form of benefit (e.g. enhanced reputation leading to future revenues). In our view, the reference in the last sentence to 'without receiving any resources in exchange' is not strictly necessary for the assessment and should be omitted. Instead, we recommend '*settling the present obligation to offset the entity's remaining greenhouse gas emissions will require an outflow of resources because the entity will be required to retire carbon credits in settlement of that present obligation*'. If retained, the sentence should be expressed in terms of 'without receiving any resources **embodying economic benefits**', for consistency with IAS 37.

Conclusion on whether a provision is recognised

- A10. We recommend stating explicitly the conclusion for each of the commitments separately (referred to in this document as **Commitment 1** and **Commitment 2**). Specifically, the conclusion in the TAD seems to be silent in relation to Commitment 1 and we therefore suggest adding an explicit conclusion to enhance clarity.

If a provision is recognised, is the expenditure required to settle it recognised as an expense or as an asset when the provision is recognised?

- A11. The question asked is whether, in the fact pattern under analysis, the recognition of a provision gives rise to an expense or an asset (in other words, what is the other side of the credit entry). Referring to '*the expenditure required to settle it*' is therefore confusing and in our view unnecessary, especially as the word 'it' in this phrase refers to the provision not the obligation⁴. Instead, we recommend using a simpler form of words such as: '*If a provision is recognised, is the amount*

³ Extract from TAD "a. *settling the obligation to reduce the entity's greenhouse gas emissions will not require an outflow of resources embodying economic benefits. Although the entity will incur expenditure to modify its manufacturing methods, it will receive other resources – for example, property, plant, equipment, energy, product ingredients or packaging materials – in exchange for that expenditure, and will be able to use these resources to manufacture products it can sell at a profit.*"

⁴ The criterion in IAS 37 paragraph 14 (b) relates to the settlement of the **obligation**.

recognised as an expense or as an asset? The Committee observed that an amount is recognised...."