IFRS Foundation

Staff paper

Agenda reference 2

IFRS Foundation Trustees' Due Process Oversight Committee (DPOC) meeting

Date	**March 2024**
Topic	**Correspondence to the DPOC on submissions to the Interpretations Committee on climate-related commitments—cover note**
Contacts	**Henry Rees (hrees@ifrs.org)**

This document is prepared for discussion at a public meeting of the IFRS Foundation Trustees' Due Process Oversight Committee (DPOC). The Trustees are responsible for governance of the IFRS Foundation, oversight of the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB), and for delivery of the IFRS Foundation's objectives as set out in the IFRS Foundation *Constitution*.

Purpose

1. This paper updates the Due Process Oversight Committee on recent correspondence from Rethinking Capital relating to the Interpretations Committee's work on climate-related commitments.

2. As previously advised, the Chair of the DPOC received:

   (a) a letter from Rethinking Capital, dated 29 February 2024—this was shortly before the Interpretations Committee's meeting on 5 March; and

   (b) a supplemental letter from Rethinking Capital, dated 8 March—this was shortly after the Interpretations Committee's meeting.

3. These letters are attached as Appendix B and Appendix C to paper 2A for this meeting.

Protocol for perceived breaches of due process

4. Section 9 of the *Due Process Handbook* specifies a 'Protocol for Trustee action for perceived breaches of due process'. Rethinking Capital stated that its letters are sent under paragraph 9.1 of this Protocol.

5. As the Protocol notes, any alleged breaches of due process are considered within the context of the DPOC's ongoing oversight of the [boards'] and the Interpretations Committee's due process.

6. Applying the Protocol, the Foundation staff:

   (a) posted the two letters to the DPOC's webpages on 29 February and 11 March in accordance with paragraph 9.3.

   (b) sent the DPOC a paper responding to the letters that was prepared by IASB technical staff involved in the Interpretations Committee's work. This paper (paper 2A) will be discussed at the DPOC's meeting on 21 March at which the Chair of the Interpretations Committee and the Chair and Vice-Chair of the IASB will be present. This meeting, as with other DPOC meetings, will be webcast and the papers available on the website.

7. As explained in the technical staff's paper, the Interpretations Committee unanimously decided to finalise its Agenda Decision at its 5 March meeting. However, before any agenda decision is published,

the IASB is asked whether it objects to the agenda decision (in accordance with paragraph 8.7 of the Handbook). The Agenda Decision on Climate-related commitments is therefore due to be presented to the IASB at its April meeting.

IFRS Foundation staff conclusion

8. IFRS Foundation staff has reviewed the technical staff's paper (paper 2A for this meeting) in response to Rethinking Capital's two letters as well as the three papers that the technical staff prepared for the Interpretations Committee's meeting on 5 March.

9. The Foundation staff is of the view that all the due process requirements to date relating to the Agenda Decision have been met. In particular, the Interpretations Committee:

   (a) exposed its Tentative (ie draft) Agenda Decision for comment for 60 days as required by paragraph 8.2 of the *Handbook*);

   (b) considered the comments received from stakeholders in response to the Tentative Agenda Decision at its 5 March meeting before unanimously deciding to finalise the Agenda Decision.

10. The Foundation staff notes that the comments in the 43 comment letters on the Tentative Agenda Decision as well as the second submission referred to in Rethinking Capital's letters to the DPOC were comprehensively analysed in the staff papers for the Interpretations Committee meeting on 5 March. We consider that these papers provided the Committee with sufficient information to make informed decisions.

Questions for the DPOC

1. Does the DPOC agree that due process requirements (to date) have been met?
2. Does the DPOC authorise the DPOC Chair to respond to Rethinking Capital to:
   (a) confirm that the DPOC has considered its letters and has confirmed that due process requirements have been met; and
   (b) respond to concerns expressed in the letters about the perceived independence of the Interpretations Committee members, especially those representing accounting firms, as set out in paragraphs 29–33 of paper 2A.

IFRS Foundation

Staff paper

Agenda reference 2A

IFRS Foundation Trustees' Due Process Oversight Committee (DPOC) meeting

Date	**March 2024**
Topic	**Correspondence to the DPOC on submissions to the Interpretations Committee on climate-related commitments**
Contacts	**Riana Wiesner (rwiesner@ifrs.org)**

This document is prepared for discussion at a public meeting of the IFRS Foundation Trustees' Due Process Oversight Committee (DPOC). The Trustees are responsible for governance of the IFRS Foundation, oversight of the International Accounting Standards Board (IASB) and the International Sustainability Standards Board (ISSB), and for delivery of the IFRS Foundation's objectives as set out in the IFRS Foundation *Constitution*.

Purpose

1. The purpose of this paper is:

   (a) to provide background to the Interpretations Committee's [draft] Agenda Decision—*Climate-related Commitments (IAS 37)* including the process followed by the Interpretations Committee (paragraphs 3–23);

   (b) to summarise the comments received in the two letters from Rethinking Capital to the chair of the DPOC (paragraphs 25–27); and

   (c) to consider the points raised by Rethinking Capital in those letters in analysing whether the applicable due process requirements have been met (paragraphs 28–37).

2. The paper has three appendices:

   (a) Appendix A—additional information about the requirements for the recognition of a provision in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*;

   (b) Appendix B—first letter received from Rethinking Capital dated 29 February 2024; and

   (c) Appendix C—supplemental letter received from Rethinking Capital dated 8 March 2024.

Background to the Agenda Decision, including the process followed by the Interpretations Committee

First submission to the Interpretations Committee

3. In October 2023, the IFRS Interpretations Committee (Interpretations Committee) received a question from Rethinking Capital asking it to clarify how IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* applies to commitments an entity makes to reduce or offset its future greenhouse gas emissions (net zero transition commitments). The submission described examples of net zero transition commitments, including:

(a) end state commitments—for example, to be 'net zero', 'carbon neutral' or 'carbon negative' (perhaps even to repair past emissions) by a specified future date, say 2050. End state commitments might be aligned with the general imperative to limit global temperature rises to 1.5 degrees Celsius.

(b) interim commitments—for example, to reduce carbon emissions by specified amount, say 50%, by a specified interim date, say 2030.

(c) commitments to actions that have the secondary effect of reducing carbon emissions—for example, to reduce plastic usage.

(d) transition plans of entities in the oil and gas sector—for example, to replace fossil fuel production with renewable energy production, or to repurpose petrochemical plants to produce chemicals using raw materials from renewable sources.

4. The submitters asked the Interpretations Committee to consider their views that:

(a) a net zero transition commitment meets the definition of a constructive obligation;

(b) IAS 37 requires that obligation to be recognised as a provision in the financial statements; and

(c) the accounting requirements in IAS 37 for the costs of fulfilling asset decommissioning provisions can be applied by analogy in determining how to account for the investment required to fulfil a provision for a net zero transition commitment. In other words, the expenditure required to settle provision may be recognised as an asset, rather than as an expense, when the provision is recognised.

5. When we (the staff) receive a submission, we often ask members of the International Forum of Accounting Standard Setters, securities regulators and large accounting firms for information about the prevalence of the matters described in the submission, and about the extent of any diversity in practice. We did not ask them for information in this case because the outreach done as part of the IASB's project on *Climate-related and Other Uncertainties in the Financial Statements* indicated that it might be unclear in some circumstances whether, in applying IAS 37, making a commitment would result in the recognition of a provision. This outreach included consultations with all the IASB's consultative groups as well as meetings with one preparer group, four regulators, four national standard-setters, 14 users or user groups and seven accounting firms.[1]

6. Among other things, Agenda Paper 14B for the September 2023 IASB meeting noted confusion about whether or when a liability should be recognised for the costs of fulfilling climate-related commitments. The IASB decided to refer to the Interpretations Committee a question about the circumstances in which an entity recognises a liability when applying IAS 37 to such commitments. However, soon after

[1] Refer to Agenda Paper 14A for the September 2023 IASB meeting for a breakdown of stakeholders by geographic region and stakeholder types.

that IASB decision, we became aware that the submitters planned to seek clarification on similar matters. Receiving a submission from external stakeholders therefore obviated the need for a referral from the IASB.

7. Prior to the formal submission made to the Interpretations Committee, we had regular interactions with the submitters from July 2023 during which we discussed:

   (a) the role of the Interpretations Committee in supporting the consistent application of IFRS Accounting Standards, including when the Interpretations Committee publishes agenda decisions and what the Interpretations Committee can and cannot do through an agenda decision—in particular that an agenda decision does not add or change requirements in IFRS Accounting Standards;

   (b) the requirements and criteria in paragraphs 5.13–5.19 of the *Due Process Handbook* (the *Handbook*) the Interpretations Committee considers when an application question has been submitted; and

   (c) the process for Agenda Decisions, including the consultation period of 60 days on tentative agenda decisions as set out in paragraphs 8.2–8.9 of the *Handbook*.

The Interpretations Committee's initial consideration of the matter

8. The Interpretations Committee first discussed the questions in the submission at its November 2023 meeting.[2] For that meeting, the staff prepared a paper that provided a summary of the matter and presented our research and analysis—Agenda Paper 2 for that meeting. In that paper, we concluded that the principles and requirements in IAS 37 provide an adequate basis for an entity to determine the required accounting for climate-related commitments as described in the submission. We therefore concluded that the criteria for narrow-scope standard-setting in paragraphs 5.16–5.17 of the *Handbook* were not met and recommended not to add the matter to the standard-setting agenda.[3]

9. The Interpretations Committee agreed with the staff recommendation (all 13 of the members present voted for the staff recommendation—one member was absent). Accordingly, the Interpretations Committee decided to publish a Tentative Agenda Decision that includes explanatory material explaining how IAS 37 applies in determining:

   (a) whether making a climate-related commitment creates a constructive obligation for the entity; and

[2] The meeting was a public meeting and webcast. The recording of and papers for the meeting are available on the website.

[3] If the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the required accounting, then standard-setting is not needed to improve financial reporting by adding or changing requirements in IFRS Standards (paragraph 5.16(b) of the *Handbook*).

(b) whether, if the entity's statement creates a constructive obligation, that obligation satisfies the criteria for recognising a provision. Specifically, the Tentative Agenda Decision explained that a provision is recognised only if:

(i) the entity has a present obligation (legal or constructive) as a result of a past event;

(ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) a reliable estimate can be made of the amount of the obligation.

10. The objective of including the explanatory material was to proactively support consistent application of requirements in IAS 37 to climate-related commitments. The Tentative Agenda Decision was published for comment on 7 December 2023 for 60 days in accordance with paragraph 8.2 of the *Handbook*; the comment period ended on 5 February 2024.

11. Appendix A to this paper includes additional information about the recognition requirements in IAS 37.

Second submission to the Interpretations Committee

12. During the comment period on the Tentative Agenda Decision, the submitters of the original submission submitted a follow-up request. In the second submission, the submitters:

(a) explained what they regard as limitations of the fact pattern described in the Tentative Agenda Decision;

(b) described two other fact patterns and express views on how IAS 37 applies to these fact patterns. Each of the two fact patterns described an emissions reduction commitment similar to that described in the Tentative Agenda Decision, but with additional information about various actions the entity has taken that affirm its intention to fulfil its commitment; and

(c) asked the Interpretations Committee to consider 17 'areas of interpretation' of IAS 37 and the submitters' conclusions on these matters.

13. Some of the information and analysis in the second submission were originally included in the submitters' original comment letter on the Tentative Agenda Decision. When the second submission was made, the submitters' comment letter was amended to remove duplicate information and replaced with the comment letter currently posted on the website.

14. The staff considered the submitters' analysis of the fact patterns in the second submission and the conclusions they reached based on that analysis. We also considered whether the second submission raises new issues that might warrant a second agenda decision or re-exposure of the Tentative Agenda Decision.

15. We considered that the features of the fact patterns described in the second submission:

    (a) did not raise technical issues beyond those already considered by the Interpretations Committee and addressed in the Tentative Agenda Decision; and

    (b) did not affect the conclusions set out in the Tentative Agenda Decision.

16. In our view, the second submission warranted neither a second agenda decision nor re-exposure of the Tentative Agenda Decision on the first submission. We analysed the 17 areas of interpretation raised by the submitters in the context of the Interpretations Committee's conclusions in the Tentative Agenda Decision to assess whether any amendments or additions might be required in the final agenda decision (see Agenda Paper 2B for the March 2024 Interpretations Committee meeting).

The Interpretations Committee's consideration of comment letters and the second submission

17. The Interpretations Committee considered the comments received on the Tentative Agenda Decision at its March 2024 meeting.[4] Three agenda papers were prepared for the Committee's discussion of the topic:

    (a) Agenda Paper 2 *Session overview and draft agenda decision* provided an overview of the matter, including the initial consideration by the Interpretations Committee and the second submission received;

    (b) Agenda Paper 2A *Climate-related Commitments—Comment letter analysis* provided a summary of the comments received from stakeholders and the staff analysis of those comments. Appendix A to that paper provided a breakdown of commentators by category; and

    (c) Agenda Paper 2B *Second submission* provided an analysis of the fact patterns in the second submission and the staff's conclusions on each of the areas of interpretation raised by the submitters.

18. The Interpretations Committee received a higher than normal number of comment letters—43 comment letters in total—from individuals, national standard-setters, accounting firms, accounting associations, organisations involved in sustainability- or impacts-related policy or reporting, preparers, representative bodies of preparers, and organisations representing a group of regulators. Those comment letters included a letter from Rethinking Capital. All comment letters were made available on the IFRS Foundation website, and a link to the relevant page on the website was provided to all Interpretations Committee members and observers.

[4] The meeting was a public meeting and webcast. The recording of and papers for the meeting are available on the website.

19. Most commentators agreed with both the Committee's conclusions and the Tentative Agenda Decision. This included:

    (a) all of the:

        (i) international accounting firms;

        (ii) groups representing primary users of financial statements;

        (iii) securities regulators; and

        (iv) accounting professional bodies;

    (b) thirteen of the fourteen national accounting standard setters;

    (c) four organisations involved in sustainability- or impacts-related policy or reporting;

    (d) two groups representing preparers of financial statements; and

    (e) one other accounting practitioner and one group of academics.

20. Having analysed the comments received (see Agenda Paper 2A for that meeting), the staff concluded that we continued to hold the view that the principles and requirements in IAS 37 provide an adequate basis for an entity to determine how to apply that Standard to climate-related commitments.

21. During the Interpretations Committee's two-hour discussion, several Committee members commented on the fact patterns in the second submission and said that it was useful to use these fact patterns to 'backtest' the tentative agenda decision to determine whether all the relevant requirements and principles were addressed. The Interpretations Committee had a detailed discussion on the analysis of both the comment letters and the second submission and when asked to vote, all 13 Interpretations Committee members present agreed (one member was absent):

    (a) that the second submission warrants neither a second agenda decision nor re-exposure of the tentative agenda decision published in December 2023; and

    (b) to finalise the agenda decision.

22. The Interpretations Committee also decided to make minor amendments to the wording of the Tentative Agenda Decision to add further detail to the fact patterns and include additional explanations in response to the feedback, including the second submission. Since that meeting, we have sent the proposed wording of the Agenda Decision to Interpretations Committee members for their comment (as is our usual process).

23. As the Interpretations Committee has completed all due process steps required to finalise an agenda decision, the IASB will be asked whether it objects to the Ageda Decision at the April 2024 IASB meeting as required by paragraph 8.7 of the *Handbook*. Specifically, the IASB will be asked whether it objects to the Interpretations Committee's conclusion:

(a) that a standard-setting project should not be added to the work plan; and

(b) that the agenda decision does not add or change requirements in IFRS Accounting Standards.

24. If four or more IASB members do not object, the final agenda decision will be published as an addendum to the March IFRIC *Update* and on the website.

Correspondence from Rethinking Capital

25. In the period between the posting of the agenda papers for the March 2024 Interpretations Committee meeting and the meeting on 5 March, the Chair of the DPOC received a letter from Rethinking Capital regarding six governance issues under the *Handbook* and the imperative for a second public consultation on its second submission as discussed in this paper. These six issues, which Rethinking Capital consider could undermine the governing principles of transparency, full and fair consultation and accountability (as stated in paragraph 3.1 of the *Handbook*), are described as follows:

(a) a vital issue to address in tackling net zero's upside down incentives, in which the Interpretations Committee can continue the conversation that has caught hold with long-term investors and the net zero community.

(b) a controversial technical interpretation not helped by the first fact pattern. The fact pattern in the first submission was not a 'real-world' example. The second submission should be considered to be the first substantive discussion.

(c) stopping the conversation within the Interpretations Committee that has really only just begun. Recognising that the First Submission was important to set the three principles, but that further fact patterns and guidance was demanded by comment letters.

(d) the surprising absence of comments from net zero focused investors and investor coalitions. Only one comment letter from pension funds was received. None were received from coalitions.

(e) the surprising absence of comments from the net zero community. One comment letter only was received. None were received from two programs in which the ISSB is actively involved or from an ISSB funder.

(f) the challenge and opportunity for the global audit firms as enablers of this transition in accounting and audit practice. The DPOC may need to think about the perceived independence of the global audit firms' five Committee members.

26. Three days after the March 2024 Interpretations Committee, the Chair of the DPOC received a supplemental letter to confirm whether and to what extent the six governance issues identified in the first letter had been addressed. Rethinking Capital concludes that five of the six governance issues have been addressed and/or will be addressed by actions committed to or discussed in the Interpretations Committee meeting on 5 March. However, they note that the governance issue

regarding the independence and perceived independence of the global audit firms 'should remain a material concern' that the DPOC should consider further, both as part of 'the approval of the final Agenda Decision and as future stages of the IFRS Foundation's programs on Connectivity and Targeted Improvements to IAS 37 are implemented'.

27. In addition, Rethinking Capital notes that, now that the Interpretations Committee has decided not to do a second consultation following its second submission, there are five technical areas they want addressed in the final Agenda Decision for the benefit of the primary users of the financial statements. This includes:

    (a) that the final Agenda Decision includes paragraphs from the fact pattern in the second submission and explain how the IAS 37 requirements are applied to it;

    (b) that the words 'powerful evidence' or similar be included for emphasis of weighting;

    (c) that the 'sequencing' of events are important and that the fact that a provision only released when the last action has taken place, is logical and can be applied by analogy to the actions to meet the commitment itself;

    (d) that the final Agenda Decision should require entities to discuss the critical issue about when a present obligation arise from a past event with their investors and other primary users in determining whether a past event has occurred; and

    (e) adding to the final Agenda Decision a statement that an analogy to asset decommissioning liabilities could be made.

Staff analysis of the points raised in the letters to the DPOC Chair

28. As the second letter from Rethinking Capital concludes that the five governance issues identified in the first letter have been or would be addressed by actions committed to or discussed in the Interpretations Committee meeting on 5 March, we will not be commenting on that.

Independence of Interpretations Committee members

29. With regards to the perceived independence of the Interpretations Committee members, especially those representing accounting firms, we note that the IFRS Foundation *Constitution* states that

> …The Trustees shall select members of the Interpretation Committee so that it comprises a group of people representing, within that group, the best available combination of technical expertise and diversity of international business and market experience in the practical application of IFRS Accounting Standards … [section 39]

Members vote in accordance with their own independent views, not as representatives voting according to the views of any firm, organisation or constituency with which they may be associated. [section 42]

30. The Trustees have also specified on the website that the following criteria should be met when considering individuals for membership on the Interpretation Committee:

    (a) have a high level of technical expertise;

    (b) add to the diversity of the Interpretations Committee in terms of international business;

    (c) have market experience in the practical application of IFRS Accounting Standards and analysis of financial statements prepared in accordance with IFRS Accounting Standards; and

    (d) can serve in an individual capacity and demonstrate their independence.

31. Any member of the Interpretations Committee is therefore required to declare any perceived conflicts of interest as and when such situations arise. Prior to the start of the Committee's discussion on 5 March, the Chair of the Interpretations Committee reminded all Committee members of their right to abstain from voting on this (or any) matter if they deem there to be a perceived conflict of interest.[5]

32. The Interpretations Committee's purpose is to respond to questions about the application of IFRS Accounting Standards and do other work at the request of the IASB relating to supporting the consistent application of the Accounting Standards. Given the Committee's purpose, 13 of its 14 members are individuals involved in *applying* the Standards in practice, either as preparers of financial statements or as practitioners in accounting firms (the other member is a user of financial statements). However, the Trustees have decided to limit representation on the Interpretations Committee from the accounting firms to five of the 14 members. As noted in paragraph 21 of this paper, all 13 of the Interpretations Committee members present at the meeting, agreed:

    (a) that the second submission warranted neither a second agenda decision nor re-exposure of the tentative agenda decision; and

    (b) to finalise the agenda decision.

33. Even if all five members abstained from voting, the decision would still have been approved unanimously by the other members.

[5] Members of the Interpretations Committee are also required to comply with an IFRS Interpretations Committee Code of Conduct

Technical matters identified in supplemental letter

34. With regards to the technical matters mentioned in paragraph 27 of this paper, we note that the matter relating to when a present obligation arises as a result of a past event (as mentioned in paragraph 27(d) of this paper) relates to disagreement with the staff's technical analysis, which the Interpretations Committee agreed with in reaching its conclusions. The matters raised do not relate to due process.

35. With regards to the other matters raised in paragraph 27, the Interpretations Committee agreed as part its discussion on 5 March to add further detail to the fact patterns and include additional explanations in finalising the Agenda Decision (as noted in paragraphs 21 and 22 of this paper). However, in our view, some of Rethinking Capital's requests would go beyond the current requirements in IAS 37 and would therefore not be appropriate for inclusion in the Agenda Decision.

36. We do however note that the role of the Interpretations Committee is to support the consistent application of IFRS Accounting Standards and that the criteria in paragraphs 5.15 and 5.16 of the *Handbook* focus on whether the principles and requirements in the Accounting Standards provide an adequate basis for an entity to determine the required accounting. If the Interpretations Committee concludes that there is an adequate basis, no standard-setting is required and an agenda decision is published to explain the basis for the Committee's conclusion—as was the case with this matter.

37. Furthermore, as stated in paragraph 8.4 of the *Handbook*, agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards.

Appendix A: Additional information about the requirements for the recognition of a provision in IAS 37

A1. In determining whether an entity recognises a provision for its net zero transition commitment, the first question to consider is whether the entity's public statement of the commitment creates a constructive obligation to discharge it.

A2. 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.

A3. Paragraph 20 of IAS 37 states that:

> 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—indeed the obligation may be to the public at large. 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.

A4. If an entity's public statement of its commitment creates a constructive obligation to discharge it, the next step is to consider whether and when that obligation meets the criteria in IAS 37 for recognising a provision.

A5. Paragraph 14 of IAS 37 sets out three criteria for recognising a provision. It requires that:

(a) the entity has a present obligation (legal or constructive) as a result of a past event (the present obligation recognition criterion);

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation (the probable outflows recognition criterion); and

(c) a reliable estimate can be made of the amount of the obligation (the reliable measurement recognition criterion).

A6. Paragraphs 18 and 19 of IAS 37 explain the present obligation recognition criterion:

> 18 Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the end of the reporting period.
>
> 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.

Appendix B: First letter received from Rethinking Capital dated 29 February 2024

Due Process Oversight Committee of the International Accounting Standards Board (**DPOC**)

IFRS Foundation

7 Westferry Circus

London, E14 4HD

29th February 2023

For the attention of Teresa Ko, Chair of DPOC—submitted to DPOC through its online portal

And to Bruce Mackenzie, Chairman of the Interpretations Committee of the IASB (the **Committee or IFRIC**)

Dear Teresa & Bruce

Two submissions to the Committee on Climate-Related Commitments (IAS37)

Six governance issues under the Due Process Handbook and the imperative for a second public consultation

This letter is being sent under paragraph 9.1 of the IASB's Due Process Handbook (**Handbook**).

Its aim is explain the imperative to continue the discussions of IAS37 on Climate-Related Commitments with IFRIC through a public consultation on the Second Submission. And avoid the unnecessary time delay of this being referred to the IASB as part of its program for targeted improvements of IAS37 that will not report until 2025 at the earliest.

It concerns six governance and issues under the Handbook. Together we believe that these issues may undermine the governing principles of transparency, full and fair consultation and accountability in paragraph 3.1 of the Handbook (the **Due Process Principles**). Specific areas of the Handbook are listed in the Appendix to this letter.

This letter concludes that:

- The 5th March 2024 discussion of the Second Submission can and should continue as scheduled.
- A public consultation on the Second Submission is the logical way to meet the Due Process Principles and address the issues with the First Submission. Not to do so may also undermine the IASB's reputation.
- In this consultation, the IASB and ISSB must seek comments from investors and the net zero community.
- During and after this consultation period, the market will have the ability to take control of this issue.
- There is no reason to refer this matter back to the IASB for standard-setting but this will inform its program.
- The global accounting firms should be key enablers of these new accounting practices.
- Perceptions of the independence of the five Committee members from those firms needs thought.
- At least, DPOC must establish whether there is demand for a second consultation from primary users.

Praise for IFRIC and IFRIC staff in elevating the conversation on net zero commitments

IFRIC has become the centre of a global conversation on commitments to reduce carbon emissions over time. We were delighted with these three principles confirmed in the discussion of the First Submission (**Three Principles**):

- That a commitment to reduce carbon emissions **can be** a constructive obligation;
- That if a constructive obligation then a provision **must be** recognised if the criteria for recognition are met;
- That if a provision is recognised then investments to meet the commitment **could be** recognised as assets.

As the effects of non-recognition include that the incentives to meet a net zero commitment are upside down (explained further in the Appendix), our community believes that the Committee has begun the pathway to unlock the ability to slash the 43% of carbon emissions needed by 2030. Rethinking Capital's rethink of double-entry bookkeeping is designed to complete the pathway to flip these upside down incentives.

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That pathway is for a net zero program to become profitable (an essential according to Ray Dalio) and to improve all material financial metrics and unlock better returns for investors including pension funds. In other words, this is materially positive and will provide better information for investors as primary users of financial statements.

Though we disagree with the staff note's technical assessment in the Second Submission, this letter does not challenge those views. It only raises the fact that this is a controversial and difficult technical interpretation. Even IASB staff seem to disagree on this interpretation shown by IASB board member Nick Anderson's public comments.

As such, the imperative is that this interpretation be discussed by the Committee on 5th March 2024 and then opened to a public consultation period. There seems no credible reason why IFRIC cannot continue this pathway. And not to do so would undermine the comments of the Committee chair on 25th January that '*connectivity is a verb not a noun*.'

The six governance issues

The six issues are below and further details on each issue are in the Appendix to this letter:

1. A vital issue to address in tackling net zero's upside down incentives. In which IFRIC can continue the conversation that has caught hold with long-term investors and the net zero community led by the UN's Race to Zero movement.

2. A controversial technical interpretation not helped by the first fact pattern. The fact pattern in the First Submission was not a 'real-world' example. The Second Submission should be considered to be the first substantive discussion.

3. **Stopping the conversation within IFRIC that has really only just begun**. Recognising that the First Submission was important to set the Three Principles but that further fact patterns and guidance was demanded by comment letters.

4. Surprising absence of comments from net zero focused investors and investor coalitions. Only one comment letter from pension funds was received. None were received from coalitions including Climate Action 100+ or GFANZ.

5. Surprising absence of comments from the net zero community. One comment letter only (Carbon Tracker) was received. None were received even from two programs in which the ISSB is actively involved or from an ISSB funder.

6. The challenge and opportunity for the global audit firms as enablers of this transition in accounting and audit practice. As expressed in our comment letter, the global audit firms can be the enabling force if they embrace it.

Conclusion and backstop

It is remarkable that these pathways have been opened in 2024 by a 23 year old standard not designed for net zero commitments. This gives seven years to increase the only 14% probability of averting a climate catastrophe according to the IPCC of the UN. Every month is critical in doing so and there should be no unneeded delay.

The submissions have catalysed a global conversation. Praise in our outreach has focused on the courage and vision of Committee Chairman, Bruce Mackenzie and Committee staff—and enhanced by Bruce's comments on connectivity and integration to view '*connectivity as a verb not a noun*.' Both connectivity and integration come into reach in 2024 if the Committee continues the conversation through a second consultation.

As a backstop, DPOC may consider outreach to establish whether there is demand for a public consultation of the Second Submission from asset owners, investment managers and the net zero community as primary users.

Paul Munter

We ask that that this letter is shared with Paul Munter who both attended the first meeting and led IOSCO's comment letter calling for further fact patterns. But for Paul's intervention in the first meeting on the problem of the '*expectations gap*', we believe that the meeting would not have had such a positive outcome.

Please acknowledge receipt of this letter. We will fully support and look forward to DPOC's response.

Andrew Watson

Co-Founder,

Rethinking Capital, andrew@rethinking-capital.org

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Appendix

The first governance issue

***1. A vital issue to address in tackling net zero's upside down incentives**. In which IFRIC can continue the conversation that has caught hold with long-term investors and the net zero community led by the UN's Race to Zero.*

While collaborating with Harvard's Impact-Weighted Accounts Initiative in mid-2020, Rethinking Capital made a startling discovery that it went on to write about in an SSRN paper, a bp case study called Constrained by Accounting.

That insight was that the incentives to meet a net zero commitment are, quite literally, upside down—the exact opposite of what would be needed to enable a just net zero transition and enable capital to freely flow into adaptation and mitigation. Those incentives result in part from the gap between IASB's standards and practice.

Here's the summary of this insight with which we lead our presentations today:

- Today's financial incentives to meet a net zero transition commitment are upside down,
- Accounting practice doesn't recognise a commitment as an obligation—rewarding doing nothing,
- And expenses investments purposed to meet it—creating an immediate penalty to invest,
- The transition beliefs are upside down, decision-making is constrained by fear,
- Net zero is surely guaranteed to fail by these rules.

This gap in climate accounting has between accounting standards and accounting practice has also been highlighted publicly by IASB board member Nick Anderson. Highlighting also that the Committee's decision on these two decisions differs even between different IASB staff when the staff note on the second submission is considered—an issue we pick up in the demand for a public consultation on the Second Submission.

This quote by Bill Gates, reviewing Capitalism Without Capital, the Rise of the Intangible Economy (Haskel and Westlake) supported our insight—and this remains the sharp insight on the real problem to solve:

'The portion of the world's economy that doesn't fit with the old model just keeps getting larger. That has major implications for everything from tax law to economic policy, to which cities thrive and which fall behind. But in general, the rules that govern the economy haven't kept up. This is one of the biggest trends in the global economy that isn't getting enough attention'

Our program with Harvard Business School then turned to how to use back to basics double entry bookkeeping and normative accounting theory with which to flip the incentives by accounting for the intangibles impacted by a net zero commitment—a body of work created by a global expert group and called normative accounting for intangibles.

Our informed and objective view is that the system has generally missed this shift—actually the third such shift in how value is created in the history of Western capitalism over the past 700 years according to Futuromics by our co-founder and economic historian Robert McGarvey.

Though others including Professor Baruch Lev and Feng Gu in The End of Accounting express frustration or worse with the role of the auditors, our view is that the global audit firms should not be judged or held to account for this. Most all stakeholders are making decisions derived from neoclassical economic theory which assumes natural resources to be abundant. To its credit, only the IASB's accounting standards appear to have largely stood the test of time.

The second governance issue

***2. A controversial technical interpretation not helped by the first fact pattern**. The fact pattern in the First Submission was not a 'real-world' example. The Second Submission should be considered to be the first substantive discussion.*

In practice, the Second Submission should be considered to be the first substantive discussion of the application of IAS37 to climate-related commitments—because though it set the Three Principles, the fact pattern put forward and

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discussed was not a real-world example of any commitment we can identify. As such, the First Submission discussion and process cannot be considered to be much more than a general conversation that set the Three Principles.

The discussion and decisions in the First Submission were based on a fact pattern of a company that states a commitment to reduce carbon emissions by 2030, publishes a plan on the same day which never changes and commits to buy carbon offsets if it hasn't met the target by 2030.

This was not at all how Net Zero or 2030 Commitments were made in reality—being one reason for the Second Submission. As the Second Submission describes when applied to 2030 Commitments (eg 50% reduction in Scopes 1 and 2 emissions by 2030 in line with science-based targets) an original statement was then followed by established patterns of practice including a transition plan, negotiation of the plan with investor groups to set acceptable returns, annual emission reduction targets and capital expenditure required.

The Second Submission therefore used 'real-world' anonymised fact patterns from the oil and gas and hard to abate sectors creating a very different analysis of IAS37 and raising seventeen new interpretation issues.

This is clearly a controversial and hard technical interpretation. When Rethinking Capital first engaged with IFRIC in September 2023, the IASB had just asked IFRIC to ask the same question of itself because of a stream of challenges from the market and others—whether a provision (a quantified accounting entry) should be recognised for a Net Zero or 2030 Commitment as a constructive obligation. We had commented in the press on this twice in The Banker at the FT and in the FT's Sustainable Views.

Responding to a LinkedIn request from Committee chair Bruce Mackenzie on 'any questions for IFRIC' we agreed with Bruce and Committee staff to make the first submission. We made it because 1266 of the world's largest 2000 companies have made a Net Zero or 2030 Commitment but, to our knowledge, none has recognised this as an accounting liability or obligation or explained why not. And that just doesn't feel right to us—or ISSB board member Richard Barker at the 25th January joint board IASB-ISSB meeting.

As DPOC will know, IAS37 was adopted in April 2001 and not designed for Climate-Related Commitments. It should be very surprising that a 23 year old accounting standard designed for a different purpose has stood the test of time. This seems to also have been the view of the IASB in its contribution to the TCFD Guidelines on page 37.

The aims of the First Submission were to begin a conversation with the Committee to show how far IAS37 could be stretched—and begin to set a pathway to hand control of this issue to the market.

The third governance issue

3. Stopping the conversation within IFRIC that has only just begun*. Recognising that the First Submission was important to set the Three Principles but that further fact patterns and guidance was demanded by comment letters.*

There is no credible reason why the Committee cannot continue this pathway through a public consultation on the Second Submission. This will also inform the IASB's program on targeted improvements to IAS37.

Not to do so would undermine the comments of the Committee chair on 25th January that '*connectivity is a verb not a noun*' but then to decide to stop the learning. And ignore the most informed comment letters from the International Foundation for Valuing Impacts (our partner in making the Second Submission), IOSCO, A4S, Carbon Tracker, XRB New Zealand—all of whom we spoke to as part of the First Submission.

And those of ISSB board member Richard Barker in the same meeting that not recognising a provision '*just doesn't feel right*', the ability to '*learn connectivity by doing it*' and to '*close the gap between IAS37 and S2*' offered by the First Submission. And his comments at the end of the first discussion on 28th November 2023 that this was '*rich in potential*'.

The fourth governance issue

4. Surprising absence of comments from net zero focused investors and investor coalitions*. Only one comment letter from pension funds was received. None were received from coalitions including Climate Action 100+ or GFANZ.*

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The only comment letter from this stakeholder group was from Christian Brothers Investment Services, Sarasin & Partners and others. Even this was concerned more with IAS36 than IAS37.

We do not know the extent of IASB or ISSB outreach to net zero focused investors or investor coalitions but we do know that none submitted a comment letter. The Three Principles create the potential to unlock higher returns and give accountability for net zero commitments for these primary users.

We conclude that a full and fair consultation with long-term investors and pension funds (known as asset owners) who would be the biggest beneficiaries of the Three Principles and as primary users has not been met.

We also conclude that a full and fair consultation with advisers to long-term investors and pension funds (known as asset managers or investment managers) who advise asset owners would be the biggest beneficiaries of the Three Principles in advising on strategic asset management and portfolio theory.

The list of groups to approach is easy to compile and indeed Rethinking Capital has carried out this outreach program. The Climate Action 100+ represents $68 trn of assets under management and GFANZ $130 trn of assets under management. The GFANZ group also represents insurers, banks and venture capital providers and has 675 member firms in 50 countries.

The other most vocal voice on the gap between accounting standards and accounting practice is Natasha Landell-Mills of Sarasin & Partners who is leading the campaign against audit firms—being '*a vocal advocate for reform of the accounting and audit system to promote long-term stewardship as well as action by company boards to confront climate change*'.

Our outreach program can be shared with DPOC. Our conclusion is that none of these stakeholders were aware of the First Submission. We believe that this calls into question the extent of stakeholder engagement on the first submission under paragraph 2.10 (a) of the Handbook. And why no invitations to comment were sent to these stakeholders contravening the principle of full and fair consultation in paragraph 3.42.

The fifth governance issue

5. Surprising absence of comments from the net zero community. *One comment letter (Carbon Tracker) was received. None were received even from two programs in which the ISSB is actively involved or from an ISSB funder.*

We do not know the extent of ISSB outreach to net zero community but we do know that none submitted a comment letter other than Carbon Tracker who engaged as part of our outreach campaign. Others who contributed letters as part of our campaign were A4S and the International Foundation for Valuing Impacts.

We conclude that a full and fair consultation with the net zero movement who would be the biggest beneficiaries of accountability from Three Principles and as primary users has not been met.

The list of groups to approach is easy to compile and indeed Rethinking Capital has carried out this outreach program. The Race to Zero campaign represents some 13,000 members and is "*The world's largest coalition of non-state actors taking immediate action to halve global emissions by 2030*".

The ISSB is also actively collaborating in at least two programs with the net zero community. These include the UNFCCC's Recognition & Accountability Framework, the Transition Plan Taskforce and the European Climate Foundation (also an ISSB funder). None of these three submitted a comment letter.

Our outreach program can be shared with DPOC. Our conclusion is that none of these stakeholders were aware of the First Submission.

We believe that this calls into question the extent of stakeholder engagement on the first submission under paragraph 2.10 (a) of the Handbook. And why no invitations to comment were sent to these stakeholders contravening the principle of full and fair consultation in paragraph 3.42.

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The sixth governance issue

6. The challenge and opportunity for the global audit firms as enablers of this transition in accounting and audit practice. *As expressed in our comment letter, the global audit firms can be the enabling force if they embrace it.*

The global audit firms can be among the key enablers of this transition in accounting practice. With the recognition rules becoming concrete, the past can be put behind and attention can focus on how to unlock the potential for better returns on net zero programs.

We would expect however that this shift will present many strategic and operational challenges for those firms. EY's then Global Managing Partner Mark Weinberger and UK Chair and Managing Partner Hywel Ball publicly admitted this in 2015 in stating that '*the audit product was at risk of being not fit for purpose*'.

The challenges include that in effect, the Committee's decisions in the First Submission are retrospective—because if a provision has to be recognised now, it should have already been recognised when net zero commitments were first made and 2030 transition plans set in FY's 2020 to 2022.

Those involved in decisions not to recognise a provision in prior years, or explain why not, should be assumed to favour the status quo of non-recognition when making a new decision on recognition now for fear of the consequences. This places a sharp focus on the role of auditors.

Oxford University Net Zero states that 1266 of the world's largest 2000 companies have made a Net Zero and/or 2030 Commitment. To our knowledge, none has recognised this as an accounting provision or a contingent liability under IAS37 or explained why not. However we are aware that EY made the case to Shell's audit committee and Shell then recognised an asset writedown in FY'21—'*conscious that maintaining its assets at full value was inconsistent with Paris goals and of IAS37*'.

Oxford University Net Zero has been approached for an analysis of how many of these 1266 are audited by the five global accounting firms represented on the Committee. The assumption is that each of the Big 4 firms will be auditors of at least 250. This gives an aggregation of risk to the firms.

Assurances should be sought from the global audit firms that they are prepared to embrace this major shift.

As DPOC will know, five of the fourteen Committee members (~36% of its votes) are held by the Big 4 firms and BDO. In addition those firms provide around 13% of the annual funding of the IASB's programs (~$2.252m) and 13.5% of the IFRS Foundation's annual funding after the formation of the ISSB (~$4,383m).

DPOC may need to think about the perceived independence of those firm's five Committee members.

Transparency of disclosing contributions from the oil and gas sector

For transparency and balance in the context of these submissions on IAS37 to net zero commitments, DPOC and the Committee chair should also consider whether it's appropriate to disclose that the IFRS Foundation's contributors include at least six petrochemical and gas companies.

According to pages 90-94 of the IFRS Foundation's 2022 Annual Report these are Petrobras, PetroChina Company Limited, China National Offshore Corporation, China Petroleum & Chemical Corporation and Korea Gas Corporation each of whom contributed funding of $25,000 each. And Suncor Energy who's financial contribution is not disclosed.

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Appendix C: Supplemental letter received from Rethinking Capital dated 8 March 2024

Due Process Oversight Committee of the International Accounting Standards Board (**DPOC**)

IFRS Foundation

7 Westferry Circus

London, E14 4HD

8th March 2024

For the attention of Teresa Ko, Chair of DPOC & Henry Rees, Head of Governance, IFRS Foundation

Copy to Bruce Mackenzie, Chairman of the Interpretations Committee of the IASB (the **Committee or IFRIC**)

Dear Teresa & Henry

Supplemental Letter: Two submissions to the Committee on Climate-Related Commitments (IAS37)

Six governance issues under the Due Process Handbook

This supplemental letter is being sent under paragraph 9.1 of the IASB's Due Process Handbook (**Handbook**). Its purpose is to confirm whether and to what extent the six governance issues in our letter of 29th February 2024 have now been addressed. It concludes that five of the six issues have been addressed and/or will be addressed by actions committed to or discussed in the Committee meeting on 5th March 2024.

Governance Issue 6 (the independence and perceived independence of the global audit firms) should remain a material concern in this 'hot topic' area for all concerned. Further comments on this are at the end of this letter.

Thank you and three major positives

Thank you to the Committee chair, staff and members for an excellent technical discussion on 5th March. The meeting outcome exceeded our expectations. The three major positives from the meeting being that:

1. negative clearance should be given by the IASB on or around 26th April 2024—accelerating adoption by around three months when compared to a second public consultation.

2. the Three Principles needed to flip today's upside-down incentives were again confirmed—
   - That a commitment to reduce carbon emissions **can be** a constructive obligation;
   - That if a constructive obligation then a provision **must be** recognised if the recognition criteria are met;
   - That if a provision is recognised then investments to meet the commitment **could be** recognised as assets.

3. it confirmed that the Connectivity Program led by IASB Vice-Chair Linda Mezon-Hutton and the IASB program on targeted improvements to IAS37 will continue the conversation after the IFRIC Final Agenda Decision is ratified.

If companies and investors are enabled to take decisions that '*action*' the Three principles, the 5th March meeting will be remembered as a pivot moment in tackling the climate and biodiversity crises. There is still work but the IFRS Foundation's three programs can achieve this between them in 2024. We explain how below.

Governance Issues 1 and 3 addressed and request to meet the Connectivity Program leadership

The meeting addressed Governance Issue 1. We were grateful for the seriousness with which the Committee discussed this issue in the context of tackling these twin crises—and the attendance of additional IASB members.

It will address Governance Issue 3 through the commitments made by IASB Vice-Chair Linda Mezon-Hutter to continue the conversation within the IASB and ISSB and as part of its Connectivity Program—including to '*close the gap between IAS37 and S2*'. Rethinking Capital offered a meeting to describe 'six bridges' to enable the Connectivity Program in a letter dated 7th November 2023 to the ISSB Chair and Vice-Chair. A copy is attached.

Could we please ask to meet with Linda and the Connectivity Program leadership to discuss this letter?

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Governance Issues 2, 4 and 5

We stated that two primary user groups which would benefit most were not fully and fairly consulted in the first consultation. Their comments were reflected in the Second Submission and we have been engaging these groups planning to raise issues in a second consultation that enable these two benefits from the Three Principles—that—

- For net zero focused investors and investor coalitions as primary users the economic benefits are (a) the potential to unlock future economic benefits and better returns (b) accountability for net zero commitments.
- For the net zero community as primary users, the economic and other benefits are (a) the potential for an entity and its investors to unlock future economic benefits and better returns—the concept of flipping the incentives and (b) accountability for net zero commitments.

As a second consultation is not now to happen, we ask that five technical areas be addressed for the benefit of these primary users. Four are for reflection in the Final Agenda Decision and each was raised in the Committee meeting.

The overriding issue is 'back testing'. The principle of back testing of the Tentative Agenda Decision (**TAD**) was raised by each of Andre Besson and Jon Nelson in the Committee meeting—both of whom said that they had back tested the TAD against the oil and gas fact pattern in the Second Submission. Though neither stated their conclusion.

The acid test of whether IFRIC's Final Agenda Decision is useful in practice can be best thought of by analogy to the quick start guide for a new washing machine—in that if a reasonable user cannot use the basic functions of the machine after reading these, they are not useful. Let's call this a **Quick Start Guide** that can now be back tested.

When applied to a Net Zero Transition Commitment or a 2030 Commitment, back testing the Final Agenda Decision as a Quick Start Guide must be able to quickly determine (a) whether the commitment is a constructive and/or legal obligation and (b) whether the criteria to recognise a provision are met.

Whether or not the TAD has been useful as Quick Start Guide is actually quite easy to establish in reality—a study of the 1266 largest companies that have made a net zero commitment can be made with their auditors to confirm how many have used the TAD to recognise a provision (or a contingent liability) in their recently signed FY23 statements. There is no evidence in the market yet of companies moving from the general practice of non-recognition.

Whether the final Agenda Decision will be useful as a Quick Start Guide can be back tested by assessing the real-world scenario of the oil and gas (though generally applicable) fact pattern in the Second Submission in Appendix 1.

The five issues are:

No	Technical Issue	Program to be addressed in and explanation
1.	Overriding issue of back testing usefulness as a Quick Start Guide	**Reflect in the Final Agenda Decision** Andre Besson and Jon Nelson discussed and Bruce Mackenzie labelled the concept of back testing. Andre and Jon stated that when they had applied the TAD to the real-world oil and gas fact pattern of the Second Submission, the rules on whether a provision should be recognised as a constructive and/or legal obligation were clear. Following this logic, we ask that the Final Agenda Decision include paragraphs at the end with the fact pattern from the Second Submission in Appendix 1 and then stating how the Final Agenda Decision would be applied to it. And ask specifically the principle of 'affirmative actions' (see 2 below) be highlighted—explaining that greater weighting as evidence should be given to these actions as both an indicator that the entity considers there to be a constructive obligation and considers its commitments to contain a past event.

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2.	Affirmative actions taken by the entity	**Reflect in the Final Agenda Decision** We noted and ask that Brian O' Donovan's comment agreeing with our point on 'affirmative actions by the entity' be included in the Final Agenda Decision. Brian commented words to the effect that: *"Actions taken (or already taken) by the entity by which the entity itself affirms the commitment'* is '*powerful evidence'* and that '*the actual allocation of capital is further powerful evidence'*. These are logical statements because unless the commitment is a constructive and/or legal obligation, management could be in breach of their fiduciary duties in taking affirmative actions. We ask that the words '*powerful evidence'* or similar should be included in the Final Agenda Decision for emphasis of weighting—because this would for example override other evidence such as the name given to the transition program (aims, aspirations), not part of the constructive obligation definition. This principle of affirmative actions then flows into what is the past event which creates the present obligation (see 4 below).
3.	Sequencing	**Reflect in the Final Agenda Decision** The comment of Jon Nelson on '*sequencing*' using the example of committing to buy then retire carbon credits was also noted to be included. This recognition that the provision is only released when the last action has taken place is logical and can be applied by analogy to the actions to meet commitment itself. In our Second Submission, we explain that in reality, 2030 Commitments were supported by a transition plan by which the entity explained its plan to reduce Scope 1 and 2 emissions by a set percentage by 2030. Specific activities were listed, together with target reductions per annum and capital required. Jon's logic can be applied here to the commitment also in that an annual provision will represent the annual reduction target for that year. And the provision will be released and unwound if and when the entity meets the committed target. We ask that this point be reflected in the Agenda Decision.
4.	Past event-present obligation	**Reflect in the Final Agenda Decision** Other than Brian O' Donovan's comments in 2 above, the meeting barely discussed this critical issue and was distracted by a discussion on carbon credits. We disagree with the staff analysis on this point and as explained in the Second Submission believe that with 2030 Commitments, the Original Statement and the subsequent established pattern of transition plans should create a present obligation to reduce emissions over time in a series of annual emission reduction targets in line with a transition plan. We ask that the Final Agenda Decision add wording to the effect that management should discuss this issue with its investors and other primary users as part of making its decision. The 'affirmative actions' point 2 above applies equally here. In that if *"Actions taken (or already taken) by the entity by which the entity itself affirms the commitment'* are '*powerful evidence'* and '*the actual allocation of capital is further powerful evidence'* then they must also logically be actions by which the

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		entity affirms that it recognises that a past event has occurred. We ask that this point be reflected in the Final Agenda Decision. IAS37 targeted improvements program & Connectivity Program The past event-present obligation issue seems to remain the most tricky part of the interpretation—which should not be surprising with a 23 year old standard not designed with net zero commitments in mind. Though the Connectivity Program may take this issue forward, we also suggest that phasing of the IASB's program on targeted improvements to IAS37 be prioritised to create clarity on this issue in the context of net zero commitments only—and market demand for prioritisation be sought through Stakeholder Engagement. We ask that the Connectivity Program consider publishing guidance under S2—our suggestion made to the ISSB Chair and Vice-Chair on 15th December.
5.	Reliable measurement and asset recognition and revaluation	Final Agenda Decision The TAD's only conclusion here is that investments into meeting the commitment can be recognised as assets if they meet the asset definition. This does not reflect the first submission's explanation that the analogy of asset decommissioning can be applied—in that the entity is committing to decommission its carbon-emitting infrastructure and business practices. We ask that this analogy is added to the Final Agenda Decision. Connectivity Program This issue can then be continued as part of the Connectivity Program. Including how IAS38 can be applied to recognise the 'asset'—beginning with the costs to create new assets in the two primary transition activities of innovation and carbon credits (paras 21-24). We repeat our request to meet this team.

Governance Issue 6: the independence and perceived independence the global audit firms

We decided not to emphasise this issue in our first letter to DPOC but to allow those Committee members to assess their own independence. We noted that all five attended, participated and voted. And in Brian O'Donovan made our best points for which we thank him. The meeting was though led by the firms down a rabbit hole of carbon credits and as such spent much less time on the much more material issue of past event-present obligation.

'Independence' must remain a material concern in this 'hot topic' area—in the words of two Committee members. Not just for us but for the reputation and integrity of the IFRS Foundation and the firms themselves. In reality it's 'defying gravity' for members to '*demonstrate their independence'* as required by the Committee's constitution given the implications of this topic for the firms they represent. The Appendix to our first letter lists these implications.

We ask that DPOC consider this issue further—within the approval of the Final Agenda Decision and as the future stages of the IFRS Foundation's programs on Connectivity and Targeted Improvements to IAS37 are implemented.

Please acknowledge receipt of this supplemental letter. We look forward to DPOC's response.

Yours sincerely

Andrew Watson

Co-Founder

Rethinking Capital, andrew@rethinking-capital.org

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Appendix 1

Fact Pattern: Oil and Gas Sector but generally typical of the 'hard to abate' sectors and companies listed on the capital markets

*In 2021 or 2022 an entity makes a first public statement of its commitment to 'be net zero by 2050'. It also at the same time or subsequently, makes a second public statement (the **Original Statement**) to reduce a percentage of its carbon emissions in Scopes 1 and/or 2 by 2030—in line with science-based targets or similar words (**a 2030 Commitment**).*

The entity then explains its current carbon emissions and then sets out separate targets in relation to each of the areas of its business where emission reductions can be achieved in this 2030 period in a Transition Plan.

The entity then takes one or more affirmative actions by which the entity itself affirms the commitment in the Original Statement and the 2030 Commitment creating an Established Pattern of Practice derived from the Original Statement that may include any of:

1. *The entity subsequently creating and possibly publishing a first Transition Plan detailing in particular how Original Statement will be achieved. The plan explains how emissions will be reduced over the time period to 2030 in a series of annual emission reduction targets and often the annual capital required. The Transition Plan also breaks down the actions needed between Scope 1 emissions (within the entity's operations)*
2. *The entity subsequently engages with Net Zero Focused Investors (and often insurers, banks and other stakeholders) to explain the Transition Plan and makes changes to it to reflect their amendments—in particular to balance the transition aims with acceptable returns for investors who commit to continue their investments on this basis. The plan is then published and shared with its investors and others.*
3. *Publication of the Original Statement and/or its Transition Plan as amended from time to time on its website and leaving it on its website. Performance against its Original Statement and its Transition Plan may be updated from time to time.*
4. *Senior executives of the entity join one or more coalitions with a mission to collaborate to achieve the emission reductions.*
5. *The entity states the emission reduction targets in its financial statements and in investor and other presentations.*
6. *Achievements against the Transition Plan are published, typically annually.*
7. *The entity begins a capital allocation program to invest into reducing its emissions which may include buying offsets.*
8. *The entity's investors and/or insurers and/or bankers and make their own transition commitments relying on these actions that derive from the entity. The entity's investors may explain to their own investors that returns expected from the entity may be lower because of the need to allocate capital into the transition.*
9. *In certain sectors, the entity may make an asset decommissioning provision or asset writedown—because it is incompatible to be aligned to the science-based targets and keep assets are current values.*
10. *In certain sectors the entity becomes a signatory to cross-industry initiatives to cut emissions such the Oil and Gas Charter at COP28 or the sector pathways in the so-called 'hard to abate sectors'—in each case to cut emissions and make other changes to increase operational efficiency in reducing carbon emissions. The other members of the group welcome the cross-industry initiative—relying on the valid expectations established across the group.*

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International Sustainability Standards Board (**'ISSB'**)

c/o IFRS Foundation

7 Westferry Circus

London, E14 4HD

For the attention of Emmanuel Faber, Chairman of the ISSB

November 2023

Dear Emmanuel

Six bridges: enabling and accelerating the mission of the ISSB by rethinking double entry bookkeeping

'ESG's evolution into accounting. CIO's and ESG investors are asking "what's next?" Normative accounting informs the most material decisions - those made by boards to allocate capital into environmental and social programs… it could be the simple bridge that's needed - and there's nothing to stop investors demanding those decisions be made and reported'. Aniket Shah, Managing Director and Global Head of ESG and Sustainability Strategy at Jefferies Group LLC

The purpose of this letter is to make a request of the ISSB on behalf of Rethinking Capital and its community. This ask will complement our submission to the Interpretations Committee of the IASB that a net zero transition commitment (for example a '*50% reduction in Scope 1 and 2 emissions by 2030*') should be recognised as a provision as a constructive obligation under IAS37—and then accounted for using the analogy of asset decommissioning. This submission will be heard on 28th November 2023 and then be put out for public consultation for two months.

The ask is that over the next four months, beginning before COP28, the ISSB collaborate with Rethinking Capital and the Interpretations Committee. As well as supporting the submission above, also on the application of normative accounting for intangibles to a net zero transition commitment with the aims:

1. To create a short bridge version of IAS38 (Intangible Assets) specifically applied to recognising a net zero transition commitment as an obligation and investments purposed to meet it as intangible assets.
2. To put this 'bridge standard' out for public consultation and observe testing to assess market demand.

This letter explains:

- The reason for the ask.
- The seven principles of IAS38 needed in the proposed bridge standard.
- The six bridges—benefits of collaboration for the ISSB and IASB, explained below and in Appendix 1.
- Why begin now.

By working together, we aim to prove that, though perceived as 'unsexy', double entry bookkeeping is among the most powerful innovations in human history—rethinking an innovation from the Golden Age of Islam (Appendix 2).

The reason for the ask

Attached is a presentation called *'Tackling the root cause of today's climate, natural and social inequities.'* The first page explains this insight that seems to have been generally missed:

<u>Today's financial incentives to meet a net zero transition commitment are upside down</u>

<u>Accounting practice doesn't recognise the commitment as an obligation—rewarding doing nothing</u>

<u>And expenses investments purposed to meet it through the income statement—an immediate penalty</u>

<u>By cause and effect the transition mindset is upside down</u>

<u>Net zero is guaranteed to fail playing by these rules</u>

<u>Net zero is a proxy because upside down accounting incentives pervade today's natural and social systems</u>

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DRAFT

Normative accounting for intangibles is a rethink of double entry bookkeeping—described by Goethe as '*among the finest inventions of the human mind.'* At its heart is the simple application of double entry bookkeeping to convert each $1 invested into building a sustainable relationship with Mother Nature as a stakeholder into an investment of $1 into that relationship as an appreciating intangible asset. It flips the incentives, and mindset, and gives a logic applicable to any investment into creating a sustainable relationship with a stakeholder.

Its six benefits in the application to a net zero transition commitment are explained here in this July 2023 paper published with the Centre for Climate Engagement at Hughes Hall, Cambridge. They include that by recognising the impact on intangibles of a net zero transition commitment, key financial metrics (profitability, shareholder equity, EPS and ROE) will improve and that it will be taken into account in credit rating analysis as described here.

The seven principles of IAS38 needed in the proposed bridge standard

We describe normative accounting for intangibles as 'informed by IAS38' because, though good, IAS38 was not designed for the purpose to which we intend to apply it. However, IAS38 already supports these seven principles that would be needed in the proposed bridge standard applied first to a net zero transition commitment:

1. A stakeholder relationship is an intangible asset—from whom resources are used to create value and benefits for an entity and to whom obligations are owed. A net zero transition commitment is such an obligation.
2. A stakeholder relationship has indefinite life—it could be long or short depending on how it is governed.
3. Innovation purposed to meet a commitment creates internally-generated intangible assets.
4. Carbon credits acquired with the purpose of meeting a commitment are intangible assets.
5. Investments made with the purpose of meeting the commitment are capitalised at cost of creation.
6. Management's best estimate will be made as to whether and when these investments will meet the intended purpose of reducing carbon emissions—and supported by external evidence.
7. Capitalised investments have indefinite life and will be tested for revaluation or impairment annually by reference to whether they will or will not meet the purpose of reducing emissions in the year in question.

A publication on the concept of normative carbon pricing is planned as guidance on reliable measurement.

The six bridges—benefits of collaboration for the ISSB and IASB

By complementing the submission to the Interpretations Committee, the benefits to the ISSB of supporting this program include building six bridges described in Appendix 1. All also benefit the IASB. Of these, the four most important and aligned to the recent ISSB Consultation on Agenda Issues are:

1. **A bridge in time as a market-based solution.** By accelerating tackling the climate crisis in real decisions made and reported in 2024 and giving autonomy of transition strategy to business management.
2. **A bridge towards a sustainability version of the IASB Conceptual Framework.** Using the <Integrated Reporting> framework and our intangible taxonomy, discussed in 2023 with Paul Chan and Jonathan Labrey.
3. **Bridges to testing in existing ISSB programs.** Including the Transition Plan Taskforce and the UNFCCC's Recognition & Accountability (RAF/CPAS) workstream.
4. **Bridge to double materiality.** We believe that the double materiality concept and aims should be achieved through a logical rethink of double entry—moving to quadruple entry with the stakeholder as an entity.

Why begin now

The time to begin is now. In particular to respond to Antonio Gutteres' brutal assessment that 'humanity has opened the gates of hell'. And because if this four month window for simultaneous public consultation and testing is missed then the window will not open again for at least twelve months—if at all. Supported by demand at COP28 in the Global Youth Statement and by parallel testing, real decisions applying normative accounting would be made in 2024.

We look forward to discussing this initiative and by whom it is being supported.

Yours sincerely

Andrew Watson, Co-Founder Rethinking Capital & The Catalysts.io Limited

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Appendix 1: The Six Bridges—benefits of collaboration for the ISSB

1. **A bridge in time as a market-based solution.** By accelerating tackling the climate crisis in real capital allocation decisions made and reported in 2024. As we understand it, S1 and S2 disclosures will be first made in 2025 but will be made on the assumptions that all investments purposed to meet the net zero transition commitment will be expensed. Subject to successful testing on parallel decisions, our vision and call for action will be that any entity that has made a net zero transition commitment could restate the commitment and its strategic plan in 2024.

2. **The first piece of the bridge in the IASB's program to review IAS38 and intangibles generally**. Because all business decisions should be enabled and informed by financial statements that show the commercial reality of the entity. And as a response to market demand, showing how new standards to be used in decision governance and reporting of intangibles can be introduced complementing and validly sitting alongside existing published statements designed for tax and reliable comparability of fixed assets.

3. **The first piece of the bridge into a sustainability version of the IASB Conceptual Framework.** In particular building the bigger circles of the resources (including assets) and obligations to stakeholders (including liabilities) and that an entity is in control of its decisions to meet or not meet an obligation to its stakeholders. And using this Conceptual Framework to pursue the objectives of simplicity to the user and interoperability by rethinking double entry bookkeeping as a central organising principle.

4. **The first piece of an accounting bridge between the IASB and ISSB's standards.** Using the ISSB's own intangible assets—including the <Integrated Reporting> framework complemented by a taxonomy of intangibles. This piece also enables pages 37 and 38 of the TCFD Guidelines (Accounting Considerations) which mention IAS37 and responds to the deliberations of the TCFD that a net zero transition commitment could be recognised as a provision as a constructive obligation under IAS37.

5. **Bridges to testing in existing ISSB programs**. Including the Transition Plan Taskforce and the UNFCCC's Recognition & Accountability (RAF/CPAS) workstreams.

6. **Bridges with other standard setters and interoperability**. Including:

   (a) EFRAG—explaining how double materiality principles could be achieved using double entry by imagining the relationship between an entity and a stakeholder like stocks and flows of resources and obligations.

   (b) IPSASB—for cities and countries. Because the concept of a constructive obligation is also contained in the IPSAS standards.

   (c) FASB—where US uptake of S1 and S2 will be a challenge but where FASB rules also contain the principles of asset decommissioning.

   (d) the International Foundation for Valuing Impacts—because normative accounting uses IFVI carbon metrics to set transition incentives.

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Appendix 2: Rethinking Islam's double-entry bookkeeping to be net zero's catalyst

Islam's hidden role in the history of double-entry bookkeeping by Robert McGarvey and Professor Jacob Soll…

Described by Goethe as '*among the finest inventions of the human mind*' and by historian Robert McGarvey as '*the ultimate alchemy*' most all historians believe that double-entry bookkeeping was invented by Italian Friar, Luca Pacioli in 1494. Dig deeper though and Professor Jacob Soll explains that the double-entry system had actually been in use in Northern Italy for around 200 years before Pacioli wrote it down. And, according to McGarvey, had already been the catalyst behind the Commercial Revolution that began around Florence and, by cause and effect, led to the Italian Renaissance in the late 13th century. Dig deeper again and both agree that double-entry's origins can be traced back to Islamic Samaria in the 6th Century BC, as an application of the science algebra. Their best informed analysis though is that double-entry bookkeeping was actually imported into Italy from Islamic Finance during the 12th century.

In Futuromics, McGarvey explains that during its Golden Age from 909-1171, Islamic capitalism had developed a highly sophisticated commercial infrastructure. Muslim merchants used many of the free market incentives, banking facilities and institutions that underpin modern capitalism. And enabling all this, Islam had created an accounting system that employed an early system of double-entry bookkeeping. It had a 'credit column' labeled lahu (for him), a 'debit column' marked alayhi (against him) and an 'equity column' indahu (with him). Merchants valued this because it seemed to create value out of nothing—by making visible through measurement the value of a business' assets.

McGarvey explains that trade was emerging in this period in the Northern Italian city-states of Florence, Venice and Genoa. But there was little banking in the West until the Knights Templar returned to Europe with the secrets of Islamic finance. The Templars had witnessed Islamic accountants converting merchant activities into gold in the form of collateral grade, bankable assets. Islamic bankers, meanwhile, conducted a breathtaking form of monetary alchemy as they created money, in the form of credit, seemingly out of thin air. The Templars observed a process that created solid assets out of little more than a system of collective beliefs.

In The Reckoning, Soll maps out a near 2000 year history of accounting in which good accounting creates accountability, financial stability and economic and social progress. With double-entry bookkeeping being the very best of accounting. And describes the opposite effect of bad accounting—where the global economy and society are today. Bill Gates describes this in his review of Capitalism Without Capital: The Rise of the Intangible Economy…

'The portion of the world's economy that doesn't fit with the old model just keeps getting larger. That has major implications for everything from…economic policy to which cities thrive and which cities fall behind, but in general, the rules that govern the economy haven't kept up. This is one of the biggest trends in the global economy that isn't getting enough attention.'

Gates' insight that the rules that govern the economy haven't kept up is a rare one because it hints at a root cause behind today's natural and social inequities. When applied to the net zero transition, those implications become clear. Because at present, accounting practice globally chooses to treat climate risks, liabilities and even transition commitments as externalities—rewarding doing nothing. While forcing transition innovation and investments to be expensed through the income statement—effectively penalising investments into programs that have the ambition and purpose of a meeting a commitment to, say, bp's to '*get to a 50% reduction in Scopes 1 and 2 by 2030*'. It's fair to say that today's net zero transition incentives are, quite literally, upside down—as is the transition belief system.

Knowing this root cause, the urgent task, beginning at COP28, is to flip the incentives and with it the system beliefs. Rethinking Capital has found this 'flip' by rethinking Islamic double-entry bookkeeping for intangible assets. The innovation is called ***'normative accounting for intangibles'*** and is applied first in a net zero governance and reporting framework. At its heart is the simple application of double-entry bookkeeping to recognise each $1 of capital allocated into building equitable relationships with the environment, nature, society or people as stakeholders, as investments into an intangible asset on the balance sheet. And though that may appear too simple, even trivial, the effects of this rethinking of double-entry bookkeeping are profound—including that all key financial metrics improve as the transition is achieved, and to create positive, immediate and certain incentives to speed up the transition.

There should be little doubt that properly tested and adopted, rethinking Islamic double-entry bookkeeping is today's catalyst for change. And not only to accelerate net zero but, by cause and effect, to flip the transition mindset

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