IFRIC *Update* March 2024

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings. Past *Updates* can be found in the IFRIC *Update* archive.

The Committee met on 5 March 2024 and discussed:

Agenda decisions for the IASB's consideration

- Climate-related Commitments (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2
- Payments Contingent on Continued Employment during Handover Periods (IFRS 3 *Business Combinations*)—Agenda Paper 3

Other matters

- Post-implementation Review of IFRS 9 *Financial Instruments*—Impairment—Agenda Paper 4
- Work in Progress—Agenda Paper 5

Addendum to IFRIC Update—Committee's agenda decisions

- Climate-related Commitments (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2
- Payments Contingent on Continued Employment during Handover Periods (IFRS 3 *Business Combinations*)—Agenda Paper 3

Related information

The work plan

Supporting consistent application

Agenda decisions for the IASB's consideration

Climate-related Commitments (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2

The Committee considered feedback on the tentative agenda decision published in the November 2023 IFRIC *Update* about how IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* applies to commitments an entity makes to reduce or offset its future greenhouse gas emissions.

The Committee concluded its discussions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the International Accounting Standards Board (IASB) will consider this agenda decision at its April 2024 meeting. If the IASB does not object to the agenda decision, it will be published in April 2024 in an addendum to this IFRIC *Update*.

Payments Contingent on Continued Employment during Handover Periods (IFRS 3 *Business Combinations*)—Agenda Paper 3

The Committee considered feedback on the tentative agenda decision published in the September 2023 IFRIC *Update* about how an entity accounts for payments to the sellers of a business it has acquired if those payments are contingent on the sellers' continued employment during a post-acquisition handover period.

The Committee concluded its discussions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the IASB will consider this agenda decision at its April 2024 meeting. If the IASB does not object to the agenda decision, it will be published in April 2024 in an addendum to this IFRIC *Update*.

Other matters

Post-implementation Review of IFRS 9 *Financial Instruments*—Impairment—Agenda Paper 4

Committee members discussed the IASB's post-implementation review of the impairment requirements in IFRS 9 *Financial Instruments*. In particular, Committee members provided input on application matters related to determining expected credit losses for:

a. intragroup financial instruments;
b. loan commitments;
c. financial guarantee contracts; and
d. purchased or originated credit-impaired financial assets.

The IASB will consider input from Committee members and other stakeholders on these matters.

Work in Progress—Agenda Paper 5

The Committee received an update on the status of open matters not discussed at its March 2024 meeting.

Addendum to IFRIC *Update*—Committee's agenda decisions

Agenda decisions, in many cases, include explanatory material. Explanatory material may provide additional insights that might change an entity's understanding of the principles and requirements in IFRS Accounting Standards. Because of this, an entity might determine that it needs to change an accounting policy as a result of an agenda decision. It is expected that an entity would be entitled to sufficient time to make that determination and implement any necessary accounting policy change (for example, an entity may need to obtain new information or adapt its systems to implement a change). Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances. Nonetheless an entity would be expected to implement any change on a timely basis and, if material, consider whether disclosure related to the change is required by IFRS Accounting Standards.

The Committee discussed the following matters and decided not to add standard-setting projects to the work plan.

Climate-related Commitments (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2

Published in April 2024[1]

The Committee received a request asking it to clarify:

a. whether an entity's commitment to reduce or offset its greenhouse gas emissions creates a constructive obligation for the entity;
b. whether a constructive obligation created by such a commitment meets the criteria in IAS 37 for recognising a provision; and
c. if a provision is recognised, whether the corresponding amount is recognised as an expense or as an asset when the provision is recognised.

The Committee considered this request by reference to the following fact pattern.

Fact pattern

In 20X0 an entity, a manufacturer of household products, publicly states its commitment:

a. to gradually reduce its annual greenhouse gas emissions, reducing them by at least 60% of their current level by 20X9; and
b. to offset its remaining annual emissions in 20X9 and in subsequent years by buying carbon credits and retiring them from the carbon market.

[1] In accordance with paragraph 8.7 of the *Due Process Handbook*, at its April 2024 meeting, the IASB discussed, and did not object to, this agenda decision.

To support its statement, the entity publishes a transition plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in its annual emissions by 20X9. The modifications will involve investing in more energy-efficient processes, buying energy from renewable sources and replacing existing petroleum-based product ingredients and packaging materials with lower-carbon alternatives. Management is confident that the entity can make all these modifications and continue to sell its products at a profit.

In addition to publishing the transition plan, the entity takes several other actions that publicly affirm its intention to fulfil its commitments.

Does the entity have a constructive obligation?

Paragraph 10 of IAS 37 defines a constructive obligation as an obligation that derives from an entity's actions where:

a. by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
b. as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Paragraph 20 of IAS 37 states that an obligation always involves another party to whom the obligation is owed, but that it is not necessary to know the identity of that party—the obligation may be to the public at large. The Committee observed that a constructive obligation to reduce or offset greenhouse gas emissions, if one exists, would be owed to all people adversely affected by the emissions so would extend to the public at large.

The Committee further observed that whether an entity's statement of its commitment to reduce or offset its emissions creates a valid expectation that it will fulfil the commitment—and hence creates a constructive obligation to do so—depends on the facts of the commitment and the circumstances surrounding it, including any actions the entity has taken that publicly affirm its intention to fulfil the commitment. Management would apply judgement to reach a conclusion at each reporting date considering all relevant facts and circumstances existing at that date. If the facts or circumstances change from one reporting date to the next, so too could the conclusion.

If the entity's statement has not created a constructive obligation, the entity does not recognise a provision. If the entity's statement has created a constructive obligation, the next question to consider is whether that obligation satisfies the criteria for recognising a provision.

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

Paragraph 14 of IAS 37 requires an entity to recognise a provision when:

a. the entity has a present obligation (legal or constructive) as a result of a past event;
b. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
c. a reliable estimate can be made of the amount of the obligation.

An entity recognises a provision only if all three of these recognition criteria are met.

Present obligation as a result of a past event

The first criterion for recognising a provision is that the entity has a present obligation as a result of a past event.

The Committee observed that, just as the enactment of a law is not sufficient to give an entity a present legal obligation, the publication of a policy or statement is not sufficient to give an entity a present constructive obligation—an entity has a present legal or constructive obligation only when the event to which the law, policy or statement applies has occurred. For example, as illustrated in Illustrative Example 2B accompanying IAS 37, an entity with a widely published policy of cleaning up land it contaminates incurs a present obligation only when it contaminates land—publishing the policy is necessary but not sufficient to give the entity a present obligation.

In explaining the requirement for a present obligation, paragraph 18 of IAS 37 states that 'no provision is recognised for costs that need to be incurred to operate in the future' and paragraph 19 of IAS 37 states that 'it is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions'.

Applying those paragraphs, the Committee concluded that if the commitments described in the fact pattern creates a constructive obligation for the entity:

a. that obligation is not a present obligation as a result of a past event when the entity publicly states the commitments in 20X0. Neither stating a commitment nor taking actions that affirm the entity's intention to fulfil that commitment are events that create a present obligation. The events that create a present obligation are the events to which the statement applies and those events have not occurred at the time the entity states its commitment. The costs that the entity will incur to reduce its annual greenhouse gas emissions and to offset the greenhouse gases it emits in 20X9 and in subsequent years are costs that it will need to incur to operate in the future—the obligations for those costs do not exist independently of the entity's future actions.
b. at any given date, the entity does not have a present obligation to reduce its emissions after that date, because the costs of operating with lower emissions in the future will remain costs that need to be incurred to operate in the future. The entity will at some future date have a liability to pay for resources it buys to carry out those future operations—for example, to pay for new plant or equipment—but only when it receives those resources in an exchange transaction.
c. only when the entity has emitted the greenhouse gases that it has committed to offset will it have a present obligation to offset those greenhouse gases. The entity will have that present obligation only if and when it emits greenhouse gases in 20X9 and in subsequent years.

Probable outflow of resources

The second criterion for recognising a provision is that it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

The Committee concluded that if the commitments described in the fact pattern create a constructive obligation for the entity:

a. settling the constructive obligation to reduce the entity's annual 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, and will be able to use these resources to manufacture products it can sell at a profit.
b. settling the constructive obligation to offset the entity's remaining annual greenhouse gas emissions will require an outflow of resources embodying economic benefits. The entity will be required to buy and retire carbon credits without receiving any resources embodying economic benefits in exchange.

Reliable estimate

The final criterion for recognising a provision is that a reliable estimate can be made of the amount of the obligation.

Paragraph 25 of IAS 37 states that 'except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision'.

The Committee concluded that in the fact pattern described, it is likely that the entity would be able to make a reliable estimate of the amount of a constructive obligation that satisfies the other recognition criteria.

Conclusion on whether a provision is recognised

The Committee concluded that in the fact pattern described:

a. whether the entity's statement of its commitments to reduce and offset its greenhouse gas emissions creates a constructive obligation to fulfil those commitments will depend on the facts of the statement and the circumstances surrounding it.
b. if the statement creates a constructive obligation:
    i. the entity does not recognise a provision when it makes the statement in 20X0. At that time, the constructive obligation is not a present obligation as a result of a past event.
    ii. the entity does not recognise a provision between 20X0 and 20X9 because it does not have a present obligation as a result of a past event until it has emitted the greenhouse gases it has committed to offset.
    iii. as the entity emits greenhouse gases in 20X9 and in subsequent years, it will incur a present obligation to offset these past emissions. If the entity has not yet settled that obligation and a reliable estimate can be made of the amount of the obligation, the entity recognises a provision.

If a provision is recognised, is the corresponding amount recognised as an expense or as an asset when the provision is recognised?

The Committee observed that if a provision is recognised, the corresponding amount is recognised as an expense, rather than as an asset, unless it gives rise to—or forms part of the cost of—an item that qualifies for recognition as an asset in accordance with an IFRS Accounting Standard.

Other accounting and disclosure implications

The Committee observed that, irrespective of whether an entity's commitment to reduce or offset its greenhouse gas emissions results in the recognition of a provision, the actions the entity plans to take to fulfil that commitment could affect the amounts at which it measures its other assets and liabilities and the information it discloses about them, as required by various IFRS Accounting Standards.

Conclusion

The Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine:

a. whether an entity's commitment to reduce or offset its greenhouse gas emissions creates a constructive obligation for the entity;
b. the circumstances in which the entity recognises a provision for the costs of fulfilling a constructive obligation to reduce or offset its greenhouse gas emissions; and
c. if a provision is recognised, whether the corresponding amount is recognised as an expense or as an asset when the provision is recognised.

Consequently, the Committee decided not to add a standard-setting project to the work plan.

Payments Contingent on Continued Employment during Handover Periods (IFRS 3 *Business Combinations*)—Agenda Paper 3

Published in April 2024[2]

The Committee received a request about how an entity accounts for payments to the sellers of a business it has acquired if those payments are contingent on the sellers' continued employment during a post-acquisition handover period.

Fact pattern

In the fact pattern described in the request:

a. an entity acquires a business and, as part of the acquisition agreement, requires the sellers to continue as employees of the acquired business. The sellers' continued employment is to ensure the appropriate transfer of knowledge from the sellers to the new management team (handover of the business).
b. the sellers are compensated for their services at a level comparable to other management executives. The entity also agrees to make additional payments to the sellers contingent upon both the performance of the acquired business and, as described below, the continued employment of the sellers for a limited period after the acquisition to complete the handover of the business.
c. the sellers are entitled to receive the additional payments if their employment is terminated due to specified circumstances—such as death or disability—or with the entity's agreement. The sellers forfeit the additional payments if their employment is terminated in any other circumstance.

[2] In accordance with paragraph 8.7 of the *Due Process Handbook*, at its April 2024 meeting, the IASB discussed, and did not object to, this agenda decision.

Findings

Evidence gathered by the Committee indicated no significant diversity in the accounting for payments contingent upon continued employment in fact patterns such as that described in the request. In these fact patterns, entities apply the accounting described in the Agenda Decision *Continuing employment* (IFRS 3 *Business Combinations*), published in January 2013, and account for the payments as compensation for post-combination services rather than as additional consideration for the acquisition, unless the service condition is not substantive.

Conclusion

Based on its findings, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee decided not to add a standard-setting project to the work plan.