Interpretations Committee of the International Accounting Standards Board (**'Interpretations Committee'**)

IFRS Foundation

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For the attention of Bruce McKenzie, Chairman of the Interpretations Committee

October 2023

Submission: Recognising a provision for a Net Zero Transition Commitment as a constructive obligation

'A **Net Zero Transition Commitment** is a sufficiently specific statement and/or established patterns of past practice through which an entity has indicated to other parties—including the public at large—that it has accepted responsibility to reduce carbon emissions and as a result of which has created a valid expectation that it will reduce those emissions. An example is '*50% reduction in Scopes 1 and 2 emissions by 2030*'. Other examples are below.

This submission is being made to the Interpretations Committee by the Rethinking Capital community and The Catatysts.io Limited. It concerns the key question of whether a Net Zero Transition Commitment meets the criteria to be recognised as a provision under IAS37 (Provisions, Contingent Liabilities & Contingent Assets) as a 'constructive obligation'.

This submission also explains:

- The perceived market distortion and other negative economic and other effects of the current accounting practice of not providing for a Net Zero Transition Commitment as a constructive obligation, and

- the positive future economic and other benefits that would flow from providing for a Net Zero Transition Commitment as a constructive obligation and an entity investing to meet the commitment over time.

Net Zero Transition Commitments began to be made at scale in early 2020 following the commitments of oil and gas leaders to transition out of fossil fuels and into a mix of fossil fuels and new energy technologies by 2050—with interim steps to reduce emissions in Scopes 1 and 2, typically by 2030. In the run up to the United Nations' COP26 in Glasgow in December 2021, driven by valid expectations of the public at large, many hundreds of companies, cities and countries followed and set both end state and interim net zero targets to reduce carbon emissions over time.

To our knowledge, no company has so far recognised and provided for its Net Zero Transition Commitment as a constructive obligation, nor explained why not. Among the negative effects of this are that the incentives to transition to net zero are upside-down, explained in the supporting presentation '*Tackling the Root Cause of Climate Inequity'.*

It is acknowledged that the IASB is currently developing proposals to amend IAS37 which could be issued in 2025. The purpose of this submission is to establish that a valid interpretation of IAS37 could provide a bridge in time and the financial incentives to enable business, investors and others to make better informed decisions to tackle the climate crisis now. The timing imperative was emphasised on 20th September 2023 by UN Secretary General Antonio Gutteres describing that, in failing to tackle the climate crisis, 'humanity has opened the gates of hell'.

This submission therefore requests that the Interpretations Committee consider the interpretations that:

1. A Net Zero Transition Commitment meets the definition of a constructive obligation under IAS37 paragraphs 10 and 20, and

2. A Net Zero Transition Commitment should be recognised as a provision according to the principles of paragraphs 11-26 of IAS37, and

3. Starting with recognising a provision, the principles and accounting for asset decommissioning should be applied to a strategy and investment program designed to meet a Net Zero Transition Commitment—using the analogy that an entity is committing to decommission its carbon-emitting infrastructure.

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1. Definitions

In this submission these words mean:

Words	Meaning
Net Zero Transition Commitment	A sufficiently specific statement through which an entity has indicated to other parties—including the public at large—that it has accepted responsibility to reduce carbon emissions and as a result of which has created a valid expectation that it will reduce those emissions. The sufficiently specific statement may have been supported by published polices and/or Established Patterns of Practice (as defined below). Examples are below, illustrating also that a common language and concepts exist including definitions of Scopes 1, 2 and 3 emissions and how they are reliably measured and reported. The entity may have created and reflected its Net Zero Transition Commitment in a transition plan describing how emissions can be reduced and possibly describing the technical, economic and other constraints to this being achieved. A Net Zero Commitment can be any or all of: 1. An entity committing to be 'net zero or 'carbon neutral' or similar words by a future date, say 2050' (**End State Commitments**). End State Commitments can sometimes be described as 'Paris-Aligned' or 'in line with IPCC Pathways' or 'science-based targets' or similar—indicating an intention to recognise the general imperative to remain within a 1.5 degrees centigrade increase (**System Level Imperative**). 2. An entity committing to interim targets to reduce carbon emissions by percentages such as 25, 30 or 50% by an interim date such as 2030 or 2035 and/or to reduce specific amounts or ranges of emissions reductions by target dates (**Interim Commitments**). 3. An entity in the oil and gas sector describing how emissions will be reduced through actions including (a) changing the products it produces and sell, for example by replacing fossil fuel production with renewable energy production and/or (b) repurposing petrochemical plants to produce chemicals using raw materials from renewable sources (c) purchasing carbon credits or offsets (d) investing into innovations such as carbon capture or direct air capture (e) investing into exploration of renewable energy sources (**Oil and Gas Sector Commitments**).

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	4. Entities in other sectors with high carbon emissions including steel, chemicals, mining and concrete (known as 'hard to abate' sectors, described further in the mission of the Mission Possible Partnership) setting out sector-level strategic plans to meet an End State Commitment across the sector, typically also making an Interim Commitment and participating in initiatives to create sector-specific pathways to Net Zero (**Sector-Specific Commitments**). 5. Entities typically in the consumer product sector responding to consumer expectations by making commitments for the entity and its supply chain and the consumers of its products. For example an Interim Commitment to 'carbon neutrality of direct operations (scopes 1+2) by 2025' and/or 'net-zero emissions of value chain (scopes 1+2+3) by 2040' (**Consumer Commitments**). 6. An entity committing to actions that have the secondary effect of reducing carbon emissions. Examples are (a) to reduce tonnes of plastic waste which has a secondary effect of reducing carbon emissions in the plastic production process or (b) investing in regenerative farming or land use preservation to increase nature's capacity to sequester carbon or (c) other forms of what are known as nature-based solutions (**Secondary Effect Commitments**). 7. An entity, for example in the cloud computing sector, committing to accelerate its net zero targets and End State Commitment by identifying how to achieve that target with certainty through a combination of moving to cloud data centres and purchasing carbon credits and/or offsets to accelerate to '20 years ahead of target' (**Acceleration Commitments**). 8. An entity stating that its operations are already carbon neutral and will remain so in future—for example by emissions being offset through the purchase of carbon credits (**Current State Commitments**). 9. An entity stating that it will be 'carbon negative' by a future date and/or that it will repair its past emissions (**Beyond Net Zero Commitments**). Although sometimes described as either 'ambitions' 'aspirations' or 'pledges' by those making them, for these purposes these and other similar statements are defined as a Net Zero Transition Commitment.
Established Patterns of Practice	Established patterns of practice by the entity over time can indicate that it recognises the obligation and/or updates and reports on its progress in meeting the Net Zero Transition Commitment, including all or any of actions such as: 1. Stating the commitment on its website or otherwise in public. 2. In the narrative to or otherwise stated in its financial statements. 3. In investor presentations. 4. By creating and/or publishing a net zero transition plan. 5. By allocating capital into meeting the obligation, which would be wasting resources if it were not an obligation.

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	6. By the entity joining programs to work on the net zero transition and sustainability generally. 7. In its statements made when 'walking back' from the commitment (including the original commitment still being on its website) that recognise the original commitment. 8. By Consumer Commitments and other valid expectations set with Net Zero Focused Consumers.
Net Zero Focused Consumers	Consumers of an entity who are conscious of whether and to what extent the entity is making decisions purposed to reduce its carbon emissions and who are or may be taking into account the entity's Net Zero Transition Commitment and its Established Patterns of Practice in their buying decisions. These decisions may include paying higher prices to share in the cost of the transition to net zero—thereby effectively contributing financially to the entity and improving the entity's cashflows.
Net Zero Focused Investors	Investors of an entity who are conscious of whether and to what extent the entity is making decisions purposed to reduce its carbon emissions, and who are or may be taking into account the entity's Net Zero Transition Commitment and its Established Patterns of Practice in their investment decisions. These investors may be accepting lower economic returns in the short term in return for long-term growth and the lowering of economic risks to the entity from the climate crisis over time—thereby effectively contributing economically to share in the cost of the net zero transition. These investors can be referred to by descriptions such as ESG, impact, sustainable, responsible or similar.

2. About Net Zero Transition Commitments

The imperative that seemed to both force and enable Net Zero Transition Commitments to be made at scale was COP26 in Glasgow in 2021 and, in particular, the climate crisis being described in its annual report by the Intergovernmental Panel on Climate Change (IPCC, the United Nation's body for assessing the science related to climate change) as 'code red for humanity' in 2021. After the 2023 IPCC report UN Secretary General Antonio Gutteres has referred to this being '*The Age of Global Boiling*'. And in his 20th September 2023 address to the United Nations conference in New York, Gutteres described how, in failing to tackle the climate crisis, '*humanity has opened the gates of hell*'.

Net Zero Transition Commitments began to be made at scale in early 2020 following commitments in the oil and gas sector to transition out of fossil fuels and into a mix of fossil fuels and new energy technologies, typically by 2050 with interim steps towards that target, typically by 2030. In response, thousands of companies made Net Zero Transition Commitments. The significance in the corporate sector cannot be understated because, according to research, 20% of embodied carbon emissions can be traced back to the global supply chains of multinational corporations. As a further response, Net Zero Focused Investors in listed companies made their own Net Zero Transition Commitments, individually and in groups such as the Glasgow Financial Alliance on Net Zero (GFANZ), Climate Action 100+, and the Net Zero Asset Owners Alliance. Together these alliances, representing hundreds of trillions of dollars of assets under management themselves 'committed' to the net zero imperative—and on the basis of which those Net Zero Focused Investors then made their own Net Zero Transition Commitments to their own investors and other stakeholders.

According to research from NetZeroClimate.org at Oxford University, some 1266 of the 2000 largest listed companies have made a Net Zero Transition Commitment, according to its 2023 Net Zero Stocktake Report. The report summary states:

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- *65% of the annual revenue of the world's largest 2000 companies is now covered by a net zero target, demonstrating that net zero is becoming a corporate norm.*
- *There has been a huge rise in targets enshrined in national legislation or policy in the last 2.5 years, from 10% to 75%. The authors say this shows that net zero has moved from ambition to implementation.*
- *Integrity is lacking; there are few signs of improvement in national, subnational and company net zero strategies over the past year.*

With which parties has a valid expectation been set?

It is our view that a valid expectation has been set:

(a) In the capital markets, with Net Zero Focused Investors many of whom have adopted a strategy of staying with the company and '*greening it*' over time. And committing to take lower financial returns in the short term in order to meet the net zero imperative with the expectation of increased shareholder value over time.
(b) In the capital markets with Net Zero Focused Investors joining alliances to support the net zero targets such as GFANZ, the Climate Action 100+, Net Zero Asset Owners Alliance and Net Zero Asset Managers Alliance. Investors within these groups have then made their own commitments within and to these groups and, by fiduciary duty, to their own investors and the public at large.
(c) In the capital and insurance markets with a similar Net Zero Insurers Alliance.
(d) With the capital markets themselves where the International Organization of Securities Exchanges (IOSCO) has committed to support and adopt new standards in climate and sustainability reporting.
(e) In the capital markets and otherwise, for boards and in particular non-executive directors, who have a duty of care to investors and to their company to hold management to account. And for whom, the entity not recognising a Net Zero Transition Commitment could even open the risk of personal liability.
(f) In the capital markets and generally to comply with and simplify the creation of transition plans—a project in which the Transition Transparency Taskforce has been active since COP26 in Glasgow in 2021.
(g) With suppliers and other stakeholders of the entity and which has just published its first Disclosure Framework.
(h) With Net Zero Focused Consumers from whom an entity would expect to receive future economic benefits in reliance on the Net Zero Transition Commitment.
(i) With the public at large who may be users, staff or have other stakeholder relationships with an entity and from whom an entity would expect to receive future economic benefits in reliance on the Net Zero Transition Commitment.

3. Negative economic and other effects of non-recognition of a provision

3.1 The accounting practice of not recognising a Net Zero Transition Commitment as a provision

Despite all these Net Zero Transition Commitments having been made:

- To our knowledge, no entity has recognised a provision for a Net Zero Transition Commitment a constructive obligation applying the principles of paragraphs 10 and 20 and 11-26 of IAS37.
- To our knowledge, nor has any entity explained why its Net Zero Transition Commitment is not being recognised as a provision as a constructive obligation.

It is mostly beyond the scope of this paper to discuss why. Our opinion is described in the presentation '*Tackling the Root Cause of Climate Inequity*' attached with this submission—suggesting why the problem may simply have become too big to recognise. Given the time imperative to act in the face of the climate crisis, it is recommended that non-recognition is accepted as fact and that the emphasis be placed on providing a solution to the problem that benefits the entity and all those with whom a valid expectation may have been created.

3.2 Market distortion and other economic effects of non-recognition

In our view, the consequences of non-recognition of a Net Zero Transition Commitment include:

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(a) Upside down incentives. That an entity is then disincentivised from making investments to meet the commitment because it cannot then recognise investments with the purpose of meeting the commitment as assets on the balance sheet. The effects here include that it '*appears*' that returning excess profits of the energy crisis (some $298 billion in 2022-23) to investors through share buybacks and dividends, is a better investment than investing into the balance sheet through meeting or accelerating the Net Zero Transition Commitment. This benefit also not therefore being taken into account in credit rating analysis.

(b) Mindset effect. That a mindset has been created that deciding to allocate capital into meeting the Net Zero Transition Commitment may risk missing projected and assumed growth rates and/or negatively impact profitability in the short term.

(c) Pressure to walk back. As shown by recent events in the oil and gas sector, pressure can be applied by investors that are not Net Zero Focused Investors to reduce an End State Commitment and the Interim Commitment even though Net Zero Focused Investors expect or may want the entity not to reduce it. This practice of 'walking back' on a Net Zero Transition Commitment then sets the tone for others in the market to do the same. This distortion is unfavourable to the economic interests of Net Zero Focused Investors, for whom Net Zero Transition Commitments should be assumed to 'become' and be priced as obligations in the future—whether by regulation or a carbon tax for example.

(d) Low accountability for stewarding economic resources. In that those parties with whom a valid expectation has been set are not able to hold the entity and its board accountable and/or that progress against meeting the target is not transparent in the annual published financial statements. And further that non-executive directors and boards are not able to hold their entities accountable or assess management's stewardship of the entities economic resources—a principle enshrined in the IASB Conceptual Framework for example in paragraphs 1.3, 1.13, 1.15, 1.16, 1.18, 1.20, 1.22 and 3.2.

(e) Consumers affecting. In that Net Zero Focused Consumers are not able to make informed decisions.

4. Proposed solution: recognising a provision for a Net Zero Transition Commitment as a constructive obligation

The proposed solution is described in the three submission questions, which are answered here and supported by the relevant paragraphs of IAS37.

Interpretations for submission

<u>Interpretation 1: A Net Zero Transition Commitment meets the definition of a constructive obligation under IAS37 paragraphs 10 and 20</u>

Paragraph 10: definition of a constructive obligation

'A constructive obligation is 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.*

(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: the obligation may be to the public at large

An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—<u>indeed the obligation may be to the public at large</u>. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

It is submitted that a Net Zero Transition Commitment does meet the definition of paragraphs 10 and 20 for these reasons:

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Reason 1: Decision logic

In making a Net Zero Transition Commitment, what logically were the directors of an entity doing? Deductive logic says that they were:

(a) recognising that a social norm was being established and recognising an obligation to investors, the public at large and other stakeholders to reduce carbon emissions.

(b) committing to a program to reduce emissions over time through a series of emission reduction targets from current emissions state to an end state or an interim state.

(c) to the extent possible when making Interim Commitments, making a decision on what emissions could be most easily achieved in a shorter timeframe to 2030—reflecting the System Level Imperative.

Reason 2: Separating the definition of a constructive obligation

Does the obligation derive from the entity's actions?

This is a matter of fact. It seems clear from each of the categories and examples reviewed that a first Net Zero Transition Commitment and then each category came from the entity, typically announced by the Chief Executive Officer or another executive level member or board member. And was then typically followed by an Interim Commitment and more granular commitments specific to the entity. Further, the entity typically then created all or any of the Established Patterns of Practice, itself recognising its own commitment.

Put another way, no third party either made the commitment and/or created the Established Patterns of Practice. Though with net zero transition plans there is evidence that Net Zero Focused Investors reacted and worked with the entity in its creation.

Concluding that the obligation has derived from the entity's own actions.

Three part logic

The following three part logic can be applied to sub-paragraph (a) of paragraph 10.

'A constructive obligation is 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.

Part 1: Strength

A Net Zero Transition Commitment can be seen as the implied terms of a contract between the entity and its stakeholders to reduce emissions over time—including investors, nature as a stakeholder from whom the entity uses resources, the public at large, staff, etc. Strength recognises the reality that achieving a Net Zero Transition Commitment is hard and needs to rethink well-established business strategies and practices and be balanced against the entity's need to be financially sustainable. Strength is a continuum ranging from:

(1) an End State Commitment which will typically be longer term (2040 or 2050) but typically expressed to be guided by the System Level Imperative acknowledging that action is needed now and over time.

(2) shorter or near term Interim Commitments with increasingly granular elements that describe what the entity can commit to now and work towards now with certainty.

Part 2: Nature

There is no realistic alternative to avoid future economic outflows as a result of a Net Zero Transition Commitment and it is only a matter of quantum. There is also no realistic alternative to avoid because, as the NetZeroClimate.org at Oxford University, 2023 Global Stocktake Report states '*There has been a huge rise in targets enshrined in national legislation or policy in the last 2.5 years, from 10% to 75%. The authors say this shows that net zero has moved from*

ambition to implementation' indicating a possible shift from not only a constructive obligation to a legal obligation (explained further below). And the reason that a commitment is to be met over time is the entity recognising that outflows must be balanced against the requirement that the entity is financially sustainable over its duration. Nature is also a continuum from:

(1) the higher certainty of the quantum of outflows needed over the shorter term to meet Interim Commitments, typically described in a net zero transition plan or other Established Patterns of Practice.

(2) the lower certainty of the quantum of outflows over the medium to long term.

Part 3: Timing

Timing is determined by dates expressed in the commitment itself. Timing seems typically to acknowledge the System Level Imperative and also the extent to which the entity can meet the Strength and Nature elements. Timing is also a continuum from:

(1) the shorter term Interim Commitments and steps in between typically described in a net zero transition plan or other Established Patterns of Practice;

(2) the medium or longer term beyond Interim Commitments and towards End State Commitments.

Logical general principles

Using these three criteria, three logical general principles can be established consistent with management's stewardship of the entities economic resources:

Principle 1: any Net Zero Transition Commitment meets the Strength, Nature and Timing criteria but

Principle 2: Longer Timing gives greater uncertainty in quantum of outflows in Nature and consequently must be lower in Strength, and

Principle 3: Shorter Timing gives greater certainty in quantum of outflows in Nature and is consequently can be greater in Strength.

The analogy here is a new business strategy, often called a pivot, to transition from a current to a new business model over time. Naturally in business (and life) longer timeframes must mean higher uncertainty.

Reason 3: Analysis of each category of Net Zero Transition Commitment

No	Category	Strength	Nature	Timing	Meets the general logical principles
1.	End State Commitments	Yes, particularly when combined with Interim Commitments and other categories.	Yes, because the starting state and the end state can be reliably and independently measured and verified.	Yes, particularly when combined with Interim Commitments and other categories.	Yes
2.	Interim Commitments	Yes, particularly when supported by Established Patterns of Practice.	Yes, because the starting state and the end state can be reliably and independently	Yes, particularly when supported by Established Patterns of Practice.	Yes

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			measured and verified.		
3 to 8.	Each or any combination of: Oil and Gas Commitments Sector-Specific Commitments Consumer Commitments Secondary Effect Commitments Acceleration Commitments Current State Commitments Beyond Net Zero Commitments	Yes, particularly when supported by Established Patterns of Practice.	Yes, because the starting state and the end state can be reliably and independently measured and verified.	Yes, particularly when supported by Established Patterns of Practice.	Yes

A legal obligation under paragraph 10 of IAS37?

We believe that as net zero transition plans become increasingly required and enforceable by legislation and litigation actions to require accountability for existing fiduciary and other duties grow, prudence in stewardship supports the argument that a Net Zero Transition Commitment has already or will become a 'legal obligation' as defined in paragraph 10 of IAS37:

A legal obligation is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

Reason 4: Has the Net Zero Transition Commitment created valid expectations under paragraph (b) and do these include the public at large?

'A constructive obligation is an obligation that derives from an entity's actions where:

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities'.

It is submitted that a valid expectation has been created with a range of stakeholders. And that this was the intended purpose of making it. In particular a valid expectation has been created with Net Zero Focused Investors and Net Zero Focused Consumers because each can have a material impact on the entity's operating success and hence its share price and the value of its debt obligations.

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Net Zero Focused Investors have typically adopted an investment strategy of staying with the company and '*greening it*' over time. And committing to take lower financial returns in the short term in order to meet the net zero imperative with the expectation of increased shareholder value over time. A constructive obligation would be supported if it could be shown that Net Zero Focused Investors either made decisions to purchase or to continue to hold the entities debt or equity securities, at least in part, because of the commitment.

In the capital markets many Net Zero Focused Investors joined alliances to support the net zero targets such as GFANZ, the Climate Action 100+, Net Zero Asset Owners Alliance and Net Zero Asset Managers Alliance. Investors within these groups have then made their own commitments within and to these groups and, by fiduciary duty, to their own investors and the public at large. A constructive obligation would be supported if it could be shown that Net Zero Focused Investors either made decisions to join these groups and make their own commitments, because of the entities in which they hold equities making a commitment.

Valid expectations have been created with Net Zero Focused Consumers from whom an entity would expect to receive future economic benefits in reliance on the Net Zero Transition Commitment. Often advertising by the entity will emphasise the commitment. And with the public at large who may be users, staff or have other stakeholder relationships with an entity and from whom an entity would expect to receive future economic benefits in reliance on the Net Zero Transition Commitment. A constructive obligation would be supported if it could be shown that Net Zero Focused Consumers had made decisions to purchase the entity's products, at least in part, because of the Net Zero Transition Commitment made by the entity at some point during the past (past action of the entity and related stakeholder transactions).

Similarly a decision by staff to seek or continue employment with the entity based on its commitment supports the existence of a constructive obligation.

It is further submitted that valid expectations have been created:

(a) In the capital and insurance markets with a similar Net Zero Insurers Alliance.
(b) With the capital markets themselves where the International Organization of Securities Exchanges (IOSCO) has committed to support and adopt new standards in climate and sustainability reporting.
(c) In the capital markets and otherwise, for boards and in particular non-executive directors, who have a duty of care to investors and to their company to hold management to account. And for whom, the entity not recognising a Net Zero Transition Commitment could even open the risk of personal liability.
(d) In the capital markets and generally to comply with and simplify the creation of transition plans—a project in which the Transition Transparency Taskforce has been active since COP26 in Glasgow in 2021.
(e) With suppliers and other stakeholders of the entity.

Interpretation 2: A Net Zero Transition Commitment should be recognised as a provision according to the principles of paragraphs 11-26 of IAS37.

It is submitted that the Net Zero Transition Commitment is a constructive obligation and should (or is required to be) be recognised as a provision according to the principles of paragraphs 11-26 of IAS37 for these reasons:

Reason 1: Paragraph 14 of IAS37

A provision shall be recognised when:	Analysis
(a) an entity has a present obligation (legal or constructive) as a result of a past event;	The entity has a present obligation because the Net Zero Transition Commitment has been made and has set a valid expectation that it will be met over time in a series of emission reduction targets. Established Patterns of Practice by the entity over time create new past events by indicating that it recognises the original Net Zero Transition Commitment. See Interpretation Submission 1 for further analysis.

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(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and	In commercial reality, the entity can realistically only meet the Net Zero Transition Commitment through a transition strategy and plan of investment into innovation that may include buying carbon credits. Net zero transition plans are typically created to explain the transition strategy and plan with specific focus on Interim Commitments that can probably achieved. See Interpretation Submission 1 for further analysis.
(c) a reliable estimate can be made of the amount of the obligation.	Reliable prices and price ranges for a tonne of carbon that are 'standard enough' already exist and are in the public domain with support from the G7 and others. Simultaneously with review of this submission the Rethinking Capital community intend to publish a paper explaining their thinking and rationale for how and from where a board should select its carbon price to reliably estimate the constructive obligation and investments made with the purpose of meeting it.

Reason 2: Further supporting paragraphs of IAS37

Paragraph	Analysis
17. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only: (a) where the settlement of the obligation can be enforced by law; or (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.	17 (b) specifically covers a constructive obligation being an obligating event.
19. 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. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.	The example of asset decommissioning of a nuclear power station is analogous and explained in the answer to Interpretation Submission 3 below. The entity cannot avoid future expenditure to meet the Net Zero Transition Commitment.
21. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the	Established Patterns of Practice represent acts that give rise to the constructive obligation being repeated and updated.

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entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.	

Interpretation 3: Starting with recognising a provision, the principles and accounting for asset decommissioning should be applied to a strategy and investment program designed to meet a Net Zero Transition Commitment—using the analogy that an entity is committing to decommission its carbon-emitting infrastructure.

The business principles, strategies and accounting for 'asset decommissioning' are well-established. They provide a good parallel in both business and accounting terms for the strategy and investment program designed to meet the Net Zero Transition Commitment—or to decide not to meet it. Paragraph 19 of IAS37 specifically mentions the established principles of asset decommissioning and in particular that of a nuclear power station is analogous.

From a business and strategy perspective, in making the Net Zero Transition Commitment, the entity is effectively committing to 'decommission its carbon emitting infrastructure and business practices' over time through a series of emission reduction targets that may be reflected in a net zero transition plan. The implied 'contract' terms can be determined from the Net Zero Transition Commitment itself and by the associated Interim Commitments and any of the other commitment categories set out in paragraph 2, together with associated Established Patterns of Practice.

The Strength, Nature and Timing and other terms of the Net Zero Transition Commitment explained in Submission Interpretation 1. may alter over time during the commitment periods (an entity may increase the emissions to be reduced and/or accelerate the commitment date and/or set granular targets for example) each of which would alter the terms.

And as with contracts for asset decommissioning, the entity should consider in its strategy, program and accounting the probability that it will (a) meet the commitment targets—and that meeting those targets will create future inflows of economic resources (the equivalent of milestone or similar payments in contracts for decommissioning a nuclear power station) or (b) miss the commitment targets and incur future outflows of economic resources (the equivalent of penalties for delays or missed targets in contracts for decommissioning a nuclear power station).

The accounting treatment for asset decommissioning having recognised the provision is well established, both in IAS37 and in accounting practice. The equivalent accounting treatment for investments purposed to meet the Net Zero Transition Commitment would be to capitalise expenditure into innovation, carbon credits and other assets at cost of creation and to either revalue or impair those investments depending on whether they achieved their intended purpose of reducing emissions in the year in question.

A note to the financial statements would be made to explain that the Net Zero Transition Commitment will be met over time in a series of annual emission reduction targets and to refer users to the strategy and transition plan for meeting it. This note would also explain the associated accounting treatment and be updated at least annually.

5. Future economic and other benefits of the proposed solution and path to adoption

The six main features and benefits of the proposed solution for the entity, Net Zero Focused Investors, Net Zero Focused Consumers, boards, capital markets, the public at large and other stakeholders will be:

(a) **Better informed decisions and stewardship.** Enabled by accounting for and governing the assets, obligations and risks impacted by the Net Zero Transition Commitment and the associated strategy and plan to meet it.

(b) **Many key financial metrics will materially improve.** As the entity allocates capital into and achieves its Net Zero Transition Commitment over time, each of profitability, shareholder equity, earnings per share, return on equity and debt to equity ratios will materially improve. It may be that the entity could appear to be more highly leveraged when it recognises the provision at the start of the year in question but the accounting treatment explained in the suggested note can explain that this appearance is necessary to recognise the future economic benefits of meeting the commitment.

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(c) **Creates positive, immediate and certain incentives**. Giving the financial incentives to invest into meeting the Net Zero Transition Commitment and incentives to accelerate—flipping today's upside down incentives.

(d) **Should remove the risk of personal liability for directors and officers**. By demonstrating that the Net Zero Transition Commitment is being recognised and investments made to meet it recognised as assets.

(e) **Transparency of the important management decisions**. Using financial statements to inform and report decisions to allocate capital to the transition in annual budget setting and strategic planning.

(f) **Accountability to internal and external stakeholders**. Showing stakeholders that the board and management are taking conscious decisions to govern economic resources impacted by the Net Zero Transition Commitment.

5.2 Path to adoption as a decision governance and parallel reporting framework & should or could?

Market based adoption

The path to adoption of the proposed solution can be determined by the market. It could be voluntarily adopted by an entity (probably after testing on previous capital allocation decisions), required by Net Zero Focused Investors and/or required by regulators and stock exchanges.

As is already standard practice in capital markets, Net Zero Focused Investors could require entities to apply it to govern and report capital allocation decisions in strategic planning and/or budgeting, either to meet a Net Zero Transition Commitment or deciding not to. And to parallel (or shadow) report these to organisations that are already active in carbon reporting such as CDP or Carbon Tracker. How reported decisions could be audited and assured can also be left to the market to determine. Such disclosures could appear in the notes to the financial statements to provide the information to Net Zero Focused Investors and Net Zero Focused Consumers and other stakeholders—while avoiding any unforeseen or unintended consequences from immediate recognition on the statement of financial position. This would be analogous to the evolution of the accounting treatment of employee stock options that occurred in the notes prior to formal recognition that appeared on the statement of financial position.

Applying normative accounting principles (in particular the subjectivity of value and the needs of the user) financial statements using the proposed solution are able to validly sit alongside existing published statements. This may require the entity to explain the reconciliation between both.

As is also standard practice in capital markets, Net Zero Focused Investors (and other affected stakeholders) could create their own financial statements applying the proposed solution from the outside for the purposes of their own decision-making.

Should or could?

For the purposes of enabling market based adoption, it is submitted that the word 'should' can be replaced with 'could' in Submission Interpretations 2 and 3.

6. Counter argument against recognition of a provision as a constructive obligation

The only argument identified against recognition and provision as a constructive obligation is the application to a Net Zero Transition Commitment previously made, say in 2020, but which has not so far been recognised as a constructive obligation and a provision by the entity. Here, the entity may have made decisions since:

(a) to invest into meeting the Net Zero Transition Commitment assuming that investments will be expensed through the income statement, effectively penalising investments into programs that have the intent and purpose of meeting the commitment. This would also have resulted in operating cash outflow classification that reinforced the impression that the board, investors and other stakeholders should not view them as investments into the future.

(b) to reduce the extent of its commitment, particularly Interim Commitments to reduce the percentage of emissions by 2030, as has been seen in 2023 in the oil and gas sector and known as 'walking back'. If not

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previously recognised as a constructive obligation, these reductions in the commitment may create materially negative economic effects including a possible charge to shareholder equity or the income statement.

The recommended logical alternative to restating financial statements backwards to the date of the original Net Zero Transition Commitment would be for the entity to update and restate its Net Zero Transition Commitment now, particularly its Interim Commitments, assuming that the proposed solution applies. And to restate its associated net zero transition plan now, explaining the reason for recognition now. This new 'past event' would create the present event criteria.

Indeed any entity, whether it has made a Net Zero Transition Commitment to date or not, would be recommended to state or restate its Net Zero Transition Commitment now to achieve the listed benefits above. The resulting accounting treatment would result in better and more complete information for all.

Yours faithfully

Andrew Watson, Co-Founder

The Rethinking Capital community and The Catalysts.io Limited

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