Net-zero commitments

When to recognise a liability and how to tell a connected story

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Net-zero commitments – When to recognise a liability and how to tell a connected story

What's the issue?

Many companies have **voluntarily** made 'net-zero' and similar climate-related commitments*. Questions are emerging on how such commitments impact financial reporting under IFRS® Accounting Standards – in particular when they trigger a liability.

Under IFRS Accounting Standards, setting and announcing a net-zero target, on its own, does not trigger a liability even if the public announcement has raised a valid expectation and resulted in a constructive obligation.

Companies need to consider how they plan to achieve this target and assess the financial reporting impact of each planned action.

What's the impact?

Users of the financial statements, regulators and the public are paying more attention to companies' net-zero commitments.

Stakeholders are focused on whether companies are telling a connected net-zero story across different forums and reports, including their financial statements.

The IFRS Interpretations Committee has recently discussed some of these issues based on a specific fact pattern and has published an agenda decision.

What's next?

Companies that have made net-zero commitments need to:

- review their net-zero action plan;
- understand the financial reporting impacts of net-zero commitments, which often depend on the detail in the supporting action plan;
- tell a connected story and explain which planned actions do and do not trigger a liability at the reporting date; and
- monitor standard-setting developments.

Use this guide to help with the analysis and tell a connected story.

Listen to our podcast and watch our video for further insights.

* This talkbook addresses net-zero and similar climate-related commitments and refers to them as 'net-zero commitments' throughout.

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When to recognise a liability

When to recognise a liability

Two tests must be met to recognise a liability in relation to a net-zero commitment

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Test 1 – Do you have a constructive obligation?

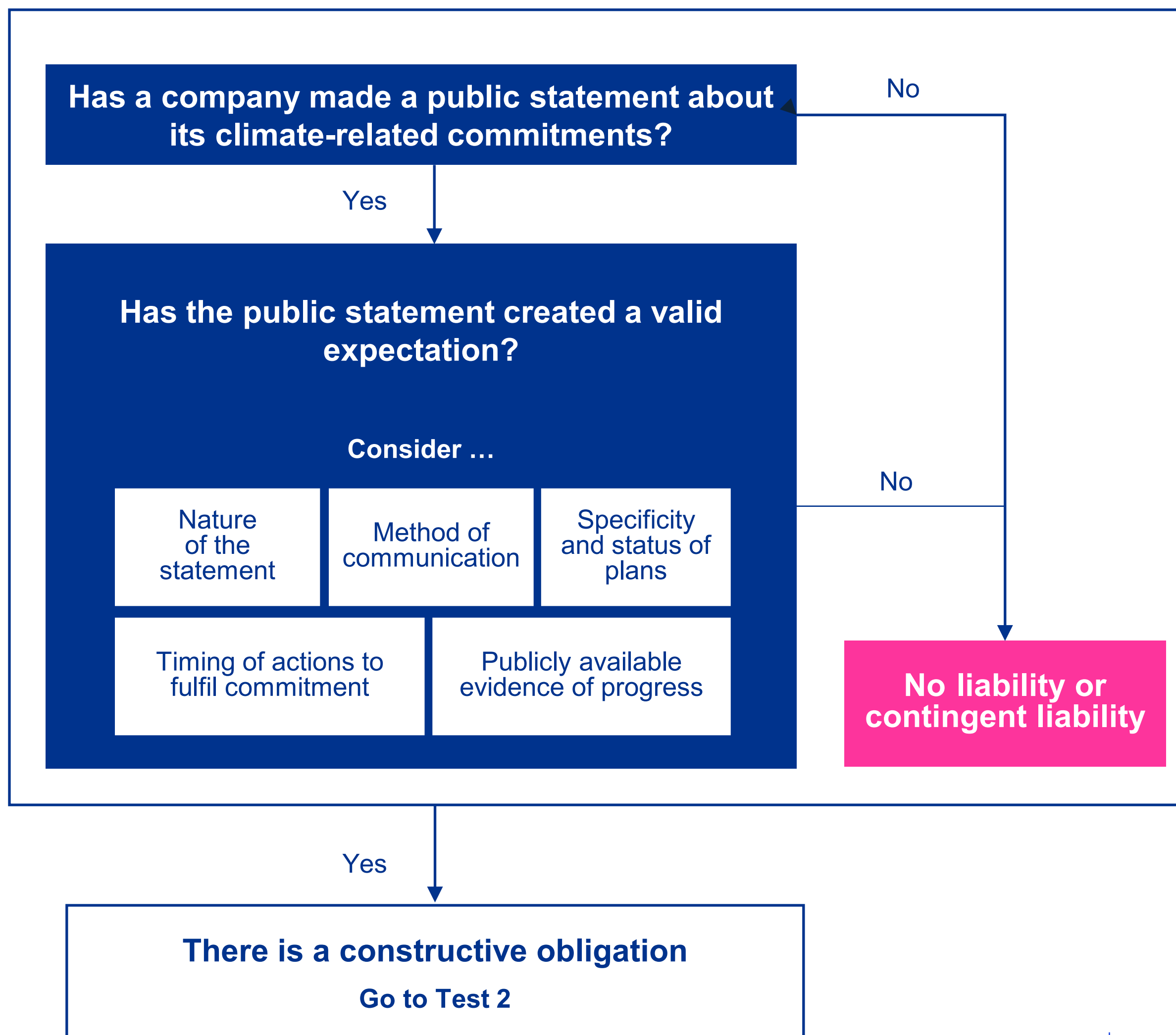
At each reporting date, a company considers whether its public statement on net-zero commitments is sufficiently specific to create a constructive obligation.

This assessment requires judgement based on the specific facts and circumstances – a public statement does not automatically create a valid expectation.

In our view, a company may use five factors to determine whether its public statement has created a valid expectation (see diagram).

If a constructive obligation is created, then the company assesses whether the criteria for recognising a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* are met – this is test 2.

If there is no constructive obligation, then the company does not recognise a liability.



A constructive obligation does not automatically result in a liability in the financial statements. A company needs to determine whether it has a present obligation as a result of a past event and if the other criteria to recognise a liability are met.

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Valid expectations – What are the factors to consider ?

In our view, a company may use **five factors** to determine whether its public statement has created a valid expectation.

Has a public statement created a valid expectation ?

Nature of the statement

Does the statement describe actions the company plans to take or its 'ambitions'?

Specificity and status of plans

Is the statement supported by formally approved plans with specific actions?

Method of communication

Is this a formally approved communication to stakeholders or an ad-hoc statement?

Timing of the actions to fulfil the commitment

Are the plans for short-, medium- or long-term actions?

Publicly available evidence of progress

Is there regular communication of progress in achieving milestones?

This assessment requires judgement based on the specific facts and circumstances – a public statement does not automatically create a valid expectation. The assessment needs to be performed at each reporting date as circumstances may change.

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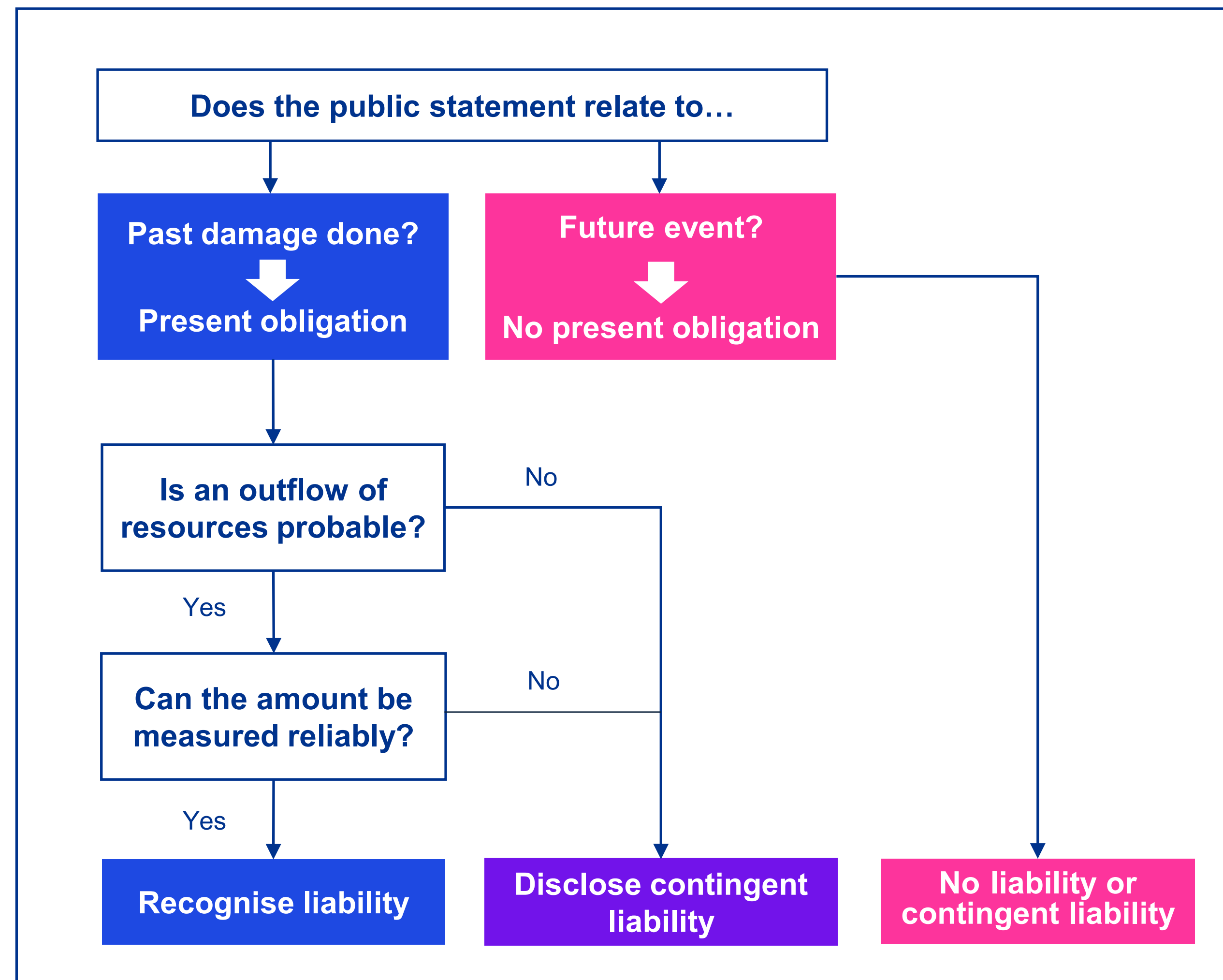
Test 2 – Are the criteria to recognise a liability met?

A company that has a constructive obligation recognises a liability only when all of the following criteria are met.

- There is a present obligation as a result of a past event (i.e. 'damage done').
- It is probable that an outflow of cash or other resources will be required to settle it.
- The company can reliably estimate the related amount.

The IFRS Interpretations Committee has discussed the accounting for climate-related commitments – specifically, how to assess whether a company's commitment to reduce or offset its greenhouse gas (GHG) emissions results in a liability in a specific fact pattern.

The International Accounting Standards Board is also reviewing its guidance on liabilities and may consider adding new examples illustrating how to apply IAS 37 to net-zero commitments.



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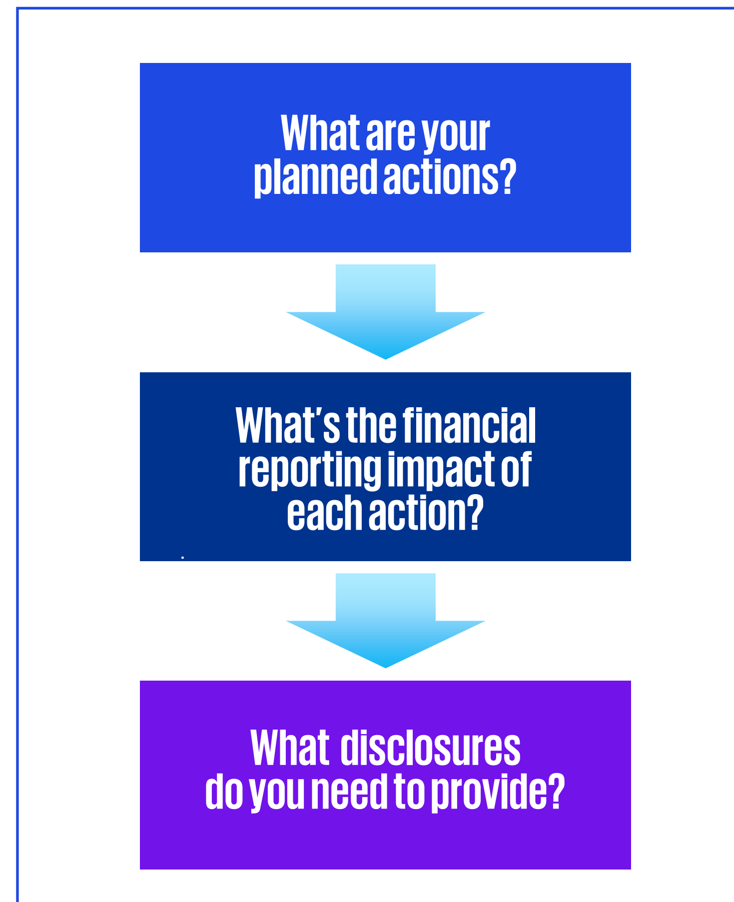
How to tell a connected story

How do you tell a connected story?

Investors and regulators expect a company's financial statements, management discussion and analysis (MD&A) and sustainability-related disclosures to provide a coherent, connected and integrated picture. To achieve this, companies need to provide enhanced disclosures on the impact of net-zero commitments in their reporting.

- **Specific disclosures in the financial statements:** Once companies have assessed the financial reporting impacts of the individual actions in their net-zero plan, they need to consider the disclosures required by the specific IFRS accounting standards. In some cases, a disclosure may be required even though there is no current-period financial statement impact.
- **Overarching disclosures in the financial statements:** Companies also need to consider the requirements of IAS 1 *Presentation of Financial Statements*. This includes disclosing additional information that is necessary for investors to understand the impact of net-zero commitments on the company's financial position and performance, and information that could influence their decisions.
- **Other disclosures outside the financial statements:** If a planned action does not impact the company's financial position and performance at the reporting date and is not subject to the specific or overarching disclosures – e.g. a commitment to offset emissions after 2030 by purchasing carbon credits – then the company may explain that there is 'no financial reporting impact' as part of the net-zero disclosures outside the financial statements. Disclosing 'no impact' may be specifically required by some sustainability reporting frameworks.



Net-zero plans – including specific actions and timelines – may evolve over time, so the assessment of the financial reporting impacts needs to be performed at each reporting date.

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Telling a connected story – Illustrative example

Fact pattern

Company M is a packaging manufacturer. On 14 March 2024, M makes a public statement at its annual shareholder meeting and on its website that it commits to:

- reduce its future annual Scope 1 and 2 emissions (as determined under the *GHG Protocol: A Corporate Accounting and Reporting Standard*) by 75% of 2023 levels by 2030; and
- purchase carbon credits for use as offsets against its residual emissions produced in 2030 and thereafter.

To support its statement, M publishes its transition plan which includes:

- steps it plans to take to meet its Scope 1 and 2 emissions target while also helping to reduce Scope 3 emissions (see diagram);
- the actions it has taken to date to support its plan; and
- its plan to report its progress annually on its website.

Companies provide information about their net-zero and similar plans through different channels, including the front part of an annual report or a sustainability report.

The illustrative example disclosures in this talkbook focus on the financial reporting impacts and the disclosures in the financial statements, except for disclosures about carbon credits in the sustainability report.

Transition plan – example actions*

01 Replace forklifts with electric models before 2026

02 Use fully recyclable packaging

03 Replace packaging machines to enable 'right-size' packaging before 2026

04 Evaluate alternative fuels for the vehicle fleet and increase the use of renewable energy by installing solar panels

05 Purchase carbon credits to offset residual emissions in 2030 and thereafter

*This example uses a selection of actions for illustrative purposes.

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01 Replace forklifts with electric models before 2026

Financial reporting considerations

- **Change in expected usage of the existing forklifts:** Consider whether the previous estimates of the useful lives and residual values continue to be appropriate. If there is a change, then account for it prospectively from that date – i.e. when the company makes the decision to replace the forklifts, not the public statement.
- **Disposal of existing forklifts:** Derecognise the assets and recognise a gain or loss on sale in the income statement on the date of disposal.
- **Acquisition of electric forklifts:** Recognise assets on the balance sheet. Estimate the useful life and residual value of the assets to determine the depreciation expense for the period. Disclose contractual commitments to acquire property, plant and equipment.

In this example, the action to replace forklifts with electric models **does not trigger a liability** at 31 December 2024 nor at the date of the public statement.

Consider the impact of the transition plan on impairment testing. IAS 36 *Impairment of Assets* includes specific requirements for the source of cash flow estimations – e.g. value in use is based on the most recent budgets and forecasts approved by management and does not include cash flows from improving or enhancing the asset's performance.

Notes to the financial statements at 31 December 2024

Property Plant and Equipment

B. Change in estimates

IAS 8.39, 16.76

During 2024, the Company replaced half of its forklift fleet with electric models and it plans to replace the rest in 2025. The fleet was previously expected to remain in use for a further five years: as a result, the expected useful life decreased and residual value increased. The effect on depreciation is an increase of EUR 120 thousand in 2024 and an increase of EUR 50 thousand in 2025. The electric models' useful life is longer – and residual value is lower – than the previous fleet.

Income and expenses

IAS 1.97

A. Other income

	In thousands of euro	Note	2024	2023
IAS 1.98(c)	Gain on sale of property, plant and equipment		X	

Commitments

IAS 16.74(c)

During 2024, the Company entered into a contract to purchase electric forklifts to support its commitments to reduce its GHG emissions. The Company is committed to incurring capital expenditure of EUR 550 thousand in 2025.

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02 Use fully recyclable packaging

Financial reporting considerations

- **New packaging materials:** Recognise as inventory at cost and consider the impact on the net realisable value.
- **Existing packaging materials:** Consider the impact of the new supply arrangements on the net realisable value.
- **Cost of finished goods:** Consider the impact of the new supply arrangements on the net realisable value.

In this example, the planned action to use fully recyclable packaging **does not trigger a liability** at 31 December 2024 nor at the date of the public statement.

IAS 2 *Inventories* requires a disclosure of the amount of any write-down of inventory, but does not refer to the triggers for the write-down.

However, this information may be helpful to investors to understand the impact of net-zero commitments on the company's financial position and performance (see illustrative example).

Notes to the financial statements at 31 December 2024

Inventories

	In thousands of euro	*Note*	2024	2023
IAS 1.78(c), 2.36(b)	Raw materials and consumables		X	
IAS 1.78(c), 2.36(b)	Finished goods		X	
	Inventory		X	

IAS 2.36(e), 1.17(c)

During 2024, the Company changed its packaging materials to recyclable equivalents, resulting in an increase in the cost of inventory. As a result, inventories have been written down to their net realisable value by EUR 10 thousand (2023: nil). This write-down was recognised as an expense during 2024.

The write-down is included in 'cost of sales'.

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03 Replace packaging machines before 2026

Financial reporting considerations

- **Existing packaging machines:** Consider whether the previous estimate of the useful lives and residual values continues to be appropriate. If there is a change, then account for it prospectively from the date of that change – i.e. when the company makes the decision to replace the machines, not the public statement.
- **New packaging machines:** Disclose contractual commitments to acquire property, plant and equipment.

In this example, the planned action to replace packaging machines **does not trigger a liability** at 31 December 2024 nor at the date of the public statement.

Consider the impact of the transition plan on impairment testing. IAS 36 includes specific requirements for the source of cash flow estimations – e.g. value in use is based on the most recent budgets and forecasts approved by management and does not include cash flows from improving or enhancing the asset's performance.

Notes to the financial statements at 31 December 2024

Property Plant and Equipment

B. Change in estimates

IAS 8.39, 16.76

During 2024, the Company entered into a contract to purchase replacement packaging machines in mid-2025. The existing packaging machines were previously expected to remain in use for a further two years and are now expected to be used only for a further six months. As a result, the expected useful life decreased and residual value increased. The effect on depreciation is an increase of EUR 50 thousand in 2024 and an increase of EUR 30 thousand in 2025.

Commitments

IAS 16.74(c)

During 2024, the Company entered into a contract to purchase packaging machines which use fewer packaging materials to support its commitments to reduce its GHG emissions. The Company is committed to incurring capital expenditure of EUR 1,250 thousand in 2025.

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04 Evaluate alternative fuels and use renewable energy

Financial reporting considerations

- **Alternate fuels for the vehicle fleet:** There is no financial reporting impact at 31 December 2024. When the company makes a decision to change fuel for its vehicle fleet, that information may be relevant to investors.
- **New solar panels:**
  - Recognise assets on the balance sheet. Estimate the useful lives and residual values of the assets to determine the depreciation expense for the period.
  - Consider the impact on any site restoration provisions for leased premises. Capitalise any increases in the provision to the corresponding right-of-use asset.

In this example, the planned action to evaluate alternative fuels and use renewable energy **does not trigger a liability** at 31 December 2024 nor at the date of the public statement.

Consider whether solar panels will continue to be used after the lease term of the manufacturing facilities. If the solar panels are used only whilst the facility is leased, then their useful life is generally restricted to the lease term of the related facility.

Notes to the financial statements at 31 December 2024

Property, Plant and Equipment

A. Reconciliation of carrying amount

	In thousands of euro	Note	Land and buildings	Plant and equipment	Fixtures and fittings	Under construction	Total
	Cost						
IAS 16.73(d)	Balance at 1 January 2024		X	X	X	X	X
IAS 16.73(e)(i)	Additions		X	X	X	X	X
IAS 16.73(d)	**Balance at 31 December 2024**		X	X	X	X	X

Provisions

C. Site restoration

i. Packing facility

IAS 37.85(a) During 2024, a provision of EUR 15 thousand was made for the required removal of solar panels installed during the year in the leased packing facility and an unwind of the discount of EUR 5 thousand was recognised in respect of the Company's obligation to restore it.

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05 Purchase carbon credits to offset emissions from 2030

Financial reporting considerations

Based on its performance to date and its latest forecasts, the company expects that it will meet its emissions reduction targets and will not be able to reduce residual emissions further. As a result, it plans to purchase carbon credits to offset its Scope 1 and 2 emissions from 2030.

Until the company emits Scope 1 and 2 emissions in 2030 and thereafter, it does not have a present obligation to purchase and retire carbon credits.

The company **does not have a present obligation and does not recognise a liability in 2024.**

The company has also considered its plan to purchase carbon credits from 2030 in the cash flow estimates for impairment testing.

If a constructive obligation arises, then it does not automatically result in a liability in the financial statements. A company needs to determine whether it has a present obligation as a result of a past event, and whether the other criteria to recognise a liability are met.

Sustainability report 2024*

Carbon Reduction Commitment and Transition Plan

As part of our commitment towards environmental stewardship and sustainable business practices, we are proactively integrating measures to reduce our carbon emissions. Our objective is to reduce our Scope 1 (direct) and Scope 2 (indirect) greenhouse gas emissions by 75% by the year 2030, using 2023 as the benchmark year. Furthermore, we commit to purchasing high-quality carbon credits to offset any residual Scope 1 and 2 emissions from 2030 onwards that cannot be avoided or reduced (expected to be 25% of 2023 baseline).

…

Our commitment to purchasing and retiring carbon offset credits starting from 2030 may also create potential liabilities under IAS 37 when those future emissions arise. In our annual financial statements, we have not recognised a liability for these carbon credits at 31 December 2024 because there is no present obligation at that date.

...

Our transition plan has a number of other financial statement impacts, as explained in Notes X, XX and XX to the financial statements for the year ended 31 December 2024.

*This disclosure is not intended to illustrate how to apply the requirements of any specific sustainability reporting framework.

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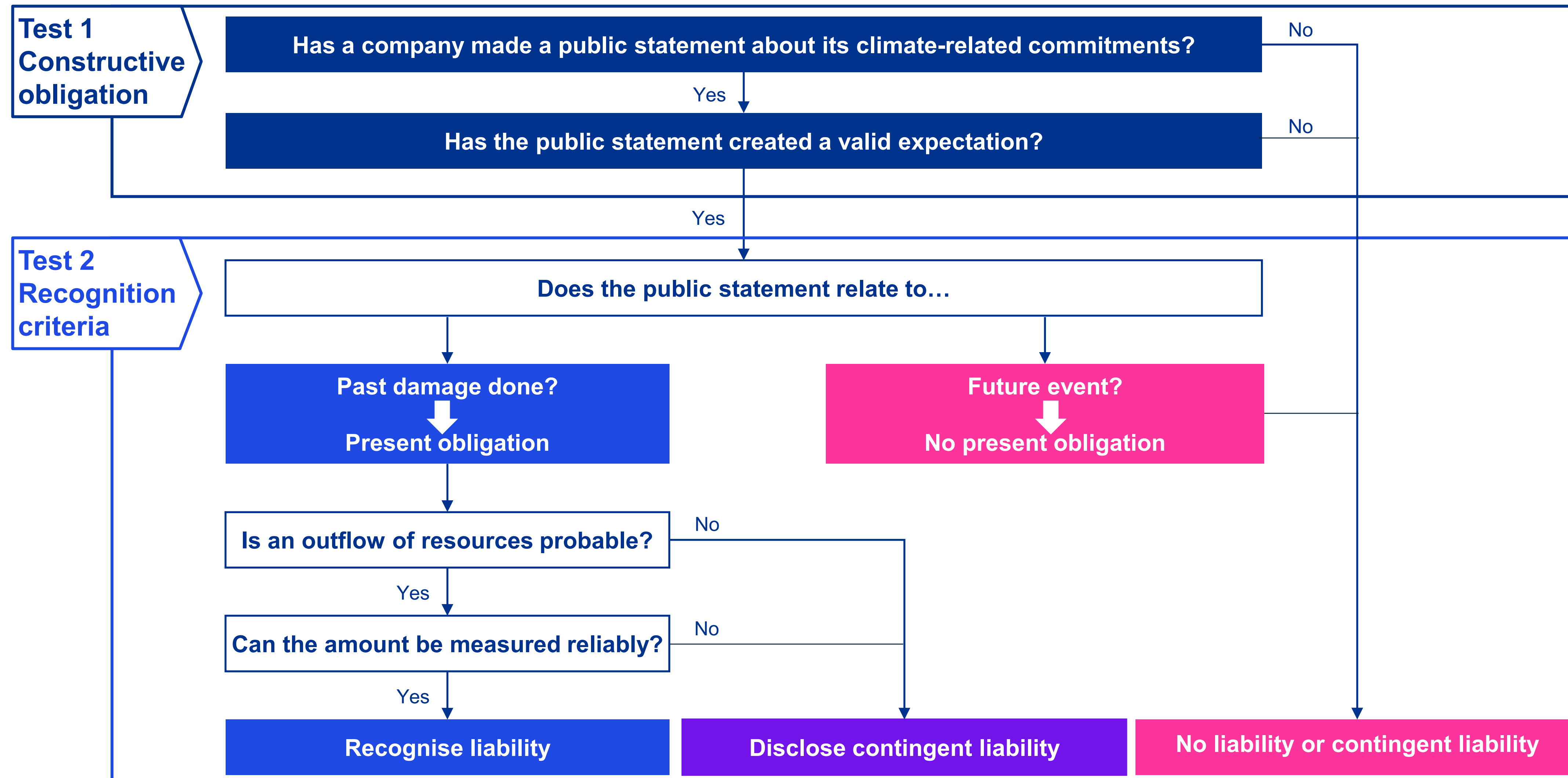
Appendix – Two-test approach at a glance



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