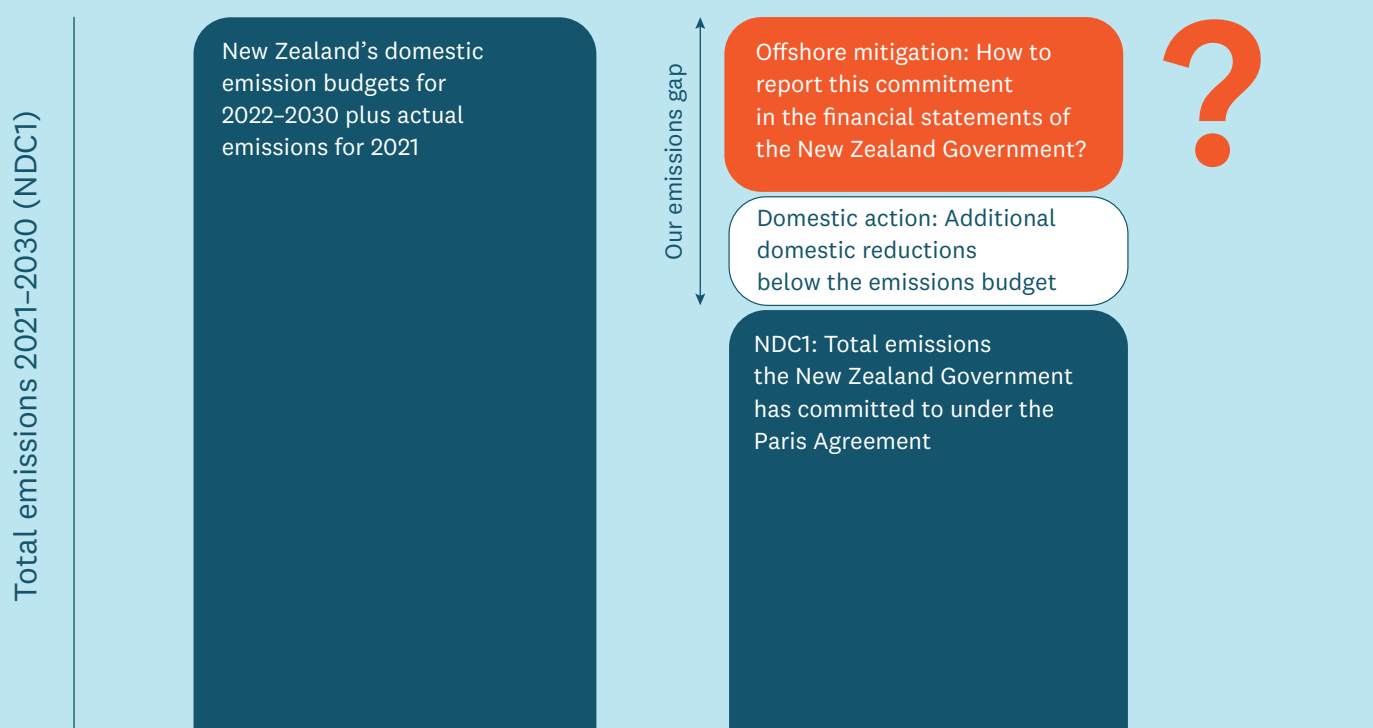


Risks Hiding in Plain Sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?

New Zealand's Nationally Determined Contributions (NDCs) Strategy



Title	<i>Discussion Paper 2024/01 – Risks Hiding in Plain Sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?</i> This paper forms part of the Institute's ReportingNZ project.
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Preface

This is a complex and emerging area of financial reporting.

Lay Wee Ng and I have thoroughly enjoyed the many conversations we have had between ourselves and with colleagues and friends that work in this space. We have also had the pleasure of discussing this issue with a number of experts living in New Zealand and overseas. Thank you, all of you who have shared your observations and expertise; this paper is all the better for those often rigorous debates.

Lay Wee's detailed understanding of the accounting system and standards is in my view second to none. We have worked together since 2018, and late last year I was delighted when Lay Wee accepted the role of patron at the Institute.

Our earlier publications that discuss reporting on climate change issues include: *Discussion Paper 2019/01: The Climate Reporting Emergency: A New Zealand case study* (2019) and *Report 17: Reporting NZ: Building a Reporting Framework Fit For Purpose* (2020). Our interest in this area is in helping ensure that climate risks are publicised. We believe transparency will help create the necessary urgency to turn policy into action, and to deliver real benefits in response to our international agreements, domestic strategies and plans.

This paper explores, through the lens of climate change, how new and emerging risks might be reported in future financial statements of the New Zealand Government. It takes one specific, but significant, issue and puts it through the accounting standards microscope.

Professor Ian Ball's expertise at key times was critical to the development of this paper. Ian said of the paper: 'It is a great illustration of how financial information can contribute (or not) to the development of a rational response to a major issue facing society, now and for a considerable period into the future.'

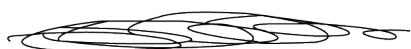
We would also particularly like to thank the authors of the Ministry for the Environment and Treasury's report *Climate Economic and Fiscal Assessment 2023 (CEFA 2023)*. This paper was useful and timely.

Thank you for taking the time to read this paper.

It has been a very interesting accounting problem to explore.

Please contact me at wmcg@mcguinnessinstitute.org to share your observations and thoughts. Lay Wee and I welcome your feedback – this issue is likely to be ongoing.

Ngā mihi



Wendy McGuinness

McGuinness Institute
Chief Executive

18 June 2024

Executive Summary

The solution to the overarching accounting problem – does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government? – can be found by reading two key tables.

Table 6.1 illustrates how the accounting standards provide guidance to preparers on the accounting treatment of liabilities and contingent liabilities (see p. 43). The table shows three ways uncertain costs can be reported:

- as a provision recognised in a statement of financial position (i.e. the balance sheet) (see rows 1 and 2);
- as a contingent liability disclosed in the notes to the financial statements (see row 3); or
- as an explanation in the notes to the financial statements (see rows 4 and 5). Preparers make these types of decisions based on a shared understanding of a set of common concepts, standards and guidance documents.

As a result of applying Table 6.1 to the overarching accounting problem, Table 6.2 lists the five reporting options that exist:

- Option (i): Liability in the statement of financial position
- Option (ii): Liability and a contingent liability in the financial statements (the Institute's preference)
- Option (iii): Contingent liability in the notes to the financial statements
- Option (iv): Explanation in the notes to the financial statements
- Option (v): Commitments are not disclosed at all

We discuss all options in detail. Two feasible options became apparent. The Institute prefers Option (ii), but also identified a second option for consideration, Option (iii). Importantly, three other options were considered not credible for various reasons: Options (i), (iv) and (v). See discussion in Section 6.5.2 (p. 76).

Importantly, as preparers of the financial statements of the New Zealand Government, Treasury can, and should, apply the accounting standards as they consider appropriate. Treasury has adopted one of the reporting options the Institute rejects, Option (iv). This difference of opinion is central to the purpose of this paper. Appendix 6 contains the 20 February 2024 *Treasury Report T2024/263: The accounting treatment of New Zealand's commitment under the Paris Agreement* (the 2024 *Treasury Opinion*), and explains Treasury's perspective.

The purpose of this discussion paper is to provide an alternative view and invite wider discussion on the accounting treatment in the financial statements of the New Zealand Government. Firstly, it is important to set out where we agree. The Treasury and the Institute agree on an number of areas, including the following:

1. The External Reporting Board's (XRB's) *Public Benefit Entity International Public Sector Accounting Standard 19 Provisions, Contingent Liabilities and Contingent Assets (PBE IPSAS 19)* is the primary accounting standard for determining the accounting treatment. Interestingly, the standard was issued in 2014 while the NDC1 commitment came into existence in 2021, meaning the standard was written before the Paris Agreement was even imagined.
2. Uncertainty exists over (i) the price of carbon credits and (ii) the number of offshore carbon credits that will need to be purchased. However, as we move closer to 2030 the level of uncertainty decreases.
3. The amount in question is highly likely to be significant and material to the financial statements of the New Zealand Government (hence Treasury's inclusion of the risk as a specific fiscal risk in the *Budget Economic and Fiscal Updates (BEFUs)* since 2021 (see Appendix 4).
4. The commitment should be disclosed to the wider public. Treasury currently acknowledges that this commitment broadly exists in an explanatory note in the 2022 and 2023 Financial Statements (but without

any detail), and discusses the size of the financial risk in the *Climate Economic and Fiscal Assessment 2023* (CEFA 2023). The assessment explores a diverse range of scenarios and finds that the cost of purchases could range anywhere between \$3.3 billion to \$23.7 billion.

5. If the Government were to report this commitment in the financial statements as a provision or a contingent liability, it would likely be a world first (although we consider this is not the test). The test is whether the financial statements of the New Zealand Government meet the principles, requirements and practices set out in New Zealand's existing public sector accounting standards.
6. Disclosing this financial risk in the financial statements, on its own, does not amount to a cash transaction. At the end of every financial year, the previous journal entry would be reversed and the new figure would be estimated and for 30 June. This would occur every year until either all the expected carbon credits are purchased in preparation for 2030 or New Zealand withdraws from the Paris Agreement.

Where we differ:

1. When the Institute applies the accounting standard *PBE IPSAS 19* to the offshore abatement issue, we find that a constructive obligation exists and that a legal obligation may exist. This is inconsistent with Treasury's view that there is no liability or contingent liability. In this paper, we evidence why we consider a constructive obligation exists, and provide some discussion on why we consider a legal obligation may exist. Given this legal uncertainty, we have made a recommendation to the Minister of Climate Change, Simon Watts, to seek a legal opinion on the latter. A legal opinion is beyond the scope of this paper.
2. In addition to the nature of the obligation, there are two other criteria stated within *PBE IPSAS 19* (see Table 6.1):
 - the likelihood an outflow of resources will be required to settle the obligation, and
 - the extent to which a reliable estimate can be made.
3. Treasury acknowledges that a specific fiscal risk exists, and in their words, 'While the Government has choices about how it achieves NDC1, it is likely that fulfilling these commitments will involve significant costs to the Government, starting within the current fiscal forecast period' (see Appendix 4, 2024 BEFU).
4. Treasury argues that a reliable estimate cannot be made because the Crown may decide to change its policy, for example 'to shift the costs onto the private sector'. See in particular, Table 3 of the 2024 *Treasury Opinion* in Appendix 6. However, in our view this would not only have a significant impact on the private sector over the next five years, it would still trigger some form of equivalent disclosure and arguably the need to report any net difference in the financial statements as a provision or contingent liability. In our view, contingent liabilities are called contingent because they aim to share with the stakeholder what the liability is contingent upon, and that means setting out the assumptions that are being relied upon.

The paper is dense in places but we have endeavoured to provide the detailed evidence and argument for those who wish to explore this issue more deeply. Reporting on climate change risks in the financial statements, in both the public and private sector, is a new and emerging area of accounting, but in our view the current standards provide sufficient guidance to report the commitment as a liability and a contingent liability. This is important because we rely on timely information to develop and implement public policy. The discussion on climate risk is likely to be of interest to those exploring how other new and emerging risks should be treated.

Our view is that the time has come for the financial statements of the New Zealand Government to recognise and report this risk, which would then be subject to audit, so that we are better able to focus on finding ways to minimise this obligation, and adapt to climate change. Climate change will challenge us in ways we cannot even imagine today, but while the implications may be uncertain, the existence of the change is certain.

In 2015, the Conference of the Parties (COP) invited New Zealand and other countries to communicate in a manner that facilitates clarity, transparency and understanding over its intended NDCs. New Zealand's response was, 'We recognise tackling atmospheric stocks of carbon dioxide as our most pressing collective problem. The limited domestic abatement potential available to New Zealand requires us to make use of global carbon markets.'¹ In effect, in 2015 New Zealand committed to pay the cost of excessively polluting the planet. Ten years later our strategy has not changed, and we are now almost two-thirds of the way to the year 2030.

1.0 Introduction

This is a technical discussion paper that explores whether a commitment by the New Zealand Government to purchase offshore carbon credits to offset emissions should be reported in the financial statements of the New Zealand Government (the overarching accounting problem). It discusses how such a commitment might be treated as a provision or as a contingent liability and whether the financial value can be determined reliably (and, if so, on what information this conclusion should be based). As a precursor to signing the Paris Agreement, Treasury officials provided advice to Cabinet on the accounting treatment in 2015/2016. Since then, Ministers have requested two further opinions: one in 2021 and another in 2024 (see Appendix 6 for Treasury's latest advice to Ministers).² In all cases, Treasury has taken a view that reporting this commitment as a liability and/or contingent liability does not meet generally accepted accounting practice (GAAP).

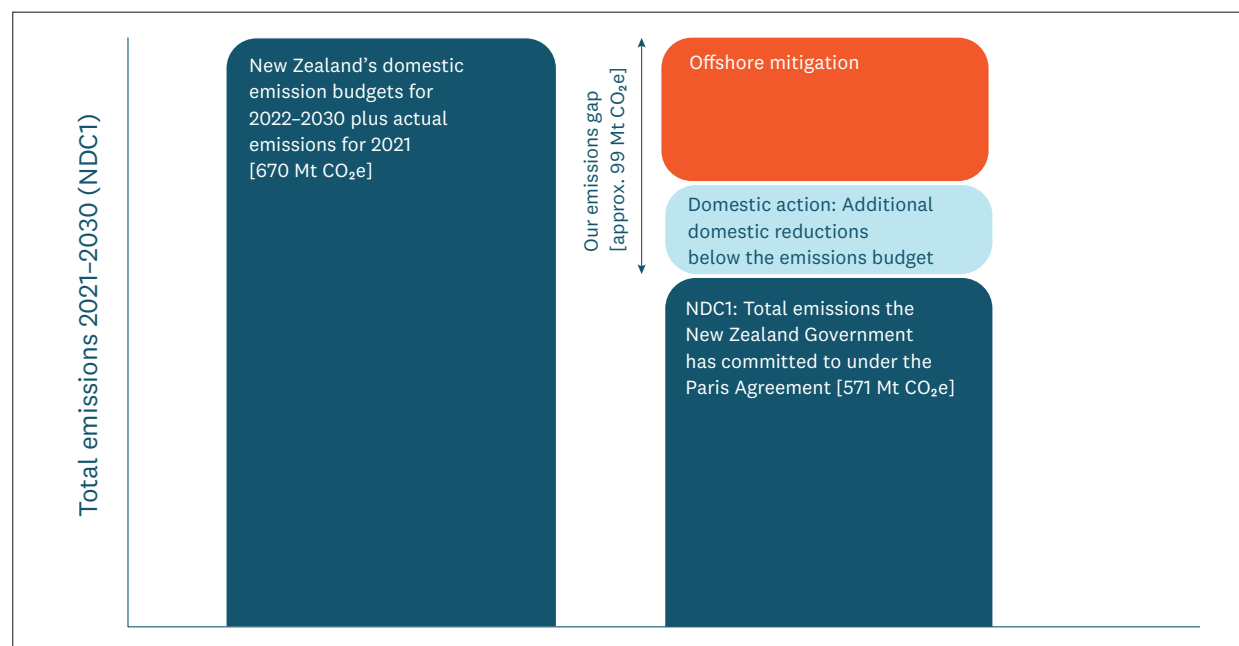
This is a new and emerging area of accounting, and an opposing view may have implications not just for New Zealand but for all nation states that produce financial statements. If you can argue that climate policy (strategy) and accounting policy (reporting) should be linked, the question becomes not if, but when, this commitment should be reported in the financial statements of nation states. This paper aims to contribute to a discussion on how financial statements should report the financial risks of climate commitments to citizens, in much the same way corporate climate reporting communicates climate risk to stakeholders.

In attempting to solve the overarching accounting problem, four accounting questions were identified, explored, discussed and, where possible, answered. Section 2 sets out the methodology and Sections 3, 4 and 5 describe the background. Section 6 attempts to answer each of the four questions. Section 7 discusses what this means for New Zealand and international standard setters (who issue standards), and puts forward a number of recommendations. Appendices 1–6 provide background information or excerpts from key documents.

The size of this commitment, what is called our emissions gap, is shaped by the difference between our emissions and our nationally determined contribution (NDC) (see Figure 1.1 below, and Appendix 2, which contains excerpts from the Climate Change Commission's (CCC's) 2021 report *Ināia tonu nei: a low emissions future for Aotearoa*). Once our emission reductions from country-wide actions are deducted, a shortfall remains. Unfortunately, this shortfall can only be met through reducing carbon domestically, or purchasing offshore carbon credits.

Figure 1.1: New Zealand's NDC1 Strategy, 1 January 2021 to 31 December 2030

Adapted from Figure 22.1: Illustration of the role of international mitigation in the NDC compared to emissions budgets, He Pou a Rangī Climate Change Commission, *Ināia tonu nei: a low emissions future for Aotearoa*, May 2021, and from the *Nationally Determined Contribution Strategy*, July 2023 [Cabinet Paper], PowerPoint (slide 8)³



1.1 Our 2021 discussion paper

On 12 October 2021, the Treasury published the *Financial Statements of the Government of New Zealand for the year ended 30 June 2021*.⁴ Given that the 2021 Financial Statements did not mention the commitment to purchase offshore carbon credits, the Institute was interested to explore whether another perspective was possible. In late 2021, we prepared a draft discussion paper, *Discussion Paper 2021/04 – An Accounting Dilemma: Does a commitment to purchase offshore carbon credits create a requirement to disclose that obligation in the financial statements of the New Zealand Government?* We invited feedback and considered it, but given recent developments (listed below) we decided a more extensive paper was required. Hence the draft 2021/04 has evolved into a completely new paper, *Discussion Paper 2024/01: Risks Hiding in Plain Sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?*

As with the 2021 discussion paper, we invited feedback on the draft of the paper (the *Discussion Paper 2024/01*). This closed on 23 March 2024. This is now the final paper.

Some key events have occurred since the initial 2021 discussion paper:

1. The *Financial Statements of the Government of New Zealand for the year ended 30 June 2022* and the *Financial Statements of the Government of New Zealand for the year ended 30 June 2023* include a discussion of this issue in the notes, but the Government has not, to date, reported the commitment in the statement of financial position (the balance sheet).^{5, 6}
2. The Secretary to the Treasury, Caralee McLiesh, estimated the possible cost of international mitigation at a conference on 19 September 2022. McLiesh stated that ‘the Treasury estimates that meeting the international commitments under the Paris Agreement through our Nationally Determined Contributions could require up to \$12.8 billion in overseas mitigation by 2030’.⁷ To provide context, \$12.8 billion is equivalent to a one-off cost of \$2429.21 per New Zealand resident.⁸ This accounting problem was discussed in more detail in the Ministry for the Environment and Treasury’s April 2023 report *Climate Economic and Fiscal Assessment 2023 (CEFA 2023)*.
3. New Zealand agreed to the Paris Agreement guidance for the tracking of and accounting for progress in implementation and achievement of NDCs for those parties planning to use offshore mitigation under Article 6, at COP26 (December 2021). This guidance establishes an emissions accounting process based on annual corresponding adjustments for transfer and use of offshore mitigation throughout the period rather than accounting after the end of the period.⁹
4. The External Reporting Board (XRB) has issued Aotearoa New Zealand Climate Standards (NZ CS). The XRB was enabled by the Financial Sector (Climate Related Matters and Other Matters) Amendment Act 2021 (the Act) to issue a climate-related disclosure framework. In response, the XRB issued NZ CS in December 2022. NZ CS apply to climate reporting entities as identified in the Act.¹⁰ Notably, the New Zealand Government was not included as a ‘climate reporting entity’ in the list of entities mentioned in s 461O.¹¹
5. Recent work by international standard setters has included:
 - the International Public Sector Accounting Standards Board (IPSASB) decision to move ahead with developing the first sustainability reporting standard for the public sector (see Section 3.3.1),
 - the International Financial Reporting Standards (IFRS) Foundation’s establishment of the International Sustainability Standards Board (ISSB) to set standards for the needs of investors and the financial markets (see Section 3.3.2),
 - the International Accounting Standards Board’s (IASB’s) project to explore whether, and how, companies can provide better information about climate-related risks in their financial statements (see Section 3.3.3),

- the April 2024 IFRS Interpretation Committee’s decision of on Climate-related Commitments and IAS 37 Provisions, Contingent Liabilities and Contingent Assets (see Section 3.3.4). In this paper we refer to the resulting decision as the *2024 IFRIC Decision*, and
- the IPSASB’s 2023 revision to its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (see Section 3.3.5).

2.0 Methodology

The purpose of this paper is to explore what information should be reported, and where and when, on the basis that this information is likely to be useful and relevant as the Government, businesses and the public transition to a net zero economy.

The New Zealand Government's commitment to purchase offshore carbon credits to offset emissions is relevant, decision-useful information. This paper builds on the Institute's *Discussion Paper 2019/01 – The Climate Reporting Emergency: A New Zealand case study* (2019) and *Report 17 – ReportingNZ: Building a Reporting Framework Fit for Purpose* (2020).

This paper tests whether existing generally accepted accounting practice (GAAP) provides adequate guidance on how this commitment may (or may not) be reported in the New Zealand Government's financial statements. For example, if applying GAAP provides little guidance or creates uncertainty over the accounting treatment of this commitment, this raises a further question – whether GAAP should be amended to provide more clarity, so that the purpose of financial reporting better aligns with the purpose of the New Zealand Government's strategic intentions and global climate policy more generally.

The paper also raises and touches on a number of policy questions that may ultimately impact reporting in the future. If it is decided that this commitment should be reported in the Government's financial statements, this calls into question whether all for-profit entities and not-for-profit public benefit entities that publicly commit to purchase carbon credits to offset emissions should also report this commitment in their financial statements. For example, public sector entities that are participants in the Carbon Neutral Government Programme are required to offset remaining gross emissions from 2025 to achieve carbon neutrality.

In addition, reporting this commitment in the financial statements of the New Zealand Government may shape domestic public policy going forward. For example, to reduce the quantity of offshore carbon credits needed in future years, the Government may decide to take greater action domestically, such as paying farmers 'not to farm' livestock, or paying manufacturers to switch to electric process heating (EPH).

2.1 Method

When writing this paper, the primary focus was on how to apply the current New Zealand Public Benefit Entities Standards (NZ PBE Standards) to answer the key question mentioned in the title. The External Reporting Board (XRB) issues both for-profit and not-for-profit standards. As the financial statements of the Government of New Zealand form part of the public sector, the New Zealand Public Benefit Entities Standards (NZ PBE Standards), in particular *PBE IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets*, set out the treatment of when and how provisions and contingent liabilities should be reported in financial statements. Based on the content of *PBE IPSAS 19*, four key questions became apparent. Section 6 answers each of these questions in detail. The earlier sections set the context and the later sections discuss the implications.

Question 1: Does a legal or constructive obligation exist?

Question 2: Can the value be reliably estimated?

Question 3: Is it a liability that should be recognised in the statement of financial position?

Question 4: Is it a contingent liability that should be disclosed in the notes to the financial statements?

2.2 Terminology

Given the technical terms included here, we outline a few key terms below as used in this paper. Section 5 also includes a list of key terms from the Public Finance Act 1989 (Box 1, p. 34) and a list of selected terms from the 2024 BEFU (Box 2, p. 34).

- **Commitment** and **obligation** have different meanings: a commitment is the start of the narrative, as in ‘the Government committed to meeting the NDC1 Budget’. In contrast, we have used the term ‘an obligation’ in the accounting sense to mean a commitment arising from a past event, the settlement of which is expected to result in an outflow of resources from the entity. For example, a ‘liability’ is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of resources. If an obligation is found to exist, the nature of the obligation will determine how the commitment is reported in the financial statements of the Government of New Zealand (see Table 6.2, p. 75).
- **Offshore abatement** and **international mitigation** have the same meaning.
- **Reporting** and **disclosure** are linked terms: reporting refers to all information contained in the financial statements. Financial statements comprise the core financial statements, including the notes. The notes explain the accounting policies used, the assumptions used to prepare the amounts in the financial statements, any activities that have influenced the financial results and any other information that the preparers of the financial statements judge is relevant. This includes alerting the reader to relevant information that may significantly influence the entity’s financial results in the future. In this paper, we have used the term ‘disclosure’ to refer to information reported in the notes, as distinct from transactions or events that meet recognition criteria and are reported on the face of the appropriate core financial statement. ‘Adequate disclosure’ is the concept that the complete package of an entity’s financial statements (including accompanying disclosures in the form of notes) provides all key information needed by users to understand the entity’s financial situation.
- **Recognised** is an accounting term: it is the process of including, in monetary amounts, the transactions and events that meet the necessary recognition criteria in accounting standards and displaying them on the face of the appropriate financial statement. The recognition criteria are that the item satisfies the definition of an element (for example, an asset, a liability, equity, revenue or expense) and can be measured. A provision is an example of a liability, so when we refer to liabilities in this paper, we are in effect referring to recognised liabilities. A liability is different from a contingent liability. A contingent liability is not ‘recognised’ in the statement of financial position as it does not meet the recognition criteria, but is instead reported (disclosed) in the notes to the financial statements.
- **Accounting estimate** has a specific meaning in accounting, and is not to be confused with estimates more generally. Importantly, both accounting estimates and inputs can be reported upon. See Section 6.2.2, p. 60.

2.3 Scope and limitations

This paper’s scope is considerably wider than initially envisaged. This is because of how great a role ‘judgement’ plays in the accounting treatment of legal obligations and constructive obligations. For this reason, the paper now includes a lot more background information on New Zealand’s current climate change framework.

We also appreciated that the earlier draft paper (*Discussion Paper 2021/04*) had two types of reader: experts in accounting standards and experts in New Zealand’s climate change framework. We have now separated information for those groups into Section 3 and Section 4 (respectively), so readers can more easily find what they seek to learn, and ignore or skim what they already know.

The feedback from the initial draft of this paper (*Discussion Paper 2024/01*) in March 2024 led to the addition of a new section, Section 5: Background: Government’s financial reporting system, and two further working papers: *Working Paper 2024/10 – List of all Cabinet Papers that relate to climate change published 2001–2024* (in progress) and *Working Paper 2024/11 – Illustration of the Government’s financial reporting system*. This is a complex paper and the feedback was essential: thank you again to the many people that took the time to contribute and share their ideas.

Given the technical nature of these topics, we have heavily cited and inserted excerpts so that readers do not have to flick between key documents.

With more time, it would have been interesting to review the work of other jurisdictions' climate-related disclosure requirements. However, to be useful this would also have required a more detailed understanding of how each selected country had (or had not) embedded the Paris Agreement in its legislation and policies, strategies and plans. As this was not critical for the paper's purposes, it was decided to keep other jurisdictions out of scope.

This paper does not explore whether the obligation to purchase offshore carbon credits is good or bad public policy, or whether offshore carbon credits should be purchased or not. It looks solely at whether this commitment should be reported in the Government's financial statements and, if so, where in the financial statements it should be reported and at what value. The accounting dilemma is one of timing and transparency.

Furthermore, the paper does not explore different measurement methods for calculating total emissions in any detail. This is a difficult and complicated area that needs to be better articulated so that it is easy to compare over time and between countries. The results of different measurement methods will also determine the value of the commitment to be reported in the financial statements. Further detail on New Zealand's approach is likely to be provided in the first biennial transparency report (BTR1) by 31 December 2024, in accordance with the modalities, procedures and guidelines (MPGs) of Article 13 of the Paris Agreement.¹²

The journal entries underlying the recommendations at the end of this paper will require a monetary amount to be estimated, and clarity over where they sit and what they are called in the statement of financial performance and the statement of financial position. We have used the \$12.8 billion figure estimated by the New Zealand Treasury as a starting point. Importantly, this figure is dated (September 2022) and was a maximum estimate suggested at that point of time. We have used this figure to illustrate the transactions and in no way wish to imply it is the final figure that should be used in the 2024 Financial Statements.

This paper does not explore the impacts on the financial statements post-2030. We have not commented on how the actual purchase of offshore abatement, if in the form of carbon credits, should be treated in the financial statements once they have been purchased, or how they might be removed from the financial statements when they are retired to offset past emissions (i.e. to help meet the NDC1 target). Given this aspect of the NDC1 policy has yet to be discussed publicly, and New Zealand officials will be working hard to develop effective trading arrangements with other countries, we have not tried to explore what the reporting impacts on the 2031 financial statements, or beyond, might look like.

Lastly, it is important to acknowledge that while this paper focuses on the reporting of the commitment under NDC1 (which finishes on 31 December 2030), in practice this reporting issue will continue and become more complicated. Once the Government puts forward its NDC2 budget in 2025 (for the five years between 2031 and 2035), the reporting of any commitment to purchase offshore carbon credits may need to be taken into account in the financial statements from 2025 onwards. Although this paper only focuses on NDC1 commitments, the treatment will set a precedent for the reporting of future NDC's commitments to purchase offshore carbon credits.

3.0 Background: financial reporting

To help readers new to this topic understand financial reporting terminology, key terms and legislation are briefly described below.

3.1 What is GAAP?

Generally accepted accounting practice (GAAP) can take the form of either reporting standards or an authoritative notice issued by the New Zealand External Reporting Board (XRB). The XRB is an independent Crown entity responsible for developing and issuing reporting standards on accounting, audit and assurance, and climate, for entities across the private, public, and not-for-profit sectors in New Zealand. Under the Public Finance Act 1989, GAAP has the same meaning as in s 8 of the Financial Reporting Act 2013.

Relevant sections in the Financial Reporting Act 2013 are:

Section 5(1): Interpretation

... applicable financial reporting standard, in relation to a reporting entity and to an accounting period or an interim accounting period of a reporting entity, means a financial reporting standard that applies to the reporting entity and to the accounting period or the interim accounting period in accordance with the financial reporting standard

authoritative notice means a notice issued under section 12(c); and includes an amendment to an authoritative notice that is issued by the Board ...

Section 8: Meaning of generally accepted accounting practice

In this Act, financial statements, group financial statements, a report, or other information complies with generally accepted accounting practice only if the report, statements, or information comply with—

- (a) applicable financial reporting standards; and
- (b) in relation to matters for which no provision is made in applicable financial reporting standards, an authoritative notice.

Section 12: Functions of Board

The Board has the following functions:

- (a) to prepare and, if it thinks fit, issue financial reporting standards for the purposes of any enactment that requires—
 - (i) financial statements or group financial statements to comply, or be prepared in accordance, with generally accepted accounting practice or non-GAAP standards; or
 - (ii) a statement, report, or other information to comply, or be prepared in accordance, with financial reporting standards:
- (aa) to prepare and, if it thinks fit, issue climate standards for the purposes of any enactment that requires climate statements or group climate statements, or a statement, report, or other information to comply, or be prepared in accordance, with the climate-related disclosure framework:
- (b) ...
- (c) to prepare and, if it thinks fit, issue authoritative notices for the purposes of—
 - (i) the definition of generally accepted accounting practice; or
 - (ii) the definition of climate-related disclosure framework ...

GAAP is also defined in the XRB accounting standards *EG [Explanatory Guide] A1: Guide to Application of the Accounting Standards Framework*:

GAAP is defined in section 8 of the Financial Reporting Act 2013 and means compliance with:

- (a) Applicable accounting standards; and
- (b) Authoritative notices. (Para 19)

In accordance with this definition, accounting standards issued by the XRB Board or the NZASB [New Zealand Accounting Standards Board] are the primary indicators of GAAP in New Zealand. They set out the recognition, measurement, presentation and disclosure requirements for transactions and events that are important in the preparation of GPFR [General Purpose Financial Reports], including those that may arise in specific industries ... (Para 20)

As outlined above, under section 12 of the Financial Reporting Act 2013, the XRB is responsible for issuing accounting standards (including 'non-GAAP standards') and authoritative notices. (Para 27)¹³

However, not all the documents issued by the XRB have legal status. Between them, the XRB Board and the NZASB issue five types of document:

- accounting standards (including non-GAAP standards) and related interpretations which are issued under s 12(a) of the Financial Reporting Act 2013
- climate standards which are issued under s 12(aa) of the Financial Reporting Act 2013
- documents or pronouncements, such as conceptual framework documents, that are issued as Authoritative Notices under s 12(c) of the Financial Reporting Act 2013
- consultation documents, such as consultation papers and exposure drafts, that have no legal status
- explanatory documents that have no legal status.¹⁴

In relation to reporting, the first three documents issued by the XRB are types of secondary legislation (as described under s 5 of the Legislation Act 2019), whereas the last two are not.¹⁵

3.2 Where is the requirement to publish annual financial statements?

The requirement to prepare and publish the annual financial statements of the New Zealand Government is set out in the Public Finance Act 1989. According to the Act's reporting requirements, annual, interim and forecast financial statements are required to apply generally accepted accounting practice (GAAP).

Relevant sections in the Public Finance Act 1989 are:

Section 2(1): Interpretation

[F]orecast financial statements means a set of statements that consists of—

- (a) a forecast statement of financial performance; and
- (b) a forecast statement of financial position; and
- (c) a forecast statement of cash flows; and
- (d) any other forecast financial statement required by generally accepted accounting practice; and
- (e) any other forecast financial statement required for a reporting entity by any regulations made, or instructions issued, under this or any other Act

Section 26H: Generally accepted accounting practice

All financial statements and forecast financial statements included in reports and updates required under this Part must be prepared in accordance with generally accepted accounting practice.

Section 26Q: Fiscal forecasts

- (1) The fiscal forecasts contained in the economic and fiscal update prepared under section 26O must, for each of the 3 financial years to which they relate, include forecast financial statements.

Section 27: Annual financial statements of Government

- (1) The annual financial statements of the Government must—
- (a) be prepared in accordance with generally accepted accounting practice; and
 - (b) include the forecast financial statements prepared under section 26Q, for comparison with the actual financial statements; and
 - (c) include, in addition to those financial statements required by generally accepted accounting practice,—
 - (i) a statement of borrowings that reflects the borrowing activities for that year, including budgeted figures for that year and comparative actual figures for the previous financial year;
 - (ii) a statement of unappropriated expenses and capital expenditure and unauthorised capital injections (excluding any capital injection to an intelligence and security department);
 - (iii) a statement of emergency expenses and capital expenditure incurred under section 25 and emergency capital injections (excluding any capital injection to an intelligence and security department) made under section 25A;
 - (iv) a statement of trust money administered by departments and Offices of Parliament;
 - (v) **any additional information and explanations needed to fairly reflect** the consolidated financial operations of the Government reporting entity for the financial year and its consolidated financial position at the end of that year. [bold added]

Two factors are worthy of special mention: the fiscal forecasts are required to look ahead three years (see s 26Q above), and the annual financial statements of Government ‘must’ contain additional information and explanations to ‘fairly reflect’ the Government’s financial operations and financial position (see s 27 above).

3.3 What are the latest developments?

3.3.1 IPSASB (and an upcoming sustainability reporting standard for the public sector)

New Zealand Public Benefit Entities Standards (NZ PBE Standards) for public benefit entities are based on International Public Sector Accounting Standards (IPSASs) and the International Public Sector Accounting Standards Board (IPSASB) Conceptual Framework.

In May 2022, the IPSASB issued a consultation paper, *Advancing Public Sector Sustainability Reporting*, to evaluate the demand from stakeholders for sustainability reporting guidance (or standards) for the public sector, focused initially on climate-related disclosures. The IPSASB has agreed to undertake the sustainability project and announced on 14 June 2023 that it will move ahead with developing the first sustainability reporting standard for the public sector.¹⁶

The IPSASB has established a Climate-related Topic Working Group. The Group will provide climate-related expertise and advice to address the objectives and specific issues of a public-sector-specific IPSASB climate-related disclosures standard. The IPSASB has also launched a Sustainability Reference Group (SRG) to provide strategic advice from a variety of perspectives on IPSASB’s overall sustainability reporting standards development programme (see Para 4.2, Sustainability Reporting – Climate-related Disclosures Project Brief).¹⁷

The IPSASB’s Climate-related Disclosures Project Brief and Outline (June 2023) states that development of the public-sector-specific IPSASB climate-related disclosures standard will build off the International Sustainability Standards Board’s IFRS S2 *Climate-related Disclosures* and layer on Global Reporting Initiative (GRI) climate-related topic and sector standards. It states:

There will be challenges ... to draw from two different standards which differ in certain ways such as financial materiality and broader impact approaches. In addition, there will be challenges to further layering on additional public sector context not addressed in private sector guidance, such as an entity's disclosures when its roles include policy making and/or regulation. However, this approach should support interoperability, as some public sector entities currently apply principles from TCFD [Task Force on Climate-Related Financial Disclosures], GRI and other frameworks, and maximize efficiencies to move quickly in addressing the urgent need for a public sector climate reporting standard. (Para 5.5)

Although there are other factors that contribute to climate change, this project will focus on GHG [Greenhouse gas] emissions in line with other international standard setters, statistics guidance and other targets (e.g. IFRS S2, UN FCCC Paris Agreement, and Nationally Determined Contributions (NDCs)). [bold added] (Para 5.6)

This project will also consider how disclosure requirements may be linked with and provide a central reporting model that may also be used for other purposes and existing public sector indicators such as NDCs, UN Sustainable Development Goal (SDG) 13 Climate Action, statistical sustainability reporting developments, and other international developments relating to climate change. [bold added] (Para 5.16)¹⁸

The IPSASB's Climate-related Disclosures Project Brief also states:

It is expected that climate-related issues will also impact financial reporting. The potential impact is expected to be similar for the private and public sectors. The International Accounting Standards Board (IASB) will also explore whether and how companies' financial statements can provide better information about climate-related risks as it was noted by private sector constituents that:

- a) Climate-related risks are often perceived as remote, long-term risks and may not be appropriately considered in the financial statements; and
- b) Investors need better qualitative and quantitative information about the effect of climate-related risks on the carrying amounts of assets and liabilities reported in the financial statements. (Para 3.2)

The objective of this project is not to address these financial reporting issues, however, staff will monitor and review any climate-related impacts to financial reporting. (Para 3.3)¹⁹

3.3.2 ISSB (and the first two IFRS Sustainability Standards)

On 3 November 2021, the Trustees of the International Financial Reporting Standards Foundation (IFRS) announced the formation of the International Sustainability Standards Board (ISSB) at the Conference of the Parties (COP26) in Glasgow, following strong market demand for its establishment. The ISSB is developing, in the public interest, standards that will result in a high-quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets.²⁰

The ISSB has issued its first two IFRS Sustainability Disclosure Standards: IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, and IFRS S2 *Climate-related Disclosures*. IFRS S2 requires an entity to disclose information about climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, access to finance and/or cost of capital over the short, medium or long term ('climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects').²¹

3.3.3 IASB (and a project to consider climate-related risks in financial statements)

In March 2023, the International Accounting Standards Board (IASB) added a project to its work plan to explore whether and how companies can provide better information about climate-related risks in their financial statements.²² This is in response to calls for the IASB to enhance the reporting of climate-related risks in the financial statements. The project will complement, and connect to, the work of the ISSB.

Even though IFRS Accounting Standards require companies to consider climate-related matters in their financial statements when the effect of those matters is material information for investors, feedback to the IASB raised questions including:

- why companies that are expected to be affected by climate-related risks do not provide information about these effects in their financial statements
- why companies that have made net-zero commitments do not recognise liabilities or impair the value of their assets as a result of those commitments, and
- how companies should factor long-term uncertainties into the measurement of amounts in the financial statements.

As climate-related risks are often perceived as remote, long-term risks, they may not be appropriately considered in financial statements. The feedback to the IASB highlighted that investors need better qualitative and quantitative information about the effect of climate-related risks on the carrying amounts of assets and liabilities reported in financial statements.

The IASB's project will explore, through research and outreach, the nature and causes of concerns about reporting climate-related risks in the financial statements, in order to be more informed about appropriate actions to take. The outcome of the project may be narrow in scope – for example, minor amendments to IASB Standards, limited new application guidance or new illustrative examples and/or further educational materials. This project and the work of the ISSB aim to complement each other in facilitating connectivity in general-purpose financial reports.

3.3.4 IASB (and the 2024 IFRIC Decision)

The IFRS Interpretations Committee (IFRIC) is a committee of the IASB. The IASB sets International Financial Reporting Standards (IFRSs) for application by for-profit entities. While New Zealand adopts IFRSs for application by New Zealand for-profit entities, New Zealand's standards for public benefit entities are based on International Public Sector Accounting Standards (IPSASs) issued by the International Public Sector Accounting Standards Board (IPSASB). IPSASs are based largely on IFRSs. The IFRIC received a request in November 2023 asking it to clarify:

- whether an entity's commitment to reduce or offset its greenhouse gas emissions creates a constructive obligation for the entity;
- whether a constructive obligation created by such a commitment meets the criteria in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for recognising a provision; and
- if a provision is recognised, whether the corresponding amount is recognised as an expense or as an asset when the provision is recognised.²³

The Committee considered this request by reference to a fact pattern (a summary of key facts that are submitted for consideration) that applied to a hypothetical for-profit entity that publicly states its commitment to reduce its annual greenhouse gas emissions, reducing them by at least 60% of their current level by 20X9, and to offset its remaining annual emissions in 20X9 and in subsequent years, by buying carbon credits and retiring them from the carbon market. To support its statement, the entity publishes a transition plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in its annual emissions by 20X9 (please note that 20X1, 20X9 etc is how international standard setters reference years in examples).

The IFRIC considered this matter and, in November 2023, issued a tentative decision for public comment by 5 February 2024. The IFRIC issued its final decision in April 2024 (the *2024 IFRIC Decision*). The decision, which was assessed using current accounting standards, provides helpful analysis of whether a constructive obligation arises when an entity makes a commitment to reduce its annual greenhouse gas emissions and to offset its remaining emissions from a particular date, and publishes transition plans to achieve its emissions reduction.

Interestingly, IFRIC discussed the extent to which a constructive obligation might be more than just a promise made and expectation created. Comments made during the committee's discussions suggest a view that there needs to be some form of consequence for failing to follow through on the commitment.²⁴ For example, if there is no consequence, it is hard to argue there is no 'realistic alternative' to the commitment (see PBE IPSAS 19, Para 25).

In assessing the fact pattern that was submitted, the IFRIC observed that whether an entity's statement of its commitment to reduce or offset its emissions creates a valid expectation that it will fulfil its commitment (and hence creates a constructive obligation) depends on management's judgement of the facts and the circumstances surrounding the commitment. Management would apply judgement to reach a conclusion at each reporting date considering all relevant facts and circumstances existing at that date. If the facts or circumstances change from one reporting date to the next, so too could the conclusion. A summary of the decision concludes:

- If the entity's statement creates a constructive obligation, the obligation is not a present obligation as a result of a past event when the entity publicly states its commitments in 20X0: at that time, the entity has not taken the actions to which the statement applies. Neither stating a commitment nor taking actions that affirm the entity's intention to fulfil that commitment are events that create a present obligation. At that point in time, the costs that the entity will incur to reduce its annual greenhouse gas emissions and to offset the greenhouse gases it emits in 20X9 and in subsequent years are costs that it will need to incur to operate in the future – the obligations for those costs do not exist independently of the entity's future actions. The events that create a present obligation are the events to which the statement applies and those events have not occurred at the time the entity states its commitment. The entity will have a present obligation to retire carbon credits only if and when it emits greenhouse gases, that is, only if and when it emits greenhouse gases in 20X9 and subsequent years;
- A constructive obligation to reduce or offset greenhouse gas emissions, if one exists, would be owed to all people adversely affected by the emissions so would extend to the public at large;
- The entity recognises a provision if a reliable estimate can be made of the amount of the obligation and it has not already retired the carbon credits needed to offset its past emissions. The IFRIC concluded that in the fact pattern described, it is likely that the entity would be able to make a reliable estimate of the amount of a constructive obligation that satisfies the other recognition criteria; and
- If a provision is recognised, the corresponding amount is recognised as an expense unless it gives rise to, or forms part of the cost of, an item that qualifies for recognition as an asset in accordance with an accounting standard.

The IFRIC's response to the fact pattern example is important:

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

The IFRIC also observed that:

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

IFRIC concluded that the current standards were sufficient, and as a result, no additional standard-setting project was required be added to the IASB's work plan:

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

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

3.3.5 IPSASB (and the updated Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities)

In December 2023, the IPSASB issued an update to its Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (revised IPSASB Conceptual Framework).²⁵ The revisions to Chapter 5: Elements in Financial Statements are of particular relevance. The IPSASB's revised Conceptual Framework is not yet applicable in New Zealand. It is currently on exposure by the XRB, with comments on the exposure draft due by 21 June 2024.

The IPSASB Conceptual Framework is not a binding standard: it establishes the concepts that are to be applied by the IPSASB in developing IPSASs. The IPSASB Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities, nor does it override the requirements of standards. The authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities are specified in standards. However, the IPSASB Conceptual Framework can provide guidance in dealing with financial reporting issues not dealt with by standards. Preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in the Conceptual Framework.

Among other matters, the revised IPSASB Conceptual Framework clarifies a number of issues with regard to the recognition of liabilities, particularly non-legally binding liabilities, which are relevant to our discussion.

The revised IPSASB Conceptual Framework states that public sector entities can have a number of obligations (Para 5.15). Relevant points from the framework are as follows:

- Obligations are 'binding when an entity has little or no realistic alternative to avoid them' (Para 5.15).
- Binding obligations can be 'legal obligations or non-legally binding obligations' (Para 5.15A).
- 'It is not essential to know the identity of the external party before the time of settlement in order for an obligation and a liability to exist' (Para 5.15A).
- 'The absence of a settlement date does not preclude an obligation giving rise to a liability' (Para 5.15B).
- In terms of legal obligations, sovereign power 'is not a rationale for concluding that an obligation does not meet the definition of a liability'. In other words, being able to change the law in the future is not relevant; 'the legal position should be assessed at each reporting date' (Para 5.15E).

- Liabilities can arise from non-legally binding obligations (this means that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement) (Para 5.15F).
- Non-legally binding obligations that give rise to liabilities have the following attributes:
 - The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
 - As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
 - The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities. (Para 5.15F)

In relation to a transfer of resources from the entity, it states:

To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer resources—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the present obligation exists, and that, at least in one circumstance, it would require the entity to transfer resources. (Para 5.16A)

An obligation can meet the definition of a liability even if the probability of a transfer of resources is low. Nevertheless, that low probability might affect decisions about the information provided about the liability and how the information is provided ... (Para 5.16B)

‘Economic coercion’, ‘political necessity’ or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur a transfer of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation. (Para 5.17D)

In the Basis for Conclusions, the IPSASB emphasised that the ability to extinguish or reduce a present obligation by methods other than fulfilment does not mean that an entity has a realistic alternative of avoiding a transfer of resources and therefore a rationale for non-recognition of a present obligation as a liability, which otherwise meets recognition criteria. (Para BC5.19D)

The Basis for Conclusions also states that:

The 2014 Conceptual Framework included guidance that ‘if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before these events occur’. The IPSASB has deleted this guidance because it was inconsistent with the statement in paragraph 5.16A. that ‘to satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties)’. (Para BC5.19E)

Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. ... Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. This gives rise to concerns that such subjectivity undermines consistency in the reporting of liabilities, and can also impact adversely on understandability. Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means. (Para BC5.31)

A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an overstatement of that government’s net financial position. According to this view, if a government has a consistent record of raising citizen expectations through publicly-announced obligations to provide financial support—for example to the victims of natural disasters—and has met such obligations in the past, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting, and leads to the provision of information that does not meet the qualitative characteristics of faithful representation and relevance. (Para BC5.32)

On balance, the IPSASB agrees with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law. (Para BC5.33)

The revised IPSASB Conceptual Framework effectively reaffirms and clarifies the criteria for a constructive obligation.

In relation to the sovereign power to avoid obligations in legal provisions, the revised IPSASB Conceptual Framework states:

Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Conceptual Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability. (Para 5.15E)

This is explained in the Basis for Conclusions:

The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations arising from both exchange and non-exchange transactions. Although in a global environment such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the impact of sovereign power on the definition of a liability. The IPSASB concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the qualitative characteristics of relevance and faithful representation. Many respondents to the Consultation Paper and the Exposure Draft supported this position. The IPSASB therefore concluded that the determination of the existence of a liability should be by reference to the legal position at the reporting date. (Para 5.35)

As such, if the Paris Agreement commitments were to be determined to be legally enforceable in the domestic context (through being incorporated in domestic legislation and in trade contracts), the Government's ability to repudiate its obligations under the Paris Agreement may no longer be a valid reason for concluding that the obligations under the Paris Agreement do not meet the definition of a liability.

The revised IPSASB Conceptual Framework also states:

In some circumstances, to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as 'other resources' or 'other obligations') when necessary to better achieve the objectives of financial reporting. (Para 5.4)

In providing for this possibility, the IPSASB acknowledges in its Basis for Conclusions that:

... there may be circumstances under which the six elements defined in the Conceptual Framework may not provide all the information in the financial statements that is necessary to meet users' needs. In the view of the IPSASB it is transparent to acknowledge that other items may be recognized. (Para BC5.55)

The revised IPSASB Conceptual Framework widens the IPSASB's ability to require 'other resources' or 'other obligations' that do not satisfy the definition of an element (for example, as an asset or a liability) to be recognised when necessary to better achieve the objectives of financial reporting. This provides an avenue for addressing Paris Agreement commitments where there is doubt about whether an obligation exists.

3.4 Summary

The financial reporting framework is complex. Each country has its own standard setter, regulator, and audit function. The standards are generally adopted from international standard setters. There have been a number of international developments in recent years, many of which we discuss again in Section 7, alongside our recommendations.

The next section (Section 4) provides essential background material on New Zealand's climate framework. This is necessary in order to set the context for exploring the central purpose of this paper in Section 6, addressing the question: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?

4.0 Background: New Zealand's climate framework

To help readers new to this topic understand the existing framework, key terms, legislation and organisations are briefly described below. Appendices 1–3 provide more detail on New Zealand's existing climate policy. Appendix 1 illustrates the significant progress that has been made regarding a long-term non-partisan approach to climate change policy.

4.1 What are Nationally Determined Contributions (NDCs)?

An NDC is a climate action plan to cut emissions and adapt to climate impacts. Each party to the Paris Agreement is required to establish an NDC and update it every five years. New Zealand's first NDC period covers the years 2021 to 2030, and is called NDC1. The United Nations website explains the purpose of NDCs as follows:

The Paris agreement asks countries to update their NDCs every five years. But given the large gap between the emissions cuts required to limit global warming to 1.5°C and the emissions reductions currently planned, the Glasgow Climate Pact in November 2021 called on all countries to revisit and strengthen the targets in their NDCs in 2022. Each new round of updates is expected to ratchet up ambition through steeper emissions cuts and more expansive adaptation measures. Building on each other over time, the NDCs are essential to ensuring a livable future for everyone on the planet.²⁶

Subsequent NDCs will be for five years. Parties to the Paris Agreement have agreed to communicate their next NDC, NDC2 (for 2031–2035), in 2025, then communicate and implement further NDCs on a five-year cycle. NDCs are nationally determined but must reflect the highest possible ambition, and each subsequent NDC must be a progression on the previous one. There is no specific end point for the Paris Agreement.

The Paris Agreement's temperature goal of 'holding the increase in global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels' (Article 2) is reflected in the more specific mitigation goal (Article 4, paragraph 1) to 'achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases in the second half of this century'. This was updated in 2021 via the Glasgow Climate Pact, which recognises that 'limiting global warming to 1.5°C requires rapid, deep and sustained reductions in global greenhouse gas emissions, including reducing global carbon dioxide (CO₂) emissions by 45 per cent by 2030 relative to the 2010 level and to net zero around mid-century as well as deep reductions in other greenhouse gases'.²⁷

New Zealand's NDC1 emissions target (to reduce net emissions to 50% below 2005 gross emissions in 2030, implemented via an emissions budget across 2021–2030) has been set at a level that will require use of offshore credits to supplement domestic emissions reductions. The estimated gap between the domestic budgets and NDC1, as illustrated in Figure 1.1, is around 100 Mt CO₂e. However the actual offshore purchase could be more if the domestic budgets are not met or less if actual domestic emissions exceed the domestic budgets.

Importantly, Article 13 of the Paris Agreement creates a clear expectation over clarity and tracking of progress towards achieving countries' individual nationally determined contributions under Article 4, and countries' adaptation actions under Article 7, including good practices, priorities, needs and gaps, to inform the global stocktake under Article 14. See relevant excerpts on page 33.

New Zealand's actual cumulative purchase of offshore credits across the 2021–2030 period will be the difference between the NDC1 commitment and actual cumulative net emissions. This calculation is not done after 2030, but is progressively implemented across 2021–2030 via biennial reporting and review that starts in 2024 (being BTR1 in 2024, BTR2 in 2026, BTR3 in 2028 etc.). The expectation under the Paris Agreement is that New Zealand should show progress in implementation (domestic and offshore) every two years through this progress-tracking framework (initially outlined in Article 13 paragraphs 7(b) and 11, with further implementation agreed at COP26 in 2021).²⁸

The importance of demonstrating regular and ongoing progress is reflected in the ‘dynamic pathway’ approach agreed by Cabinet in the *2023 Nationally Determined Contribution Strategy (2023 Cabinet Paper)*, which links implementation of the *NDC Strategy* to the biennial Paris Agreement reporting cycle, including every two years determining ‘how much offshore mitigation is required to demonstrate progress for the next cycle’.²⁹ See discussion on the *NDC Strategy* in Section 6.1.2 (p. 46).

Lawyers for Climate Action New Zealand Inc (LCANZI) filed a judicial review in 2021 relating to the Climate Change Commission’s advice, and the Minister of Climate Change’s resulting decisions, on NDC1 and the domestic emissions budgets. One key issue in this case is whether the recommendations and decisions properly gave effect to the statutory purpose under the Climate Change Response Act 2002 to contribute to limiting warming to 1.5°C. LCANZI considers that the level of ambition did not go far enough. The High Court did not find in favour of LCANZI, but the case was appealed, was heard by the Court of Appeal in November 2023 and is now awaiting judgement.

This case has potential consequences for the extent to which there could be a legal obligation for achievement of the NDC1 and/or for offshore purchase, separately from questions on the ambition of NDC1 and the domestic budgets. For example, if the Court were to find that domestic budgets do not need to align with 1.5°C because the NDC represents an appropriate current level of commitment contributing to the global Paris Agreement’s climate mitigation effort, then delivering the international cooperation portion of the NDC (via international purchase) could be necessary for the domestic budgets to meet the requirements of the Act.

The *NDC Strategy* includes two scenarios that illustrate alternative pathways toward net zero.

Figure 4.1 contains two graphs from the *2023 Cabinet Paper*. The graphs illustrate that the more (or less) emissions change domestically, the less (or more) offshore abatement is required. Scenario A, the CCC’s demonstrative pathway, shows the pathway if current domestic emissions budgets are met. Scenario B, the CCC’s tailwinds pathway, shows an alternative future of more impactful domestic action paired with more optimistic assumptions around technology uptake and behaviour change. These scenarios illustrate three features of NDC1 that are relevant when considering the appropriate treatment of offshore abatement in the financial statements of the Government of New Zealand:

1. The Government has presented the NDC1 Budget of 571 Mt CO₂e as a straight line from 2020 base-year emissions to the 50% reduction target in 2030. This indicates that the NDC1 target can be seen as both a cumulative emissions budget (as shown in Figure 1.1, p. 8) and a linear progression over a period of time (i.e. 2021–2030, as shown in Scenarios A and B in Figure 4.1 overleaf).
2. Even in the most ambitious domestic scenario, Scenario B, domestic emissions are higher than the NDC1 target level in every year from 2021 to 2030. This means offshore abatement is required to cover this gap for every year in the NDC1 period.
3. While the annual gap between domestic emissions and the NDC1 target level can be reduced in future years, a shortfall has already occurred for three-and-a-half years (i.e. 2021, 2022, 2023 and half of 2024).

The *NDC Strategy* states:

The NDC1 Challenge

New Zealand’s NDC1 commitment is more ambitious than what can be achieved through domestic action alone

EB1 290 Mt (2022-2025)

EB2 305 Mt (2026-2030)

EB3 240 Mt (2031-2035)

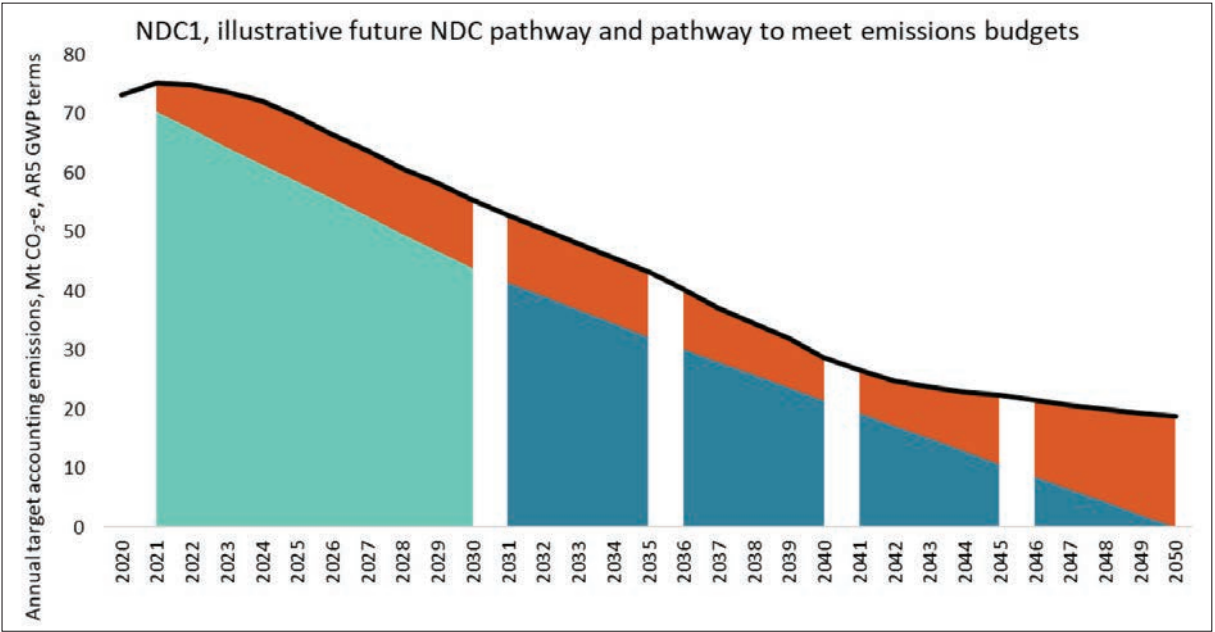
NDC 571 Mt (2020-2030)

Achieving New Zealand’s legislated domestic emissions budgets leaves a further 100 million tonnes of CO₂e to meet the NDC.

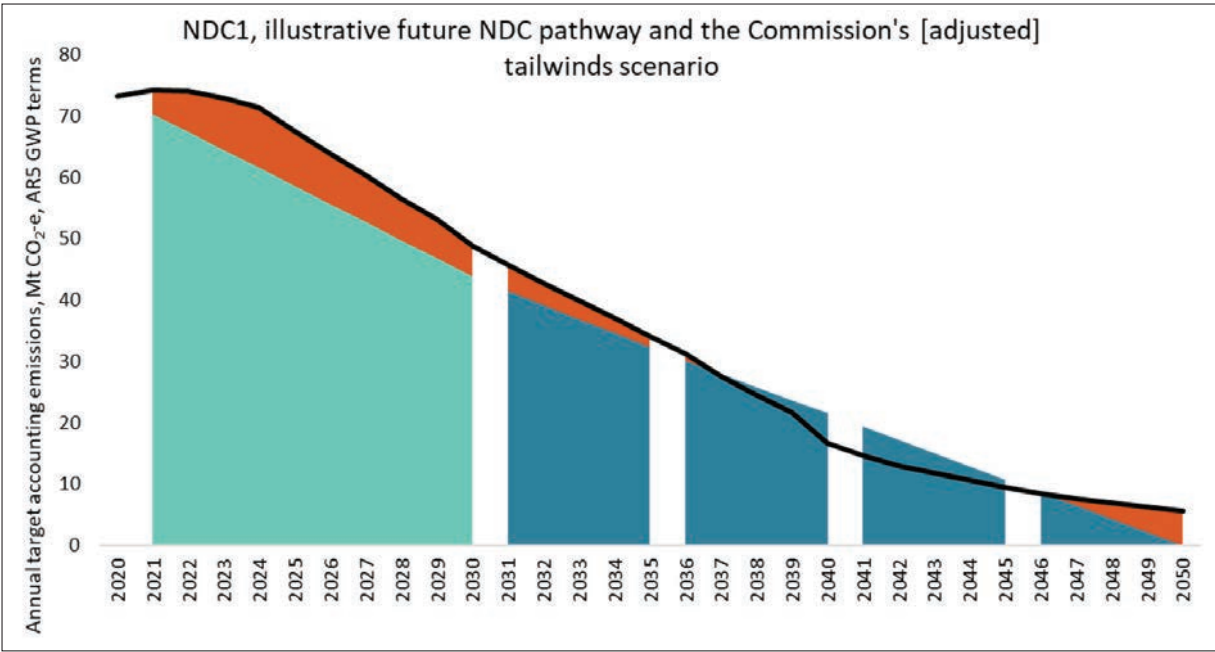
Even the Climate Change Commission’s ‘Tailwinds’ Scenario [overleaf] (more impactful domestic action with considerably more optimistic assumptions around technology uptake and behaviour change) **still leaves a gap of 75 Mt CO₂e.** [bold added]³⁰

Figure 4.1: Scenario A: The demonstrative pathway, and Scenario B: The tailwinds pathway

Scenario A: The demonstrative pathway³¹



Scenario B: The tailwinds pathway³²



Key

- Scenario A: CCC's demonstrative pathway (modelled path to meet domestic emissions budgets)
- Scenario B: CCC's tailwinds pathway (with adjustments in line with emissions budget decisions)
- Offshore abatement (orange)
- NDC1 Budget (turquoise), set at 571 Mt CO₂e
- NDC2-NDC5 Budgets (dark blue), yet to be set

Commentary

Each scenario impacts the level of offshore abatement required. The two scenarios illustrate the range of offshore abatement (shown in orange) that might be required to meet our NDC1 budget (shown in turquoise):

- Scenario A: Offshore abatement is about 100 Mt CO₂e.
- Scenario B: Offshore abatement is about 75 Mt CO₂e.

NDC1-NDC5

The data for NDC1-NDC5 (shown in turquoise and dark blue) is the same in both Scenario A and B. The emissions the New Zealand Government has agreed to live within are fixed (as a minimum). Parties to the Paris Agreement can only increase their ambition.

AR5 GWP

Refers to the 100-year time horizon global warming potentials (GWP) relative to CO₂ using the IPCC Fifth Assessment Report, 2014 (AR5).

4.2 What is the purpose of the Climate Change Response Act 2002?

The Climate Change Response Act 2002, including significant amendments in 2019 and 2020, sets out the framework by which New Zealand aims to develop and implement clear and stable climate change policies. The *Submission under the Paris Agreement New Zealand's first Nationally Determined Contribution* (updated 4 November 2021)³³ describes the Act's purpose as enshrining in legislation four key elements:

1. A domestic emissions reduction target for 2050

This target requires greenhouse gases (other than biogenic methane) to reach net zero by 2050 and emissions of biogenic methane to reduce to 10% below 2017 levels by 2030, and to 24–47% below 2017 levels by 2050.

2. A system of emissions budgets and emissions reduction plans (ERPs)

These are designed to act as stepping stones to the 2050 target and provide a framework for planning. Emissions budgets set a limit on the amount of greenhouse gas emissions allowed across a five-year period (or, in the case of the first budget, a four-year period). Emissions reduction plans set out the policies and strategies for achieving emissions budgets.

3. A Climate Change Commission (CCC) to provide independent advice and monitor progress

The Minister may direct the Commission to have regard to Government policy for the purposes of the Commission on providing advice about New Zealand's nationally determined contributions under the Paris Agreement (see s 5O). A 2021 note by the CCC made clear the intention and need to purchase offshore carbon credits and estimated the potential costs.

In the near term (over the next decade), purchasing offshore mitigation allows Aotearoa to strengthen its NDC while putting the country on the pathway to a low emissions future and managing the impacts on communities and businesses ...

Costs of purchasing offshore abatement

Assuming net emissions reduce in line with the Commission's proposed emissions budgets, **an additional 52 Mt of offshore mitigation would be needed to meet the current NDC.**

How much this would cost is uncertain. The Commission included a range of possible prices in our assessment in Ināia Tonu Nei up to \$140/tonne CO₂-e. These prices were chosen based on the range of prices in comparable markets overseas, and ENZ [Emissions in New Zealand] modelling of the cost of abatement within Aotearoa. [bold added]³⁴

The CCC's *Draft Advice to inform the strategic direction of the Government's second emissions reduction plan* (April 2023) provides clarity about the relationship between the budgets, plans and the NDCs (arguably more clearly than in the final advice).

Emissions reduction plans ... are focused specifically on meeting emissions budgets, the domestic 2050 target, and Aotearoa New Zealand's domestic contribution to limiting warming to 1.5°C. This [draft] advice on the direction of policy for the second emissions reduction plan therefore does not focus on these global contributions, including the Nationally Determined Contribution (NDC) under the Paris Agreement.

We note, however, that these international contributions remain relevant to this advice, as any emissions reductions achieved over and above those required within a budget period will help close the gap between Aotearoa New Zealand's domestic and global contributions. (p. 8)

Emissions budgets are the upper limit for allowable emissions rather than a goal. If achieving emissions reductions beyond the emissions budget requirements becomes possible, doing so would offer several advantages, including closing the gap to meeting Aotearoa New Zealand's Nationally Determined Contribution (NDC) under the Paris Agreement. (p. 32)³⁵

The CCC's 2023 *Advice on the direction of policy for the Government's second emissions reduction plan* (22 November 2023), noted:

Aotearoa New Zealand's first Nationally Determined Contribution and other international context

Aotearoa New Zealand has joined international efforts to address climate change alongside its domestic targets. This advice does not address this wider programme of work, as emissions reduction plans are focused specifically on domestic action led by the Government to meet emissions budgets, the domestic 2050 target, and Aotearoa New Zealand's domestic contribution to limiting warming to 1.5°C.

However, our commitments to international efforts are relevant to this advice, as emissions reductions resulting from emissions reduction plans will contribute towards meeting them. International targets can go beyond Aotearoa New Zealand's domestic emissions reduction targets. Overachieving emissions budgets – in other words achieving greater emissions reductions than required within an emissions budget period – will help close any gaps between Aotearoa New Zealand's domestic and global commitments.

International context

Advances in climate action give Aotearoa New Zealand the opportunity to access billions of dollars in trade deals as other countries incorporate climate requirements in fair trade agreements. For example, in July 2023, Aotearoa New Zealand signed a free trade agreement with the EU [European Union], worth NZ\$20.2 billion annually in 2022. The agreement seeks cooperation on climate solutions while holding each other accountable for commitments made under the Paris Agreement. (p. 85)

The Nationally Determined Contribution and offshore mitigation

... Offshore mitigation is expected to make a substantial contribution. In 2022, the Commission estimated that if the Government achieves its first and second domestic emissions budgets, **99 Mt CO₂e of offshore mitigation will be needed to meet the NDC.**

In *Ināia tonu nei*, the Commission provided advice on the NDC in response to a specific request from the Minister of Climate Change.

In October 2023, the Minister of Climate Change made another special request that we provide advice to help inform Aotearoa New Zealand's second NDC, which must be set by 2025 and will cover 2031–2035. The Commission's advice will be provided to the Minister of Climate Change by 31 December 2024. [bold added] (p. 86)

Note that a key reason why offshore mitigation is needed for meeting the current NDC is that Aotearoa New Zealand made **little [domestic] progress in reducing gross emissions to meet its previous emissions reduction targets (over 2008–12 and 2013–2020).** Ensuring [domestic] climate policies drive gross emissions down will help avoid a repeat of this situation. [bold added] (p. 182)

... the Paris Agreement does not allow countries to bank over achievement to count towards future NDCs. [bold added] (p. 187)³⁶

It is worth noting that the NZ-EU FTA agreement is expected to provide New Zealand with 'an annual boost to GDP of up to \$1.4 billion and increase of exports to the EU by up to \$1.8 billion per year by 2035'.³⁷

4. Adaptation measures to assess and address the risks from a changing climate

A number of policies and institutional arrangements have been established. Examples include the New Zealand Emissions Trading Scheme (NZ ETS), the Government Investment in Decarbonising Industry Fund (GIDI) and the Carbon Neutral Government Programme (CNGP).

4.3 How are emissions targets expressed?

Ensuring pledges are communicated in a consistent and transparent manner is essential if international partners, firms, and the public are to effectively assess New Zealand's targets over time, as well as compare New Zealand's targets with those of other countries.

There are many ways to set and account for greenhouse gases targets, the most common being gross emissions, net emissions or through emissions budgets. New Zealand has used both the net emissions and the emissions budget approaches. On 31 October 2021, the Government announced it was updating its NDC1 target, and in doing so, described the comparability challenge:

The updated NDC announced today is expressed as a target to reduce net emissions 50 per cent below gross 2005 levels by 2030. This equates to a 41 per cent reduction on 2005 levels using what is known as an 'emissions budget' approach.

New Zealand's updated NDC has been expressed as a point-year target today to align with how most other countries report their NDC's. This aids transparency and comparability. To date, only a small number of countries, including New Zealand, Australia, and Switzerland, report their NDCs as an 'emissions budget.'

Despite expressing the new NDC as a 'point in time' target, New Zealand's NDC will still be managed as a multi-year emissions budget. This means New Zealand will be accountable for all emissions produced in the years of the target period (2021–2030).

The Government continues to believe this provides greater certainty in emissions pathways. The budget-based approach is better for the climate, as it is not only emissions in 2030 that impact climate outcomes. Managing the NDC through an emissions budget means progress towards **our target will be measured by comparing emissions for all the years of the target period (2021–2030) and not by isolating emissions in a single year (2030).**

The provisional emissions budget for the new NDC is 571 Mt, a significant decrease on the 2016 NDC budget (623 Mt). [bold added]³⁸

The different measurement methods make it difficult to compare emissions targets for a specific country over time or compare emissions targets for two or more nations at one point in time (see discussion in Section 2.3).³⁹

4.4 To what extent do international emissions trading systems exist?

International emissions trading is wickedly complex, and despite efforts to establish a new trading mechanism under the Paris Agreement's Article 6 paragraph 4, no well-established centralised trading system yet exists. However, Article 6 paragraph 2 (and the implementation guidance for this agreed at COP26) enables countries to proceed with bilateral or multilateral cooperation. This could take the form of crediting for reductions occurring in another jurisdiction (such as the bilateral cooperation programmes established by Switzerland and Japan), or linking emissions trading systems (linking the European Emissions Trading System (EU ETS) with Switzerland and Norway).⁴⁰ See Table 4.1.

Table 4.1: Possible ways an entity might purchase offshore carbon credits⁴¹

The wild west approach	Linking trading schemes	Bilateral or multilateral arrangements	UN centralised crediting system (new)
Anything goes. Countries and firms shop around the world looking for emission reduction projects and claim the offsets, either within the bounds of established trading schemes, or outside existing structures.	The NZ ETS is linked with an equivalent offshore trading scheme, such as the EU ETS, allowing transfer of units arising from verified abatement between the two schemes. Importantly, the NZ ETS is currently aligned to our domestic targets, not our international targets. Linking carbon pricing schemes is difficult, as they are generally very complex and designed with domestic considerations in mind. For example, minor differences such as the treatment of forests lost to flood or fire can be major barriers to international linking. One-way linking (allowing overseas units into the NZ ETS) would avoid many of these complications.	Countries sign agreements setting out how they will count emissions sequestered in one jurisdiction but funded by another jurisdiction. These can be between individual countries, or groups of countries. An example of a bilateral arrangement might be New Zealand signing an agreement with Brazil to fund forest planting and counting the sequestration towards our NDC. Such an agreement would have to ensure Brazil did not also count the sequestration towards its own international commitments.	Work is under way to establish a new centralised crediting system to serve the Paris Agreement, replacing the Kyoto Protocol's Clean Development Mechanism, under Article 6.4 of the Paris Agreement. Negotiations at COP28 failed to agree to launch the new system, delaying its implementation by at least a year. Some carry-over of units from the Clean Development mechanism may also be used toward Paris Agreement NDCs.

4.5 What are the latest legislative developments?

The Climate Change Response (Zero Carbon) Amendment Act 2019 (13 November 2019) amended the Climate Change Response Act 2002, setting out both the target for 2050, and the requirement for the Minister of Climate Change to prepare an emissions reduction plan every five years from 2026 (with the exception of the first three years [2022 to 2025, see s 5X, overleaf]). The Act states:

Part 1A: Climate Change Commission

5Q Target for 2050

- (1) The target for emissions reduction (the 2050 target) requires that—
 - (a) net accounting emissions of greenhouse gases in a calendar year, other than biogenic methane, are zero by the calendar year beginning on 1 January 2050 and for each subsequent calendar year;
 - (b) emissions of biogenic methane in a calendar year—
 - (i) are 10% less than 2017 emissions by the calendar year beginning on 1 January 2030; and
 - (ii) are 24% to 47% less than 2017 emissions by the calendar year beginning on 1 January 2050 and for each subsequent calendar year.
- (2) The 2050 target will be met if emissions reductions meet or exceed those required by the target.

5ZG Requirement for emissions reduction plan

- (1) The Minister must prepare and make publicly available a plan setting out the policies and strategies for meeting the next emissions budget, and may include policies and strategies for meeting emissions budgets that have been notified under section 5ZD in accordance with the dates set out in section 5X(3).
- (2) The plan must be prepared and published—
 - (a) after the relevant emissions budget has been notified under section 5ZD; but
 - (b) before the commencement of the relevant emissions budget period.

- (3) The plan must include—
 - (a) sector-specific policies to reduce emissions and increase removals; and
 - (b) a multi-sector strategy to meet emissions budgets and improve the ability of those sectors to adapt to the effects of climate change; and
 - (c) a strategy to mitigate the impacts that reducing emissions and increasing removals will have on employees and employers, regions, iwi and Māori, and wider communities, including the funding for any mitigation action; and
 - (d) any other policies or strategies that the Minister considers necessary ...

5X Duty of Minister to set emissions budgets and ensure they are met

- (1) The Minister must set an emissions budget for each emissions budget period in accordance with this subpart
- (2) From 31 December 2021, there must be 3 consecutive emissions budgets, 1 current and 2 prospective, in place at any one time.
- (3) An emissions budget must be set and notified in the Gazette under section 5ZD as follows:
 - (a) for the emissions budget period 2022 to 2025, by 31 December 2021:
 - (b) for the emissions budget period 2026 to 2030, by 31 December 2021:
 - (c) for the emissions budget period 2031 to 2035, by 31 December 2021:
 - (d) for the emissions budget period 2036 to 2040, by 31 December 2025:
 - (e) for the emissions budget period 2041 to 2045, by 31 December 2030:
 - (f) for the emissions budget period 2046 to 2050, by 31 December 2035:
 - (g) or any subsequent emissions budget period, by 31 December not less than 10 years before that emissions budget period commences.
- (4) The Minister must ensure that the net accounting emissions do not exceed the emissions budget for the relevant emissions budget period.

Importantly, it is the 2021–2030 NDC1 target that may, directly or indirectly, trigger a legal obligation to purchase offshore carbon credits, because the counterfactual (not meeting our Paris Agreement via our domestic reductions) may be inconsistent with the requirements of the Climate Change Response Act. See discussion in Section 6.1.2 (p. 46).

On 15 September 2021, Cabinet agreed to begin consultation on the Emissions Reduction Plan in early October 2021, and promised to release a final Emissions Reduction Plan in May 2022 (in line with the 2022 Budget).⁴² The international equivalent to New Zealand’s *Emissions Reduction Plan* is the *Long-Term Low Emissions Development Strategy* (LT-LEDS), which was released at COP26.

On 31 October 2021, the Government announced an update to NDC1:

New Zealand will significantly increase its contribution to the global effort to tackle climate change by reducing net greenhouse emissions by 50 percent by 2030, Prime Minister Jacinda Ardern and Climate Change Minister James Shaw announced today on the eve of the United Nations climate conference in Glasgow.⁴³

Appendix 3 sets out New Zealand’s current international and domestic emissions targets.

4.6 What are the risks of the offshore mitigation strategy?

The problem New Zealand faces is not solely about reporting offshore mitigation in the annual financial statements. The Climate Action Tracker (7 March 2023 update) explained their concerns over how New Zealand's strategy of purchasing a significant amount of offshore credits in 2030 creates an alarming precedent, a strategy that other countries might follow. They suggested that the strategy is at odds with the intent of the Paris Agreement, and that it exposes current and future generations to financial risk.

The Climate Action Tracker states:

The New Zealand government plans to purchase emissions credits to achieve its 2030 NDC target using international offsets, in anticipation of an emissions overshoot. This would amount to New Zealand having to purchase international offsets amounting to around 75–102 Mt CO₂e over time given the NDC's emissions budget is 571 Mt CO₂e, which would set an alarming precedent for significant offset purchasing to meet an NDC. New Zealand is set to meet by far the highest proportion of its target (two thirds of the action required) through buying international offsets compared with any other OECD country. [bold added]⁴⁴

This is beyond the scope of this paper, but it is an important backdrop. It illustrates why the reporting of our strategy to purchase offshore credits and the resulting risk is important not just to New Zealand, but to other countries. Some may argue that our current strategy implies New Zealanders think it is acceptable to pollute here and pay others to make good our pollution elsewhere.

4.7 Summary

This section briefly summarises key events that set the background for the discussion in Section 6. Together with Appendices 1 and 2, the events illustrate the evolution of climate policy over time, moving from a policy problem to a policy solution, and in so doing, establishing a pattern of commitment by both major political parties (i.e. National and Labour) to creating durable and stable climate change policy.

The implications in terms of the financial reporting of the offshore mitigation approach, described in the *NDC Strategy*, are discussed in Section 6.

5.0 Background: Government's financial reporting system

The Government's financial reporting system may be viewed through two lenses; the first lens is linear and looks out over time. This lens distinguishes the financial statements of the Government, the forecast financial statements and the long-term fiscal statement in terms of the time period to which they relate (see Figure 5.1, p. 35). In contrast, the second lens distinguishes the degrees of uncertainty that may exist (for example in relation to the risk associated with a certain event occurring) at a particular point in time. This distinction can be seen in the treatment of risk in the twice-yearly economic and fiscal updates (BEFU and HYEUFU) and the pre-election economic and fiscal update (PREFU). The updates outline what the Treasury observes in the current economic climate and foresee what might happen in the future. For example, they categorise risks into one of two categories: the fiscal forecast (which becomes part of the fiscal outlook in the economic and fiscal update) and a specific fiscal risk (which becomes the statement of specific fiscal risks, also contained in the economic and fiscal update). There is a linkage between the fiscal outlook and the forecast financial statements.

Our understanding is that the fiscal outlook feeds directly into the forecast financial statements, but the statement of specific fiscal risks does not. This is important given the financial risk of the NDC1 is currently included in the specific fiscal risks, and therefore does not currently appear as a provision and/or contingent liability in the financial statements of the Government or the forecast financial statements. However, this may change given the recent *2024 Treasury Opinion* indicates they are considering reporting the risk in the fiscal forecast. This may make it more likely that NDC1 is reported as a liability and/or contingent liability in the financial statements.

Furthermore, when the commitment is reported as a liability, any increase in the liability is seen as a consumption of resources, which would imply the need for an appropriation, given the fundamental principle that Parliament must authorise all use of public resources. This means that this issue ultimately will need to be resolved in a Budget context ahead of the financial statement preparation. If that were not done, the expense would be unappropriated. This reflects the linkage between the Budget and the financial statements.

The Government's financial reporting system is illustrated in Figure 5.1 (see our *Working Paper 2024/11 - Illustration of the Government's financial reporting system* for more detail on the specific legislation mentioned in Figure 5.1).⁴⁵ The Institute has created this diagram to illustrate how the three key reports work together. All three types of reports, the annual financial statements of Government, the forecast financial statements and the long-term fiscal position, should be consistent and complementary, rather than repetitious. Risks that exist in the long-term fiscal position should be considered to see if they need to be reported in the forecast financial statements and equally whether the content of the forecast financial statements should be disclosed in the annual financial statements of Government. Generally, the more certain and significant the risk, the more likely that it should appear in the financial statements, but in practice our system of reporting is more complex than this. This chapter aims to explain the nuances, and what that means in terms of the Government decision to purchase offshore abatement to offset our 2030 commitments.

The Public Finance Act 1989 is the primary legislation. It focuses on the accountability and transparency of public financial resources and fiscal risks. The purpose of the Act is set out in s 1A directly below. Box 1 (p. 34) provides some key terms from the legislation and Box 2 (p. 34) provides a list of key terms from the glossary of the *2024 BEFU*.

Section 1A Purpose

- (1) The purpose of this Act is to consolidate and amend the law governing the use of public financial resources.
- (2) To that end, this Act—
 - (a) provides a framework for parliamentary scrutiny of—
 - (i) the Government's expenditure proposals; and
 - (ii) the Government's management of its assets and liabilities; and

- (b) establishes lines of responsibility for effective and efficient management of public financial resources; and
- (c) specifies the principles for responsible fiscal management in the conduct of fiscal policy and requires regular reporting on the extent to which the Government's fiscal policy is consistent with those principles; and
- (d) specifies the **minimum financial and non-financial reporting obligations** of Ministers, departments (including departmental agencies, interdepartmental executive boards, and interdepartmental ventures), Offices of Parliament, Schedule 4 organisations, and Schedule 4A companies; ...
[bold added]

Box 1: Public Finance Act 1989, s 2 Interpretation

Annual financial statements of the Government means the annual consolidated financial statements for the Government reporting entity (called the Financial Statements of the Government of New Zealand by the Treasury).

Budget means the Minister's statement in moving the second reading of the main Appropriation Bill for a financial year.

Estimates means a statement in any form that (a) describes and supports the appropriations being sought in the main Appropriation Bill for a financial year; and (b) contains the information referred to in s 14 the Public Finance Act 1989.

Expenses means expenses measured in accordance with generally accepted accounting practice, and includes costs.

Financial year means a period of 12 months commencing on 1 July and ending with 30 June.

Forecast financial statements means a set of statements that consists of (a) a forecast statement of financial performance; and (b) a forecast statement of financial position; and (c) a forecast statement of cash flows; and (d) any other forecast financial statement required by generally accepted accounting practice; and (e) any other forecast financial statement required for a reporting entity by any regulations made, or instructions issued, under the Public Finance Act 1989 or any other Act.

Liability means a liability that is defined, recognised, and measured in accordance with generally accepted accounting practice.

Main Appropriation Bill, in respect of a financial year, means the first **Appropriation Bill** that relates to that financial year, and main Appropriation Act has a corresponding meaning.

Box 2: Selected terms from the glossary in the 2024 BEFU

Contingent liabilities

Costs that the Crown will have to face if a particular uncertain event occurs, or present liabilities that are unable to be measured with sufficient reliability to be recorded in the financial statements (unquantified contingent liabilities). Contingent liabilities typically comprise guarantees and indemnities, legal disputes and claims, and uncalled capital.

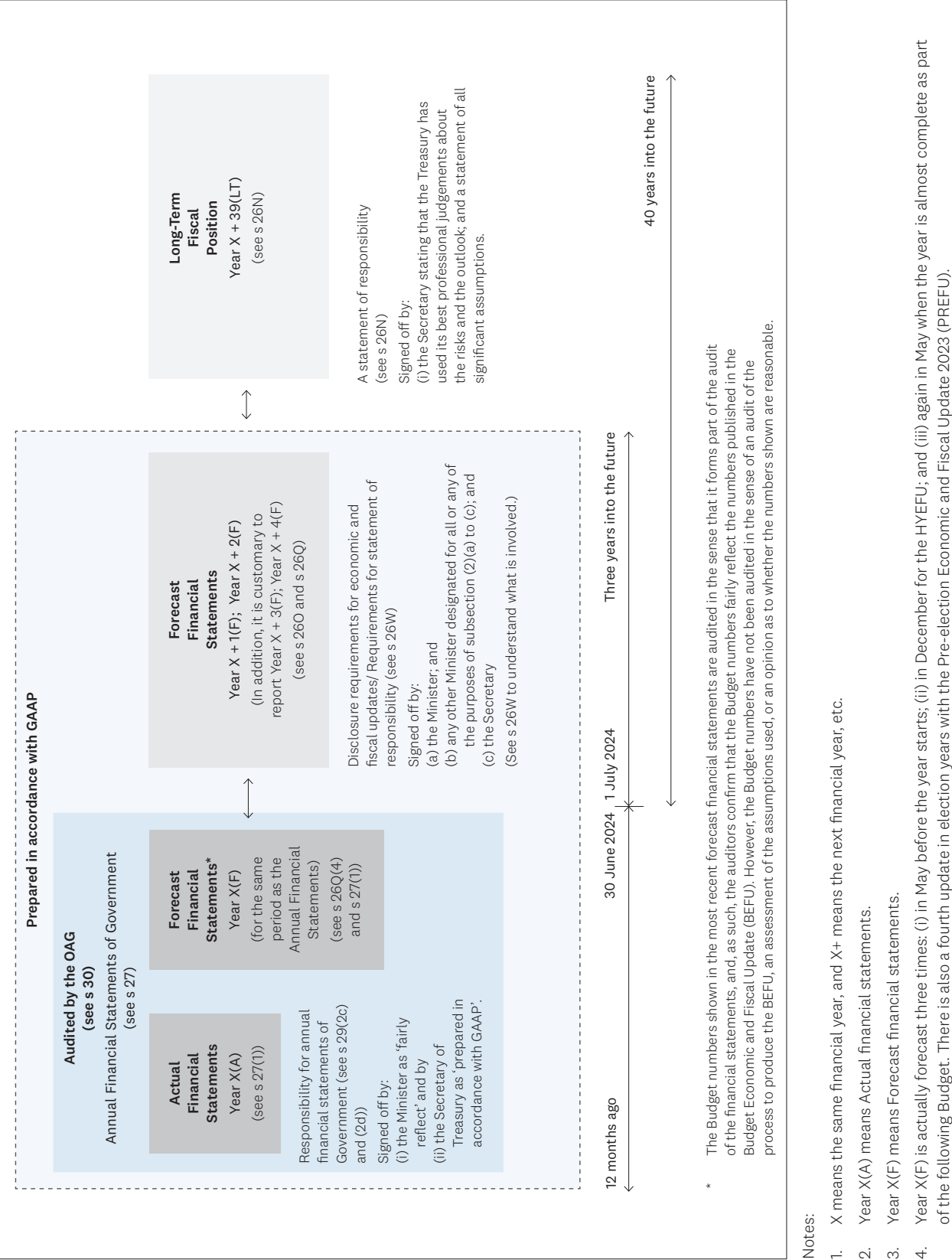
Operating balance before gains and losses (OBEGAL)

Represents total Crown revenue less total Crown expenses excluding minority interest share. OBEGAL can provide a [more] useful measure of underlying stewardship than the operating balance as short-term market fluctuations are not included in the calculation.

Specific fiscal risks

All government decisions or other circumstances known to the Government which may have a material impact on the fiscal and economic outlook but are not certain enough in timing or amount to include in the fiscal forecasts.

Figure 5.1: The Government’s financial reporting system
 Source: McGuinness Institute’s *Working Paper 2024/11 – Illustration of the Government’s financial reporting system*



5.1 How does the Government's financial reporting system report risk?

Treasury's November 2023 paper *A Guide to the Public Finance Act (2023 Guide)* explains some of the history of the 1989 Act and how it should be interpreted. There are two key parts to the Act that are relevant to the treatment and reporting of the commitment discussed in this paper, Part 2 and Part 3.

Part 2 of the Act is described in the *2023 Guide*:

Part 2 of the Public Finance Act 1989 is founded on two key planks: **transparency and accountability**. It seeks to achieve this by requiring:

- regular public reporting by each Government on their long-term fiscal objectives and short-term fiscal intentions and the extent to which these objectives and intentions are consistent with the principles of responsible fiscal management, and
- reporting on a wide range of economic and fiscal information ...

More specifically Part 2 promotes sound fiscal policy and fiscal transparency by:

- requiring that each Government pursue its policy objectives in accordance with the principles of responsible fiscal management set out in the Act
- **imposing regular fiscal reporting obligations on the Treasury and the Minister of Finance**. The reports and statements required to be presented to the House of Representatives include:
 - an annual fiscal strategy report
 - an annual budget policy statement
 - a periodic statement on the long-term fiscal position
 - a periodic investment statement on the Crown's assets and liabilities
 - regular economic and fiscal updates at least twice each year, and
 - an annual statement of tax policy changes in the Budget economic and fiscal update. [bold added]⁴⁶

The *2023 Guide* explains the linkage between annual reporting and fiscal risks:

Fiscal risks

The fourth principle [see s 26G(1)(d)] requires that each Government identifies and manages prudently the fiscal risks facing the Government. Fiscal risks can arise in relation to:

- **financial position**, for example, changes in the value of assets and liabilities and the potential for **off-balance sheet items** such as guarantees **to give rise to liabilities**, or
- operating flows, for example, changes in the tax base and the risk of certain expenditures exceeding budget.

By ensuring that fiscal risks are monitored and managed, this principle helps to **reduce the level of uncertainty** associated with the Government's future financial performance and position. [bold added]⁴⁷

The *2024 BEFU*, Chapter 2: Fiscal Outlook, notes:

The Treasury's fiscal forecasts are based on a number of assumptions and judgements using the best information available and our best professional judgement. As with any kind of forecast there are risks that actual events will differ from expectations. This uncertainty increases as the forecast horizon extends. This section outlines the key risks to the fiscal forecasts.⁴⁸

The 2024 BEFU, Chapter 3: Specific Fiscal Risk, notes:

The Treasury's fiscal forecasts are based on a number of assumptions and key judgements using the best information available and our best professional judgement. As with any kind of forecast, there is a risk that actual events will differ from expectations. The Economic Outlook and Fiscal Outlook chapters highlight broad risks to the forecasts such as changes to economic assumptions, forecasting risks relating to revenue or variations in the returns from, and valuation of, the Government's investments. This chapter outlines the specific risks that could affect the fiscal forecasts. These are reflected in the statement of specific fiscal risks and the statement of contingent liabilities and contingent assets.⁴⁹

[and]

Regardless of the criteria outlined above, judgement is still required to determine whether a government decision or other circumstance meets the definition of a specific fiscal risk. The Treasury has applied the following [six] principles in assessing whether a decision or other circumstance meets the definition of a specific fiscal risk [see Table 5.1 below].⁵⁰

Table 5.1: Criteria for fiscal forecast or specific fiscal risks

Source: Adapted from Treasury, 2024 BEFU⁵¹

Fiscal forecasts	Specific fiscal risks
Matters are incorporated into the fiscal forecasts when: - the matter can be quantified for particular years with reasonable certainty, and - a decision has been taken, or - a decision has not yet been taken but is reasonably probable that the matter will be approved or the situation will occur. 'Reasonably probable' is taken to mean that the matter is more likely than not to be approved within the forecast period (i.e. there is a greater than 50% chance of the matter occurring or being approved). [bold added]	Matters are disclosed as specific fiscal risks if the likely impact is \$100 million or more over the forecast period and either: - a decision has not yet been taken but it is reasonably possible (but not probable) that the matter will be approved or the situation will occur, or - it is reasonably probable or possible that the matter will be approved or the situation will occur, but the matter cannot be quantified for, or assigned to, particular years with reasonable certainty. 'Reasonably possible' is taken to mean that the matter might be approved within the forecast period (i.e. there is a 20% to 50% chance of the matter occurring or being approved). [bold added]

Appendix 4, Table A4.1: Excerpts from the Statement of Specific Fiscal Risks related to NDC1, found in the *Budget Economic and Fiscal Update 2021–2024* and *Half Year Economic and Fiscal Update 2021–2024*, shows that this treatment has been consistent since the *Half Year Economic and Fiscal Update 2021* (15 December 2021).

The 2021 HYEPU states:

New Zealand's 'Nationally Determined Contribution' to global mitigation efforts is to reduce net greenhouse emissions by 50% below gross 2005 levels by 2030. This equates to an emissions budget for the target period (2021 to 2030) of 571Mt. To achieve this, New Zealand **will need** to pursue sizeable domestic or offshore abatement to mitigate emissions over 2021 to 2030. [bold added]

In the 2024 BEFU, it states:

Sizeable offshore abatement will be needed to meet NDC1 on top of domestic commitments. Scenarios showing the possible fiscal impact of this offshore abatement have been set out in the Climate Economic and Fiscal Assessment 2023. While the Government has choices about how it achieves NDC1, it is likely that fulfilling these commitments will involve significant costs to the Government, starting within the current fiscal forecast period.
[bold added]

Once a risk moves from being reported as a specific fiscal risk (less certain) to being disclosed in the forecast financial statements (more certain), it is unlikely to be reported in both places – in other words it is an 'either/or' situation. See the last row in Table 5.2 below.

Table 5.2: Six principles to determine whether a specific fiscal risk exists

Source: Adapted from Treasury, 2024 BEFU⁵²

Type of risk	Principles
1. Risks associated with assumptions used in the forecast for revenue and expenses and valuation of assets and liabilities (e.g., discount rates, cash flow assumptions, economic conditions)	The forecasts for some revenue and expense items and the valuation of some assets and liabilities included in the fiscal forecasts can be subject to significant assumptions. These assumptions may change in the future and impact on the fiscal position. However, revenue, expenses, assets and liabilities are measured or valued at a point in time using the best available information and accepted forecasting and valuation techniques and assumptions, which means they are quantified in the fiscal forecasts for particular years with reasonable certainty. Significant assumptions are disclosed in the fiscal forecasts as required by generally accepted accounting practice, and the Financial Statements of the Government provide further disclosures around the sensitivity of changes in key assumptions to the measurement and valuation of revenue, expenses, assets and liabilities. Where there is a government decision or other circumstance that creates uncertainty for the measurement or valuation of revenue, expenses, assets or liabilities (such as a review of policy settings or impending Court decisions that may impact assumptions used), these may be disclosed as a specific fiscal risk.
2. Risks associated with a future event outside of the Government's control	Judgement is applied as to whether the future event is reasonably possible within the forecast period. Reasonably possible is assessed as being in the range of 20% to 50% likely. Judgement is informed by factors such as how often similar events have happened in the past. If it is not reasonably possible that the event will happen within the forecast period, it is not a specific fiscal risk.
3. Risks associated with policy work and reviews	Policy work is ongoing across the public sector, much of which, if agreed to and implemented, will result in material fiscal impacts. In addition, there are several reviews under way of policy settings, sectors and individual organisations in the public sector. In general, ongoing policy work or reviews are not disclosed as specific fiscal risks as it is not reasonably possible that there will be fiscal implications until the Government takes decisions on the policy or responds to review findings. However, where policy work or reviews have been publicly announced by the Government or are being consulted on, this increases the likelihood the policy will be progressed or expectations of a fiscal response to reviews, which may result in a specific fiscal risk. Additionally for reviews, judgement is required based on the terms of reference and objectives of each review.
4. Risks to the fiscal forecasts from changes in accounting policy	As explained on page 108 the forecast financial statements are prepared in accordance with the accounting policies that are expected to be used in the comparable audited actual Financial Statements of the Government. Changes to accounting policies can arise from new accounting standards issued by standard setters, new interpretations of existing standards or evolving application of policies (particularly where there are unique or novel transactions or balances). Future changes to accounting policies may have significant implications for the fiscal forecasts. Generally, a specific fiscal risk is not included for future accounting policy changes. Until applied these are subject to changes and amendments. Where a detailed impact assessment of a policy change has been completed, it is reasonably possible that the change will occur in the forecast period and material fiscal impacts are reasonably possible, a specific fiscal risk may be disclosed.
5. Risks aggregated into a cross-portfolio risk	Generally, cross-portfolio risks are a single risk that can affect more than one portfolio. In some instances, several risks at an individual portfolio level can be aggregated into a cross-portfolio risk. A high bar is applied as to whether individual risks are aggregated into a cross-portfolio risk. The underlying nature and driver of the risks must be the same, and there must be no loss of information from aggregating risks. If there is doubt, risks are individually disclosed as specific fiscal risks by portfolio.
6. Risks associated with contingent liabilities and contingent assets	Contingent liabilities and contingent assets are disclosed separately to specific fiscal risks in this chapter. This typically covers risks associated with guarantees and indemnities, uncalled capital, and legal disputes and claims. There is a link between specific fiscal risk disclosures and the contingent liabilities and contingent assets disclosure. However, in general, contingent liabilities and contingent assets are not also disclosed as specific fiscal risks. [bold added]

5.2 What is the role of the Auditor-General?

Chapter 4 of the 2023 *Guide* sets out the roles and responsibilities of the different parties, including those of the Auditor-General:

1. The Government is required to produce monthly and annual consolidated financial statements for the Government reporting entity.
2. These financial statements provide information on the Government's assets and liabilities, revenue and expenses and cash flows.
3. In common with appropriations and financial forecasts, the financial statements are prepared using the accrual basis of accounting and in accordance with generally accepted accounting practice (GAAP).
4. Many of the items reported in the financial statements of the Government are similar to the items reported in the financial statements of other entities. However, the Government also reports on some rights and obligations and transactions that are unique to governments including taxes obtained from the use of sovereign powers and non-exchange transactions such as welfare benefits.
5. The Auditor-General is responsible for expressing an independent opinion on the annual financial statements of the Government. [bold added]⁵³

The Auditor-General has responsibility to audit the financial statements and provide an opinion, which includes a statement of key audit matters (KAM). The Independent Audit Report of the Controller and Auditor-General for the *Financial Statements of the Government of New Zealand for the year ended 30 June 2022* states:

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the Government for the current year. In making this determination, I considered those matters that are complex, have a high degree of uncertainty, or are important to the public because of their size or nature. Key audit matters were addressed in the context of my audit of the financial statements of the Government as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.⁵⁴

In 2022 the Auditor-General identified 'climate change' as a KAM and the NDC1 commitment was discussed; see the discussion in Table 5.3 below.

Table 5.3: Excerpt from the 30 June 2022 Independent Audit Report of the Controller and Auditor-General

Source: Treasury, 2022

Climate Change	How we addressed this matter
The Government has declared a climate emergency and has committed to emissions reductions targets, either by international treaty, domestic legislation, or policy announcement.	
Obligations arising from emissions reduction targets As disclosed in note 21 on page 118, the Government has not recognised any liabilities in relation to its commitments to achieve its carbon targets, including its updated Paris Agreement commitment to reduce net greenhouse emissions to 50 percent below gross 2005 levels by 2030. To meet its international commitments, New Zealand will need to reduce its domestic emissions and purchase carbon credits from international markets. The amount of carbon credits required will depend on the extent of domestic emissions reductions. The cost of the carbon credits will depend on carbon prices at the time. There is no financial reporting standard that explicitly sets out whether or how nations should recognise their carbon reduction commitments in their financial statements. Determining at what point a liability should be recognised requires judgement.	We reviewed the Treasury's assessment of whether a liability should be recognised for committed emissions reductions targets. The Treasury's assessment noted that there is no enforceable obligation in the Paris Agreement and unlike the Kyoto Protocol (for which a liability was recognised) there is no settlement mechanism. We considered whether the nature of the Paris Agreement meant a liability should be recognised. It is challenging determining whether or not the Government has an obligation that should be recognised as a liability. The matter requires judgement and consideration of factors such as the ability of the Government to modify or change the obligation before it crystallises. We reviewed the annual financial statements of other governments to see whether they had recognised a liability for their Paris Agreement commitments. I am satisfied that not recognising a liability for the Government's emissions reductions targets at this point in time is a reasonable interpretation of the financial reporting standards and that the disclosures are appropriate. [bold added]

Importantly, if Government did produce an annual report (a document the Institute has been recommending for many years), then the International Standard on Auditing (ISA) would be relevant, in particular *ISA (NZ) 720 (Revised): The Auditor's Responsibilities Relating to Other Information*.⁵⁵ This standard explains the importance of alignment between the financial statements, and in this case the annual report.

Reading and Considering the Other Information

14. The auditor shall read the other information and, in doing so shall:

(a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarise, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements; and

(b) Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit.

15. While reading the other information in accordance with paragraph 14, the auditor shall remain alert for indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated. [bold added]⁵⁶

Given the above it is important to note:

1. The NDC commitment is specific (unique) to the Government and does not relate to any particular department. The *2023 Guide* acknowledges that Government also reports on rights and obligations and transactions that are unique to Government (see point 4 above). Furthermore, the annual consolidated financial statements of the Government are broader than simply consolidating all the financial statements of entries that make up the Government reporting entity (see s 27 below). It requires two further tests: 'fairly reflect' and prepared in 'accordance with generally accepted accounting practice' (see s 29(2)(c) and (d)). This is where the unique obligations should be considered, and if judged appropriate, reported upon. As noted in Figure 5.1, only the forecast financial statement in the year matching the annual report is reported (and therefore audited) in the annual financial statements of the Government. The remaining forecast financial statements for later years can be found in the *Economic and Fiscal Update* and are not audited. Hence, if the liability and/or contingent liability is reported in the Financial Statements of the Government of New Zealand, it will be treated as part of the audit by the Auditor-General. If it sits in the financial forecasts (being forecasts for year 2 or more) or in the Statement of Specific Fiscal Risks, the transaction is not audited. Given the level of public interest, an audited figure (in terms of volume and market price) provides benefits in terms of trust and transparency.
2. The forecast financial statement forms part of the fiscal forecasts, which in turn form part of the economic and fiscal update (see for example, s 26O of the Public Finance Act). Under law, the forecast financial statements are required to look out three financial years, but that has customarily been extended to four years. The latest *Budget Economic and Fiscal Update 2024 (2024 BEFU)* looks out five years, from 2024 to 2028.⁵⁷ See for example, the statement on the NZ Parliament website:

Section 45.3.2: Half Year Economic and Fiscal Update

An Economic and Fiscal Update must be published in the November–December period (unless a pre-election update has been published in the last three months of the year). This update is required to contain economic and fiscal forecasts for the current and the next two financial years but customarily includes such forecasts for the **next four financial years. This information is critical to the preparation of the Budget.** The update is referred to the Finance and Expenditure Committee. Although the committee is not obliged to, it has generally reported the update with the Budget Policy Statement. [bold added]⁵⁸

3. The 2024 BEFU reports on economic forecasts separately from fiscal forecasts. Risks can be reported as either a fiscal forecast risk (and therefore included in the forecast financial statements) or a specific fiscal risk. Table 5.1 above sets out the criteria. The 2024 BEFU notes that ‘if the fiscal implications of government decisions and other circumstances cannot be quantified for particular years with reasonable certainty, or the outcome is still unclear, those government decisions and other circumstances are disclosed in the statement of specific fiscal risks’ (as required by sections 26Q(3)(b) and 26U of the Public Finance Act 1989).⁵⁹

5.3 Discussion

Given that the annual financial statements are the ‘go to’ report for parliamentarians and the wider public, their role in the reporting ecosystem is front and centre. The other reports are a lot less known or understood.

As we move closer to 2030, the ability to argue that the NDC1 commitment remains outside of the fiscal forecasts, what accountants colloquially refer to as off the books, becomes very thin. This explains why the addition of an explanatory note to the financial statements was prudent. However, if and when Treasury decide to report the commitment in the fiscal forecasts, it should logically follow that the commitment should, for the purposes of alignment, be reported in the actual financial statements. Given that the financial statements, the appropriations and the financial forecasts are prepared using the accrual basis of accounting and in accordance with generally accepted accounting practice (GAAP), any liability and/or the contingent liability in the forecast financial statements should equally appear in the annual financial statements.

Further, the timetable for the Budget process can be found on the New Zealand Parliament website.⁶⁰ Key Budget documents include the *Estimates*, the *Budget Economic and Fiscal Update* and the *Fiscal Strategy*.⁶¹ If Government decided to purchase international carbon credits in 2024 or 2025 to meet NDC1, such a transaction would be included in the appropriations bill, and become part of the *Estimates*. To date, this obligation is not included in the annual Budget of Government.

We consider the NDC1 commitment does meet the fiscal forecasts criteria set out in Table 5.1. We consider the commitment can be quantified for particular years with reasonable certainty and that a decision has been made. In our view that decision was made by Cabinet in 2016. The initial results indicate that since 2001, of the 143 Cabinet papers that discuss climate change, 41 mention NDCs (almost 30%). Importantly, over that time, none of these papers indicate a change in that original 2016 decision to purchase offshore abatement. See *Working Paper 2024/10 – List of all Cabinet Papers that relate to climate change published 2001–2024* (in progress).⁶²

5.4 Summary

The government’s financial reporting system forms one large information ecosystem. Within the system, the NDC1 commitment appears in only two places: (i) an unchanged risk in the 2024 *Statement of Specific Fiscal Risks* (see Appendix 4) and (ii) an explanatory note in the 2023 Financial Statements (see p. 68). Given the proximity to the year 2030 and the materiality of the item, we had expected the NDC1 commitment would be treated, at the very least, as a liability in the 2027 and 2028 forecast financial statements. Our understanding is that contingent liabilities are only reported in the annual financial statements, and therefore, unlike liabilities, contingent liabilities would not be included in the forecast financial statements for the 2027 or 2028 years. Paragraphs 27–30 of the 2024 *Treasury Opinion* discuss this issue but do not make this distinction clear. The commitment to purchase offshore abatement remains largely hidden from those seeking to manage or assess the Government’s financial performance.

6.0 Four accounting questions

Using existing standards, this part of the paper explores four accounting questions that the Institute believes should be answered to deliver clarity over whether a commitment to purchase offshore carbon credits should be reported in the financial statements of the Government of New Zealand.

The Institute was keen not only to explore whether a commitment to purchase offshore carbon credits would create a requirement to report, but also, if it did, where the commitment would be reported, and at what value.

As the Government is a public benefit entity, we used the accounting standards and conceptual frameworks for public benefit entities (PBEs). There are similar accounting standards for for-profit entities (FPEs).

We explore the following four questions using Table 6.1 as a basis for the discussion. It summarises the Institute's understanding of the treatment of liabilities and contingent liabilities under PBE Standards.

Question 1: Does a legal or constructive obligation exist?

Question 2: Can the value be reliably estimated?

Question 3: Is it a liability that should be recognised in the statement of financial position?

Question 4: Is it a contingent liability that should be disclosed in the notes to the financial statements?

Key context

The 9 November 2015 Cabinet Paper *Paris Climate Change Agreement – Report back to Cabinet and Approval for Signature* (the *2015 Cabinet Paper*) states: 'Since there is currently no legally enforceable obligation on the Crown to expend resources to meet the target, there is no requirement to reflect this in Crown accounts currently'.

However, the key word here is 'currently'. For example:

- Could any events from 2015 to today trigger a change in officials' advice? Could recent amendments to the Climate Change Response Act 2002 lead officials to decide in 2024 that a legally enforceable obligation now exists? In 2015, officials acknowledged that their original advice might change when stating: 'the 2030 target should not be reflected in the Crown accounts **at this time**' [bold added]. See the *2015 Cabinet Paper* excerpt in Section 6.1.2 (p. 46).
- Furthermore, whether a legally enforceable obligation exists is not the only test for reporting purposes. Officials need to also consider whether a constructive obligation exists, and if not, whether any other possible obligation or present obligation arising from a past event triggers the disclosure in the notes to the financial statements. These tests are listed in rows 1 to 5 in Table 6.1 opposite.

Table 6.1: The accounting treatment of liabilities and contingent liabilities

Source: Primarily adapted from PBE IPSAS 19: *Provisions, Contingent Liabilities and Contingent Assets*, the 2016 *Public Benefit Entities' Conceptual Framework* and guided by NZ IAS 37 (For-Profit)⁶³

The three conditions that help determine the accounting treatment of liabilities and contingent liabilities See PBE IPSAS 19, Para 22 (overleaf)			The Institute's understanding of the current reporting requirements	Discussion
(a): The nature of the obligation	(b): The likelihood an outflow of resources will be required to settle the obligation	(c): The extent to which a reliable estimate can be made	The highest form of reporting in the financial statements (but can be less)	See the following sections in this paper
1. It is a legal obligation (and there is a present obligation arising from a past event/s)	... and the outflow of resources is 'probable' (i.e. more likely than not)	... and the estimate is 'reliable'	... then it is recognised as a <u>liability</u> in the statement of financial position (the balance sheet)	Section 6.1.2, Question 1: Does a legal or constructive obligation exist? Section 6.2, Question 2: Can the value be reliably estimated? Section 6.3, Question 3: Is it a liability that should be recognised in the statement of financial position?
2. It is a constructive obligation (and there is a present obligation arising from a past event/s)	... and the outflow of resources is 'probable' (i.e. more likely than not)	... and the estimate is 'reliable'	... then it is recognised as a <u>liability</u> in the statement of financial position (the balance sheet)	Section 6.1.3, Question 1: Does a legal or constructive obligation exist? Section 6.2, Question 2: Can the value be reliably estimated? Section 6.3, Question 3: Is it a liability that should be recognised in the statement of financial position?
3. It is a possible obligation or a present obligation arising from a past event/s)	... but the outflow of resources is 'not probable', but the likelihood is more than remote (i.e. less than 50% but not highly unlikely either)	... and/or the amount of the obligation cannot be measured with sufficient reliability	... then it is disclosed as a <u>contingent liability</u> in a note to the financial statements	Section 6.2, Question 2: Can the value be reliably estimated? Section 6.4, Question 4: Is it a contingent liability that should be disclosed in the notes to the financial statements? [Note: A possible estimate can be disclosed in a monetary amount or in units.]
4. It is a possible obligation or a present obligation arising from a past event/s)	... but the likelihood of the outflow of resources is 'remote' (i.e. highly unlikely)	[Not applicable]	... then it is not required to be disclosed in financial statements ... UNLESS ... its disclosure provides a necessary description and/or <u>explanation</u> in a note to the financial statements	Section 6.2, Question 2: Can the value be reliably estimated? Note: See s 27(2)(c)(v) of the Public Finance Act 1989: 'include ... any additional information and explanations needed to fairly reflect the consolidated financial operations of the Government reporting entity for the financial year ...' Note: This was the treatment in the 2022 and 2023 Financial Statements of the New Zealand Government (see excerpts in Section 6.4.2)
5. It is NOT a possible obligation or a present obligation arising from a past event/s)	[Not applicable]	[Not applicable]	... then it is not required to be disclosed in financial statements ... UNLESS ... its disclosure provides a necessary description and/or <u>explanation</u> in a note to the financial statements	

6.1 Question 1: Does a legal or constructive obligation exist?

6.1.1 Accounting Standards

PBE IPSAS 1: Public Benefit Entity International Public Sector Accounting Standard 1 Presentation of Financial Statements (PBE IPSAS 1)

‘Liabilities’ are defined in PBE IPSAS 1 as:

[P]resent obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential. (Para 7)⁶⁴

PBE IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets

A ‘legal obligation’ is defined in PBE IPSAS 19 as an obligation that derives from:

- (a) A contract (through its explicit or implicit terms);
- (b) Legislation; or
- (c) Other operation of law. (Para 18)

A ‘constructive obligation’ is defined in PBE IPSAS 19 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. [bold added] (Para 18)

The relationship between liabilities (provisions) and contingent liabilities is described in PBE IPSAS 19 as:

In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard, the term contingent is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of **one or more uncertain future events not wholly within the control of the entity**. In addition, the term contingent liability is used for liabilities that do not meet the recognition criteria. [bold and underline added] (Para 20)

This Standard distinguishes between:

- (a) Provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
- (b) Contingent liabilities – which are not recognised as liabilities because they are either:
 - (i) Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
 - (ii) Present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made). (Para 21)

The recognition criteria for a liability (also referred to as conditions) are listed in PBE IPSAS 19 as:

A provision shall be recognised when:

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

- (b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
- (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised.

If these conditions are not met, no provision shall be recognised. (Para 22)

Reliable is defined in PBE IPSAS 19 as:

Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent. (Footnote 1)

A ‘past event’ may create an obligation at a later date and does not need to be to a specific party;
PBE IPSAS 19 states:

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. (Para 25)

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 decision by an entity’s management, governing body, or controlling entity does not give rise to a constructive obligation at the reporting date, unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities. [bold added] (Para 28)

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 by an entity, 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 the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation**. [bold added] (Para 29)

The disclosure requirements for each class of liability (provision) is set out in PBE IPSAS 19:

An entity shall disclose the following for each class of provision:

- (a) A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential;
- (b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 58; ... (Para 98)

Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur. [bold added] (Para 58)

The disclosure requirements for each class of contingent liability is set out in PBE IPSAS 19:

Unless the possibility of any outflow in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, where practicable:

- (a) An estimate of its financial effect, measured under paragraphs 44–62;
- (b) An indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) The possibility of any reimbursement. (Para 100)⁶⁵

The PBE Conceptual Framework

The *Public Benefit Entities' Conceptual Framework* discusses liabilities and states:

Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities. (Para 5.23)

'Economic coercion', 'political necessity' or other circumstances may give rise to situations where, although the public benefit entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation. [bold added] (Para 5.26)

Faithful Representation

To be useful in financial reporting, information **must be a faithful representation of the economic and other phenomena that it purports to represent**. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance which is not necessarily always the same as its legal form. [bold added] (Para 3.10)⁶⁶

6.1.2 Discussion: Is there a legal obligation?

This discussion focuses on whether the New Zealand Government has created a 'legal obligation', either through signing the Paris Agreement or through the extent to which the NDC target is domestically enforceable. Notably, since it was ratified by New Zealand on 4 October 2016, no statement has been found by the authors that might suggest the New Zealand Government would withdraw from the Paris Agreement. Nor was there any statement that it might not purchase offshore carbon credits to balance New Zealand's NDC1.

The *2015 Cabinet Paper* acknowledges a legal obligation existed in 2015 in terms of 'transparency processes' under the Paris Agreement (for updating, accounting, and regular reporting and review of NDC implementation and achievement). The *2015 Cabinet Paper* noted certain paragraphs in the agreement used the term 'shall', implying some aspects did contain a legal obligation (see excerpt of the Paris Agreement overleaf). However, advice from officials makes clear that they consider no legal obligation existed at that time for the delivery of prescribed goals and ambitions towards achieving the NDCs. Arguably, there is no legal obligation to exactly achieve the NDC target, but there is a legal obligation to take action towards achieving it.

The *2015 Cabinet Paper* notes:

The Agreement **obliges** New Zealand to submit and undertake 5-yearly updates of nationally determined (mitigation) contributions (NDCs), and to pursue domestic measures towards achieving them. New Zealand must participate in the Agreement's transparency (accounting, reporting and review) regime. [bold added] (Para 5)

Officials advise that the 2030 target should not be reflected in the Crown accounts **at this time**. Whether the target will be included in Crown accounts **depends on the degree to which the target is internationally binding, as well as the domestic enforceability of the target, including any obligation on the Crown to expend resources to meet the target**. Since there is currently no legally enforceable obligation on the Crown to expend resources to meet the target, there is no requirement to reflect this in Crown accounts **currently**. [bold added] (Para 47)⁶⁷

This implies officials consider that while the ‘transparency processes’ are legally binding under international law, the ‘delivery processes’ (for the delivery of prescribed goals and ambitions, and in particular the amount of the contribution of the NDCs and the purchase of any offshore carbon credits to achieve the NDC) are not. Given some consider parts of the delivery process are mandatory, such as pursuing policy towards achieving the NDCs, the question whether a legal obligation exists should be revisited.

The Paris Agreement

The Paris Agreement contains many components: the NDC communicates New Zealand’s progress towards Article 2 (temperature goals) and Article 4 (mitigation/emissions reductions). New Zealand’s action towards other components of the Paris Agreement (such as adaptation, finance, technology, capacity-building etc.) are communicated through National Communication and Biennial Transparency Reporting processes.

Relevant excerpts from the Paris Agreement are as follows:

Article 2

This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by: (a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change; ... (Article 2, Para 1)

Article 4

Each Party shall prepare, communicate and maintain successive nationally determined contributions that it intends to achieve. **Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions.** [bold added] (Article 4, Para 2)

Each Party’s successive nationally determined contribution will represent **a progression beyond** the Party’s then current nationally determined contribution **and reflect its highest possible ambition**, reflecting its common but differentiated responsibilities and respective capabilities, in the light of different national circumstances. [bold added] (Article 4, Para 3)

Mitigation co-benefits resulting from Parties’ **adaptation actions and/or economic diversification plans** can contribute to mitigation outcomes under this Article. [bold added] (Article 4, Para 7)

Each Party **shall** communicate a nationally determined contribution every five years in accordance with decision 1/CP.21 and any relevant decisions of the Conference of the Parties serving as the meeting of the Parties to this Agreement and be informed by the outcomes of the global stocktake referred to in Article 14. [bold added] (Article 4, Para 9)

A Party **may** at any time **adjust** its existing nationally determined contribution with **a view to enhancing its level of ambition**, in accordance with guidance adopted by the Conference of the Parties serving as the meeting of the Parties to this Agreement. [bold added] (Article 4, Para 11)

Article 6

Parties recognize that some Parties choose to pursue voluntary cooperation in the implementation of their nationally determined contributions to allow for higher ambition in their mitigation and adaptation actions and to promote sustainable development and environmental integrity. (Article 6, Para 1)

Parties shall, where engaging on a voluntary basis in cooperative approaches that involve the use of internationally transferred mitigation outcomes towards nationally determined contributions, promote sustainable development and ensure environmental integrity and transparency, including in governance, and shall apply robust accounting to ensure, inter alia, the avoidance of double counting, consistent with guidance adopted by the Conference of the Parties serving as the meeting of the Parties to this Agreement. (Article 6, Para 2)

The use of **internationally transferred mitigation** outcomes to achieve nationally determined contributions under this Agreement **shall be voluntary and authorized by participating Parties**. [bold added] (Article 6, Para 3)

A mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development is hereby established under the authority and guidance of the Conference of the Parties serving as the meeting of the Parties to this Agreement for use by Parties on a voluntary basis. It shall be supervised by a body designated by the Conference of the Parties serving as the meeting of the Parties to this Agreement, and **shall** aim:

- (a) To promote the mitigation of greenhouse gas emissions while fostering sustainable development;
- (b) To incentivize and facilitate participation in the mitigation of greenhouse gas emissions by public and private entities authorized by a Party;
- (c) To contribute to the reduction of emission levels in the host Party, which will benefit from mitigation activities resulting in emission reductions that can also be used by another Party to fulfil its nationally determined contribution; and
- (d) To deliver an overall mitigation in global emissions. [bold added] (Article 6, Para 4)

Article 11

All Parties enhancing the capacity of developing country Parties to implement this Agreement, including through regional, bilateral and multilateral approaches, shall regularly communicate on these actions or measures on capacity building. **Developing country Parties should regularly communicate progress** made on implementing capacity-building plans, policies, actions or measures to implement this Agreement. [bold added] (Article 11, Para 4)

Article 13

The purpose of the framework for **transparency of action** is to provide a clear understanding of climate change action in the light of the objective of the Convention as set out in its Article 2, **including clarity and tracking of progress** towards achieving Parties' individual nationally determined contributions under Article 4, and Parties' adaptation actions under Article 7, including good practices, priorities, needs and gaps, to inform the global stocktake under Article 14. [bold added] (Article 13, Para 5)

Each Party shall regularly provide the following information:

- (a) A national inventory report of anthropogenic emissions by sources and removals by sinks of greenhouse gases, prepared using good practice methodologies accepted by the Intergovernmental Panel on Climate Change and agreed upon by the Conference of the Parties serving as the meeting of the Parties to this Agreement; and
- (b) Information necessary to track progress made in implementing and achieving its nationally determined contribution under Article 4. (Article 13, Para 7)

Information submitted by each Party under paragraphs 7 and 9 of this Article **shall** undergo a technical expert review, in accordance with decision 1/CP.21. For those developing country Parties that need it in the light of their capacities, the review process shall include assistance in identifying capacity-building needs. In addition, each Party shall participate in a facilitative, multilateral consideration of progress with respect to efforts under Article 9, and its respective implementation and achievement of its nationally determined contribution. [bold added] (Article 13, Para 11)⁶⁸

Article 4, paragraph 11, states parties can only increase their ambition. Importantly the Paris Agreement creates a clear expectation over clarity and tracking of progress towards achieving parties' individual nationally determined contributions under Article 4, and their adaptation actions under Article 7, including good practices, priorities, needs and gaps, to inform the global stocktake under Article 14.

Article 6, paragraphs 1 and 3, reinforce that using internationally transferred mitigation (e.g. purchasing carbon credits from overseas) for NDC implementation and achievement is voluntary. In other words there is no direct legal obligation under the Paris Agreement for countries to participate in international cooperation: they may choose to implement and achieve their NDCs via domestic action alone if this is feasible.

Article 6, paragraph 3, does clearly state that internationally transferred mitigation is voluntary under the agreement. We understand that the phrase 'and authorized by participating Parties' refers to a requirement that a buyer country cannot count international units unless a host country agrees that they can, and agrees to account for the transfer appropriately. This implies there is an 'authorisation' step where the two countries

formalise this agreement, but the agreement between them remains voluntary. This suggests that New Zealand should be working hard to identify potential host countries, in advance of 2030.

There also exists some uncertainty as to whether the Paris Agreement is a legally binding international treaty, and if so, whether only parts of the agreement are legally binding. Notably, the United Nations Climate Change web page *The Paris Agreement: What is the Paris Agreement?* states:

The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at the UN Climate Change Conference (COP21) in Paris, France, on 12 December 2015. It entered into force on 4 November 2016.⁶⁹

Interestingly, the World Economic Forum article *'Is the Paris Climate Agreement legally binding? Experts explain'* (22 November 2021) disagrees. It states:

The UN Framework Convention on Climate Change is unequivocal by describing the 2015 Paris Agreement as a 'legally binding international treaty on climate change.' Yet the treaty itself has few legal teeth. It does not impose penalties, such as fees or embargos, for [P]arties that violate its terms, and there is no international court or governing body ready to enforce compliance. That has prompted some prominent experts to argue the Paris accord is not a legally binding document after all. (Para 35)⁷⁰

The most likely position is stated in a *Guardian* article from 5 December 2023, which discusses the United Kingdom's situation. Under current policies, the UK's greenhouse gas emissions are likely to be 59% lower in 2030 than they were in 1990. However the UK's NDC is for a 68% reduction, meaning that Britain is highly likely to miss its target with current policies. The article states:

Pledges on emissions cuts [being NDCs] under the Paris pact are not legally binding – the treaty itself is, but the pledges come in a non-binding annexe. However, to **renege on them** would be regarded as a significant concern ... Representatives of developed and developing countries at Cop28 said if a large economy such as the UK were to deviate from its NDCs without strong reason it would be regarded as a serious breach of its pledges. [bold added]⁷¹

However, for countries like New Zealand that have chosen to set NDCs that cannot be realistically met with domestic action alone, the question of whether there is a legal obligation to make offshore purchases hinges on the wider legal requirements in the Paris Agreement relating to NDC implementation and achievement.

Meeting NDC targets is not legally binding under the Paris Agreement, but this does not mean that they are purely voluntary either. There is a wider related set of legal obligations: to prepare, communicate and maintain successive NDCs that each party intends to achieve (Article 4 paragraph 2), to pursue domestic mitigation measures with the aim of achieving the NDC objectives (Article 4 paragraph 2), and to regularly report and be reviewed on progress in implementing and achieving the NDC (Article 13 paragraphs 7(b) and 11). There is an open legal question as to how much these wider requirements constrain actions: it could be argued for example that Article 4 paragraph 2 creates a legal obligation for policy to be coherent with achievement of the NDC (i.e. that the sum of projected domestic action and international cooperation 'adds up').

Legal obligations relating to NDC achievement and offshore purchase would be much clearer if they were embedded in New Zealand law. However, it should not be ruled out that the Paris Agreement does not create a legal obligation to act.

Officials' advice in 2015/2016

To summarise, based on the *2015 Cabinet Paper*, it is clear that Cabinet was made aware that the Paris Agreement created 'legal obligations' in terms of transparency processes (accounting, reporting and review). However, while the treaty's transparency processes were considered binding, officials' advice to Cabinet suggested that the delivery processes were not binding. For example, the *2015 Cabinet Paper* states: '[s]ince there is currently no legally enforceable obligation on the Crown to expend resources to meet the [NDC] target, there is no requirement to reflect this in Crown accounts currently'.

Some may argue that actions such as intentionally reducing domestic emissions in order to reduce the costs of purchasing offshore carbon credits are an example of the domestic enforceability of the NDC target. The term ‘domestic enforceability’ is cited by officials in paragraph 47 of the *2015 Cabinet Paper* to describe a potential trigger for the NDC target to ‘be included in Crown accounts’ (see excerpt on p. 46).

Officials’ advice in 2017

A 2017 Ministry for the Environment memo (the *2017 MfE memo*), on their website, discussed the financial impact of the proposed treatment on the Crown’s financial statements, and concluded:

The possible economic costs of meeting the NDC are not currently recognised in the Crown’s financial statements. The treatment reflects an accounting assumption that the NDC will not necessarily result in an economic sacrifice or outflow of economic resources for the Crown. The Crown may choose to buy units in the future to meet any shortfall arising from emissions in excess of its target to achieve New Zealand’s NDC, but there is no legal requirement to meet it. Generally accepted accounting practice sets a high bar for recognising an obligation and if [an] entity has discretion to avoid the obligation and not face a tangible economic sacrifice then no obligation can be recognised. [bold added] (Para 7)

The *2017 MfE memo* states that it has been derived primarily from the *2013 Treasury Guidance* and PBE IPASB 19 (NZ IAS 37): Provisions, Contingent Liabilities and Contingent Assets. It is interesting to note the following:

1. Although a legal obligation does not exist to achieve the target, a possible obligation is established.

There is no legal commitment to achieve the target; but we are required to implement policies and measures aimed at achieving it. A possible obligation is established by current policy and the announced target by the Government as opposed to an exchange contract, deed, or legislation. The policy does create an expectation that the Government will meet its target. (Para 10)

2. The public at large test is probably met.

NZ IAS 37 does indicate that an obligation can be made to the **public at large**. On the basis that the communication of the target has been made both domestically and internationally, this has created a valid expectation that the Government will discharge its responsibilities to achieve the target **so this test is likely to be met**. The announced target and commitment to the Paris Agreement will help enhance the reputation of NZ with its trading partners and have intangible benefits in trade negotiations. [bold added] (Para 11)

3. In the future, public policies designed to meet NDC targets are likely to have accounting implications.

The Government may decide to buy units in the future if emissions are in excess of its target to meet its public commitment but there is currently no compulsion or requirement to do so. If the Government develops legislation to require it to meet its stated responsibility target this test could be met and it could be enforced by others, including the public.

The Paris Agreement creates an obligation to pursue domestic measures aimed at achieving the target. This means that the Government must implement policies. The accounting implications of these will be determined and applied as policies are implemented. (Para 12)

4. It is possible to prepare an accounting estimate.

The details of how the target will be measured have been announced. The expectation is that the measurement approach will follow the 2006 IPCC rules or other guidance adopted by the Conference of the Parties. Therefore measurements and estimates can be made of future emissions and the possible obligation. (Para 15)

5. Of the three conditions identified at the top of Table 6.1, two of the conditions were thought to have been met in 2017 by MfE. The exception was the outflow of resources condition: the likelihood was considered remote. However, this is understandable given there were 13 years to reduce emissions domestically, leading one to think that the obligation to purchase offshore credits in the year 2030 was remote.

Based on the announced target and commitment as it stands, no obligation can be recognised on the Crown's financial statements because it doesn't result in an economic sacrifice or outflow of economic resources according to generally accepted accounting practice. However, if the Crown was to enshrine the target in legislation to meet its stated responsibility target this could change the accounting approach. (Para 17)⁷²

The second condition in Table 6.1 (row 2) identifies three types of likelihood: more than 50% (probable); less than 50% but not highly unlikely (possible, i.e. between probable and remote); and highly unlikely (remote).

Over time, the Government's assessment of the likelihood of needing to purchase offshore carbon credits has moved from remote to possible to probable. In 2017, MfE considered the likelihood to be remote; in other words, New Zealand could meet NDC1 by actively reducing domestic emissions without purchasing offshore carbon credits. The 2021 *Statement of Specific Fiscal Risks* stated that 'to [meet NDC1] New Zealand will need to pursue sizeable domestic or offshore abatement to mitigate emissions over 2021 to 2030' (i.e. possible). The 2024 *Statement of Specific Fiscal Risks* used the phrases 'will be needed' and 'it is likely' and stated that '[s]izeable offshore abatement will be needed to meet NDC1 on top of domestic commitments' (i.e. probable). See Appendix 4.

Changes from 2017 to 2024

Since officials first provided advice to Cabinet in 2015, New Zealand legislation has changed significantly (see Section 4.5 for a list of recent changes). Today, the Paris Agreement appears 22 times in the text of the Climate Change Response Act 2002.⁷³

Notably, key changes to the Climate Change Response Act 2002 may mean that their advice in 2015 might be very different from their advice today. Examples include:

- On 14 November 2019, the Paris Agreement was included in the purpose of the Climate Change Response Act 2002 (see s 3(1)(aa)), under s 4 of the Climate Change Response (Zero Carbon) Amendment Act 2019 (see Appendix 1).
- On 23 June 2020, an obligation to the Paris Agreement was included under ss 6(1) and 199 of the Climate Change Response (Emissions Trading Reform) Amendment Act 2020. This resulted in the Climate Change Response Act 2002 including the text of the actual agreement (see Schedule 2A: Paris Agreement in the Act). Notably, the Paris Agreement sits alongside the Kyoto Protocol to the United Nations Framework Convention on Climate Change (see Schedule 2 of the 2002 Act) and the United Nations Framework Convention on Climate Change (see Schedule 1 of the 2002 Act).
- Importantly, s 3(1)(a) of the Climate Change Response Act 2002 now recognises that there is an obligation in domestic law 'to meet its international obligations under the Convention, the Protocol, and the Paris Agreement'. The addition of this text may mean that a 'legal obligation', as defined in PBE IPSAS 19, may now exist domestically. See Appendix 1 (p. 98) for actual text from s 3(1)(aa) and s 3(1)(a).
- Strategies are embedded in the Climate Change Response Act 2002. The Climate Change Response Act 2002 tends to separate emission reduction strategies from adaptation strategies. Given that emission reduction strategies underpin the ambition underlying NDCs, the law does recognise the important role strategies have in reducing net emissions. For example, s 5ZG, inserted on 23 June 2020, discusses emissions reduction strategies:

Section 5ZG: Requirement for emissions reduction plan

- (1) For each emissions budget period, the Minister—
 - (a) must prepare and make publicly available a plan setting out the policies and strategies for meeting the relevant emissions budget; and
 - (b) may include in the plan policies and strategies for meeting any emissions budgets that have been notified under section 5ZD for the 2 emissions budget periods after that.
- (2) The plan must be prepared and made publicly available by the deadlines specified in section 5ZI.
- (3) The plan must include—

- (a) sector-specific policies to reduce emissions and increase removals; and
- (b) a multi-sector strategy to meet emissions budgets and improve the ability of those sectors to adapt to the effects of climate change; and
- (c) a strategy to mitigate the impacts that reducing emissions and increasing removals will have on employees and employers, regions, iwi and Māori, and wider communities, including the funding for any mitigation action; and
- (d) any other policies or **strategies that the Minister considers necessary.** [bold added]

In September 2023 the Government proactively released three documents on its *NDC Strategy*: the (i) *Nationally Determined Contribution Strategy* (the *2023 Cabinet Paper*) (3 July 2023), (ii) *Appendix 1: Nationally Determined Contribution Strategy* (3 July 2023) and (iii) *Minute of decision* (the *2023 Cabinet Minute*) (3 July 2023).

The *2023 Cabinet Paper* states:

- 2 The paper details how the strategy at Appendix 1 will work in practice. This includes how the government will operationalise its priority for domestic action to meet the NDC, and how this will be supplemented with international cooperation. **It also details how we will adapt the approach over time as domestic action is scaled up and the need for offshore mitigation decreases.**
- 4 The Government declared a climate change emergency on 2 December 2020. The Cabinet Business Committee (CBC) agreed that climate change ‘demands a sufficiently ambitious, urgent, and coordinated response across government to meet the scale and complexity of the challenge’ [CBC-20-MIN0097 refers].
- 5 Meeting our Paris Agreement NDC is critical to upholding the Government’s commitment to ambitious climate action and is in keeping with the declaration of climate emergency. The proposals in this paper are our strategy for achieving this ...
- 15 This paper details how the strategy will work in practice. This includes:
 - 15.1 priority given to domestic action through determined implementation of ERP1 and additional domestic action through ERP2, including some indicative examples
 - 15.2 international cooperation, **primarily for our first NDC** [bold added]
 - 15.3 an illustrative view of what future NDCs could look like, consistent with 1.5°C and our legislated net zero target for 2050, showing that the need for international cooperation has the potential to decrease over time as New Zealand takes additional domestic action
 - 15.3 an adaptive management approach that sets a ‘Dynamic Pathway’ **for assessing the appropriate mix of domestic and offshore mitigation over time**, through two-yearly monitoring and reporting cycles which provide critical decision points where adjustments may be made
 - 15.4 a view of further cross-government work needed to enable implementation of the NDC strategy. This includes funding options, accounting approaches, and institutional arrangements for monitoring progress and overseeing the Dynamic Pathway.
- 16 I propose that the NDC strategy at Appendix 1 be used to support officials and Ministers in the policy design and decision-making relevant to meeting the NDC. This includes developing ERP2, progressing international cooperation, and making adaptive decisions on the policy mix over the duration of NDC1 ...
- 24 At the time of updating our NDC, Cabinet also [CAB-21-MIN-0435]:
 - 24.2 agreed to complement domestic action with international cooperation to access offshore mitigation, taking a portfolio approach that prioritises sustainable development outcomes and resilience in the Asia-Pacific region ...
- 59 While significantly enhancing domestic emissions reduction is critical, **there are also opportunities to enhance domestic CO₂ removals to further minimise the need for offshore mitigation. At present, forestry is the only commercially viable source of large-scale domestic removals.**

- 60 Due to lead times for planting and growth, **new forestry initiatives will have minimal impact on NDC1**. However, considering these initiatives now and getting implementation underway would help reduce reliance on offshore mitigation in future NDC periods. The Government will consider options for increased afforestation within the framework of a longer-term carbon removals strategy.
- 64 The Commission concluded that ‘even in the most technology optimistic scenarios ... a significant amount of offshore mitigation is needed to meet the current NDC’.
- 65 Aligned with the Commission’s advice, Cabinet agreed to **complement domestic action with international cooperation to access offshore mitigation, taking a portfolio approach that prioritises sustainable development outcomes and resilience in the Asia-Pacific region** [CAB-21-MIN-0435 refers] ...
- 84 Under-delivering domestic action will require additional offshore mitigation, but exceeding the emissions budgets will require less. The current projected shortfall, based on meeting the first two emissions budgets, requires approximately 99Mt of CO₂-e.
- 91 Effective oversight of NDC strategy implementation would require bringing the ERP monitoring processes and the international portfolio process into alignment.
- 97 **The cost of using offshore mitigation from international cooperation is highly uncertain**. However, at the time of updating our NDC in 2021, Cabinet noted that the cost is likely to be significant. Although officials did not provide a specific cost estimation to meet an NDC of a 50% reduction by 2030, **Cabinet noted that offshore mitigation required for a 49% reduction might cost in the range of \$7.5 to \$13.2 billion between 2021 and 2030** [CAB-21-MIN-0434].
- 98 More recently, the cost of offshore mitigation to meet the NDC commitment has been estimated by Treasury and Ministry for the Environment officials to be between \$3-24 billion by 2030. These updated CEFA estimates are based on Cabinet’s direction to develop a portfolio of options for accessing offshore mitigation, prioritising partnerships in the Asia-Pacific region. [bold added]

Recommendations

- 18 **note** that at the time of updating the NDC in 2021, Cabinet noted cost estimates for the required offshore mitigation were in the range of \$7.5 to \$13.2 billion by 2030 for an NDC of a 49% reduction [CAB-21-MIN-0434].
- 19 **note** the cost of using offshore mitigation has been estimated by CEFA analysis to range between \$3-24 billion by 2030.
- 20 **note** the total fiscal cost of achieving our first NDC will depend on the costs of international emissions reductions, as well as the direct and indirect fiscal costs of accelerating New Zealand’s domestic transition ...
- 23 **agree** to the adaptive approach provided by the ‘Dynamic Pathway’ for monitoring, assessing and adjusting the balance of domestic and international mitigation at key decision points agree that the NDC strategy document (Appendix 1) be used to support officials and Ministers in policy design and decision-making relevant to meeting the NDC.⁷⁴

Appendix 1 of the released documents noted:

New Zealand has options for how to meet our NDCs, involving domestic action and international cooperation [and the] Government is committed to prioritising domestic action to meet our NDCs.⁷⁵

The 2023 *Cabinet Minute* (heavily redacted) noted that on 26 October 2021 Cabinet agreed to update NDC1.

noted that on 26 October 2021, Cabinet agreed to update New Zealand’s Nationally Determined Contributions (NDCs) to better align with the temperature goals of the Paris Agreement, committing to reduce net greenhouse gas emissions to 50 percent below gross 2005 levels by 2030 [CAB-21-MIN-0434]; (Para 1)

The 2023 *Cabinet Minute* also included the following relevant paragraphs:

noted that the government’s priority is to meet NDC1 through domestic action as much as possible to support New Zealand’s transition to a low-emissions climate-resilient future; (Para 2.1)

agreed to **complement domestic action with international cooperation to access offshore mitigation**, taking a portfolio approach that prioritises sustainable development outcomes and resilience in the Asia-Pacific region; (Para 2.2)

noted that at the time of updating the NDC in 2021, Cabinet noted **cost estimates for the required offshore mitigation were in the range of \$7.5 to \$13.2 billion by 2030** for an NDC of a 49 percent reduction [CAB-21-MIN-0434]; (Para 18)

agreed to the adaptive approach provided by the ‘Dynamic Pathway’ for monitoring, assessing and **adjusting the balance of domestic and international mitigation at key decision points**; (Para 22)

agreed that the **NDC strategy document**, attached to the paper under CAB-23-SUB-0283, be used to support officials and Ministers in policy design and decision-making relevant to meeting the NDC; (Para 23)

agreed to **progress policy work** to determine the funding arrangements for the NDC strategy ... [the remaining text was redacted]; (Para 25)

noted that the Minister of Climate Change is progressing further analysis on methodologies and time frames to expand NDC accounting to include **non-forest land use categories**, and intends to bring a paper back to Cabinet seeking decisions on this work by mid-2024; (Para 26)

agreed in principle, subject to more detailed advice on accounting implications, that:

- 27.1 New Zealand’s NDC target cover all different types of land, and that the government work towards including **non-forest land** use and management interventions by 2030;
- 27.2 non-forest abatement be encouraged in climate policy in advance of its eventual inclusion into New Zealand’s NDC; [bold added] (Para 27)⁷⁶

As noted earlier, there are three categories that determine whether a legal obligation exists, but other than being mentioned, the standards provide little guidance on what is required for each category to be triggered.

The first category is **whether a contract exists**. In New Zealand, a legally binding agreement is any contract that is valid and is therefore enforceable. To meet this requirement a number of core elements must exist, such as ‘a clear offer; unequivocal acceptance; adequate consideration; an intention for all parties to enter into legal relations; and certain terms’.⁷⁷ It is hard to argue that a clear legally binding contract existed in 2015 (as stated in the *2015 Cabinet Paper*); however, an actual agreement with another country to purchase authorised intentional units would be such a contract (see Article 6 paragraph 3 in the Paris Agreement).

The second category is **whether an obligation is created in legislation**. This can be argued given that (a) the Minister provided an *NDC Strategy* to Cabinet in September 2023, (b) it is a strategy the Minister ‘considers necessary’, (c) the strategy does include a commitment to purchase offshore carbon credits, and (d) most importantly, it may fit the intent of the strategy as mentioned in law (in s 5ZG of the Climate Change Response Act 2002).

The last category is **whether recent events create a legal obligation through the creation of an ‘other operation of law’**. As there is no guidance on what this means, it could be argued that the *NDC Strategy* may fit more comfortably under this category. The Institute’s government department strategy (GDS) work, in particular the *GDS Index*,⁷⁸ provides a number of examples where a strategy is mentioned in legislation, so this practice is not uncommon.

Suggestions for the Minister of Climate Change

There are tensions in existing climate legislation which would benefit from further legal analysis and clarification, particularly given the increasing levels of interdependency that exist between international agreements and domestic law. See detailed suggestions for the Minister of Climate Change in Section 7.4.

6.1.3 Discussion: Is there a constructive obligation?

Regardless of whether a legal obligation exists, the aim of this section is to explore whether a ‘constructive obligation’ exists as a result of the Government’s actions or package/series of actions. In order not to be repetitive, many of the points described in Section 6.1.2 are not repeated here, but they are relevant.

While judgement is always required in each circumstance, the *2024 IFRIC Decision* is helpful, relevant and timely even though it applies to for-profit entities and at an entity level, not to a public benefit entity or to the Government at the national level (see Section 3.3.4, p. 18). This is because:

- PBE IPSAS 19 is based on IAS 37 and contains identical requirements
- the decision clarifies that the principles and requirements in existing accounting standards provide an adequate basis for an entity to exercise the necessary judgement to address the issues
- the fact pattern used by IFRIC to arrive at the decision is broadly similar to the issues discussed in this paper in relation to the New Zealand Government.

The *2024 IFRIC Decision* also has important implications for both for-profit and public benefit entities in New Zealand. If entities make similar public commitments to reduce and offset their emissions, they will now have to consider whether constructive obligations have arisen. In the public benefit sector, local councils that declare climate emergencies (and make emission reduction commitments under those declarations) or other entities that are participants in the Carbon Neutral Government Programme will now need to reconsider the accounting implications of those declarations and commitments, in order to determine whether constructive obligations have arisen. It is important that ratepayers and the public at large understand that such declarations and commitments have substance and real consequences: they are not merely publicity statements.

Addressing these issues at the entity level is also important and useful for the Government. As the international obligation rests on the New Zealand Government, if for-profit and public benefit entities in New Zealand do not meet their emission reduction goals at the entity level, their shortfalls become the Government's shortfall to address (or offset as far as the Paris Agreement is concerned).

The Government has taken a series of specific, well-publicised actions in its effort to combat climate change. These specific actions and events, particularly when taken together collectively, would have contributed to a valid expectation by the public that the Government would meet its commitments under the Paris Agreement, including the obligation to purchase offshore carbon credits where an emissions gap is expected. The release of the *NDC Strategy* in September 2023 and the various domestic climate policies have together raised valid public expectations that domestic mitigation will not be sufficient to meet our international commitments. Arguably, the following actions and events, particularly when taken together, raise valid expectations and result in a constructive obligation:

1: 4 October 2016 (part of a global climate agreement)

New Zealand indicates to the other signatories to the Paris Agreement and to the New Zealand public that it will accept responsibility for the country's net emissions profile.

A constructive obligation could have resulted when New Zealand ratified the Paris Agreement on 4 October 2016, as it created a valid expectation by the public that the Government would meet its commitments under the Paris Agreement. Setting targets domestically to meet New Zealand's Paris Agreement commitments is a sufficiently specific statement or action that arguably could require the disclosure of an obligation to purchase offshore carbon credits, where an emissions gap is expected.

2: 22 June 2020 (part of a domestic climate policy)

The New Zealand Government advises the New Zealand public that it will reduce emissions and, where it cannot, it will purchase offshore carbon credits to make up the difference.

A constructive obligation could have resulted on 22 June 2020 with the passing of the Climate Change Response (Emissions Trading Reform) Amendment Act 2020, as it created a valid expectation by the public that the Government would meet its commitments under the Paris Agreement. Legislation, together with the Government's emissions budget (published on 31 December 2021) and/or the Government's Emissions Reduction Plan (published in May 2022), individually or together, are sufficiently specific statements or actions that arguably could trigger the disclosure of an obligation to purchase offshore carbon credits, where an emissions gap is expected.

3: 3 July 2023 (part of a domestic climate policy)

The NDC Strategy is agreed in principle by Cabinet.

See discussion in Section 6.1.2 (p. 46).

4: 9 July 2023 (part of a global climate agreement)

New Zealand signs the Free Trade Agreement with the European Union, agreeing to implement the Paris Agreement, ‘including commitments with regard to nationally determined contributions’, and that it could trigger a material dispute if not implemented.

New Zealand signed a free trade agreement with the European Union on 9 July 2023. Under the agreement, the parties recognise the importance of taking urgent action to combat climate change and its impacts, and the role of trade in pursuing this objective, consistent with the United Nations Framework Convention on Climate Change (UNFCCC), the purpose and goals of the Paris Agreement, and other Multilateral Environmental Agreements (MEAs) and multilateral instruments in the area of climate change. As such, each party agrees to effectively implement the UNFCCC and the Paris Agreement, including commitments with regard to nationally determined contributions.

A party’s commitment to effectively implement the Paris Agreement includes the obligation to refrain from any action or omission that materially defeats the object and purpose of the Paris Agreement (see Article 19.6: Trade and climate change). In addition, if the NDC is not implemented, it may trigger a dispute if a party fails to refrain from any action or omission that materially defeats the object and purpose of the Paris Agreement (see Chapter 19: Trade and sustainable development).

The specific references to, and inclusion of, the parties’ commitment to the Paris Agreement arguably created a valid expectation for the EU and for the public of New Zealand that the Government would meet its commitments under the Paris Agreement in order to comply with the terms and conditions of the Free Trade Agreement.⁷⁹ The Free Trade Agreement is a specific statement and action that arguably could trigger the disclosure of an obligation to purchase offshore carbon credits, where an emissions gap is expected.

5: 9 December 2023 (part of a global climate agreement)

The Government releases the COP28 National Statement for New Zealand.

The statement included the following paragraph expressing support for the Paris Agreement:

New Zealand has an ambitious NDC to reduce net greenhouse gas emissions by 50 per cent below gross 2005 levels by 2030. We are committed to achieving this, and our 2050 domestic net zero target, by tackling the key drivers of emissions, and working with the private sector so they make transformative investments:

- in resilient infrastructure;
- in renewable energy and cleaner low-carbon fuels; and
- in new technologies to reduce agricultural emissions and capture carbon.

Our NDC implementation will be grounded in high quality data, transparency, accountability and stable pricing signals.⁸⁰

6: 15 April 2024 (part of a global climate agreement)

The Prime Ministers of Singapore and New Zealand release a joint statement.

This statement included the following paragraph expressing support for the Paris Agreement:

The Prime Ministers recognise the need to limit global warming to 1.5 degrees Celsius and support the global economic transition that is under way as part of their shared commitment to implement the Paris Agreement and seize growth opportunities in the green economy. New Zealand and Singapore will work together to ensure their economies are prosperous, clean, and future-proofed. (Para 7)⁸¹

Taking a collective view

The six previous statements and actions, particularly when taken collectively, would have created a valid expectation for the public that the Government would meet its commitments under the Paris Agreement. This would include the obligation to purchase offshore carbon credits, where an emissions gap is expected, thereby resulting in a constructive obligation.

7: 1 January 2021 (part of a domestic activity)

New Zealand first emits greenhouse gases under the Paris Agreement.

However, the most logical and clear ‘trigger’ for the constructive obligation is the date the ‘first emission’ was released into the environment (being 1 January 2021).⁸² This is consistent with, and supported by, the *2024 IFRIC Decision* as the trigger date for the constructive obligation and its disclosure (see Section 3.3.4, p. 18, for more information on the *2024 IFRIC Decision* and Appendix 5 for a comparison between the *2024 IFRIC Decision* and New Zealand’s Paris Agreement commitment and actions). The obligation was not a present obligation at the date of the signing of the Paris Agreement. At that point no action had been taken by the New Zealand Government to which the Paris Agreement applies. However, the ‘past event’ is triggered (and hence the constructive obligation arises) when the greenhouse gases that the New Zealand Government has committed to offset are emitted. The obligation begins when greenhouse gases are emitted that New Zealand is unable to offset completely by domestic means. From that point, there is a present obligation to use offshore carbon credits to offset those greenhouse gases where domestic offsets are insufficient.

In the *2024 IFRIC Decision*, the fact pattern is that the entity publicly states its commitment ‘to offset its remaining emissions in 20X9 and thereafter, by buying carbon credits and retiring them from the carbon market’ [bold added]. The entity therefore has a present obligation to offset its carbon emissions only if and when it emits greenhouse gases in 20X9 and later years. In the IFRIC fact pattern, the entity is committed to retiring its entire annual carbon emissions that it emits from 20X9 and thereafter. The past event is therefore triggered in 20X9 when the entity emits greenhouse gases.

In contrast to the *2024 IFRIC Decision*, New Zealand’s NDC1 Budget sets out pathways where emissions are progressively reduced (with budgeted offsets) in each period from 2021 to 2030. New Zealand’s commitment is to offset only that portion of the carbon emissions that it is unable to offset by domestic means. There is no clear indication in the NDC1 Budget (or in any other documentation that we are aware of) that the commitment to offset New Zealand’s carbon emissions will occur only after 2030, or when the NDC1 Budget of 571 Mt CO₂e has been reached. As such, the past event is considered to be triggered on the date the Paris Agreement comes into effect and the greenhouse gases are emitted. From that date, any emissions in excess of the emissions that the New Zealand Government has committed to under the Paris Agreement are required to be offset.

There is a need to recognise the expense (and liability) regardless of when the actual timing of the purchase of offshore carbon credits will occur. Accruing the expense (and liability) does not obligate the Government to purchase the offshore carbon credit offsets from that date: purchases of offshore carbon credit offsets can occur at any time during the NDC1 period, after 2030, or when the NDC1 Budget of 571 Mt CO₂e has been reached.

Accruing the estimated costs (and liability) for each period from 1 January 2021 to 2030 enables the estimated costs to be attributed to the appropriate accounting period and is consistent with periodic financial reporting and accrual accounting. Bearing the estimated costs for purchasing offshore carbon credits across each year of the ten-year period also aligns with the tracking and accounting approach for NDCs under the Paris Agreement guidance. Under the tracking and accounting approach, determining the carbon credit offsets that are required is not done after 2030 (or after the NDC1 Budget of 571 Mt CO₂e has been reached), but is progressively implemented across 2021–2030 via biennial reporting and review that starts in 2024 with BTR1. Cabinet, in the *2023 Cabinet Paper*, agreed the ‘dynamic pathway’ approach which links implementation of the NDC Strategy to the biennial Paris Agreement reporting cycle, including determining every two years ‘how much offshore mitigation is required to demonstrate progress for the next cycle’. (See Section 4.1, p. 24)

Other actions and events in the future

Lastly, it is important to note that there are likely to be a number of actions and/or events in the future that might further strengthen the view that a constructive obligation exists. For example, Treasury's 2027 *Budget Economic and Fiscal Update (BEFU)* is part of the annual cycle of stewardship documents that sets out how the Treasury observes the current economic climate and what they expect to see in the future. These observations of the economy, alongside the Government's fiscal policy decisions, inform their view on the Government's financial performance and financial position over the current year, and over the next four years (the forecast period).⁸³ This means that Treasury's 2027 *BEFU* will need to consider the fiscal implications of offshore abatement in 2031.

6.1.4 Conclusion

Legal obligation: The Institute considers it would be useful for the Minister to seek a legal opinion to clarify the situation, in particular, whether incorporation of the Paris Agreement into domestic legislation makes the commitment to the Paris Agreement domestically enforceable. This is particularly so given recent developments in the legal arena, for example, New Zealand's trade agreement with the EU, and the Netherlands civil court ruling that found Shell must, by 2030, cut its CO₂ emissions by 45% (compared to 2019 levels). Moreover, if the commitment is determined to be a legal obligation, the Government's ability to repudiate its obligations under the Paris Agreement may no longer be a valid reason that the obligations do not meet the definition of a liability.

Constructive obligation: The 2024 *IFRIC Decision* clarifies that 'judgement' is always required in each circumstance. It is helpful that it also clarifies that the principles and requirements in existing accounting standards provide an adequate basis for an entity to exercise the necessary judgement to determine whether statements and actions about reducing or offsetting greenhouse gas emissions trigger a constructive obligation that is owed to all people adversely affected by the emissions. Such an obligation extends to those affected by the emissions and to the public at large: it is not necessary to know the identity of the party to whom the obligation is owed. Therefore, existing accounting standards would be used to determine whether an obligation exists.

The Institute considers that the Government's international and domestic climate policies, treaties and legislation were actions and events that, taken collectively, could have met the definition of a constructive obligation as defined in PBE IPSAS 19. The actions and events were sufficiently specific, for example, signing and ratifying the Paris Agreement, setting up domestic agencies (e.g. the Climate Change Commission), passing numerous pieces of legislation to address climate change, and setting emissions reduction plans. These indicate an established pattern of past practice and published policies. These well-publicised actions and events collectively were sufficient for the New Zealand Government to indicate to the New Zealand public that it would accept certain responsibilities, and created a 'valid expectation' for the New Zealand public that the New Zealand Government will discharge its responsibilities under the Paris Agreement.

Further indications that the public has a valid expectation that the New Zealand Government will meet its obligations to reduce (and if not, offset) its emissions include the ongoing litigation and actions of the Lawyers for Climate Action Inc. In addition, the *Ipsos NZ 2023 Global Advisor Climate Change Report*, which surveyed 1003 people aged 18+ in New Zealand, stated, among other matters, that:

- Significantly more New Zealanders are concerned about the impacts of climate change that are already being seen around the country (80%, up from 76% in 2022), while 82% of New Zealanders are also concerned about the impacts of climate change that are already being seen in other countries around the world.
- Compared to others around the world, significantly more New Zealanders recognise that individuals, businesses and the government need to act now.
- 66% stated that if the government does not act now to combat climate change, it will be failing the people of New Zealand (compared to a global average of 61%).

- 65% stated that if businesses do not act now, they will be failing their employees and customers (59% global average).
- 67% stated that if individuals do not act now, we will be failing future generations (63% global average).⁸⁴

The duty of the government: It seems appropriate to consider the duty of the government to keep the public informed and ideally consult on the size of the potential commitment. Given the lack of clarity over whether a potential legal or constructive obligation might occur in the future, it seems prudent to seek a non-partisan view on the *NDC Strategy*, particularly in terms of when that commitment is triggered/crystallised as a legal obligation. Questions that arguably need answers in the next few months include: do the public/organisations need to know, and if yes, at what point in time and by what instrument? And secondly, can the public assume the current Government agrees with the 2023 *NDC Strategy*, or is the current Government working on another strategy? Even though the Paris Agreement was signed by a National Government on 23 April 2016,⁸⁵ this 2023 *NDC Strategy* cannot be assumed to continue under the coalition Government of National, ACT and New Zealand First. Ideally, the Government should clarify whether the *NDC Strategy* is a non-partisan response to the Paris Agreement and whether the Government continues to support the overall strategic approach.

6.2 Question 2: Can the value be reliably estimated?

6.2.1 Accounting Standards

PBE IPSAS 19 states:

Reliable Estimate of the Obligation

The use of estimates is an essential part of the preparation of financial statements, and does not undermine their reliability. This is especially true in the case of provisions (liabilities), which by their nature are more uncertain than most other assets or liabilities. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes, and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision. (Para 33)

Measurement Best Estimate

The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the reporting date. (Para 44)

The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the reporting date. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date. (Para 45)

The estimates of outcome and financial effect are determined by the judgment of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

[bold added] (Para 46)⁸⁶

The *Public Benefit Entities' Conceptual Framework* (2016 *PBE Conceptual Framework*) sets out five measurement bases for liabilities. Two of these provide relevant guidance for measuring the New Zealand Government's commitment to purchase emissions offsets. The measurement bases are the cost of fulfilment and market value.

The *PBE Conceptual Framework* states in relation to the cost of fulfilment:

Cost of fulfilment is:

The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. (Para 7.74)

Where the cost of fulfilment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfilment, which aims to reflect all those possible outcomes in an unbiased manner. (Para 7.75)

Where fulfilment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation. (Para 7.76)

Where fulfilment will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the reporting date. (Para 7.78)⁸⁷

The *PBE Conceptual Framework* states in relation to market value:

Market value for liabilities is:

The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction. (Para 7.80)

The advantages and disadvantages of market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, where the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market. However, in cases where the ability to transfer a liability is restricted and the terms on which such a transfer might be made are unclear the case for market values, even if they exist, is significantly weaker. This is particularly the case for liabilities arising from obligations in non-exchange transactions, because it is unlikely that there will be an open, active and orderly market for such liabilities. (Para 7.81)⁸⁸

6.2.2 Discussion

PBE IPSAS 19 and the *PBE Conceptual Framework* provide the necessary guidance to enable estimation of a liability. In this case, the Government could estimate the cost of fulfilling its commitment by estimating the number of offshore carbon credits it needs to cover excess emissions that have already occurred, and additionally the excess emissions that are projected to occur over the remainder of the NDC period, and multiplying this figure by a price per unit from a credible international carbon market or GHG emissions trading scheme.

The Institute acknowledges that estimating the cost of fulfilling the Government's commitment to purchase offshore carbon credits is complicated and requires judgement. Many factors can affect the reliable measurement of the New Zealand Government's liability, including estimating the size of the emissions gap in each year to 2030, estimating the number of offshore carbon credits that the Government is required to purchase each year and the ability to reference relevant international carbon prices in globally accepted markets. However, as stated in paragraph 33 of PBE IPSAS 19, 'the use of estimates is an essential part of the preparation of financial statements', and does not undermine their reliability. This is especially true in the case of liabilities (provisions) and contingent liabilities, which, by their nature, are more uncertain than most other assets or liabilities.

Paragraph 33 of PBE IPSAS 19 states that 'except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision'. Moreover, the *2024 IFRIC Decision* also concludes that in the fact pattern that they considered (which is similar in principle to the Government's statements about buying offsets), it is likely the entity would be able to make a reliable estimate of the amount of a constructive obligation that satisfies the other recognition criteria.

The Climate Economic and Fiscal Assessment 2023 report

The *Climate Economic and Fiscal Assessment 2023* report (CEFA 2023), authored by the Ministry for the Environment and Treasury, sets out in detail in Chapter 7.2 the methodology for estimating the fiscal costs of offshore mitigation over the NDC1 period. Analysis of the three price and volume scenarios shows that estimates vary substantially with costs ranging from \$3.3 billion to \$23.7 billion. While the CEFA 2023 states that the estimates are ‘illustrative only’, it does illustrate that estimates can be made.

The CEFA 2023 states:

- The cost of purchasing offshore mitigation to achieve New Zealand’s NDC1 presents a significant fiscal risk. For all scenarios considered, our analysis estimates this cost to be multiple billions over the period 2024 to 2030.
- Our analysis includes a significant range of cost estimates, reflecting uncertainty around both required volume and purchase price. Variability in price is a relatively greater driver of this range. Our analysis of fiscal cost estimates is based on a number of illustrative scenarios for both volume and price.
- In a scenario where the price of New Zealand’s offshore mitigation purchases aligns with the average of current prices for well-established international emissions markets, purchase cost estimates range from \$7.7 billion to \$9.9 billion, depending on how New Zealand’s domestic emissions track in relation to emissions budgets.
- However, the future price of international reductions is uncertain, reflecting that many markets are at early stages or yet to be developed.
 - In a scenario where the price of New Zealand’s offshore mitigation purchases aligns with the carbon price assumed by the IEA [International Energy Agency] for emerging and developing economies (about \$41 per tonne of CO₂-e on average), the cost of purchases could range from \$3.3 billion to \$4.2 billion.
 - In a scenario where the price of New Zealand’s offshore mitigation purchases aligns with the carbon price assumed by the IEA for advanced economies under a scenario of enhanced global climate action (about \$227 per tonne of CO₂-e on average), the cost of purchases could range from \$18.3 billion to \$23.7 billion. [See more detail in endnote 89.]
- Domestic policy decisions will materially influence the amount of domestic mitigation New Zealand is able to achieve and at what cost. This will have important implications for what volume of offshore mitigation New Zealand may look to procure to achieve its NDC1. (p. 80)

The CEFA 2023 paper states in regard to the reporting of accounting estimates and input:

This report reflects the current state of knowledge and highlights areas of uncertainty

The assessment of climate-related impacts in this report is based on current knowledge, which is subject to limitations and uncertainties. In many cases the likelihood of an impact is highly certain, but information about its potential size and timing may be limited. Where possible, the report gives quantitative estimates to show the potential size of a given impact. **Where these estimates are not available, impacts are discussed more qualitatively. Over time, we expect the information on the scale and timing of some impacts to improve.** [bold added] (p. 18)

The CEFA 2023 paper states in Chapter 7, in relation to New Zealand’s first Nationally Determined Contribution – scenario analysis of fiscal risk from offshore mitigation:

The estimates are illustrative only

The analysis in this chapter relies on large assumptions and is grounded in a number of uncertainties. The estimates provided above **should therefore be treated as highly illustrative and not as forecasts or projections.** The intent of the analysis is to demonstrate the broad size of the potential fiscal cost of the purchase of given volumes of offshore mitigation to achieve New Zealand’s NDC1. (p. 87)⁹⁰

It is understandable that the CEFA 2023 paper considers the estimates to be ‘illustrative’ only given that the term ‘estimates’ has a specific meaning in accounting standards.

NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

NZ IAS 8 is a standard that applies to for-profit entities (the IPSASB and the XRB are yet to include these amendments in their equivalent IPSAS 3 and PBE IPSAS 3). NZ IAS 8 was amended in March 2021: the Standard applies to for-profit entities for annual reporting periods beginning on or after 1 January 2023. The amendments are useful in this context as they help clarify, among other matters:

- a. how accounting policies and accounting estimates relate to each other, explaining that accounting estimates are used in applying accounting policies and clarifying the definition of accounting estimates; and
- b. that selecting an estimation technique, or valuation technique, used when an item in the financial statements cannot be measured with precision, constitutes making an accounting estimate.

NZ IAS 8 now defines accounting estimates as:

Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty (Para 5).

NZ IAS 8 also clarifies in paragraphs 32 to 32B, in relation to ‘Accounting estimates’:

Accounting estimates

An accounting policy may require items in financial statements to be measured in a way that involves measurement uncertainty—that is, the accounting policy may require such items to be measured at monetary amounts that cannot be observed directly and must instead be estimated. In such a case, an entity develops an accounting estimate to achieve the objective set out by the accounting policy. **Developing accounting estimates involves the use of judgements or assumptions based on the latest available, reliable information.** Examples of accounting estimates include:

- (a) a loss allowance for expected credit losses, applying *NZ IFRS 9 Financial Instruments*;
- (b) the net realisable value of an item of inventory, applying *NZ IAS 2 Inventories*;
- (c) the fair value of an asset or liability, applying *NZ IFRS 13 Fair Value Measurement*;
- (d) the depreciation expense for an item of property, plant and equipment, applying *NZ IAS 16 [Property, Plant and Equipment]*; and
- (e) a provision for warranty obligations, applying *NZ IAS 37 Provisions, Contingent Liabilities and Contingent Assets*. [bold added] (Para 32)

An entity uses measurement techniques and inputs to develop an accounting estimate. Measurement techniques include estimation techniques (for example, techniques used to measure a loss allowance for expected credit losses applying NZ IFRS 9) and valuation techniques (for example, techniques used to measure the fair value of an asset or liability applying NZ IFRS 13). (Para 32A)

The term ‘estimate’ in NZ IFRS sometimes refers to an estimate that is not an accounting estimate as defined in this Standard. For example, it sometimes refers to an input used in developing accounting estimates. [bold added] (Para 32B)⁹¹

Paragraph 32B of IAS 8 provides the necessary guidance to enable estimated units of carbon emissions to be reported in financial statements. In this regard, we note that the units used in the two *CEFA 2023* scenarios are the same. They use 80 Mt CO₂e and 100 Mt CO₂e (approximately) to determine the range (we calculated the units by dividing the total dollars in the *CEFA 2023*’s illustrations by the price per tonne in each scenario).

These figures align with Minister Shaw’s statement in the *2023 Cabinet Paper*:

Our NDC1 is substantially more ambitious than the domestic emissions budgets we have set for the same period (2021-2030) under the Climate Change Response Act 2002 (CCRA). There is an **estimated 99 Mt CO₂-e of additional abatement** needed to meet the NDC over and above achievement of our first two domestic emissions budgets. [bold added]⁹²

Observations to note:

- An accounting estimate, such as the \$12.8 billion, could be reported in the financial statements. This figure is from the speech by the Secretary to the Treasury, Caralee McLiesh, on 19 September 2022. McLiesh stated that ‘the Treasury estimates that meeting the international commitments under the Paris Agreement through our Nationally Determined Contributions could require up to \$12.8 billion in overseas mitigation by 2030’.⁹³
- The input (the estimated units), such as the 80 Mt CO₂e and 100 Mt CO₂e, could be reported in the financial statements. These units are consistently used in the *CEFA 2023* scenarios and we assume they are the best estimates at this point in time. How this input might be reported is discussed in Table 6.2.
- We assume figures provided by the Secretary to the Treasury meet the reliability condition unless otherwise stated.
- It is important to note that the price per unit is increasing. For example, the Average Auction Clearing Price (Euro/allowance) was 52.74 in June 2021, but by June 2023, the price was 85.04 (an increase of 62% in two years).⁹⁴

Table 6.2 explores how this accounting estimate and estimated inputs might be reported.

6.2.3 Conclusion

GAAP provides sufficient general guidance to enable the New Zealand Government to estimate and report its obligation in terms of metric tonnes. It may be more difficult to estimate a dollar value per metric tonne, but given that an international emissions trading system is likely to emerge, a price per metric tonne may become more acceptable and globally recognised in the foreseeable future. While estimating the cost of offshore mitigation over the entire NDC1 period might encounter more uncertainties, arguably, a price per metric tonne may be more reliable at a particular point of time (in this case 30 June).

Similar to paragraph 33 of IPSAS 19, the *2024 IFRIC Decision* states that ‘except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision’. Importantly, the *CEFA 2023*’s illustrations of the estimated fiscal costs show that it is possible to make estimates of the offshore mitigation costs.

6.3 Question 3: Is it a liability that should be recognised in the statement of financial position?

6.3.1 Accounting Standards

PBE IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets

PBE IPSAS 19 distinguishes between provisions (recognised liabilities) and contingent liabilities:

- (a) Provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
- (b) Contingent liabilities– which are not recognised as liabilities because they are either:
 - (i) Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
 - (ii) Present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made). (Para 21)⁹⁵

PBE IPSAS 19 makes clear that provisions (recognised liabilities) are only to be recognised when:

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

If these conditions are not met, no provision shall be recognised. (Para 22)⁹⁶

PBE IPSAS 19 states in regard to ‘past events’:

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 continue an entity’s ongoing activities in the future. The only liabilities recognised in an entity’s statement of financial position are those that exist at the reporting date. (Para 26)⁹⁷

6.3.2 Discussion

A provision (liability) is recognised only if all three conditions for recognition of a provision set out in paragraph 22 of PBE IPSAS 19 are met. If those conditions are not met, no provision is required to be recognised.

Paragraph 22(a)

The Institute considered under Question 1 that the Government’s international and domestic climate policies, treaties and legislation were actions and events that collectively could have met the definition of a constructive obligation as defined in PBE IPSAS 19 (Para 22(a)). The publicity surrounding the relevant actions and plans of the Government to reduce and/or offset the country’s emissions as well as legislative changes relating to climate change would have created a valid expectation on the part of the public that the New Zealand Government would meet its obligations under the Paris Agreement. Emissions in excess of levels consistent with the NDC1 have occurred since 1 January 2021, constituting a past event that gives rise to an obligation to offset.

Paragraph 22(b)

The question is whether the commitment by the New Zealand Government to purchase offshore carbon credits to offset emissions should be recognised as a liability. On the basis that there was a constructive obligation created, to meet paragraph 22(b) of IPSAS 19 requires that it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

The Institute acknowledges that there are many variables affecting the Government’s liability under the Paris Agreement, and therefore the size of the outflow of resources. For example:

- the Government may increase New Zealand’s NDC1 target to reduce greenhouse gas emissions, thereby increasing any potential future liability
- certain entities in New Zealand are required by law or policy changes to offset their own emissions and therefore the obligation and liability for the emissions offset may not rest solely on the Government
- Government policies may change over the period to require more entities/sectors to meet their own emissions offsets, reducing the Government’s liability for the emissions offsets
- domestically generated offsets/emissions removals may increase (reducing or eliminating the need for the Government to purchase offshore carbon credits)

- new technology may reduce carbon emissions (reducing or eliminating the need for the Government to purchase offshore carbon credits); and/or
- the future price of offshore carbon credits may change (affecting the amount of any future liability).

However, the Institute considers it is highly unlikely that the Government could completely avoid paying for the purchase of offshore carbon credits (future expenditure) by taking a future action, such as changing its policies on how it mitigates future emissions. It is well accepted that it is unlikely that domestic actions and policies will be able to totally offset the country's emissions gap.

The Ministry for the Environment and Treasury's report *CEFA 2023* makes it clear that achieving New Zealand's first Nationally Determined Contributions (NDC1) of reducing net emissions by 50% below the country's gross 2005 level by 2030 will require domestic and offshore mitigation:

Meeting New Zealand's first NDC represents a large fiscal cost, and depends on domestic and international factors

New Zealand's Nationally Determined Contributions (NDCs) represent its commitments to contribute to global efforts to limit warming to within 1.5°C. To meet the first NDC (NDC1), New Zealand's domestic net emissions over 2021 to 2030 less mitigation New Zealand supports overseas must not exceed 571 megatonnes of carbon dioxide equivalent (Mt CO₂-e). Based on New Zealand's domestic emissions budgets over the same period, **supporting offshore mitigation will be required to meet NDC1.** [bold added] (p. 9)

The role of offshore mitigation in meeting NDC1

The Government has expressed its intention to meet New Zealand's NDC1 through a combination of domestic and offshore mitigation, prioritising domestic action.

This approach is consistent with recommendations from the CCC. It advised that attempting to achieve New Zealand's previous NDC1 by driving domestic action significantly beyond its recommended emissions budgets would likely lead to severe social and economic costs on communities, people and businesses. The CCC recommended strengthening New Zealand's NDC1, which the Government did in late 2021. However, it noted that offshore mitigation would be critical to meeting New Zealand's NDC1 and in line with the spirit of the Paris Agreement, which explicitly recognises that international cooperation can serve the goals of increasing ambition and promoting sustainable development and environmental integrity.

Offshore mitigation could be procured through a number of mechanisms, such as:

- direct investment in offshore emissions reductions activities
- investment in international carbon funds (through the new centralised market mechanism agreed under Article 6 of the Paris Agreement)
- purchasing from other established emission trading schemes, including through linking the NZ ETS with these schemes.

The Government is in the early stages of developing a portfolio for accessing offshore mitigation, including exploring options to:

- source or support offshore mitigation activities that meet the requirements for environmental integrity, prioritising those in the Asia-Pacific that also promote sustainable development and resilience
- link the NZ ETS to international markets that meet the requirements for environmental integrity.

Several countries have publicly stated their intention to use international carbon markets to meet their NDCs and are already engaging with potential partners. However, international markets for trading emissions reductions between countries to contribute towards NDCs are currently in a relatively nascent state. [bold added] (p. 81)⁹⁸

The need for offshore mitigation is particularly likely given that even a change of government is unlikely to bring about any change in climate change policy. Both major political parties have made it clear that they are committed to the Paris Agreement. The initial Paris Agreement was signed by the National-led Government in 2016, and the Climate Change Response (Zero Carbon) Amendment Bill 2019 was passed by a large majority of MPs from most of the parties (the Labour Party, the Green Party, NZ First and the National Party; the only exception being ACT). It is therefore the Institute's view that paragraph 22(b) of PBE IPSAS 19 has also been met and it is highly probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

While election pledges are not usually considered to be binding, the National Party election pledge reaffirmed its climate policy in 2023:

National is absolutely committed to New Zealand's climate change targets, including:

- Net zero greenhouse gas emissions excluding biogenic methane by 2050;
- Biogenic methane reduced by 10 per cent by 2030 and 24–47 per cent by 2050 compared to 2017 levels; and
- New Zealand's Nationally Determined Contribution under the Paris Climate Agreement to reduce net greenhouse gas emissions to 50 per cent below gross 2005 levels by 2030.⁹⁹

This was further reaffirmed in April 2024 when Prime Minister Christopher Luxon announced nine Government Targets to be delivered by 2030. One of these was a target to reduce net greenhouse gas emissions:

On track to meet New Zealand's 2050 net zero climate change targets, with total net emissions of no more than 290 megatonnes from 2022 to 2025 and 305 megatonnes from 2026 to 2030.¹⁰⁰

Paragraph 22(c)

The final criterion for recognising a provision is that a reliable estimate can be made of the amount of the obligation (Para 22(c) of PBE IPSAS 19). The extent to which paragraph 22(c) of PBE IPSAS 19 can be met is less certain. For example, the total cost of offshore mitigation over the entire NDC1 period will depend on several future actions and events, including:

- the size of New Zealand's NDC target
- how much of the NDC is met with domestic emission reductions and removals
- the price of offshore mitigation.

These factors may make it difficult to determine a reliable estimate of the total cost. Therefore, if the Government wishes not to report this as a liability in the statement of financial position, it might argue that it is too difficult at this time to estimate the value of the entire liability (see discussion in Question 2).

Furthermore, if the Government is obliged to disclose a liability (in the form of a provision) at the end of each financial year, it could be argued that the obligation is limited only to the actual amount of emissions offsets required to meet the obligations for that year. This amount meets the definition of a liability because, at balance date, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation for that year, and a reliable estimate can be made of the amount of the obligation as the amount would be calculated based on the current year's price as at the end of the financial year (30 June of each year).

This proposition is supported by the *2024 IFRIC Decision*: the obligation is not a present obligation as a result of a past event when the entity publicly states its commitment. At that time, the entity has not taken the actions to which the statement applies. Only when the entity has emitted the greenhouse gases that it has committed to offset will it have a present obligation to retire the carbon credits required to offset those greenhouse gases.

On this basis, the Government's liability crystallises when greenhouse gases are emitted from 1 January 2021. This triggers an ongoing expectation that the Government will purchase offshore carbon credits to meet its 2030 target to offset excess emissions that have already occurred and, arguably, for the remainder of the NDC1 period. This creates an ongoing reporting obligation which should be recognised in the first set of financial statements after 1 January 2021 as this is when the liability begins and is the first time it can be measured in quantifiable terms.

6.3.3 Conclusion

The Institute considers that the New Zealand Government has a constructive obligation (liability) for the purchase of offshore carbon credits to cover our expected carbon emissions gap (the gap between our projected emissions and our commitments under the Paris Agreement that we are unable to reduce domestically). Whether it is possible to recognise the liability in the financial statements depends on whether the amount of the liability can be reliably estimated (see the discussion in Question 2).

6.4 Question 4: Is it a contingent liability that should be disclosed in the notes to the financial statements?

6.4.1 Accounting Standards

PBE IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets

A contingent liability is defined in accounting standard PBE IPSAS 19 as:

- (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) A present obligation that arises from past events, but is not recognised because:
 - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - (ii) The amount of the obligation cannot be measured with sufficient reliability. (Para 18)¹⁰¹

PBE IPSAS 19 does not allow an entity to recognise a contingent liability (Para 35). However, it requires a contingent liability to be disclosed, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (Para 36). It states:

Unless the possibility of any outflow in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, where practicable:

- (a) An estimate of its financial effect, measured under paragraphs 44–62;
- (b) An indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) The possibility of any reimbursement. (Para 100)¹⁰²

PBE IPSAS 19 is clear that by their nature, both provisions and contingent liabilities are estimated and it is only in extremely rare circumstances that no reliable estimates can be made. PBE IPSAS 19 requires a contingent liability to be assessed continually to determine whether an outflow of resources has become probable. This requires continual assessment of when an outflow of resources for an item previously reported as a contingent liability has become probable. When an outflow of resources has become probable, a provision must be recognised in the financial statements.

Contingent liabilities may develop in a way not initially expected. Therefore, they are **assessed continually** to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the **extremely rare circumstances** where no reliable estimate can be made). For example, an entity may have breached an environmental law, but it remains unclear whether any damage was caused to the environment. Where, subsequently[, it becomes clear that damage was caused and remediation will be required, the entity would recognise a provision because an outflow of economic benefits is now probable. [bold added] (Para 38)¹⁰³

6.4.2 Discussion

The NDC1 commitment period came into being on 1 January 2021. The first set of financial statements of the Government (for the year ended 30 June 2021) did not mention NDCs at all.

The *Financial Statements of the Government of New Zealand for the year ended 30 June 2022* did include the following statement under Note 21 Climate Change Commitments: New Zealand Emissions Trading Scheme:

At the Glasgow COP26 Conference in November 2021 the Government strengthened New Zealand's National Determined Contribution (NDC) to reduce greenhouse gas emissions over the 2021-2030 period to a target of a 50% reduction in net emissions from **2005 levels**. This follows New Zealand's ratification of the Paris Agreement in October 2016, the introduction in New Zealand of the Climate Change Response (Zero Carbon) Amendment Act 2019, with a target of net zero carbon emissions by 2050 and the Government's declaration of a climate emergency in December 2020 (joining at the time, over 1,800 jurisdictions in 32 countries to declare a climate emergency and commit to reducing emissions to avoid a more than 1.5°C rise in global warming).

As there is no enforceable obligation in the Paris Agreement to enforce the achievement of the NDC, no liability is recognised in these financial statements as at 30 June 2022. Liabilities are not reported at balance date for costs associated with the Government's policy objectives and targets (even if included in legislation or declared in international treaties) if there is no clear financial liability that the Government will incur if these targets are not met.

The Government's commitment to climate change action does not constitute a present obligation on the Government's balance sheet unless the Government is clear on the cost it intends to incur, when payment will be made, and to whom and as a consequence, has raised a valid expectation in those affected that they will benefit, either because the criteria for the payment has been met or the entity, as a result of the expectation, has been influenced to incur expenditure, or acted in the expectation of receiving assistance. Climate change commitments made are ongoing and adjustable future costs and are not considered a present obligation, as they do not exist independently of a government's future actions. While future costs will be incurred in pursuit of these objectives and targets, these costs will be reported in the future as they are incurred. [bold added] (p. 118)¹⁰⁴

The *Financial Statements of the Government of New Zealand for the year ended 30 June 2023* include the following statement under Note 1 Climate Change Obligations: Basis of Reporting:

New Zealand's current Nationally Determined Contribution (NDC) to deliver on the goals of the Paris Agreement sets a headline target of a 50 per cent reduction of net emissions below our **gross 2005 level** by 2030. This follows New Zealand's ratification of the Paris Agreement in October 2016, the introduction in New Zealand of the Climate Change Response (Zero Carbon) Amendment Act 2019, with a target of net zero carbon emissions by 2050 and the Government's declaration of a climate emergency in December 2020 (joining at the time, over 1,800 jurisdictions in 32 countries to declare a climate emergency and commit to reducing emissions to avoid a more than 1.5°C rise in global warming).

As there is no enforceable obligation in the Paris Agreement to enforce the achievement of the NDC, no liability is recognised in these financial statements as at 30 June 2023. Liabilities are not reported at balance date for costs associated with the Government's policy objectives and targets (even if included in legislation or declared in international treaties) if there is no clear financial liability that the Government will incur if these targets are not met.

The Government's commitment to climate change action does not constitute a present obligation on the Government's balance sheet unless the Government is clear on the cost it intends to incur, when payment will be made, and to whom and as a consequence, has raised a valid expectation in those affected that they will benefit, either because the criteria for the payment has been met or the entity, as a result of the expectation, has been influenced to incur expenditure, or acted in the expectation of receiving assistance. Climate change commitments made are ongoing and adjustable future costs which are not considered a present obligation, as they do not exist independently of a government's future actions. While future costs will be incurred in pursuit of these objectives and targets, any costs will be reported in the future as they are incurred. [bold added] (p. 54)¹⁰⁵

Two changes were made in how this issue was reported in the 2023 Financial Statements compared to the 2022 Financial Statements. The issue is now reported as ‘Climate change obligations’ (rather than as ‘Climate change commitments’) and it is more prominently reported in Note 1 (rather than in Note 21).

The 2022 Financial Statements of the Government’s Audit Report included climate change as a key audit matter for the first time (see excerpt in Table 5.3). The Auditor-General made no further comment in his 2023 Audit Report as there had been no change to the treatment of the basis for reporting the climate obligations in the financial statements.

The Government has not recognised its commitments/obligations under the Paris Agreement as a liability in its financial statements or disclosed a contingent liability. Note 1 on Climate change obligations in the 2023 Financial Statements states that the Government’s climate change commitments and obligations under the Paris Agreement were determined not to constitute a present obligation on the Government’s balance sheet unless the Government is clear on:

- (i) the cost it intends to incur
- (ii) when payment will be made, and
- (iii) to whom and
 - (a) as a consequence, has raised a valid expectation in those affected that they will benefit, either because the criteria for the payment has been met; or
 - (b) the entity, as a result of the expectation:
 - (1) has been influenced to incur expenditure, or
 - (2) acted in the expectation of receiving assistance.

Additionally, Note 1 states that climate change commitments are also not considered a present obligation because they are ‘ongoing and adjustable future costs as they do not exist independently of a government’s future actions. While future costs will be incurred in pursuit of these objectives and targets, any costs will be reported in the future as they are incurred.’

Treasury’s *2013 Guidance on Recognising Liabilities and Expenses (2013 Guidance)* provides application guidance and examples illustrating when it is appropriate to recognise provisions and constructive obligations. It sets out when to recognise a provision for a liability of uncertain amount or timing for financial reporting purposes, particularly for an obligation which is not ‘exchanged’ so that practice complies with standards and consistent treatment is followed. Although the *2013 Guidance* is based on PBE IPSAS 19 that applied in 2013, the relevant provisions about constructive obligations have remained substantively the same over time.

The notes to the 2022 and 2023 Financial Statements contain elements of the criteria set out in the *2013 Guidance*. The criteria in the *2013 Guidance* for recognising constructive obligations are based on the specific criteria outlined in PBE IPSAS 19 under Application of Recognition and Measurement Rules for determining constructive obligations that arise from an entity’s plan to restructure its activities or operations. The *2013 Guidance* uses those specific criteria as ‘principles’ to determine whether the Government has a constructive obligation for other types of claims and to address the question of whether an obligation arises pursuant to a policy being pursued by the Government. In particular, the *2013 Guidance* reworded the specific criteria from PBE IPSAS 19 for restructuring to determine whether a constructive obligation arises in the context of ‘Government assistance’.

Paragraph 44 of the *2013 Guidance* sets out the criteria in relation to whether the Government has a constructive obligation to provide ‘assistance’ as follows:

A non-exchange constructive obligation arises only when:

- a) the government has a detailed formal policy identifying at least:
 - i) which public sector entity will provide the assistance;
 - ii) what events qualify for assistance;

- iii) the types and approximate number of entities who will receive assistance;
 - iv) the estimated cost; and
 - v) when the assistance will be provided; and
- b) has raised a valid expectation in those affected that it will provide assistance by starting to implement that plan or announcing its main features to those affected by it. (Para 44)

Paragraph 43 of the *2013 Guidance* emphasises that:

These criteria focus on the need for evidence that the entity with the obligation is likely to act on its intention to provide resources to another entity such that a valid expectation is created and the entity cannot realistically avoid settlement. The criteria are intended to provide more detailed guidance than the definition of a provision itself and thereby improve the consistency and comparability of reported information. However, the recognition of such constructive obligations is still governed by the definition of an obligating event, which requires that an entity has no realistic alternative to settling the obligation ... (Para 43)¹⁰⁶

We consider the *2013 Guidance* to be inappropriate for assessing the Government's Paris Agreement obligations: the *2013 Guidance* was written in 2013 for assessing constructive obligations arising from the Government providing assistance to specific eligible parties. Climate obligations under the Paris Agreement were not an issue in 2013. PBE IPSAS 19 allows for judgement to be exercised whereas the criteria in the *2013 Guidance* are restrictive and confined to situations where the Government is providing 'assistance' to specific eligible parties.

In the case of the Paris Agreement, the public (and possibly the participants to Paris Agreement), through the Government's policies and actions to date, have a valid expectation that the Government will carry out its commitments. However, the cost/payment to meet the commitment to purchase offshore offsets is not provided, directly or specifically, to the parties who have the valid expectation (the public) but to parties selling offshore carbon credits. The relationship is not a direct relationship, unlike those situations where the Government is providing 'assistance' directly to specific eligible parties.

Treasury has also set out further reasons for not currently treating New Zealand's commitment under the Paris Agreement as a liability in its 20 February 2024 *Treasury Report T2024/263: The accounting treatment of New Zealand's commitment under the Paris Agreement* (the *2024 Treasury Opinion*), see Appendix 6. (For clarity, we have referred to this paper as an opinion, to separate it from other reports mentioned in this paper and because of the level of judgement highlighted in their report.)

Among other matters, the *2024 Treasury Opinion* sets out the tests for the existence of a present obligation in Table 2 (see Table 2 in Appendix 6) and its application to NDC1. The *2024 Treasury Opinion* considers that there is no legal obligation because:

- parties do not have an obligation to achieve their NDCs under the Paris Agreement;
- the obligations relate to conduct and intention rather than outcome; and
- there is no other party to whom the obligation is currently owed that can enforce the obligation.

However, we consider that the enforceability of the obligation may change with the Paris Agreement now being included in domestic legislation and in trade agreements (such as the EU Trade Agreement).

Moreover, under the PBE Conceptual Framework, legal enforceability is not necessary for constructive obligations (a form of non-legally binding obligation). Non-legally binding obligations can give rise to liabilities even though the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement (Para 5.23). This position is reaffirmed in the revised IPSASB Conceptual Framework (Para 5.15F).

The *2024 Treasury Opinion* considers that there is no constructive obligation because the Government has not indicated a responsibility to other parties to achieve NDC1 by a sufficiently specific statement (so that there is a valid expectation of a present obligation that the Government has little discretion to avoid). This is because the Government:

- has not announced a specific approach to achieving NDC1: it can modify its approach, for example, it can adjust the timing, nature or magnitude of the costs incurred by selecting different policy options; and
- has realistic alternatives to settling NDC1 through a transfer of resources: it has realistic alternatives to sacrificing its own resources to settle the NDC1 obligation, for example, by passing the costs of achieving NDC1 on to private entities or not entirely achieving NDC1, even if this is not the Government's intention and would carry reputational risk.

The *2024 Treasury Opinion* also considers that there is no constructive obligation because no counterparties exist, and a constructive obligation requires clearly identified parties to whom obligations are owed. The Government has not confirmed which entities it will procure offshore mitigation from, and in Treasury's view, the general public is not a counterparty.

In our view, the criteria used to determine whether a constructive obligation exists in relation to the Government's Paris Agreement commitments need to be made using the principles set out in PBE IPSAS 19 for determining a constructive obligation:

... 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. [bold added] (Para 18)

The *2024 Treasury Opinion* (Para 4) reiterates that meeting NDC1 will almost certainly require a combination of domestic and offshore mitigation. Notwithstanding this, the *2024 Treasury Opinion* illustrates that Treasury exercises much judgement in determining that no present obligation exists. For example, the *2024 Treasury Opinion* (pp. 2, 9) states that the exact threshold where Government action would create a liability is not precisely defined and it is difficult to determine precisely which Government actions would lead to the recognition of a liability ahead of time. As such, there is an emphasis in the *2024 Treasury Opinion* on the criterion requiring a specific statement or a specific action from Government in order to trigger a constructive obligation.

However, 'a sufficiently specific current statement' is not the only criterion that can create a valid expectation. In our view, any one of the criteria in paragraph 18(a) of PBE IPSAS 19 ('an established pattern of past practice' or 'published policies' or 'a sufficiently specific current statement') could, on their own, be used to determine whether a valid expectation has been created that results in a constructive obligation. We consider that the Government's published policies and actions to date are sufficiently specific (and unchanged since the signing of the Paris Agreement). Collectively, they also create an established pattern of past practice. Moreover, to date, all public statements indicate offshore mitigation will be required, no statement has been made to the contrary and no action has been taken by the Government to pass the costs of offshore mitigation on to other parties. The reputational risks that New Zealand will be subject to by not entirely achieving NDC1 indicate that the alternatives may not be realistic.

Under PBE IPSAS 19, while an obligation is always owed to another party, it is not necessary to know the identity of the party to whom obligation is owed. This is reaffirmed in the revised IPSASB Conceptual Framework, where it is stated that it is not essential to know the identity of the external party before the time of settlement in order for an obligation and a liability to exist (Para 5.15A). The transaction with the overseas external party to procure offshore mitigation is a separate transaction that is carried out to meet the constructive obligation that is owed to the public: it would form a separate transaction/legal obligation. It should be noted that the fact pattern in the *2024 IFRIC Decision* also requires the entity to purchase carbon credits to offset its emissions from 20X9. Notwithstanding this, the *2024 IFRIC Decision* did not require a counterparty to be identified in determining that a constructive obligation could be owed to the public.

The *Financial Statements of the Government of New Zealand for the year ended 30 June 2023* include the following accounting policies and note:

Note 27: Contingent Liabilities and Contingent Assets:

Contingent liabilities are:

- costs that the Government will have to face if a particular event occurs, or
- present liabilities that are unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liabilities).

Typically, contingent liabilities consist of guarantees and indemnities, legal disputes and claims, and uncalled capital. The contingent liabilities facing the Crown are a mixture of operating and balance sheet risks, and they can vary greatly in magnitude and likelihood of realisation.

In general, if a contingent liability were realised, or the amount becomes sufficiently reliable to record as a liability, it would reduce the operating balance and net worth and for contingencies within the core Crown or Crown entities, increase net debt. However, in the case of some contingencies (eg, uncalled capital), the negative impact would be restricted to net debt.

Contingent assets are possible assets that have arisen from past events but the amount of the asset, or whether it will eventuate, will not be confirmed until a particular event occurs.

Contingent liabilities and contingent assets involving amounts of over \$20 million are separately disclosed. Any quantifiable contingencies less than \$20 million are included in the 'other quantifiable' total. Some contingencies are not able to be quantified; these unquantifiable contingent liabilities and contingent assets are disclosed as at 30 June 2023 where they are expected to be material but not remote. Where there is an obligation, amounts have been recognised in the financial statements.

...

Contingent liabilities and contingent assets are reported at the point at which the contingency is evident or when a present liability is unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liability). Contingent liabilities, including unquantifiable liabilities, are disclosed if the possibility that they will crystallise is more than remote. Contingent assets are disclosed if it is probable that the benefits will be realised. [bold added] (p. 127)¹⁰⁷

Contingent liabilities in the financial statements are narrowly defined. They currently refer 'typically' to guarantees and indemnities, legal disputes and claims, and uncalled capital. There is no information (or reasons given) in the note to the financial statements on whether any consideration was given to determining whether the climate change obligations under the Paris Agreement could be (or should have been disclosed as) contingent liabilities. It should be noted that PBE IPSAS 19 (Para 34) requires that in the extremely rare case where no reliable estimate can be made and a liability cannot be recognised, the liability should be disclosed as a contingent liability.

The notes to the financial statements refer to specific contingent liabilities. Arguably, the contingent liabilities include a narrower set of contingent liabilities than the Institute's understanding of how the term 'contingent liabilities' is defined in accounting standards.

The 2023 Financial Statements also state, under Note 2: Key Assumptions and Estimation on Climate change commitments and risks:

The Treasury's assessment of the possible economic and fiscal impacts of climate change on New Zealand are brought together in Ngā Kōrero Āhuarangi Me Te Ōhanga: Climate Economic and Fiscal Assessment 2023. Climate change will create multiple cost pressures for the Crown and is likely to negatively affect its tax base through changes to economic activity. The choices the Government will make, including around revenue and expenditure and the balance of spending and non-spending levers used as part of a wider climate policy portfolio, will be key drivers of any fiscal impacts.

The New Zealand Emissions Trading Scheme is New Zealand's main emissions pricing tool and is a key tool for meeting climate change targets. Refer to Note 21: New Zealand Emissions Trading Scheme for more information on the scheme's direct fiscal impact on these financial statements. (p. 65)¹⁰⁸

The reference to *Ngā Kōrero Āhuarangi me te Ōhanga – Climate Economic and Fiscal Assessment 2023* is the extent of the information disclosed in the financial statements on the climate change commitments and the huge risks that the Government faces.

If it is considered that the obligation to purchase offshore carbon credits to offset the emissions does not meet the criteria for recognition as a liability, the Government must consider whether the commitment should be disclosed as a contingent liability. In our minds, unless it considers the likelihood of any outflow of resources to be remote, it must, at the very minimum, treat it as a contingent liability in a note to the financial statements.

Moreover, while the future costs relating to the climate change commitments may not be a present obligation as they may not exist independently of a government's future actions, costs relating to greenhouse gases that have been emitted since the Paris Agreement and NDC1 came into effect (from January 2021) are independent of the government's future actions as these gases have already been emitted. These costs should be recognised as expenses (and liabilities) in the relevant periods when they were incurred (accruals basis) rather than as expenses as costs are incurred (cash basis).

6.4.3 Conclusion

We consider that costs related to emissions yet to be emitted under NDC1 and the commitment to purchase offshore carbon credits to offset any future emissions do meet the criteria for disclosure as a contingent liability, unless the likelihood of any outflow of resources being required to fulfil the obligation is considered to be remote.

We conclude by citing the observations mentioned in the Ministry for the Environment and Treasury's report *CEFA 2023*:

New Zealand's level of reliance on offshore mitigation to meet its NDC1 is expected to be high relative to others. This is because it has an atypical emissions profile for a developed country, with a significant portion of emissions from the transport and agriculture sector, and relatively few emissions from the electricity sector. Such a profile means that New Zealand currently has relatively fewer opportunities for driving significant emissions reductions at relatively low-cost compared to other countries.

Supporting and contributing to global reductions in line with the ambition of the Paris Agreement's temperature goals and in a way that helps both New Zealand's economy and the wellbeing of New Zealanders, will therefore require supporting reductions outside of New Zealand. [bold added]¹⁰⁹

6.5 Summary

6.5.1 Responses to the four questions

To summarise, the Institute's high-level responses to the four questions are as follows:

Question 1: Does a legal or constructive obligation exist?

What we found: Even if it was determined that there was no legal obligation, the Institute considers the Government has a constructive obligation to meet its obligations under the Paris Agreement as it has created a valid expectation through a series of past events and specific actions that it has taken.

Question 2: Can the value be reliably estimated?

What we found: Making reliable estimates is possible, as evidenced in the *CEFA 2023* report and by Secretary to the Treasury Caralee McLiesh's statement that 'the Treasury estimates that meeting the international commitments under the Paris Agreement through our Nationally Determined Contributions could require up to \$12.8 billion in overseas mitigation by 2030'.¹¹⁰ Making reliable estimates is possible, particularly for the shortfall in greenhouse gases that have already been emitted using current carbon prices.

Question 3: Is it a liability that should be recognised in the statement of financial position?

What we found: Yes, it can be argued that it is a liability. This is because it is not feasible that domestic actions and policies will be able to totally offset the country's emissions gap, and the size of the gap is significant. Therefore, it is highly probable that a significant outflow of resources embodying economic benefits or service potential will be required to settle the obligation. However, if it is considered that an obligation to purchase offshore carbon credits to offset the emissions does not meet the criteria for recognition as a liability, the Government may need to still disclose the commitment as a contingent liability, particularly for the shortfall in future emissions under NDC1 (see Question 4 below).

Question 4: Is it a contingent liability that should be disclosed in the notes to the financial statements?

What we found: Yes, it can be argued that there is a contingent liability. For it not be considered a contingent liability, the Government would need to believe any chance of outflow of resources to settle the obligation to be remote. Our research found no Government literature, press releases or publications that indicate an alternative view, that the Government might renege on its commitment to purchase offshore credits to meet its NDC1 commitments.

While Section 6.2.2 (p. 60) discusses the number of inputs (i.e. units) and the monetary amount of each input, Table 6.2 below explores how that information might be reported.

Table 6.2 also shows the extent to which the financial statements of the New Zealand Government have already moved along the continuum: from no reporting in the 2021 financial year (Option (v)), to explaining NDC1 in the 2022 and 2023 financial years (Option (iv)). The 2023 Financial Statements make reference to Ngā Kōrero Āhuarangi me te Ōhanga – Climate Economic and Fiscal Assessment 2023. However, the scope and detail to date contains little or no information on the financial implications.

This paper sets out the reasons why further transparency is essential, particularly given the extent to which financial risks are hidden, and the impact this may have on the quality and timeliness of decision making, and the level of public support for greater domestic action to reduce the costs of offshore mitigation. Climate change is a shared problem and public support is essential to help identify innovative solutions to reduce overall emissions and garner support for difficult policy decisions (e.g. the future of livestock farming).

To conclude, after applying Table 6.2, we discuss each of the options for reporting in the upcoming Financial Statements of the New Zealand Government in order of preference. The final order of these preferences was the result of feedback on the draft discussion paper and our further thinking.

Section 6.5.2 sets out our preferences and views on the possible reporting options.

Table 6.2: A range of reporting options exist (applying Table 6.1 to the overarching accounting problem)

← Highest form of reporting → Lowest form of reporting					
Q1: How might the New Zealand Government report on this commitment in future financial statements?					
The options	Option (i) Liability in the statement of financial position	Option (ii) Liability and a contingent liability in the financial statements (the Institute's preference).	Option (iii) Contingent liability in the notes to the financial statements.	Option (iv) Explanation in the notes to the financial statements.	Option (v) Commitments are not disclosed at all.
Type 1. Recognised as a liability in the balance sheet (in the form of a provision)	✓	✓	–	–	–
Type 2. Disclosed as a contingent liability in the notes to the financial statements	–	✓	✓	–	–
Type 3. Disclosed as a note in the financial statements in order to meet the 'faithfully represented' requirement	–	–	–	✓	–
The outcome	All commitments to 31 December 2030 (i.e. past and present) are recognised as a liability in the statement of financial position.	Past commitments are recognised as a liability in the balance sheet and future commitments are disclosed as a contingent liability in the notes to the financial statements.	All commitments to 31 December 2030 (i.e. past and present) are disclosed as a contingent liability in the notes to the financial statements and reported in units of Mt CO ₂ e (see Section 6.4.2).	All commitments are disclosed in an explanation in the notes to the financial statements in order to meet the 'faithfully represented'/'fairly reflected' requirement (see Section 3.2, and, in particular, s 27(2)(c)(v) of the Public Finance Act 1989).	No commitments are disclosed in the financial statements.
Q2: How has the New Zealand Government reported on this commitment in previous financial statements?					
				The 2022 and the 2023 Financial Statements of the New Zealand Government reported along the lines of Option (iv) (see excerpts in Section 6.4.2).	The 2021 Financial Statements of the New Zealand Government reported along the lines of Option (v) (see Section 6.4.2).

6.5.2 A summary of the reporting options

Table 6.2 builds on Table 6.1. It showcases a selected number of reporting options. It also evidences a continuum, with movement from left to right illustrating the highest form of reporting (i.e. fully recognised) to the lowest (i.e. no recognition or disclosure).

First preference: Option (ii): Liability and a contingent liability in the financial statements

Outcome: Past commitments are recognised as a liability in the balance sheet and future commitments are disclosed as a contingent liability in the notes to the financial statements.

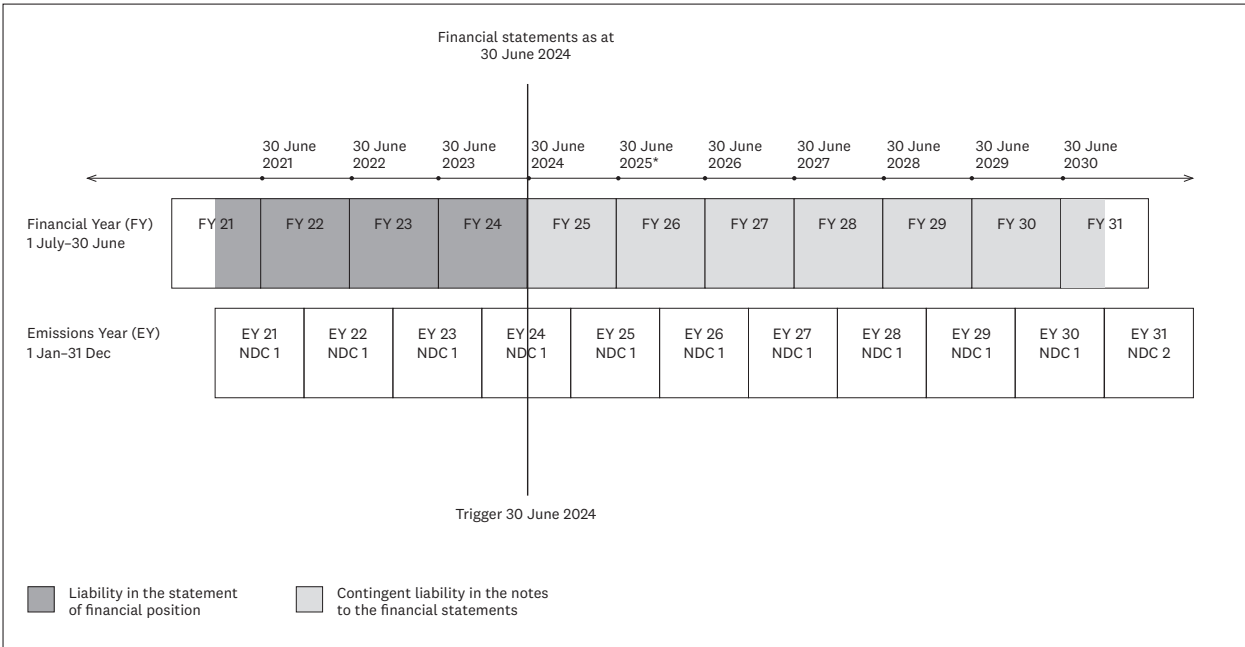
Comment: Notably, the NDC1 framework is in multi-year periods (a period of ten years). Accounting is in single-year periods. Under this option, at least three broad reporting approaches exist in terms of how the commitment to purchase of offshore abatement might be calculated and reported in the financial statements. (See Box 3, p. 80, for two possible methods for calculating the monetary amounts of the liability and the contingent liability.)

Reporting approach one: Cost is borne across each year of the ten-year period

The first approach is to account for the cost of excess emissions across each year of the ten-year period. In our view, reporting approach one aligns with the tracking and accounting approach for NDCs under the Paris Agreement guidance. It spreads the estimated costs and the liability for purchasing offshore carbon credit offsets across each year of the ten-year period. Accruing expenses/costs in the year of the expected shortfall aligns with periodic financial reporting. In the absence of a liability being recognised, the rationale for purchasing offshore carbon credit offsets is unclear, regardless of when those purchases are made. Using the June 2024 Financial Statements as an example, the obligation for the first three-and-a-half years would be treated as a liability in the 2024 Statement of Financial Position, and the remaining six-and-a-half years would be treated as a contingent liability in the 2024 Notes to the Financial Statements. Box 3 explores how these figures might be calculated.

Figure 6.1: Option (ii): Reporting approach one: Cost is borne across each year of the ten-year period

(Results in a liability and a contingent liability in the financial statements in FY 24)



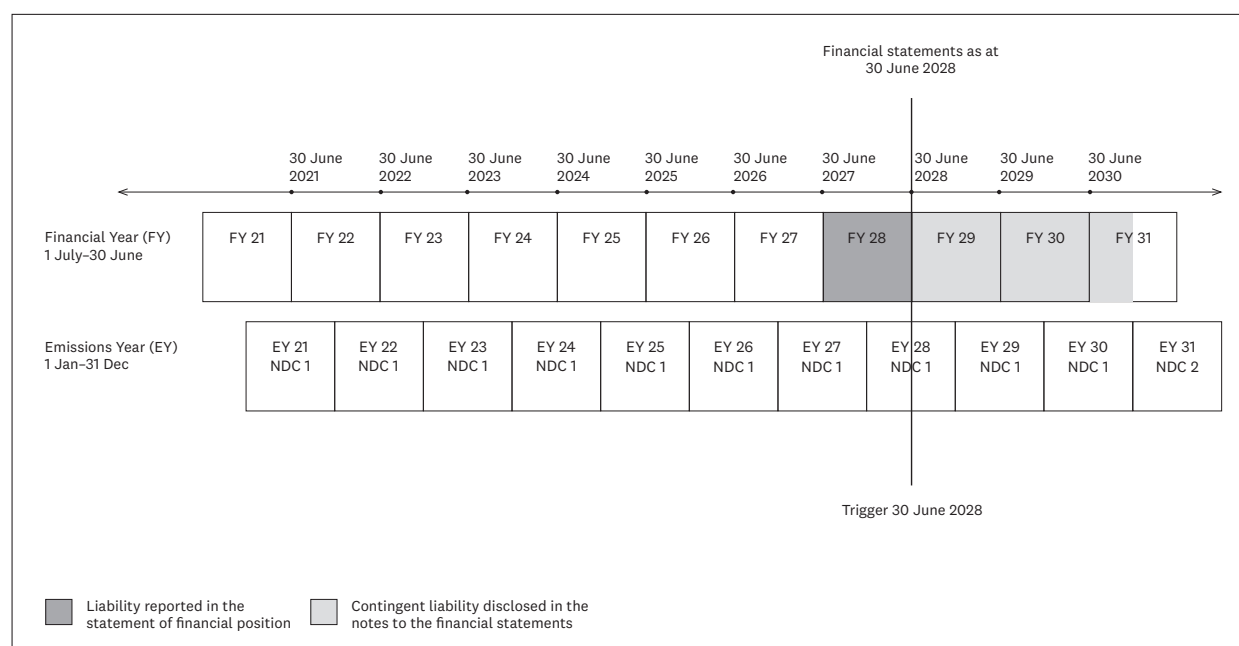
Reporting approach two: Cost is only borne in the last few years of the ten-year period

Another approach would be to consider the cost is only borne in the last few years of the ten-year period, once the total NDC1 Budget has been exceeded. In other words, the reporting trigger occurs once the country has started emitting above 571 Mt CO₂e (the latest estimate of the NDC1 Budget under the Paris Agreement). This would mean the cost is only recognised in the last few years as a provision (as a liability in the statement of financial position) and a contingent liability in the notes. It is argued by some that reporting approach two is consistent with the *2024 IFRIC Decision*. This is notwithstanding that there is no clear indication in the NDC1 Budget that the commitment to offset New Zealand's carbon emissions will occur only after 2030, or when the NDC1 Budget of 571 Mt CO₂e has been reached. Similar to the trigger date in the *2024 IFRIC Decision*, the 'past event' is triggered (and hence the constructive obligation arises) when the greenhouse gases that the New Zealand Government has committed to offset are emitted (see Section 3.3.4, Section 6.1.3 and Appendix 5).

The key difference between the IFRIC fact pattern and the New Zealand case, is that the entity in the *2024 IFRIC Decision* commits to offset annually everything it emits. In contrast, the New Zealand Government commits to offset annually (from 2021 when the Paris Agreement came into effect), the difference between actual emissions and the agreed NDC1 budgeted emissions (taking into account domestic reductions). From that point, there is a present obligation to use offshore carbon credits to offset those greenhouse gases where domestic offsets are insufficient. However, this difference is not relevant in terms of how the *2024 IFRIC Decision* can be applied to the New Zealand context. The *2024 IFRIC Decision* is useful for determining whether a constructive obligation exists, and for determining the trigger point for recognition of the constructive obligation. See Appendix 5.

In our view, reporting approach two is inconsistent with New Zealand's Paris Agreement commitment, as agreed by Cabinet, to link implementation of the NDC Strategy to the biennial Paris Agreement reporting cycle via the regular and ongoing reporting under the BTRs. Approach two is also inconsistent with periodic financial reporting. Using our earlier example of \$12.8 billion, this treatment might result, for example, in no provision or contingent liability being shown in the 2021 to 2027 Financial Statements. However, this would likely change in the 2028 Financial Statements, where a provision of about \$4.3 billion and a contingent liability of about \$8.6 billion might be required. In 2029, the Financial Statements may show something like \$8.6 billion and a contingent liability of about \$4.3 billion. At the extreme, in 2030, the Financial Statements may show the entire \$12.8 billion and no contingent liability.

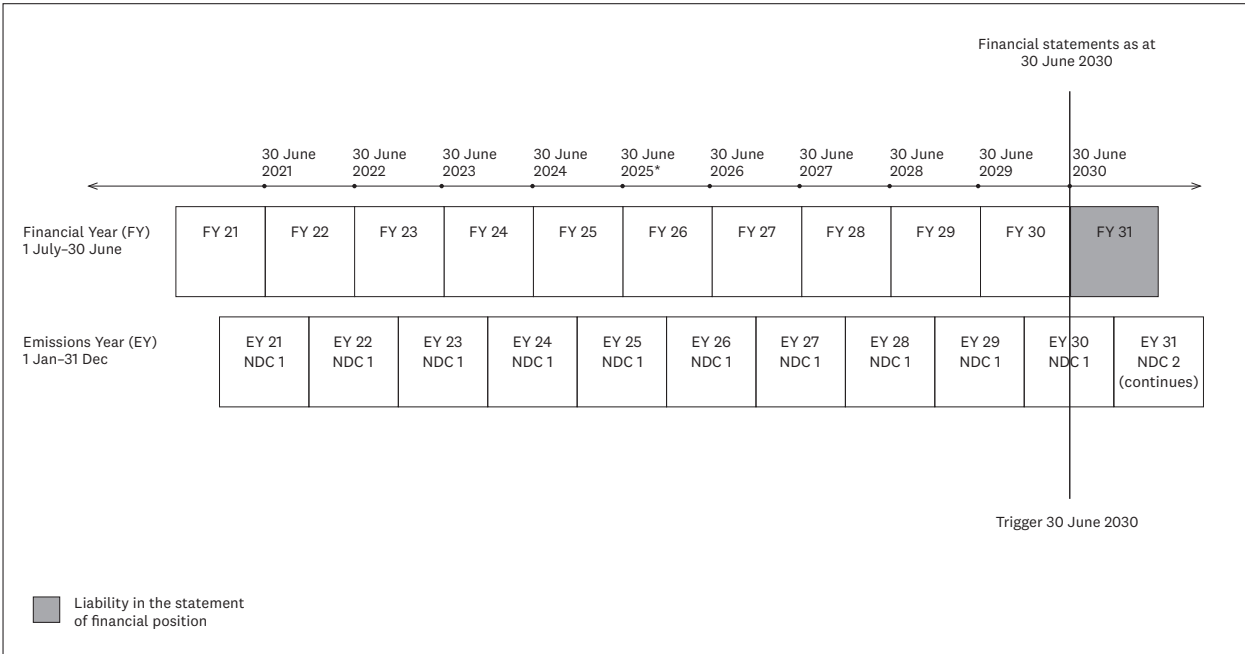
Figure 6.2: Option (ii): Reporting approach two: Cost is only borne in the last few years of the ten-year period
(Results in a liability and a contingent liability in the financial statements in FY 28)



Reporting approach three: Cost is only borne after the ten-year period

A third approach is not to report the cost until after 2030, when the actual balance is identifiable. However, this would mean in practice that the liability would not be reported until 2031/32.

Figure 6.3: Option (ii): Reporting approach three: Cost is only borne after the end of the ten-year period
(Results in a liability in the financial statements in FY 31)



Comparing reporting approaches

As noted earlier, judgement is a normal part of the process when preparing financial statements. Provisions in the statement of financial position and contingent liability in the notes to the financial statements are how accountants report uncertainty. In our view, reporting approach one better reflects that uncertainty in the financial position of government to users of the financial statements. The fact that estimates are revisited every year allows for fluctuations or even, in some cases, for provisions to be removed completely (i.e. if they no longer meet the three recognition conditions). For accountants, the real test is to look seriously at each year end and work hard to reflect fairly the assets and liabilities at that point in time.

In contrast to reporting approach one, reporting approach two treats emissions as dollars in the bank, and only when they are used up do you go into debt. In our view, the latter approach is not credible because the fact is that the bank is getting poorer and this change is not reflected in the financial statements. The impact of a change over time on the financial resources of government is being hidden from the public. In addition, we are unsure whether reporting approach two aligns with the purpose and intent of the Paris Agreement and the reason the NDC instrument was included. Our understanding is the purpose was to transition in an informed and transparent manner from 1 January 2021.¹¹¹

At the heart of comparing these three approaches is considering which approach ‘fairly reflects’ the financial position of government to the people of New Zealand (see, in particular, s 29 of the Public Finance Act 1989 below). Based on the information to date, the Institute remains unconvinced that the reporting approach two meets the expectation set in New Zealand law and that reporting approach three meets the intent of accrual accounting. Once again, this depends on the judgement of the Minister and the Secretary to the Treasury, who ultimately sign the statement of responsibility (see Section 29 below). Hence, our preferred approach is reporting approach one.

Section 29: Responsibility for annual financial statements of Government

- (1) Every annual financial statement shall be accompanied by a statement of responsibility signed by the Minister, any other Minister designated by the Prime Minister for either or both of the purposes of paragraphs (a) and (d) of subsection (2), and the Secretary.
- (2) The statement of responsibility shall comprise—
 - (a) a statement of the responsibility of the Minister, and of any other Minister designated by the Prime Minister for the purpose of this paragraph, for the integrity of the financial statements; and
 - (b) a statement of the Treasury's responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Government reporting entity; and
 - (c) a statement by the Secretary that the Treasury has prepared the financial statements in accordance with generally accepted accounting practice; and
 - (d) a statement that, in the opinion of the Minister, and of any other Minister designated by the Prime Minister for the purpose of this paragraph, the financial statements fairly reflect the consolidated financial position and operations of the Government reporting entity for the reporting period. [bold added]

Second preference: Option (iii): Contingent liability in the notes to the financial statements

Outcome: All commitments to 31 December 2030 (i.e. past and present) are disclosed as a contingent liability in the notes to the financial statements and reported as an estimated total monetary amount, including units of Mt CO₂e and a price per unit (see Section 6.4.2).

Comment: All relevant information should be disclosed, including all key assumptions that are being relied upon. The notes to the financial statements might refer to (i) a specific number of units, such as a commitment to purchase 100 Mt CO₂e of offshore abatement in 2030 or (ii) a range of units, such as a commitment to purchase 75–100 Mt CO₂e of offshore abatement in 2030 (see Figures 1.1 and 4.1).

However, as both the *CEFA 2023* report and Secretary to the Treasury Caralee McLiesh provide an estimate (see previous page), this option is unlikely to have merit. This illustrates that the cost of offshore abatement can be considered both probable and able to be estimated.

Although this option is better than Option (iv) (and definitely more useful and relevant than Option (v)), the financial risks remain relatively hidden from stakeholders and citizens. The next Financial Statements, for the period to 30 June 2024, could go significantly further along the continuum than the previous three Financial Statements published since 1 January 2021. However, if reporting approach two and reporting approach three are applied, we consider that disclosure of a contingent liability is the minimum necessary to ensure that the risks and costs are not hidden in the 2024 financial statements of the Government.

Box 3: Possible methods for calculating the monetary amount

In the *CEFA 2023*, the methodology for estimating fiscal costs of offshore mitigation and for constructing purchase price scenarios is stated as follows:

7.2 Methodology for estimating fiscal costs of offshore mitigation

The fiscal cost of offshore mitigation will depend on a number of factors, including the future volume and price of purchases.

To estimate the anticipated fiscal cost of the offshore purchases needed to achieve NDC1 our approach multiplies the expected volume required to be purchased by an assumed purchase price in each considered year. Estimated costs are then discounted to present value. (p. 82)

Constructing purchase price scenarios

... In all price scenarios, it is assumed that New Zealand starts its purchase of offshore mitigation in 2024 and continues through to 2030 (the end of the NDC1 period). The purchase prices considered across each scenario are therefore those that have been calculated for the 2024 to 2030 period, based on the source information relied upon. More detail on the assumptions and approach carried out to derive these price scenarios can be found in Technical Appendix 2. (p. 85)

NZ IAS 8 states an entity 'uses measurement techniques and inputs to develop an accounting estimate' (see Section 6.2.2, p. 60). The portion to be treated as a 'liability' or as 'contingent liability' can be calculated a number of ways. Below are two methods for calculating the monetary amount to create the accounting estimate, using the June 2024 financial statements as an example:

(a) Actual and projected: This method uses the actual (past) and projected (future) excess emissions in units times market value.

This method relies on units as the 'input used' in developing accounting estimates (see discussion on NZ IAS 8 in Section 6.2.2, p. 60). If the actual excess emissions in units of megatonnes of CO₂e are able to be determined, the provision (liability) could be estimated using units times the current market price per tonne. If the projected excess emissions from 1 July 2024 to 30 June 2031 are also calculated in megatonnes of CO₂e, an estimated market price per tonne could be used to calculate the monetary value of the contingent liability. This would mean actual units times estimated current market price would be treated as a liability in the financial statements and projected units times estimated future market price would be treated as a contingent liability.

(b) Average: This method uses the actual average excess emissions estimated over the ten-year period, and then allocated proportionally by time (past and future).

If the estimated cost of offshore abatement over the ten-year period is thought to be say \$12.8 billion, the cost would be divided by 120 months to calculate an average cost per month. This figure could then be used to determine how much of the estimate should be treated as a liability (e.g. 42 months out of 120 months, being 35%) and how much should be treated as a contingent liability (e.g. the remaining 78 months, being 65%). This would mean \$4.5 billion should be treated as a liability and \$8.3 should be treated as a contingent liability.

Under either method, the financial statements should include detail on any relevant assumptions, as the figures for both the provision and the contingent liability would be material. For example, it is interesting to observe that Note 23 of the 2023 Financial Statements includes five provisions 'by type', four of which are under \$3 billion. This implies that a provision of approximately \$4.5 billion, using example (b) above, would be considered 'material' and therefore should be recognised in the 2024 Statement of Financial Position, alongside a note detailing the provision. In addition, a contingent liability of, say, \$8.3 billion, using example (b) above, should be specifically disclosed in a note. Under both methods the cost of this commitment should be revisited and recalculated at 30 June each financial year. In this way, the accounting estimate is regularly recalculated over time and adjusted to reflect the current position. Importantly, whatever method is selected, the assumptions should be 'based on the latest available, reliable information' (see discussion on NZ IAS 8 in Section 6.2.2, p. 60) and the more significant assumptions should be disclosed in the notes to the financial statements. Given the number of units emitted underscore the accounting estimate, the only real difference between these two methods is whether the 'actual number' emitted can be calculated in time.

The other three options

In our view, the other three options are not feasible for the following reasons.

Option (i): Liability in the statement of financial position

This would mean all commitments to 31 December 2030 (past and present) are recognised as a liability in the statement of financial position. This option would not be consistent with accounting standards because the past event has not been triggered for the future emissions, as they do not exist independently of future actions.

It is clear that New Zealand has been consistently slow in reducing emissions. The CCC states in the *2023 Advice on the direction of policy for the Government's second emissions reduction plan* that a 'key reason why offshore mitigation is needed for meeting the current NDC is that Aotearoa New Zealand [has] made little [domestic] progress in reducing gross emissions to meet its previous emissions reduction targets (over 2008–12 and 2013–2020)' (see also Section 4.2). Given this general lack of action to date, this option could be argued by some to be the most 'faithfully representative' and prudent option. However, we would counter that this option is not consistent with accounting standards and the inclusion of the liability and the contingent liability for future commitments is more in line with expectations that action will drive change and drive down emissions.

Option (iv): Explanation in the notes to the financial statements

This has been Treasury's preferred option in recent years and is further supported by the *2024 Treasury Opinion* (see Appendix 6).¹¹²

Our view is that, at the very least, a constructive obligation exists in June 2024, and that a legal obligation may exist in practice.

Without an up-to-date legal opinion, the possibility that a legal obligation exists cannot be excluded. The Institute has recommended to the Minister of Climate Change, Simon Watts, in May 2024, that he requests a legal opinion as to whether a legal obligation exists. We note that New Zealand has consistently embedded the Paris Agreement into legislation and trade agreements, and that recent events have provided more uncertainty over this point, rather than less. It is beyond the scope of this paper to make a legal opinion on this matter but it is important to note that our 2022 draft discussion paper and an earlier 2024 draft took a stronger view that a legal obligation did not exist. We have since changed our view and consider that a legal opinion is essential to clarify this point.

In terms of whether a constructive obligation exists, the Institute has not undertaken a detailed analysis, but we have looked briefly at the position of Australia and the United Kingdom, and it appears to us that New Zealand has been more specific in legislation and more consistent in Cabinet papers and in the press. However, more research is needed. The fact that other countries have not recognised this commitment as a legal or constructive obligation in their financial statements is in our view not the test (see *2024 Treasury Opinion*, paragraph 19, in Appendix 6).

In the 2022 Financial Statements, the Auditor-General did comment (see excerpt in Section 6.4.2), but no comment was made on the commitment in the 2023 Audit Report given that there was no change to the basis of reporting between 2022 and 2023. Importantly, if the Government were to continue to report along these lines of Option (iv) in the June 2024 Financial Statements, they could provide additional information and explanations (e.g. volume and price) and the potential financial implications for the future. Secondly, it is important to note that in the event that the Auditor-General disagrees with the preparers, he can issue a qualified audit opinion.

Option (v): Commitments are not disclosed at all

The Institute does not consider this a credible option. Given that the 2022 and 2023 Financial Statements do include an explanation in the notes to the financial statements, this implies Treasury also agrees.

6.5.3 Our conclusion

Appendix 6 contains the 20 February 2024 *Treasury Report T2024/263: The accounting treatment of New Zealand's commitment under the Paris Agreement* (the *2024 Treasury Opinion*) and explains Treasury's perspective. The *2024 Treasury Opinion* finds that all three conditions set out in the accounting standards, and shown in Table 6.1, have not been met (see in particular Tables 2 and 3 in Appendix 6).

In contrast, our interpretation of the current accounting standards is more in line with the findings outlined in the *2017 MfE memo* (see p. 50). However, in 2024 we consider that the likelihood that offshore abatement is necessary has moved from remote to probable, which leads to at minimum, the reporting of a contingent liability in the financial statements.

Furthermore, we believe that the regular reporting of the NDCs in the financial statements of the Government of New Zealand is a critical first step that will, in turn, generate a wider and more informed discussion on strategy, not only in terms of how New Zealand meets our commitment under Paris, but also how we meet our responsibilities to future generations.

New Zealand needs to generate a sense of urgency in order to attract resources, creative thinking and public support for domestic action. Regular reporting will help make the debate urgent, measure progress and provide signposts for a financially secure future. Importantly, we acknowledge assumptions and judgement play a significant role in the making of reporting decisions of this kind. Hence, the overall test is which of the above options 'fairly reflect' the Government's financial operations and financial position. In our view Option (ii), followed by Option (iii), are the only credible options.

7.0 Overall conclusions and recommendations

We conclude this paper by setting out what we have found, what we suggest the Ministers of Finance and of Climate Change and key organisations should do, and where next from here.

7.1 High-level summary

1. **We acknowledge that the current accounting standards are not as clear as they could be with regard to reporting climate-related financial risks and impacts.**
 - The *2024 IFRIC Decision* concluded that while judgement is required, current standards were sufficient to determine if a constructive obligation exists. It also clarified that while an obligation always involves another party, it is not necessary to know the identity of that party and any constructive obligation can be owed to all people adversely affected by the emissions and so may extend to the public at large.
 - The revision to the IPSASB Conceptual Framework also provides some further clarification for the recognition of a liability, including providing the option in some circumstances for the recognition of economic phenomena that are not captured by the elements as defined in the Conceptual Framework to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity.
 - But this paper raises a further question – whether accounting standards should be amended to provide more clarity, so that the purpose of financial reporting better aligns with the purpose of the New Zealand Government’s strategic intentions and global climate policy more generally.
 - However, this lack of clarity does provide some useful flexibility. For example, it creates a valuable opportunity for relevant parties (the Government, entities and standard setters) to do the right thing by disclosing information that is relevant to users.
2. **We consider that the actions of signing up to international climate agreements and declaring climate emergencies have substance and are significant: they are much more than publicity statements.**
 - Reporting the commitments will highlight the size and timing of the financial and fiscal risks and costs for the Government, entities and the wider public.
3. **It is important for the commitments, obligations and/or liabilities to be reported at both the entity level and the country level.**
 - At the entity level this will ensure entities are aware and take their commitments, obligations and/or liabilities seriously and act promptly.
 - At the country level this will ensure the Government is aware and takes its commitments, obligations and/or liabilities seriously, and will set policies and strategies to address the country’s financial and fiscal risks.
 - Moreover, the more entities that disclose their commitments, obligations and/or liabilities, the easier it is for the Government to determine what actions and policies it needs to undertake and to determine the size of its residual liabilities to purchase offsets.
 - It is therefore important that the principles in the *2024 IFRIC Decision* apply not just at the for-profit entity level but at the public entity level and at the government level.

4. **Currently, financial statements and climate statements are often disclosed as separate statements.**
 - Under existing legislation, the annual report (not the financial statements) must contain a link to climate statements.
 - Under existing standards, this is not useful as it creates an information gap. It is necessary to link financial and climate information so that these statements are coherent, consistent and useful to both domestic and international users.
 - This creates a huge opportunity for domestic, and particularly international, standard setters to add value to the information that is presented in both the financial and climate statements and to ensure that those statements present relevant information to users through fit-for-purpose standards.
5. **Uncertainty undermines democracy, delivers shocks and crises and provides less space to manoeuvre.**
 - It is hard to argue that the Government's actions on climate thus far 'taken collectively' have not created a valid expectation on the part of the public that the Government will meet its commitments.
 - The public and business need certainty in order to support government policy and go about their business in an informed and constructive manner.
 - Ministers, officials, the public and businesses should work together today to identify instruments and/or policies for storing carbon and/or reducing emissions now (as it is too late to plant trees). This is essential in order to decrease New Zealand's net emissions before 2030, so that we can reduce the amount of offshore credits we will need to purchase to meet NDC1.
6. **New Zealand's current situation lacks alignment and transparency; we have committed to purchase offshore carbon credits to the Parties of the Paris Agreement abroad, but we have failed to disclose the financial impacts of that commitment to the citizens at home.**

New Zealand's current approach is to hide these significant financial risks in plain sight. The Government must either communicate these fast-approaching fiscal consequences to the public using the core financial instrument (the financial statements) or pull out of the Paris Agreement altogether. The latter option comes with significant reputational and economic risks (such as the free trade agreement with the EU).

Climate reporting is a new and evolving area in accounting. This discussion paper aims to explore a range of possibilities and draw some conclusions for others to consider, accept or reject, or ideally to contribute to the discussion. Current GAAP has not been written to specifically address issues related to climate reporting in the financial statements: it only provides general guidance. Judgement is required in the interpretation of accounting concepts in existing GAAP to address climate issues, including how the Government should address the purchase of emissions offsets to meet our Paris Agreement obligations. As such, others may reach a different view from the Institute.

While existing standards do not address directly how climate commitments and offsets should be accounted for in the financial statements, the concepts and principles underlying existing standards do provide guidance. In applying these concepts and principles, some important questions need to be asked:

- What constitutes useful information to disclose to the public: what is the 'right' thing to do to alert taxpayers, ratepayers, citizens and the public to the impending costs so that timely and appropriate action can be taken by the Government, by public entities, by businesses and by individuals to help mitigate and reduce those costs?
- Is narrowly applying accounting standards that do not specifically address climate reporting issues the right thing to do, and does it provide useful information?
- What is the substance and consequence of making commitments, signing agreements and treaties and declaring emergencies and how should their impacts be highlighted to assist policy makers and relevant parties to take timely and appropriate action?

- How (and, more importantly, when) do we translate the climate strategies, actions, targets and metrics set by entities in their (mandatory) climate statements, or promises made under international treaties, into financial impacts in the financial statements?

Our preference is for the Government's commitment to purchase carbon credits to offset emissions under the Paris Agreement to be reported in the financial statements of the New Zealand Government: that is, for past commitments (1 January 2021 to 30 June 2024) to be recognised as a liability (provision) in the balance sheet, and future commitments (1 July 2024 to 31 December 2030) to be disclosed as a contingent liability in the notes to the financial statements. This will help inform the public of the estimated monetary amount of the financial commitment, which in turn should drive public policy towards a fast but fair transition.

The NDC instrument was created to help transition countries quickly. The NDC instrument, to be effective, calls for countries to make ambitious goals and work hard to deliver them. Without reporting on this liability and/or contingent liability in the countries' respective financial statements, the instrument is likely to fail to deliver the outcomes that were envisaged. This is the issue New Zealand and the world face. For the NDC instrument to be effective, regular reporting is essential.

New Zealand is one of a handful of countries that are net buyers due to our unique emissions profile and the ambitious goals we have set (see Appendix 3). *CEFA 2023* notes that 'New Zealand's level of reliance on offshore mitigation to meet its NDC1 is expected to be high relative to others'.¹¹³ Each country is responsible for managing its response and the solutions to this issue are likely to be varied.

Our unique profile and our ambition has created a risk: New Zealand has taken on a commitment but has failed to disclose the estimated monetary amount in its primary financial instrument. Figuratively, it is like a neighbour knowing a hole in a road exists, but not telling the other drivers on the road. In this case the hole is significant and the closer we get to it, the less able we are to manoeuvre around it. There is a difference between 'doing something right' and 'doing the right thing'. The Government may legitimately decide to narrowly apply accounting standards that were not specifically intended to address climate-related matters and use the rationale that no other countries disclose their commitments, and therefore avoid disclosing a liability. However, we argue that this does not provide the necessary useful information to users of the financial statements. The overarching test is whether there has been 'adequate disclosure'; does the complete package of an entity's financial statements (including accompanying disclosures in the form of notes) provide all the key information needed by users to understand the entity's financial situation?

The liability and/or contingent liability needs to be reported in the financial statements, not only so it is clear how much our commitment will cost, but so we start to focus on who we are going to buy credits from (i.e. give this money to), how that trade might work in practice and how that commitment will be funded. It should be noted that there may be a significant time delay between deciding to buy units and finding a credible way to do so.

Climate reporting standards have been issued both domestically and internationally to require selected entities to disclose important information about their governance, strategy, risk management and metrics and targets as they relate to climate. Such climate statements are disclosed as a separate report from financial statements. As a result, the link between the information in climate statements and the information in financial statements is unclear. Notwithstanding that there are obvious financial impacts from the strategies, risks and metrics and targets set in entities' climate statements, an information gap exists because current accounting standards were not set to directly address climate-related matters. It is important to create the linkage between the two statements promptly to address the information gap so that the financial impacts of an entity's climate strategy, risk management and metrics and targets can be reflected in financial statements. Similarly, it is important to close the information gap between what a country has committed to under the Paris Agreement and what is disclosed in a country's financial statements.

7.2 Recommendations for international standard setters

The IFRS Foundation has two independent standard-setting boards. The International Accounting Standards Board (IASB) was established in 2001 and the International Sustainability Standards Board (ISSB) was established in 2021. The IFRS Foundation aims to provide high-quality global standards that result in corporate information that informs investment decisions. The ISSB sets global baseline climate and sustainability standards for for-profit entities at the entity level.

At the entity level, the *2024 IFRIC Decision*, discussed in Section 3.3.4 (p. 18), is welcome progress towards clarifying that existing standards can be applied and provides general guidance to address whether, and how, emission commitments and offsets for for-profit entities should be accounted for in financial statements.

We also note with interest the further work of the IASB on climate-related risks in financial statements so that financial statements of for-profit entities can provide better information about climate-related risks (see Section 3.3.3). While the IASB is able to develop an accounting standard (or amend existing accounting standards) to align an entity's reporting to reflect its contribution to the country's climate policy, neither the IASB nor the ISSB are able to develop standards for public benefit entities or for the government of a country.

In contrast, the International Public Sector Accounting Standards Board (IPSASB) does have a mandate to develop standards for public benefit entities. The IPSASB is well placed, as a long-standing setter of public sector accounting standards, to address the accounting and reporting of sustainability and climate-related matters for public benefit entities at the entity level. It is also well placed to determine how best to amend existing accounting standards and concepts so that they address and align with climate and sustainability reporting and concepts, where these intersect.

More importantly, the IPSASB is the most appropriate standard setter to fill the current international gap for reporting climate matters for the government of a country. The IPSASB is able to set standards that a government or country can apply to align its external reporting with its policies so that its international climate commitments are transparent to stakeholders, and governments can be held to account for their international commitments.

We note, with interest, that the IPSASB's Climate-related Disclosures Project Brief and Outline (discussed in Section 3.3.1) will also focus on 'other targets (e.g. IFRS S2, UNFCCC Paris Agreement, and Nationally Determined Contributions (NDCs))' and 'will also consider how disclosure requirements may be linked with and provide a central reporting model that may also be used for other purposes and existing public sector indicators such as NDCs'.¹¹⁴

7.2.1 IPSASB, IASB and the ISSB

We also strongly encourage all three international boards to consider how to better link and connect the information provided in financial statements to information provided in climate statements. Having two separate statements creates an information gap. It is necessary to ensure that financial statements can provide better information about climate-related risks and vice-versa.

We strongly encourage the IPSASB to fill the current international gap for reporting climate matters in the financial statements prepared by the government of a country. Filling this gap is where the IPSASB can add most value internationally to ensure that a country's financial statements provide the necessary useful information to its domestic and international users. Addressing climate reporting at the entity level for public sector entities is important. However, climate reporting at a 'country level' is also critical to address additional issues that are not necessarily addressed at the 'entity level' and which will not be accounted for on consolidation, for example, the risks and commitments that a country faces as a result of signing up to the Paris Agreement and committing to NDCs. We recommend that the IPSASB ensures that its standards address, and take into account, a country's risks and commitments to the Paris Agreement and their NDCs.

As noted in Section 3.3.5, IPSASB has provided, in its revised Conceptual Framework, for IPSASs to require or allow the recognition of resources or obligations that do not satisfy the definition of an element identified in the Conceptual Framework ('other resources' or 'other obligations') when necessary to better achieve the objectives of financial reporting (Para 5.4 of the revised IPSASB Conceptual Framework). This is useful as climate commitments (by an entity or by a country under the Paris Agreement) are not directly addressed in current standards: much judgement is required to determine if such commitments meet the definition of a liability. Current standards were not set to specifically address climate commitments in financial statements. To ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, the IPSASB could, as an alternative, address this matter more specifically in standards (and remove all doubt) by ensuring that climate commitments are considered to be 'other obligations' that need to be recognised in financial statements.

It should be noted that IPSAB considers guidance in IFRIC decisions and proposes amendments to IPSASs based on the IFRIC's interpretations which are applicable for public sector entities and are helpful in applying existing IPSASs. It is likely IPSASB will consider the *2024 IFRIC Decision* in due course.

We strongly encourage the IPSASB to promptly consider and incorporate the *2024 IFRIC Decision* and its interpretation of IAS 37 as it relates to climate-related commitments into IPSASs.

7.3 Recommendations for domestic organisations

We set out our recommendations and proposals for possible actions that relevant organisations like the Treasury, the XRB and the Office of the Auditor-General (OAG) could take. We conclude by setting out our high-level recommendations for the Minister of Climate Change in the next section.

7.3.1 Treasury

The Secretary to the Treasury, Caralee McLiesh, noted in the 2023 Statement of Responsibility in the introduction to the *2023 Financial Statements of the Government of New Zealand*:

These financial statements have been prepared by the Treasury in accordance with the provisions of the Public Finance Act 1989. The financial statements comply with New Zealand generally accepted accounting practice and with Public Benefit Entity Accounting Standards (PBE standards) for the public sector.

The Treasury is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly **record the use of all public financial resources by the Crown.** [bold added]¹¹⁵

As noted at the end of Section 6.5, the Institute's preference is to report along the lines of Option (ii) in Table 6.2, in other words, to recognise the Government's commitment to purchase offshore carbon credits in the financial statements of the New Zealand Government, as the commitment does reduce the Government's financial resources. For the June 2024 financial year, our recommendation is that past commitments (i.e. 1 January 2021 to 30 June 2024) are recognised as a liability in the balance sheet, and future commitments (i.e. 1 July 2024 to 31 December 2030) are disclosed as a contingent liability in the notes to the financial statements.

This could be calculated on the estimated number of units that would be required to be purchased against a carbon market price at balance date, being 30 June every year. For example, the price could be based on (i) the EU Emissions Trading System (EU ETS), which is the first and largest ETS, (ii) the average price derived from a combination of reliable and trusted carbon markets, (iii) the *2023 CEFA* weighting of ETS prices, or (iv) the *2023 CEFA* low scenario (which is reflective of market price of bilateral cooperation). It would show as a line on the balance sheet, followed by a note explaining how the estimated figure was derived. Every year this would be recalculated based on our emissions profile and the market price.

If Treasury considers that the commitment was only a 'possible' liability, it would still need to reflect the commitment in a note to the financial statements as a contingent liability, unless it considers that the probability of an outflow of resources to settle the obligation is remote. We note that 2030 is fast approaching.

Moreover, treating the commitment as a ‘remote’ liability may be inconsistent with the substance of the actions that the Government has taken thus far, domestically and internationally, in relation to the Paris Agreement. Such an approach is not in the public interest. While reporting the Climate Change Obligations: Basis of Reporting in Note 1 to the 30 June 2023 Financial Statements is important, we consider that as a minimum, the financial statements should disclose a contingent liability, with a reference from Note 1 to a note on contingent liabilities.

It would also be useful for a more integrated approach to be adopted where references to other documents that address climate-related matters could be more prominently linked and drawn to the attention of the readers of the financial statements, for example, links to relevant documents that provide more detailed supporting information, for example the 2023 CEFA and other forecasts information. This will ensure that an integrated and comprehensive picture of the country’s climate policies, strategies, commitments and risks is visible and transparent. However, we appreciate that linking information to other unaudited documents from financial statements creates a risk that such information may be considered to be part of the audited financial statements through incorporation by reference.

The Financial Statements of the Government for the years ended 30 June 2023 and 30 June 2022 include narrowly defined and specific policies for liabilities and contingent liabilities. This has resulted in the Paris Agreement commitments being excluded from the financial statements. The Institute recommends that Treasury considers liabilities and contingent liabilities in a wider context when preparing future financial statements. In that regard, we also recommend that Treasury updates its 2013 *Guidance on Recognising Liabilities and Expenses* to also address climate-related commitments and risks so that it is not just focused on constructive obligations that arise as a result of the Government providing assistance but incorporates the principles of PBE IPSAS 19 as they relate to constructive obligations along the lines of the 2024 *IFRIC Decision*.

The Institute recognises a number of reporting options do exist:

1. Include in the upcoming 2024 Financial Statements a liability and a contingent liability (see Option (ii) on Table 6.2, the Institute’s preference), by applying accounting standard PBE IPSAS 19: *Provisions, Contingent Liabilities and Contingent Assets* (PBE IPSAS 19) (our preferred option).

Accounting is in single-year periods, whereas the NDC framework is in multi-year periods (NDC1 is for a ten year period and NDC2+ are for periods of five years). This means in the 2024 Financial Statements, the first three-and-a-half years of the NDC1 commitment should be treated as a liability in the statement of financial position, and the remaining six-and-a-half years should be treated as a contingent liability in the notes to the financial statements. This approach enables the public to monitor progress over time, support policies and plans, and hold the government to account.

2. Publish as additional information in the 2024 Financial Statements, by applying s 27(2)(c)(v) of the Public Finance Act 1989. This requires the Treasury to include in the annual financial statements of the New Zealand Government ‘additional information and explanations’ that ‘fairly reflect’ the Government’s financial operations and financial position (see Section 3.2). The additional information should at minimum include estimated monetary amount per unit and estimated number of units.
3. As a bare minimum, move the reporting of the NDC1 risk from the statement of specific fiscal risks to the fiscal forecast in the next economic and fiscal update; and recognise this risk in the next set of forecast financial statements. See discussion in paragraphs 27–31 of the 2024 *Treasury Opinion*, found in Appendix 6.
4. Prepare a 2024 update of the *Climate Economic and Fiscal Assessment 2023* (2023 CEFA) with the Ministry for the Environment. This would be a useful and timely way to provide the public with more information on the methods and evidence that are being relied upon to (i) estimate units and prices, (ii) calculate an accounting estimate of the monetary amount, and (iii) explore economic and fiscal costs.¹¹⁶ It would be preferable to include in the financial statements the more detailed information in the 2023 CEFA or to provide a link to the 2023 CEFA from the financial statements to ensure that the quantitative impact of the climate risks on the financial statements are highlighted.
5. Review the 2013 *Guidance on Recognising Liabilities and Expenses*, and consider updating it.

6. Publish the first Climate Statement of the Government of New Zealand. The statement should comply with the XRB's climate-related disclosure framework, including Aotearoa New Zealand Climate Standards NZ CS 1, NZ CS 2 and NZ CS 3. The ultimate aim of the XRB's Aotearoa New Zealand Climate Standards is to support the allocation of capital towards activities that are consistent with a transition to a low-emissions, climate-resilient future.¹¹⁷ Importantly, if climate change did not exist, there would be no commitment to meet the NDCs, nor indeed any need for the Paris Agreement.

To enable primary users to understand how climate change is currently impacting an entity and how it may do so in the future. This includes the *scenario analysis* an entity has undertaken, the climate-related risks and opportunities an entity has identified, the anticipated impacts and financial impacts of these, and how an entity will position itself as the global and domestic economy transitions towards a low-emissions, climate-resilient future. [bold added] (NZ CS 1, Para 10)¹¹⁸

7. Publish as 'management commentary' alongside the financial statements. Importantly, the 2023 Financial Statements include a narrow fiscal commentary on the financial statements. We consider the financial statements of the Government of New Zealand could be expanded to include a comprehensive management commentary. The wider commentary could include 'additional information and explanations needed to fairly reflect the consolidated financial operations of the Government reporting entity for the financial year and its consolidated financial position at the end of that year' in accordance with s 27(2)(v) of the Public Finance Act 1989. There is no legal requirement for a management commentary in New Zealand; however, the Treasury could voluntarily do this.
8. Prepare the first annual report of the Government of New Zealand, which would bring together a comprehensive management commentary, discussed above. The annual report would provide an opportunity to bring together the financial statements of the Government of New Zealand and the conclusions of future *CEFA* reports, and either contain, or direct users to, the Climate Statement (mentioned in 3 and 4 above). The aim is to connect, align and share information about risks, costs and benefits, and ensure that the overall operations and financial performance in the preceding 12 months of the New Zealand Government can be found in one place.

Other actions Treasury could take, but with approval from Parliament:

9. Support an amendment to the Public Finance Act 1989 to require the financial statements to align reporting with the Government's climate policy to 'fairly reflect' the position of the New Zealand Government by taking into account long-term obligations. This could include a specific section that requires our obligations to purchase offshore carbon credits to meet our NDCs to be disclosed (along the lines of the list in s 211: Contents of annual report of the Companies Act 1993).
10. Purchase offshore carbon credits in the short term as a hedge against the commitment to purchase offshore carbon credits in 2030. This will automatically bring the obligation into the financial statements.

7.3.2 Ministry for the Environment

As the key department responsible for communicating on climate change to the wider public, MfE has a significant role in terms of communicating climate risks and developing durable public policy. This includes working with industry (on domestic reductions), the Ministry of Foreign Affairs and Trade (MFAT) on options for offshore abatement) and the Treasury (on the fiscal risks of climate change). We recommend that MfE continues to look at ways to improve domestic and international collaboration, and to improve the quality of climate reporting to Members of Parliament and to the public at large. The 2023 *CEFA* is an excellent example of collaboration between departments and reporting on climate risks. We recommend the report become a regular occurrence.

7.3.3 New Zealand External Reporting Board (XRB)

The XRB is responsible for, among other matters, setting accounting and climate standards. The XRB has a role to play in helping to provide more clarity in standards to address any uncertainty in the accounting treatment of climate-related obligations.

We recommend that the XRB:

- proposes to the IPSASB to clarify existing IPSASs and/or the IPSASB Conceptual Framework. The IPSASB should be asked to consider providing guidance on IPSAS 19, along the lines of the 2024 *IFRIC Decision* on IAS 37, to enable a public entity to reflect its commitments to climate policies (entity level) and to enable the Government to reflect its commitment to purchase carbon credit offsets under the Paris Agreement (at a country level).

This is important:

- to address whether the commitment to purchase carbon credit offsets results in an obligation, and the timing of the recognition of such an obligation;
 - to ensure the accounting and reporting requirements for climate-related commitments are aligned between for-profit and public benefit entities;
 - to clarify how the financial statements of the Government of New Zealand should account for emission commitments and offsets; and
 - to ensure that the commitment to purchase NDC offsets does not fall outside the scope of the existing accounting standards;
- engages with the IPSASB and, in particular, its newly established Climate-related Topic Working Group. One of the key differences between the public and private sectors is the issue of NDCs. The XRB's engagement in this project will be essential to ensure that the IPSASB's Climate-related Disclosures Project will also focus on other targets like the Paris Agreement and NDCs and also consider how disclosure requirements may be linked to, and be used for, existing public sector indicators such as NDCs;
 - monitors closely the further work of the IASB and the IPSAB to ensure that financial statements can provide better information about climate-related risks by linking the requirements of climate standards with the requirements of financial reporting standards;
 - if necessary, develops domestic guidance to clarify the requirements of existing PBE Standards with regard to accounting by the New Zealand Government for emission commitments and offsets; and/or
 - if necessary, develops domestic guidance to clarify the requirements of existing PBE Standards and NZ IFRS with regard to how an entity accounts for emission commitments and offsets at the entity level (along the lines of the 2024 *IFRIC Decision*).

7.3.4 The Office of the Auditor-General

The Auditor-General audits the financial statements of the New Zealand Government and the financial statements of public entities in New Zealand. The Auditor-General is able to set high expectations for the quality of reporting by the entities that they audit. Where necessary, the Auditor-General can make comments in the audit reports of the entities.

The New Zealand Government and many councils audited by the Auditor-General have declared climate emergencies and made commitments to reduce and/or offset emissions.

We propose that the Auditor-General asks appointed auditors to carefully consider whether public entities' and the Government's obligations arising from emissions reduction targets and offsets (together with their climate emergency declarations) should be recognised as a constructive obligation in their respective financial statements. This is important if such declarations and commitments are to be taken as having substance and real consequences for the entities and are not merely publicity statements. In this regard, we propose that the Auditor-General gives consideration to the implications of the *2024 IFRIC Decision* for public benefit entities' financial statements and for the Government's financial statements. It is noted that, while the NDC1 issue applies to Government from 1 January 2021, equally the Carbon Neutral Government Programme applies to government agencies from 2025.

7.3.5 The accounting and legal professions and academia

Whether the purchase of offshore carbon credits should be recognised in the financial statements of the Government involves judgement. This is because there is uncertainty over whether the Paris Agreement creates legal obligations for the Government, particularly in the domestic context given the inclusion of the Paris Agreement in domestic legislation and trade agreements. In the accounting context, existing accounting standards do not deal specifically with climate-related matters. Judgement is required to apply principles in existing accounting standards to the issue of whether the Government's actions to date have created a valid expectation that it would comply with their Paris Agreement obligations.

Given the huge potential economic and legal impact of this issue, we consider that the accounting and legal professions, whether in practice or in academia, have an important role to play in helping to clarify the position.

We recommend and strongly encourage:

- legal professionals and firms to consider whether the Paris Agreement obligations create a legal obligation for the Government;
- accounting professionals, firms and accounting bodies (Chartered Accountants Australia & New Zealand (CAANZ) and CPA Australia) to consider and confirm that the Government's obligations under the Paris Agreement to purchase offshore carbon credits offsets result in a constructive obligation and a contingent liability under the principles of existing standards;
- accounting and legal academics in academia to carry out further research and work into this important emerging area, such as comparing the extent to which New Zealand has embedded our commitments under Paris in our legal system and our trade agreements, and whether a legal obligation exists; and
- the legal and accounting fraternity and academics to engage with, advise and further inform the public and relevant Ministers on their findings.

7.3.6 Implications for other New Zealand organisations

Notably, the New Zealand Government is not the only entity that has made a public statement that it intends to offset carbon emissions through a commitment to purchase offshore carbon credits. This further widens the implications of our findings. This may require additional work streams for other public and private organisations, such as the Financial Markets Authority (FMA), the New Zealand Stock Exchange (NZX), and Ministry of Business, Innovation and Employment (MBIE).

This paper also raises issues over the extent to which other trade agreements directly or indirectly refer to the Paris Agreement. No doubt MFAT will have undertaken such an assessment.

The results of this paper raise questions over whether private organisations that commit to purchase offshore carbon credits at some future time may also be required to disclose this obligation in their financial statements or annual report (such as in their management commentary). The *2024 IFRIC Decision* indicates that for-profit entities need to consider the issue using existing standards. For example, in November 2023, Fonterra set its on-farm emissions reduction target, and released a Climate Roadmap and voluntary Climate-related Disclosure report.¹¹⁹ If we are going to meet our NDC1 targets and reach net-zero by 2050, the actions and policies of the for-profit entities will be critically important, raising questions over what information should be reported and what information should be audited.

7.4 Recommendations for the Minister of Climate Change and the Minister of Finance

In the next two years, New Zealand must undertake at least two actions under the Paris Agreement:

1. Submit the next round of NDCs (i.e. NDC2) by 2025 and every five years thereafter (i.e. 2030, 2035, 2040), regardless of implementation time frames.¹²⁰ NDCs are submitted at least 9 to 12 months in advance of the relevant session of the Conference of the Parties.¹²¹
2. Submit New Zealand's first biennial transparency report (BTR1) in accordance with the modalities, procedures and guidelines (MPGs), by 31 December 2024 at the latest.¹²² This report may provide greater detail on the measurement methods used by New Zealand for calculating total emissions, and explain how and why they differ from other countries.

Given the number of issues identified in this paper, we suggest the Minister should seek advice on a number of additional matters. We suggest the public needs more clarity over the extent to which New Zealand can reduce emissions by domestic actions, such as outlined in the previous Government's 2023 *NDC Strategy*.

As we go to print, the Government announced that it will introduce legislation amending the Climate Change Response Act 2002 to ensure agriculture does not enter the NZ ETS. Instead, the Government will establish a new Pastoral Sector Group to tackle biogenic methane and invest in ways to lower on-farm emissions. Climate Change Minister Simon Watts stated, '[t]hese investments signal the Government's support for farmers while ensuring New Zealand meets its international climate change obligations'.¹²³ This statement once again reinforces the Government's commitment to reduce domestic emissions, as well as purchasing offshore carbon credits to cover surplus emissions, so that New Zealand meets NDC1. Further, the \$400 million investment announced by the Minister will show on the financial statements of the Government of New Zealand. However, based on the current *2024 Treasury Opinion*, the offshore abatement will not.

We are also concerned that the *2024 Treasury Opinion* suggests that one option is for the 'Crown to shift the costs of meeting NDC1 onto the private sector' (see Table 3 in Appendix 6). This suggestion raises the question of who in the private sector, when they would pay and how they would pay. Good policy takes time, and 2030 is not far away. Even if some of the costs could be shifted to the private sector, there is still likely to be an outstanding balance that would require offshore abatement.

Reporting the commitment in the 2024 Financial Statements of the Government of New Zealand is one way to garner support for reducing emissions and designing durable public policy. Hence, it is timely for officials to advise Cabinet on the following:

2023 NDC Strategy

Recommendation 1: Provide clarity over the status of the 2023 *NDC Strategy*, and whether this strategy is supported by the current Government.

Financial reporting: legal or constructive obligation

Recommendation 2: Seek a legal opinion on whether a ‘legal obligation’ now exists in New Zealand, particularly given that the interaction between international climate agreements and domestic law is an emerging area of legal interest. There are tensions in existing climate legislation which would benefit from further legal analysis and clarification, particularly given the significant size of the obligation.

Recommendation 3: Request an accounting opinion to confirm that a constructive obligation arises (under PBE IPSAS 19) from the commitment to purchase international carbon credits to offset our emissions.

Recommendation 4: Request that the Treasury provides a detailed accounting opinion that explains their decision not to create a liability or a contingent liability based on the relevant paragraphs in PBE IPSAS 19. In our view, the *2024 Treasury Opinion* lacks specific references to the accounting standards.

Recommendation 5: Request the Minister of Finance to make a statement before the 30 June 2024, to trigger (without doubt) a provision and contingent liability in the financial statements. Although the *2024 Treasury Opinion* is not clear on what that could look like, it does provide some broad thoughts on what might trigger a provision and contingent liability (see Appendix 6).

Explore strategic options

Recommendation 6: Seek out a range of strategic options for wider consultation along the lines of those proposed in the *NDC Strategy*.

Option A: To increase domestic action (by decreasing emissions) significantly

One key reason for reporting the Paris Agreement commitment in the financial statements of the New Zealand Government, other than cash flow management, is to better engage with business and the general public in ways to minimise the impending cost of purchasing offshore carbon credits. Strategic conversations are urgently required in order to better explore and socialise ideas in the public arena, test initiatives and implement practical solutions. Having the financial obligation visible every year in the financial statements, knowing the estimated figure can be relied upon because it has been audited, and being able to accurately track progress, is one sure way to amplify that conversation – and save the country money.

If officials consider that a legal or constructive obligation currently exists (or indeed the current government feels obliged to honour the Agreement), they should provide advice on the options available to reduce this liability, in particular options for reducing the net emissions gap. This is mentioned in the *NDC Strategy*, which seeks advice from officials on this exact point: how to progress policy work and interventions to meet NDC commitments through storing more carbon in the natural environment.

Lastly, it is timely to consider all options that could be implemented today to reduce our emissions significantly before 2030. For example, it may be cheaper, and more beneficial for farmers, to pay them not to farm livestock than to purchase offshore carbon credits in 2030. As Jo Hendy, Chief Executive of the CCC, advises, it is now too late to get the carbon benefits of planting new trees: ‘[P]lanting forests to soak up emissions can help us reach our longer-term climate change goals, but planting new forests will not help achieve the second emissions budget [or our 2030 NDCs], because trees take time to grow and store carbon.’¹²⁴

Option B: To identify a credible international mitigation host country

The time required to identify and develop a strategic trusted relationship with a country or countries will be considerable. It may take years before an agreement can be signed. One of the challenges is to find an international host country that will provide confidence and accountability, and share similar values. For example, New Zealand could develop an ‘ecological corridor’ carbon offset agreement with Bhutan. Bhutan is looking to develop its ninth ecological corridor. It has proven carbon accounting expertise and would be a credible emissions reduction partner given it is already a net-zero country.¹²⁵

Option C: To simply not purchase

If officials consider that no legal or constructive obligation currently exists, they should advise on the implications if New Zealand decides not to purchase offshore carbon credits to achieve the NDC. This is important as Ministers should socialise this possibility now, both with the public of New Zealand and with the international parties to the Paris Agreement. The timing is important since we are almost halfway into the ten-year NDC1 term (2021–2030). The halfway mark is 1 January 2026. Furthermore, in 2025 New Zealand's second NDC (NDC2) is due, covering the five-year period 2031–2035.

If the Government is at all considering the option not to purchase the outstanding overseas carbon credits necessary to balance NDC1, it needs to understand the implications, such as the reputational risks and economic impact on existing treaties (such as the EU free-trade agreement) and future treaties. For example, the UK has said it will use its multilateral fora to galvanise international partners to adopt climate-ambitious trade policy, to promote global trade rules that are aligned to net zero and the Paris Agreement, and to seek to reaffirm its commitment to the Paris Agreement in all UK trade agreements.¹²⁶

7.5 Next steps

This paper explores an interesting and evolving area of climate change policy, and how policy intersects with financial reporting. It is an issue that deserves consideration, research and ongoing discussion.

In our view, accounting for this liability over time makes sense in that we are recognising costs incurred in each financial reporting period, rather than in 2030. Not to do so lacks transparency and may mean the public and entities do not understand the financial implications and therefore do not act to curb emissions. It also risks creating a huge economic shock in 2030. Including this information in the financial statements every year until 2030 enables the Government and the public to make better decisions in the short term, so that fewer offshore carbon credits must be purchased in (or before) 2030 to meet our obligations under the Paris Agreement. Our actions have created the worst outcome; we have agreed to pay the costs of this commitment overseas, without reaping the benefits of this commitment at home. The financial costs need to be socialised to drive change.

The financial statements are one of the few instruments that are evidence-based, independently audited and regularly published. They are where the public go to learn more about our economy, the state of our assets and liabilities, and to assess the quality of financial governance. A failure not to disclose in such a core and trusted financial instrument is, in effect, hiding a significant financial risk in plain sight.

Abbreviations

AR5	IPCC's Fifth Assessment Report
BAU	Business as usual
BEFU	<i>Budget Economic and Fiscal Update</i>
BTR1	New Zealand's first biennial transparency report
CBD	Convention on Biological Diversity
CCATWG	Climate Change Adaptation Technical Working Group
CCC	Climate Change Commission
CCRA	Climate Change Response Act 2002
CEFA 2023	Ministry for the Environment and Treasury's report <i>Climate Economic and Fiscal Assessment 2023</i>
CERF	Climate Emergency Response Fund
CNGP	Carbon Neutral Government Programme
CO ₂	Carbon dioxide
COP	Conference of the Parties
CP1	The first commitment period of the Kyoto Protocol
CP2	The second commitment period of the Kyoto Protocol
DOC	Department of Conservation
DPMC	Department of the Prime Minister and Cabinet
EECA	Energy Efficiency & Conservation Authority
EG	Explanatory Guide
ENZ	Emissions in New Zealand
EPA	Environmental Protection Authority
EPH	Electric process heating
ERP	Emission Reduction Plan
EU	European Union
EU ETS	European Union Emissions Trading System
FMA	Financial Markets Authority
GAAP	Generally accepted accounting practice
GDS	Government Department Strategy
GHG	Greenhouse gas
GIDI	Government Investment in Decarbonising Industry Fund
GPFR	General Purpose Financial Reporting
GRI	Global Reporting Initiative
GWP	Global warming potential
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IASB	International Accounting Standards Board
IEA	International Energy Agency

IFRIC	IFRS Interpretation Committee
IFRS Foundation	International Financial Reporting Standards Foundation
IFRS S1	General Requirements for Disclosure of Sustainability-related Financial Information
IFRS S2	Climate-related Disclosures
INDC	Intended Nationally Determined Contribution
IPCC	Intergovernmental Panel on Climate Change
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
ISSB	International Sustainability Standards Board
KAM	Key audit matters
LCANZI	Lawyers for Climate Action New Zealand Inc
LGNZ	Local Government New Zealand
LT-LEDS	Long-Term Low Emissions Development Strategy
MAF	Ministry of Agriculture and Forestry
MBIE	Ministry of Business, Innovation and Employment
MEA	Multilateral Environmental Agreement
MfE	Ministry for the Environment
MPGs	Modalities, procedures and guidelines
MPI	Ministry for Primary Industries
Mt	Megatonne (a metric unit equivalent to 1 million (10 ⁶) tonnes, or 1 billion (10 ⁹) kilograms)
Mt CO ₂ e	Megatonnes of carbon dioxide equivalent
NAP	National Adaptation Plan
NDC	Nationally Determined Contribution
NDC1	The first NDC covering the ten years 2021–2030
NDC2	The second NDC covering the five years 2031–2035
NIWA	National Institute of Water and Atmospheric Research
NWO	Network Waitangi Ōtautahi
NZ CS	New Zealand Climate Standards
NZ ETS	New Zealand Emissions Trading Scheme
NZASB	New Zealand Accounting Standards Board
NZX	New Zealand Stock Exchange
OAG	Office of the Auditor-General
OECD	Organisation for Economic Co-operation and Development
PBE	Public Benefit Entities
PBE IPSAS 1	Public Benefit Entities Presentation of Financial Statements

PBE IPSAS 19	Public Benefit Entities Provisions, Contingent Liabilities and Contingent Assets
PCE	Parliamentary Commissioner of Environment
RBNZ	Reserve Bank of New Zealand
RGNDI	Real Gross National Disposable Income
SDG	Sustainable Development Goal
SRG	Sustainability Reference Group (launched by IPSASB)
TCFD	Task Force on Climate-Related Financial Disclosures
UAE	United Arab Emirates
UK	United Kingdom
UNFCCC	United Nations Framework Convention on Climate Change
XRB	New Zealand External Reporting Board

Appendix 1: Timeline of climate-related policy

Figure A1.1: Timeline of climate-related policy¹²⁷



Background: Timeline of key events

22 May 1998: New Zealand signs the Kyoto Agreement

New Zealand signed the Kyoto Agreement on 22 May 1998, and then ratified it on 19 December 2002.¹²⁸ The New Zealand Parliament website states:

The first commitment period (CP1) of the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which set **legally-binding emission reduction targets** for 37 industrialised countries, came to an end in 2012. Although a second commitment period (CP2) is now in place over 2013 to 2020, not all countries that participated in CP1 have signed on for CP2, including New Zealand ... New Zealand remains a party to the Kyoto Protocol but is taking a quantified economy-wide GHG emission reduction target of five percent below 1990 levels under the [United Nations Framework Convention on Climate Change (UNFCCC)] over the 2013 to 2020 period. **The main difference is that the Kyoto Protocol is legally-binding whereas the UNFCCC agreement is not.** [bold added]¹²⁹

5 November 2002: Climate Change Response Act 2002 passed

The second reading of the Bill took place on 5 November 2002, which resulted in 63 ayes to 57 noes.¹³⁰ On 18 November 2002, the Climate Change Response Act 2002 became law. The current purpose of this Act (including amendments) is set out in s 3(1), and includes to:

- (aa) provide a framework by which New Zealand can develop and implement clear and stable climate change policies that—
 - (i) contribute to the global effort under the Paris Agreement to limit the global average temperature increase to 1.5° Celsius above pre-industrial levels; and
 - (ii) allow New Zealand to prepare for, and adapt to, the effects of climate change:
- (a) enable New Zealand to meet its international obligations under the Convention, the Protocol, and the Paris Agreement, including (but not limited to)—
 - (i) its obligation under Article 3.1 of the Protocol to retire Kyoto units equal to the number of tonnes of carbon dioxide equivalent of human-induced greenhouse gases emitted from the sources listed in Annex A of the Protocol in New Zealand in the first commitment period starting on 1 January 2008 and ending on 31 December 2012; and
 - (ii) its obligation to report to the Conference of the Parties via the Secretariat under Article 12 of the Convention, Article 7 of the Protocol, and Article 13 of the Paris Agreement [bold added]

31 March 2011: First greenhouse gas emissions target set

On 31 March 2011, Hon Nick Smith, Minister for Climate Change Issues, ‘set a target for a 50% reduction in New Zealand greenhouse gas emissions from 1990 levels by 2050’ in the *Gazette* (pursuant to s 224 of the Climate Change Response Act 2002).¹³¹ This section of the Act was later repealed on 14 November 2019 and replaced by s 11 of the Climate Change Response (Zero Carbon) Amendment Act 2019.

22 April 2016: New Zealand signs the Paris Agreement

In 2016, Hon Paula Bennett, Minister for Climate Change Issues, tabled a *2015 Cabinet Paper, Paris Climate Change Agreement - Report back to Cabinet and Approval for Signature*, at the Cabinet Economic Growth and Infrastructure Committee, seeking support of ministers to sign the Paris Agreement.¹³² The executive summary of the *2015 Cabinet Paper* stated:

The historic Paris Agreement on climate change was concluded at the twenty-first Conference of Parties to the United Nations Framework Convention on Climate Change (COP21) on 12 December 2015. It ensures, for the first time, all countries will now contribute to the global response to climate change on an equal legal footing. The intended nationally determined contributions (INDCs) pledged under the Agreement cover Parties responsible for 99% of global emissions. (Para 1)

I propose New Zealand signs the Agreement on 22 April at the high-level signing ceremony to be convened in New York. Signing signals our intention to be bound by the Agreement. I expect we will be in a position to ratify the Agreement within a 2-3 year timeframe. (Para 2)

New Zealand's INDC (for the period 2021-2030) was tabled on a provisional basis pending clarification of rules under the Agreement relating to accounting for land sector emissions and use of carbon markets.

New Zealand will not need to communicate its finalised first nationally determined contribution (NDC) until it ratifies the Agreement. (Para 3)

The Agreement satisfies the expectations set out in the negotiation mandate approved by Cabinet. In particular, New Zealand's interests are well protected by the excellent outcome on international carbon markets. Provisions on accounting for the land sector and transparency align closely with New Zealand priorities. (Para 4)¹³³

The *2015 Cabinet Paper* also mentioned that officials advised Cabinet that the financial statements of the Government of New Zealand would not be impacted at this time because, at present, no legally enforceable obligation to disclose existed. However, the *2015 Cabinet Paper* implied that such an obligation might exist in the future – if the target were to become internationally binding and/or domestically enforceable.

The *2015 Cabinet Paper* discussed the extent to which the Paris Agreement is legally binding, and the resulting financial obligations and financial implications:

The Paris Agreement sets out obligations and expectations of Parties at a high level, and is accompanied by a Conference of Parties (COP) decision containing additional detail and establishing a forward work programme. The Agreement contains both legally binding obligations ('Parties shall ...') and political expectations (provisions that Parties 'should', are 'invited' or 'encouraged' to adhere to). (Para 11)

Financial implications

Financial and economic implications will result from obligations to take progressively higher emission reduction targets and provide progressively greater amounts of financial assistance to developing countries. The economic cost of New Zealand's 2021-2030 target is estimated at \$36 billion (2012 prices), or 1.20% of RGNDI [Real Gross National Disposable Income]. The costs of our subsequent targets under the Paris Agreement and future packages of financial assistance to developing countries are unknown. (Para 46)

Officials advise that the 2030 target should not be reflected in the Crown accounts at this time. Whether the target will be included in Crown accounts depends on the degree to which the target is internationally binding, as well as the domestic enforceability of the target, including any obligation on the Crown to expend resources to meet the target. **Since there is currently no legally enforceable obligation on the Crown to expend resources to meet the target, there is no requirement to reflect this in Crown accounts currently.** [bold added] (Para 47) ¹³⁴

New Zealand ratified the Paris Agreement on 4 October 2016, committing the country to setting an emissions reduction target that would be regularly updated.¹³⁵ The Paris Agreement entered into force on 4 November 2016 and took effect from 2020. The Paris Agreement, contained in Schedule 2A of the Climate Change Response Act 2002, states:

Each Party shall prepare, communicate and maintain successive nationally determined contributions that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions. (Article 4, Para 2)¹³⁶

Nationally determined contributions (NDCs) embody efforts by each country to reduce national emissions and adapt to the impacts of climate change. To meet our NDC, a range of mitigations must take place domestically, whether voluntarily or through government policies and/or legislation.

The Ministry for the Environment's website states:

Ratification also commits us to:

- continue to regularly report on our emissions and how we're tracking towards meeting our target
- continue to provide financial support to assist developing countries' mitigation and adaptation efforts
- plan for adaptation.¹³⁷

2 December 2020: A climate emergency is declared

The Government passed a motion to declare a climate emergency, with 76 ayes to 43 noes.¹³⁸

31 May 2021: First CCC's final advice published

On 31 May 2021, the Climate Change Commission's first advice to the New Zealand Government was published, *Ināia tonu nei: a low emissions future for Aotearoa*. The report was delivered to the Minister of Climate Change and then tabled in Parliament in June 2021.¹³⁹ One of the issues raised was how ambitious New Zealand might want to be in terms of our NDC (see excerpt of the report in Appendix 2). The Paris Agreement allows parties to increase the ambition of their NDCs. There are domestic and international calls for developed nations, like New Zealand, to lower emissions faster than set out in their original Agreement. If New Zealand were to increase its NDC, this action would likely lead to an equivalent increase in our obligation to purchase additional offshore carbon credits. An article in Stuff on 2 February 2021 put it this way:

'The NDC (Paris target) is always set on the basis of what *should* we do. Domestic action is about what *can* we do, and they do interplay,' commission chair Rod Carr told *Stuff*.

But even to meet a target with middling ambition, the costs could be anywhere from \$1.9b and \$11.5b, according to commission's analysis. The price depends on the cost of carbon, and how much additional income is assumed to be lost to New Zealand by sending the money overseas.

That added cost, called a multiplier, could be slapped on the total to reflect the fact that when money is spent on tree planting or building renewable energy overseas, New Zealand misses out on, not only the upfront cost, but also trickle-down benefits to the wider economy when the money is re-spent.

At a \$50 global carbon price, with no added penalty for wider costs, the projected cost would be \$3.2b for a middling level of ambition, the commission said.

Carr said the numbers were highly uncertain. 'We don't know the quantity ... of our NDC because we're suggesting we should see much more than 35 per cent reduction. We don't know the price per (carbon) unit, because there is no global market for offshore mitigation [yet]. And then we don't know exactly what the terms of trade effects of paying away are, rather than doing more domestic action.'

'We don't have a good handle on what that is.'

Although the 2030 cost is widely uncertain, the Government likely needs to make a decision this year – before Glasgow climate summit in November.

Whatever the ultimate price is, Carr and his fellow commissioners want the Government to be more upfront about the effect on its balance sheet.

'That's why we say that the Government needs to annually report on the liability under the NDC that it should choose to settle on,' he said. [bold added]¹⁴⁰

The Commission's report made it clear that climate risks should be disclosed:

Without clear and transparent information about exposure to climate risk, firms, lenders, investors, insurers and other stakeholders may be left with unforeseen liabilities or risks ...

The mandatory climate-related financial disclosures regime recently enacted by the Government is an important step in improving transparency and information about climate risk in Aotearoa. It draws on the recommendations of the *Task Force on Climate-related Financial Disclosures*, which are considered international best practice for climate-related financial reporting. (pp. 247 and 248, Paras 84 and 88)¹⁴¹

The Commission discussed the factors relevant to setting the level of the NDC in chapter 22 of its report, under a subsection titled ‘Aotearoa should plan for how it will meet the NDC’.¹⁴² Section 22.3.1, ‘It is not yet clear how Aotearoa will access offshore mitigation’, stated:

The need for offshore mitigation to meet the NDC also raises the question of how the purchasing will be paid for and managed. Purchasing could be undertaken by the Government or by emitters, and this will depend in part on how Aotearoa secures access to international emissions markets. (p. 366, Para 54)¹⁴³

Section 22.3.2, ‘Accountability and reporting on the NDC will be critical’, also stated:

The credibility of the NDC relies on the Government showing its intent to achieve both the domestic and international emissions reductions required to meet it. Domestic emissions budgets and the emissions reduction plan will fulfil the former, **but it is not yet clear how the government will deliver on the latter.**

The government should develop a plan for how it will access and purchase offshore mitigation and take steps to implement it. **This will demonstrate a credible commitment to meeting the NDC both domestically, and to the international community.** It will not be responsible for Aotearoa to wait for others to develop the markets for us, or leave this until the late 2020s – this work needs to start now.

Our domestic and international reporting and accounting framework does not currently provide enough information on how meeting the NDC, including through purchasing offshore mitigation, may impact on public finances. The NDC is not within scope of the Commission’s annual monitoring reports, because these reports are about the 2050 target and emissions budgets.

Given that the Government intends to require a range of businesses to disclose climate change risks in their financial reports, it is not unreasonable to expect the Government to do the same. We therefore consider that **the Government should hold itself accountable for meeting the NDC through regular transparent reporting, including the disclosure of any fiscal risks that may arise from the purchasing [of] offshore mitigation and its strategy for managing those risks.** [bold added] (p. 367, Paras 55–58)¹⁴⁴

The Commission’s report made the following recommendation:

We recommend that the Government should:

1. In making its decisions, continue to enable the NDC to be met through a combination of domestic emission reductions, domestic removals, and use of international carbon markets.
2. Report annually on how it plans to meet the NDC, including the balance of planned domestic emission reductions, removals, and offshore purchasing.
3. Clearly communicate its strategy for purchasing offshore mitigation to meet the NDC and how it will identify and manage fiscal and other risks and their consequences. (p. 367, Recommendation 31)¹⁴⁵

On 31 December 2021, the Government was required to set the first three emissions budgets for the period 2022–2035. From 2022, the Commission began monitoring how the Government’s emissions reduction plan was implemented, including how well Aotearoa New Zealand was tracking to meet the 2050 net zero target.¹⁴⁶

Appendix 2 contains an excerpt from the final report, *Ināia tonu nei: a low emissions future for Aotearoa* (31 May 2021).

21 October 2021: Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill passed

Less than 12 months after the Government passed a motion to declare a climate emergency, the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill passed its third reading, requiring large financial organisations to disclose and ultimately act on climate-related risks and opportunities. Interestingly, this motion was passed with 110 ayes to 10 noes, indicating a strengthening of MP support and a broader commitment to current climate change policy.¹⁴⁷

4 November 2021: New Zealand's NDC1 updated

New Zealand updated its NDC1 for the period 2021–2030. Informed by advice from the Climate Change Commission, the updated NDC called for a 50% reduction of net greenhouse gas emissions below gross 2005 levels by 2030.

12 December 2023: Second CCC's final advice published

The Climate Change Commission published its second report, the first being *Ināia tonu nei: a low emissions future for Aotearoa*. The second report, *2023 Advice on the direction of policy for the Government's second emissions reduction plan*, provided the Commission's advice covering Aotearoa New Zealand's 2026–2030 emissions budget period. See Section 4.2 for a discussion and key excerpts.

Appendix 2: Excerpt from *Ināia tonu nei: a low emissions future for Aotearoa*

Source: He Pou a Rangi Climate Change Commission (2021) (pp. 360–365)¹⁴⁸

Note: The information in this excerpt was published before New Zealand updated its NDC on 4 November 2021, so the figures contained below are only accurate up to 4 November 2021.

22.1 How Aotearoa could meet the NDC

- ⁸ The NDC sets limits on net emissions over the period. This comprises all gross emissions, any domestic emissions removals (such as from forestry), as well as any international mitigation that Aotearoa decides to purchase (offshore mitigation).
- ⁹ Emissions reductions to meet the NDC will come from a combination of action within Aotearoa and offshore mitigation. This is illustrated in Figure 22.1 below.
- ¹⁰ This is different from emission budgets, which must be met as far as possible through domestic action. The Climate Change Response Act (the Act) limits the use of offshore mitigation in emissions budgets to situations where there has been a major change in circumstances, not accounted for when the budgets were set, which affects the ability to meet the relevant emissions budget domestically.
- ¹¹ Should Aotearoa wish to increase the ambition of its NDC, it could reduce domestic greenhouse gas emissions faster, increase removals of carbon dioxide, or purchase additional offshore mitigation. The Government would need to carefully consider the challenges associated with these options.

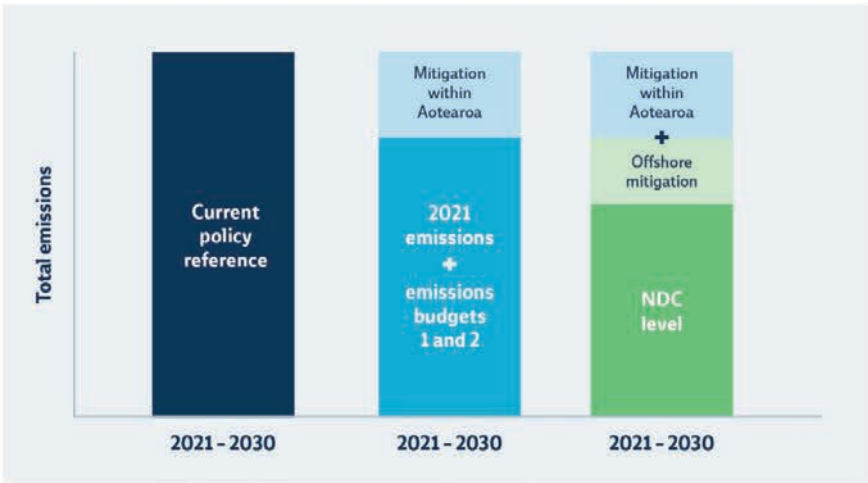


Figure 22.1: Illustration of the role of international mitigation in the NDC compared to emissions budgets

22.1.1 There is a growing gap between the NDC and net emissions in Aotearoa

- 12 The gap between the NDC and net emissions has arisen because past climate change targets have been met primarily using offsets from exotic production forestry (predominantly pine), rather than reductions in gross emissions.
- 13 For production forests only the first rotation sequesters additional carbon (under international accounting rules). Subsequent rotations of harvesting and replanting maintain the forest's stock of carbon at its long-term average associated with the offsets that have already been used, but not offsetting further emissions. (See Box 22.3 in *2021 Supporting evidence Chapter 3: How to measure progress*). Only expansion to the area planted in forest will generate new offsets.
- 14 To meet previous emissions reduction targets, Aotearoa has principally relied on the large area of forests planted in the 1990s. However, the additional area of new forest planted between 2000 and 2020 was relatively small, compared to the level of planting between 1990 and 2000 (see Figure 22.2 below).
- 15 The last of the forests planted in the 1990s are now reaching their long-term average carbon stock, and are no longer contributing to emissions reduction targets. A smaller area of forest was planted in the 2000s and 2010s. This means that the total amount of emissions offset by forestry is going down. As the total offsetting effect of forests in Aotearoa slows, net emissions will rise significantly between 2019 and 2022.
- 16 Under the Paris Agreement, each new NDC target must represent a progression in ambition on previous targets – targets must become more stringent over time.
- 17 This means that at the same time as emissions removals through forestry are dropping off, the level of allowed emissions under the country's NDC is getting stricter compared to previous targets.

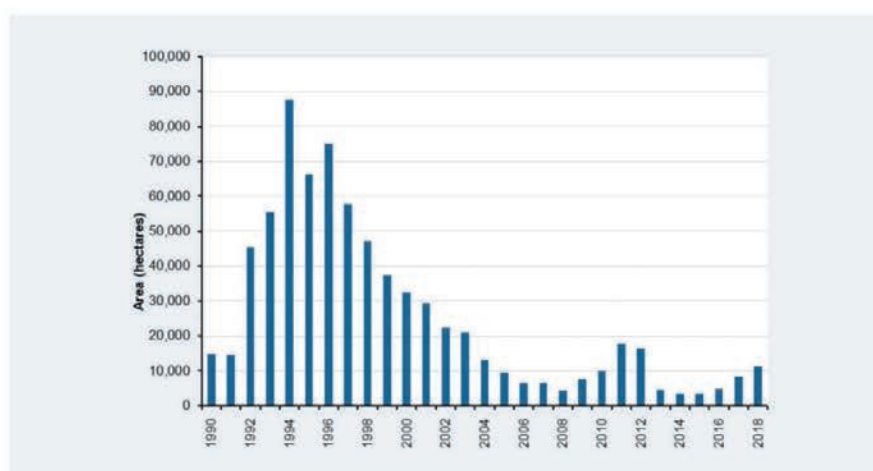


Figure 22.2: Areas of new forest planted in Aotearoa 1990 – 2018

Source: MfE, New Zealand's Greenhouse Gas Inventory 1990-2018

- 18 Our demonstration path includes the ongoing establishment of areas of new forest. This includes significant areas of exotic production forests in coming years, with increasing areas of permanent native forest over future decades. Native forests generally sequester greater amounts of carbon and over a longer period than exotic production pine so represent a more enduring carbon sink.
- 19 The current NDC emissions period has already started and runs to 2030. Increasing planting rates now will assist with meeting future targets, but will not contribute much to meeting the current NDC. This is because it takes around 5-7 years for newly planted forest to start removing significant amounts of carbon.
- 20 Figure 22.3 below shows actual net emissions in Aotearoa (dark blue line) and projected out to 2021 (dotted).
- 21 Net emissions increase as the amount sequestered by our forests drops. The coloured areas illustrate the country's international commitments, which are getting progressively stricter over time. This figure shows the growing gap between emission budgets and the NDC.

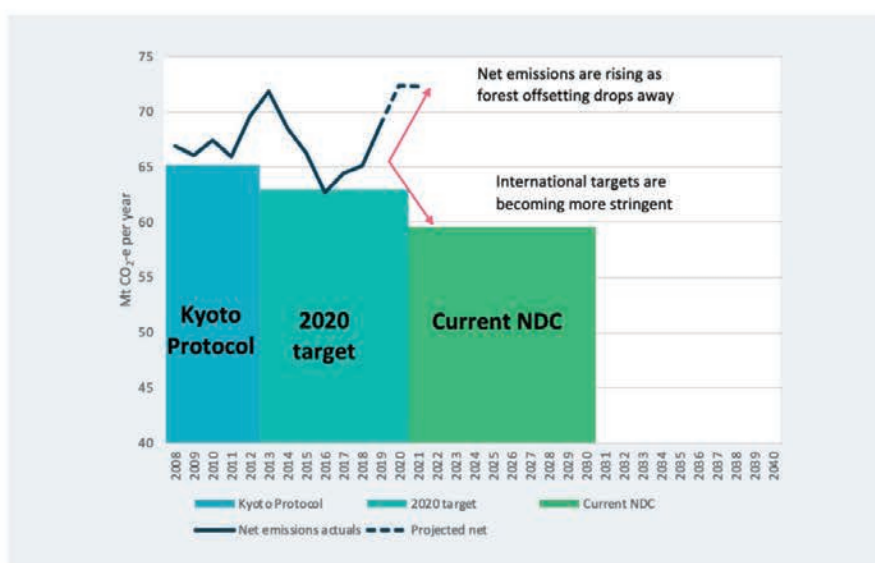


Figure 22.3: New Zealand's past emissions targets and current NDC and projected net emissions (target accounting)

Note: International commitments under past targets presented here have been recalculated to match the current GHG inventory for consistency of comparison.

22.1.2 Meeting the current NDC through domestic action alone would be highly challenging

- ²² The Act states that emissions budgets must be ambitious but achievable. It also states that emissions budgets must be met as far as possible through domestic actions.
- ²³ Our recommended emissions budgets, described in our *2021 Supporting Evidence, Chapter 2: What are other countries doing?*, would limit net emissions in Aotearoa to 576 MtCO₂e over the periods 2022-2025 and 2026-2030 together.
- ²⁴ When forecast emissions for 2021 are included, emissions over the NDC period (2021-2030) would be 648 MtCO₂e – if our proposed emissions budgets are adopted and achieved.
- ²⁵ Our analysis shows that these emissions budgets are ambitious but achievable and will put Aotearoa on track to meeting the 2050 targets. In recommending these budgets, we have had regard to the matters set out in section 5M of the Act where relevant, and 5ZC (see also Table 3 in *Chapter 3: The role of the Commission*).
- ²⁶ If the Government were to commit to reducing greenhouse gas emissions faster than we propose in our emissions budgets, there is a risk that Aotearoa could lose production in areas where technological solutions to reduce emissions could be applied, if more time were available.
- ²⁷ For example, in food processing, replacing a coal boiler with a biomass boiler requires finding a supplier, and undertaking design work to integrate it into the existing process. If time is not allowed for this to happen, some businesses may simply have to shut down.
- ²⁸ The scale of emissions reductions needed to bridge the gap between emissions budgets and the NDC means that meeting the NDC domestically would likely lead to severe social and economic impacts on communities, people and businesses – far more than would be necessary to achieve the same amount of emissions reductions given more time.
- ²⁹ The likelihood of achieving larger emissions reductions is another consideration. Our modelling shows that it may be possible to reduce emissions more than our budgets propose, but that this requires technologies that are not yet proven – particularly to reduce biogenic methane. Whether these technologies will be successfully developed and deployed is uncertain.
- ³⁰ Committing to achieving greater emissions reductions domestically than we recommend through our emissions budgets introduces significant risks. However, if new technologies are developed and proven in time, Aotearoa would be able to meet a larger portion of its NDC through domestic action. It would also be in a better position to set a more stringent second NDC.

Box 22.1 Meeting the NDC through domestic action

A number of submitters from the public and NGO community have proposed setting the domestic emissions budgets at the same level as the NDC.

If we set domestic emissions budgets at the level of the NDC, the scale of the reductions needed mean they could not be met without rapidly shutting down many of our emitting activities. For businesses such as farms and factories, the scale of the closures would need to be severe for the budgets to be met. This is because net emissions are starting at a point much higher than the average NDC level and the trajectory is for projected net emissions to rise over the next few years.

We estimated that if the current NDC had to be met solely domestically, an additional 52 MtCO₂e would need to be reduced over the period *in addition* to the effort required to meet our proposed emissions budgets. Any combination of actions to deliver so much mitigation in so short a time would require large scale cuts to economic output across Aotearoa.

For example, closing iron and steel production from 2025 would bridge less than a third of the gap. In addition, it would require either cuts to all agricultural output of the order of halving output by 2030. Alternatively it would require imposing tight restrictions on private transport use – beyond those that saw the need for carless days in the 1970s – alongside broad cuts to agricultural output.

From an intergenerational equity perspective, excessively fast cuts to emissions would have a legacy impact on the quality of life for younger generations as families are left without employment or essential services.

This pace of change would also disproportionately affect Iwi/Māori in terms of the Māori economy, given its large agricultural base, and Māori workforce who are disproportionately represented in agricultural and manufacturing industries.

We consider that the impacts on people and communities of setting our budgets at the same level as the NDC would be unmanageable.

22.1.3 Offshore mitigation will be required to meet the NDC

- ³¹ Offshore mitigation refers to where one country funds emissions reductions in another country and counts those reductions towards its own emissions reduction target.
- ³² This is a valid contribution to addressing climate change, as long as the offshore mitigation represents real, verifiable and additional emissions reductions. The benefit to the atmosphere of an emissions reduction is the same, regardless of where it happens.
- ³³ In contrast to domestic emissions budgets under the Act, the NDC explicitly allows for offshore mitigation. This means that Aotearoa can contribute more to the global effort than it is currently able to domestically.
- ³⁴ The Paris Agreement recognises that international cooperation through market mechanisms can serve the goals of increasing ambition and of promoting sustainable development and environmental integrity.
- ³⁵ This is consistent with a mātauranga Māori view of the interconnectedness between the climate and global system, and tikanga – doing the right thing in the right way. The NDC represents the total mitigation contribution to the world, beyond just what we can do at home.
- ³⁶ Due to the challenges, risks and likely impacts of meeting the NDC through domestic action alone, offshore mitigation will be critical to meeting the current NDC.

Appendix 3: International and domestic emissions targets

Source: Adapted from Ministry for the Environment website (MfE, 2021)¹⁴⁹

New Zealand has made commitments to the following international and domestic emissions targets.

A: International targets

International targets are targets that New Zealand accepted as part of international climate change agreements.

- **2020 target (2013–2020)**
This target was for net emissions to be 5% below 1990 gross greenhouse gas (GHG) levels for the period 1 January 2013 to 31 December 2020, under the United Nations Framework Convention on Climate Change (UNFCCC).
- **2030 target NDC1 (2021–2030)**
On 4 October 2016, New Zealand's initial target was to reduce net emissions by 30% below gross 2005 levels by 2030. This target was New Zealand's first Nationally Determined Contribution (NDC) under the Paris Agreement.

On 4 November 2021, this target was further updated to reduce net emissions 50% below gross 2005 levels by 2030. This equates to a 41% reduction on 2005 levels using what is known as an 'emissions budget' approach. See discussion in Section 4.3.
- **New Zealand's future NDCs**
New Zealand's second NDC (NDC2) is due in 2025 to cover the period starting from 2031. No decision has been taken yet with regard to New Zealand's NDC2 (post-2030).¹⁵⁰

B: Domestic targets under the Climate Change Response Act (CCRA)

Domestic targets are targets that New Zealand decided as part of its domestic policy decisions.

- Net zero emissions of all GHGs other than biogenic methane by 2050.
- 24 to 47% reduction below 2017 biogenic methane emissions by 2050, including 10% reduction below 2017 biogenic methane emissions by 2030.

Appendix 4: Excerpts from the Statement of Specific Fiscal Risks related to NDC1

Table A4.1: Excerpts from the Statement of Specific Fiscal Risks related to NDC1

Source: Budget Economic and Fiscal Updates and Half Year Economic and Fiscal Updates, 2021–2024

Budget Economic and Fiscal Update 2024 (30 May 2024)	Half Year Economic and Fiscal Update 2023 (20 December 2023)	Pre-election Economic and Fiscal Update 2023 (12 September 2023)	Budget Economic and Fiscal Update 2023 (18 May 2023)
Unchanged Risks [by Portfolio]	Unchanged Risks by Portfolio	Unchanged Risks by Portfolio	Unchanged Risks by Portfolio
Climate Change [portfolio]	Climate Change [portfolio]	Climate Change [portfolio]	Climate Change [portfolio]
Achieving New Zealand's International and Domestic Climate Change Targets	Risk title: Achieving New Zealand's International and Domestic Climate Change Targets	Risk title: Achieving Aotearoa New Zealand's International and Domestic Climate Change Targets	Risk title: Achieving Aotearoa New Zealand's International and Domestic Climate Change Targets
Risk type: (Expenses and Capital)	Risk type: (Policy Change – Expenses and Capital)	Risk type: (Policy Change – Expenses and Capital)	Risk type: (Policy Change – Expenses and Capital)
The Climate Change Response (Zero Carbon) Amendment Act 2019 requires the Government to set and achieve domestic greenhouse gas emissions targets and budgets (with the first three emissions budgets covering 2022 to 2035). The Government is set to release its second emissions reduction plan in December 2024, which will outline policies and strategies to achieve these emissions budgets. Some of these policies will be funded through existing baselines. If policies require funding from the Government, decisions will be needed about whether this can be funded through existing baselines or if additional funding will be required. New Zealand also has international obligations to reduce emissions under the Paris Agreement: our first Nationally Determined Contribution (NDC1), which covers 2021 to 2030. NDCs are countries' self-determined plans detailing what they will do to reduce their emissions in support of the international goal of limiting global warming to 1.5°C. <u>Sizeable offshore abatement will be needed to meet NDC1 on top of domestic commitments.</u> Scenarios showing the possible fiscal impact of this offshore abatement have been set out in the <u>Climate Economic and Fiscal Assessment 2023</u>. While the Government has choices about how it achieves NDC1, <u>it is likely</u> that fulfilling these commitments will involve significant costs to the Government, starting within the current fiscal forecast period. (p. 71) [Continues overleaf]	The Climate Change Response (Zero Carbon) Amendment Act 2019 requires the Government to set and achieve domestic greenhouse gas emissions targets and emissions budgets (first budget covering 2022 to 2025). The previous Government released the first emissions reduction plan in May 2022 which outlines a suite of complementary policies to achieve New Zealand's domestic targets. Some of these policies are currently funded under existing baselines, but many may require additional funding in the future. New Zealand also has international commitments under the Paris Agreement to limit global average temperature increases. <u>Sizeable domestic and offshore abatement will be needed to meet the first Nationally Determined Contribution (2021 to 2030) commitments on top of domestic commitments.</u> The Government has choices around how it achieves this. However, regardless of what these choices are, <u>it is likely</u> that fulfilling these commitments will involve significant costs to the Government, starting within the current fiscal forecast period. (p. 66) [Continues overleaf]	The Climate Change Response (Zero Carbon) Amendment Act 2019 requires the Government to set and achieve domestic greenhouse gas emissions targets and emissions budgets (first budget covering 2022 to 2025). The Government released its first emissions reduction plan in May 2022 which outlines a suite of complementary policies to achieve New Zealand's domestic targets. Some of these policies are currently funded under existing baselines, however many may require additional funding in the future. New Zealand also has international commitments under the Paris Agreement to limit global average temperature increases. <u>Sizeable domestic and offshore abatement will be needed to meet the first Nationally Determined Contribution (2021 to 2030) commitments on top of domestic commitments.</u> The Government has choices around how it achieves this, however, regardless of what these choices are, <u>it is likely</u> that fulfilling these commitments will involve significant costs to the government, starting within the current fiscal forecast period. Further information on this risk can be found in the <u>Climate Economic and Fiscal Risk Assessment</u>. (p. 88) [Continues overleaf]	The Climate Change Response (Zero Carbon) Amendment Act 2019 requires the Government to set and achieve domestic greenhouse gas emissions targets and emissions budgets (first budget covering 2022 to 2025). The Government released its first emissions reduction plan in May 2022 which outlines a suite of complementary policies to achieve New Zealand's domestic targets. Some of these policies are currently funded under existing baselines, however many may require additional funding in the future. New Zealand also has international commitments under the Paris Agreement to limit global average temperature increases. <u>Sizeable domestic and offshore abatement will be needed to meet the first Nationally Determined Contribution (2021 to 2030) commitments on top of domestic commitments.</u> The Government has choices around how it achieves this, however, regardless of what these choices are, <u>it is likely</u> that fulfilling these commitments will involve significant costs to the government, starting within the current fiscal forecast period. (p. 88) [Continues overleaf]

Half Year Economic and Fiscal Update 2022 (14 December 2022)	Budget Economic and Fiscal Update 2022 (19 May 2022)	Half Year Economic and Fiscal Update 2021 (15 December 2021)
<u>Updated Risks by Portfolio</u>	Unchanged Risks by Portfolio	<u>Updated Risks by Portfolio</u>
Cross-portfolio	Cross-portfolio	Cross-portfolio
Risk title: Achieving Aotearoa New Zealand's International and Domestic Climate Change Targets	Risk title: Achieving New Zealand's International and Domestic Climate Change Targets	Risk title: Achieving New Zealand's International and Domestic Climate Change Targets
Risk type: (Policy Change – Expenses and Capital)	Risk type: Policy Change – Expenses and Capital	Risk type: Policy Change – Expenses and Capital
The Climate Change Response (Zero Carbon) Amendment Act 2019 requires the Government to set and achieve domestic greenhouse gas emissions targets and achieve emissions budgets, starting with 2022 to 2025. The Government released its first emissions reduction plan in May 2022, which outlines a suite of complementary policies to achieve Aotearoa New Zealand's domestic targets. Some of these policies are currently funded under existing baselines, but many will seek new or additional funding in future, which will affect the Government's operating balance and net core Crown debt. Aotearoa New Zealand also has international commitments under the Paris Agreement to limit global average temperature increases. <u>Sizeable domestic and offshore abatement will be needed to meet the first Nationally Determined Contribution (2021 to 2030) commitments, on top of domestic commitments.</u> The Government has choices around how it achieves this. However, regardless of what these choices are, <u>it is likely</u> that fulfilling these commitments will involve significant costs to the Crown, starting within the current fiscal forecast period. (pp. 89–90) [Continues overleaf]	The Climate Change Response Act 2002 also requires the Government to set domestic greenhouse gas emissions budgets. Each emissions budget covers a period of five years (except the first emissions budget, which will cover the period 2022 to 2025). Emissions budgets will act as stepping stones, or interim targets, to reaching New Zealand's 2050 emissions reduction targets. The Government has published its first Emissions Reduction Plan (ERP) in May 2022. The ERP contains plans to put into action the five principles on which New Zealand's strategy for reducing emissions is based: playing our part and cutting pollution in line with what the science demands, upholding the role of te Tiriti o Waitangi and applying a tikanga Māori lens, a just transition to a zero-carbon economy that is fair and equitable, using nature-based solutions to tackle the climate emergency development, and delivering the outcome of a productive, sustainable and inclusive economy. Where the actions in the plan are sufficiently developed that they can be quantified for particular years with reasonable certainty they have been included in the forecasts. However, some actions are likely to require further development and funding to meet the objectives of the plan. Achieving both domestic and international emissions targets will incur significant costs to the Crown, starting in the current fiscal forecast period. There is an overview specific fiscal risk for this and several subsidiary specific fiscal risks. New Zealand's Nationally Determined Contribution to global mitigation efforts under the Paris Agreement is to reduce net greenhouse emissions by 50% below gross 2005 levels by 2030. This equates to an emissions budget for the target period (2021 to 2030) of 571Mt. To achieve this, New Zealand will need to pursue sizeable domestic, <u>and likely offshore, abatement</u> to mitigate emissions over 2021 to 2030. (pp. 63–64) [Continues overleaf]	The Climate Change Response (Zero Carbon) Amendment Act 2019 also requires the Government to set domestic greenhouse gas emissions budgets. Each emissions budget covers a period of five years (except the first emissions budget which will cover the period 2022 to 2025). Emissions budgets will act as stepping-stones, or interim targets, to reaching our 2050 emissions reduction targets. The Government has consulted on its choices around how it achieves its climate targets and must publish its first emissions reduction plan in May 2022. Achieving both domestic and international emissions targets will involve significant costs to the Crown, starting in the current fiscal forecast period. There is an overview specific fiscal risk for this and several subsidiary specific fiscal risks. New Zealand's 'Nationally Determined Contribution' is to reduce net greenhouse emissions by 50% below gross 2005 levels by 2030. This equates to an emissions budget for the target period (2021 to 2030) of 571Mt. To achieve this, New Zealand will need to pursue sizeable domestic <u>or offshore abatement</u> to mitigate emissions over 2021 to 2030. (pp. 55–56) [Continues overleaf]

Budget Economic and Fiscal Update 2024 (30 May 2024)	Half Year Economic and Fiscal Update 2023 (20 December 2023)	Pre-election Economic and Fiscal Update 2023 (12 September 2023)	Budget Economic and Fiscal Update 2023 (18 May 2023)
[Note: no text similar to the text in previous EFUs (see right) was found] [underline added]¹⁵¹	However, over the long term, the total cost of achieving emissions reduction targets and addressing the impacts of climate change will be significant and is likely to exceed provisions made in the forecasts. (p. 51) [underline added]¹⁵²	Over the longer term, the actual cost of achieving emissions reduction targets and addressing risks from climate change will likely exceed the overall size of the fund. Given the uncertainty around these costs, and their likely timing, these are reported in the Specific Fiscal Risks section. (p. 67) [underline added]¹⁵³	Over the longer term, the actual cost of achieving domestic and international emissions reduction targets and addressing risks from climate change will likely exceed current provisions. Given the uncertainty around these costs, and their likely timing, these are reported in the Specific Fiscal Risks section. (p. 63) [underline added]¹⁵⁴

Half Year Economic and Fiscal Update 2022 (14 December 2022)	Budget Economic and Fiscal Update 2022 (19 May 2022)	Half Year Economic and Fiscal Update 2021 (15 December 2021)
Over the longer term, the actual cost of achieving emissions reduction targets and addressing risks from climate change will likely be in excess of the \$7.4 billion overall size of the fund. Given the uncertainty around these costs and their likely timing, these are reported as specific fiscal risks to the forecasts. (p. 61) [underline added] ¹⁵⁵	Over the longer term, mitigation costs to achieve international and domestic targets are likely to be significantly higher than the amount that has currently been allocated to the CERF, but are not yet sufficiently certain for particular years to be included in the fiscal forecasts. (p. 63) [underline added] ¹⁵⁶	Climate change poses significant challenges to New Zealand's wellbeing and to the Government's fiscal position and operations. These risks appear in two domains: • Mitigation (Reducing emissions) Mitigation represents New Zealand's contribution to the global effort to reduce emissions and prevent warming. This involves reducing emissions domestically as well as supporting overseas emissions reductions. • Adaptation (Responding to the physical impacts of climate change) Adaptation is about taking steps within New Zealand to respond to challenges presented by the physical effects of climate change, such as more frequent and severe weather events. (p. 55) [underline added] ¹⁵⁷

Appendix 5: Comparison between the 2024 IFRIC Decision and New Zealand's Paris Agreement commitment and actions

Table A5.1: Comparison between the 2024 IFRIC Decision and New Zealand's Paris Agreement commitment and actions

IFRIC Decision (April 2024)			
	20X0	20X0–20X8	20X9 +
IFRIC fact pattern	Entity's commitment Entity publicly states its commitment to: - gradually reduce its annual greenhouse gas emissions, reducing them by at least 60% of their current level by 20X9; and - offset its remaining annual emissions in 20X9 and in subsequent years by buying carbon credits and retiring them from the carbon market.	Entity's actions To support its commitment, the entity: - publishes a transition plan setting out how it will gradually modify its manufacturing methods between 20X1 and 20X9 to achieve the 60% reduction in its annual emissions by 20X9; and - takes several other actions that publicly affirm its intention to fulfil its commitments.	Entity emits greenhouse gases Entity emits greenhouse gases that it has committed to offset in 20X9 and in subsequent years.
Recognise constructive obligation?	No No constructive obligation is recognised	No No constructive obligation is recognised	Yes Recognise a constructive obligation
Reasons	Entity does not recognise a provision in 20X0 when it makes the statement: - At that time, there is no constructive obligation or a present obligation as no action has been taken by the entity in relation to its statement and the greenhouse gases which it has committed to offset have not been emitted. - Neither stating a commitment nor taking actions that affirm the entity's intention to fulfil that commitment are events that create a present obligation. - The events that create a present obligation are the events to which the statement applies and those events have not occurred at the time the entity states its commitment. The costs that the entity will incur to reduce its annual greenhouse gas emissions and to offset the greenhouse gases it emits in 20X9 and in subsequent years are costs that it will need to incur to operate in the future – the obligations for those costs do not exist independently of the entity's future actions. - The entity does not recognise a provision when it makes the statement in 20X0. At that time, the constructive obligation is not a present obligation as a result of a past event.	Entity does not recognise a provision between 20X0 and 20X8: - During the period, the entity takes actions that create a valid expectation but it does not have a present obligation as the greenhouse gases which it has committed to offset have not been emitted. - The entity does not recognise a provision between 20X0 and 20X9 because it does not have a present obligation as a result of a past event until it has emitted the greenhouse gases it has committed to offset.	The 'past event' is triggered in 20X9 when the entity begins to emit greenhouse gases it has committed to offset - It has a present obligation to offset those emissions annually. - It recognises, at the end of 20X9, a provision for the greenhouse gases it emitted in 20X9 (and at the end of each subsequent year that it emits greenhouse gases) if it has not yet settled them and a reliable estimate can be made of the amount of the obligation. - As the entity emits greenhouse gases in 20X9 and in subsequent years, it will incur a present obligation to offset these past emissions. If the entity has not yet settled that obligation and a reliable estimate can be made of the amount of the obligation, the entity recognises a provision.

New Zealand NDC1 commitment under the Paris Agreement			
	2015–2016	2016–2020 and beyond	2021 +
New Zealand's 'fact pattern'	New Zealand Government's commitment - Government signs Paris Agreement in October 2016. - Paris Agreement comes into force in November 2016 and takes effect in 2020. - Government submits its first NDC (NDC1) under the Paris Agreement for the 2021–2030 period in October 2015 (this is later updated in October 2021). - Government commits, through NDC1, to use offshore carbon credits to offset those emissions that are not offset by domestic means in each year between 2021 and 2030. - The commitment is reflected in all public consultation, economic modelling, Cabinet papers, and New Zealand's formal communication to the UN.	New Zealand Government's actions/events Government publicly announces and consults on its plan for domestic emission reductions and proceeds to implement this plan through, for example: - passing legislation to put in place the necessary legal frameworks through the Zero Carbon Act (2019) and the Climate Change Response (Emissions Trading Reform) Amendment Act (2020); - setting up an independent advisory Climate Change Commission (2019); and - revising the NDC target level and its structure (October 2021) to a target pathway from 2020 net emissions to the 2030 target point with all emissions across the 2021–30 period managed as an emissions budget (i.e. every year's emissions count, not just emissions in 2030). Since then, the Government has also: - consulted on and set binding emissions budgets for 2022 to 2035 (2022); - consulted on and published the first sector-by-sector Emissions Reduction Plan (2022); - implemented emissions-reducing policies in specific sectors and taken steps to strengthen the emissions trading scheme; and - repeatedly and consistently recommitted to the NDC since 2016 by: - amending domestic climate legislation to include reference to the NDC, including Paris Agreement implementation in trade agreements (for example with the EU); and - setting legally binding budgets for domestic emissions under the Climate Change Response Act (May 2022), thereby clarifying the quantity of offshore credits needed to meet the more ambitious NDC.	New Zealand emits greenhouse gases - Paris Agreement takes effect. - The NDC1 period commences. - New Zealand emits greenhouse gases that it has committed to offset under NDC1.

New Zealand NDC1 commitment under the Paris Agreement			
	2015–2016	2016–2020 and beyond	2021 +
Recognise constructive obligation?	No No constructive obligation is recognised	No No constructive obligation is recognised	Yes Recognise a constructive obligation
Reasons	No provision should be recognised when the commitment was made in 2016: - at that time, there is no constructive obligation or a present obligation as no substantive action had been taken by the Government in relation to its statement; - the NDC1 period has not commenced.	No provision should be recognised between 2016 and 2020: - the NDC1 period has not commenced; - during the period, the Government takes various actions that create a valid expectation that it would meet the NDC1 commitments but it does not have a present obligation as the greenhouse gases which it has committed to offset under NDC1 have not been emitted.	The ‘past event’ is triggered from 1 January 2021 (and in subsequent years) for the greenhouse gases that it has committed to offset in the NDC1 emissions budget: - The Paris Agreement takes effect and the NDC1 period commences; - Government has a present obligation at the end of each year from 2021 to offset those emissions over and above the levels committed to in the NDC1 emissions budget by recognising a provision for the greenhouse gases emitted in 2021 (and at the end of each subsequent year that passes); - From 1 January 2021 (the beginning of the NDC period) excess emissions have occurred in each year above the levels committed to in NDC1 emissions budget that needs to be offset; Emissions having occurred leads to a present obligation to offset those past excess emissions by: - recognising a constructive obligation at the end of each year that New Zealand emits greenhouse gases over and above the amount committed to in the emissions budget for that year; and - disclosing, as a contingent liability, at the end of each year the future greenhouse gases that New Zealand has budgeted to emit under the NDC1 over and above the amount committed to in the emissions budget for the remaining years to 2030. To meet both the domestic and international targets New Zealand must: - hold domestic emissions to the legislated budgets under the Climate Change Response Act; and - offset emissions across the 2021–2030 period that are above the NDC1 emissions budget with offshore mitigation. There would be reputational impacts, such as trade, and financial consequences for failure to follow through.

Appendix 6: 2024 Treasury Opinion: The accounting treatment of New Zealand’s Nationally Determined Contribution under the Paris Agreement (2024)

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TE TAI ŌHANGA
THE TREASURY

Treasury Report:

The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement

Date:	20 February 2024	Report No:	T2024/263
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Nicola Willis Minister of Finance	Refer this report to the Minister of Climate Change	None

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Callum Lo	Analyst, Climate Change	s9(2)(k)	N/A (mob) ✓
Nicky Lynch	Manager, Climate Change	s9(2)(g)(ii)	

Minister’s Office actions (if required)

Return the signed report to Treasury.

Refer a copy of this report to the Minister of Climate Change.

Note any feedback on the quality of the report

Enclosure:

No

DISCUSSION PAPER 2024/01 | MCGUINNESS INSTITUTE

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IN-CONFIDENCE**Treasury Report: The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement**

Executive Summary

The Treasury does not currently treat New Zealand's commitment under the Paris Agreement as a liability

New Zealand's first Nationally Determined Contribution (NDC1) under the Paris Agreement commits to keeping total net emissions over the period 2021 - 2030 below 571 megatonnes of carbon dioxide (or equivalent gases). Meeting NDC1 will almost certainly require supporting offshore mitigation, in addition to achieving domestic emissions budgets.

The Crown's accounts are prepared in accordance with generally accepted accounting practice (GAAP). Under GAAP, a liability is "a present obligation of an entity to transfer an economic resource because of past events." A "present obligation" can be either legal or 'constructive'. In our view:

- **NDC1 does not create a legal obligation:** Parties to the Paris Agreement are not legally obliged to achieve their NDCs, as set out in paragraph 10.
- **NDC1 does not create a 'constructive obligation':** A constructive obligation only exists if the Government's actions and statements are specific enough that it has little or no realistic alternative to meeting its commitment. In our judgement, the Government has not made sufficiently specific statements and actions to meet this test.

Even if an obligation existed, NDC1 does not meet the additional criteria for a "liability" (future economic sacrifice must be probable and reliably measurable).

Future government actions, policies and announcements could change NDC1's accounting treatment

Announcing or committing to specific plans to achieve NDC1 could cause the criteria above to be met. If this occurred, a liability would likely accrue gradually over time as emissions are produced in excess of the volume allowed under NDC1. Each incremental increase in the liability would also produce a corresponding expense, and a negative OBEGAL impact.

The exact threshold where government actions would create a liability is not precisely defined. It will depend on the overall judgement of the Treasury as to whether the criteria above are met, drawing on all relevant circumstances.

Offshore mitigation purchases could soon meet the tests for inclusion in fiscal forecasts

The Treasury's forecast period currently extends into 2028. Moving forward, the end of this forecast period will approach the end of the NDC1 period (2030). This means that we will need to consider whether the tests for inclusion in the forecasts are met, because the forecast period will increasingly cover the period when purchases could be made. As a result, future offshore mitigation purchases could soon meet the tests for inclusion in the fiscal forecasts. This would occur irrespective of whether NDC1 is treated as a liability.

Whether future offshore mitigation purchases qualify for inclusion in fiscal forecasts depends on the Treasury's judgement of whether they are sufficiently probable and sufficiently quantifiable. In making this judgement, the Treasury will consider all the actions the Government has taken towards its offshore mitigation strategy.

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We will monitor developments in this area closely and will advise you ahead of any Cabinet decisions with accounting implications. In the meantime, we have taken a number of steps to provide public transparency over these costs, including through the publication of cost scenarios in the Climate Economic and Fiscal Assessment, inclusion in the fiscal risks chapter of Economic and Fiscal updates, and the addition of a note in the Financial Statements of Government explaining the current treatment.

Recommended Action

We recommend that you:

- a **Note** the contents of this report.
- b **Refer** a copy of this report to the Minister of Climate Change.

Refer / not referred.

Nicky Lynch
Manager, Climate Change

Hon Nicola Willis
Minister of Finance

_____/_____/_____

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Treasury Report: The accounting treatment of New Zealand's Nationally Determined Contribution under the Paris Agreement

Purpose

1. At your recent bilateral on climate change priorities with the Minister of Climate Change, you discussed the accounting treatment of New Zealand's Paris Agreement commitment. We undertook to supply follow up advice on this matter, which this report now provides. It is for information only; no decisions or actions are required from you.
2. This report explains:
 - the Treasury's current accounting treatment of New Zealand's commitment under the Paris Agreement (including offshore mitigation purchases),
 - which events could change this accounting treatment in future, and
 - how future offshore mitigation may be treated in upcoming fiscal forecasts.

Background

3. New Zealand's first Nationally Determined Contribution (NDC1) under the Paris Agreement commits to keeping total net emissions over the period 2021 - 2030 below 571 megatonnes of carbon dioxide (or equivalent gases).
4. The ambition of NDC1 is considerably higher than the ambition of domestic emissions budgets over the same period. Meeting NDC1 will therefore almost certainly require a combination of domestic and offshore mitigation. Offshore mitigation can be accessed in a number of ways: for example, through direct investment in projects internationally, linking of Emissions Trading Schemes or purchasing of units in international markets. In any case, for offshore mitigation to be able to count towards the NDC, it must meet eligibility criteria under the Paris Agreement for Internationally Transferrable Mitigation Outcomes (ITMOs).
5. In 2023, the Treasury and the Ministry for the Environment's "Climate Economic and Fiscal Assessment" (CEFA) provided a range of scenarios for the fiscal costs of offshore mitigation. These costs varied between \$3.3 billion to \$23.7 billion, depending on the price achieved and the volume required.¹
6. The Treasury does not currently treat NDC1 as a liability in the Crown's financial statements, a position that has attracted public interest and debate.
7. We closely monitor developments in both the application of the relevant accounting standards, and public debate. Recent developments include:
 - In November 2023, the International Financial Reporting Interpretations Committee (IFRIC) released a tentative decision on the accounting treatment of

¹ The Treasury and the Ministry for the Environment: Ngā Kōrero Āhuarangi Me Te Ōhanga Climate Economic and Fiscal Assessment 2023, p 86.

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commitments to reduce or offset greenhouse gas emissions. This decision, and its ramifications for New Zealand, are explored in Annex One.

- In February 2024, the McGuinness Institute published a discussion paper recommending that past commitments to purchase offshore carbon credits be recognised as a liability, and future commitments as a contingent liability.² The arguments in the discussion paper are analysed in this report.

How the costs of NDC1 are currently treated in financial reporting

8. The Treasury produces several financial reporting publications, each with a specific purpose and scope. Table 1 below outlines how NDC1 is currently treated in these products. The information provided has evolved in recent years giving greater transparency to the fiscal implications of climate change, including through:
- publication of the first Climate Economic and Fiscal Assessment,
 - elaboration in the Specific Fiscal Risks,
 - explaining accounting treatment in the Notes to the Financial Statements.

Table 1: The treatment of NDC1 in Treasury publications

Publication	Purpose of publication	Treatment of NDC1
Estimates of Appropriations	Provides a picture of each Vote and appropriation for Parliament.	No appropriations for offshore mitigation purchases exist yet, so NDC1 does not feature in the Estimates. However, departments have received some funding for policy work on offshore mitigation, which sits within general departmental appropriations.
Fiscal forecasts (within Economic and Fiscal Updates)	Provides an outlook of the Government's financial performance and financial position.	Potential future offshore mitigation purchases towards NDC1 are not yet included in the fiscal forecasts. This is because the Treasury has not yet been satisfied that offshore mitigation purchases are: ◦ more likely than not during the forecast period, and ◦ quantifiable. However, the potential fiscal costs of meeting NDC1 are described qualitatively in a "Specific Fiscal Risk".
Financial Statements of Government	Provides a record of the Government's financial performance and financial position.	NDC1 is not currently recognised in the Financial Statements of Government as a liability. However, the Notes to the Financial Statements include a description of the NDC1 commitment and an explanation of its accounting treatment.

² The McGuinness Institute: Risks hiding in plain sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?
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Climate Economic and Fiscal Assessment	Provides information on the economic and fiscal impacts of climate change on New Zealand.	The Climate Economic and Fiscal Assessment (CEFA) was published by the Treasury and the Ministry for the Environment in 2023. It provided illustrative estimates of the costs of offshore mitigation required to meet NDC1, to provide additional transparency. Annex Two provides a summary of the offshore mitigation scenarios presented in the CEFA.
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NDC1 does not currently meet the definition of a “liability”

9. A liability is defined in GAAP as “a present obligation of an entity to transfer an economic resource because of past events.”

NDC1 does not create a “present obligation”

10. A “present obligation” can be either:³
- **a legal obligation:**
an obligation deriving from a contract, legislation, or other operation of law.
 - **a ‘constructive’ obligation:**
an obligation deriving from an entity’s actions where:
 - through past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
 - the entity has therefore created a valid expectation that it will discharge those responsibilities, such that it has little or no realistic alternative to avoid settling the obligation.
11. Our view is that there is no legal or constructive obligation. Our application of the relevant tests to NDC1 is summarised in Table 2 below.

Table 2: Tests for the existence of a present obligation

Test	Application to NDC1
Is there a legal obligation?	<u>No legal obligation</u> because: Parties do not have an obligation to achieve their NDCs under the Paris Agreement. The Paris Agreement requires a party to “prepare, communicate and maintain successive nationally determined contributions that it intends to achieve.” The obligations relate to conduct and intention rather than outcome. Therefore there is no other party to whom the obligation is currently owed, that can enforce the obligation.

³ External Reporting Board: Public Benefit Entities’ Conceptual Framework, paragraphs 5.15 – 5.23. Source: <https://www.xrb.govt.nz/dmsdocument/1825#page=31>

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Is there a constructive obligation?	No constructive obligation because: The Government has not indicated a responsibility to other parties to achieve NDC1 by a sufficiently specific statement (so that there is a valid expectation of a present obligation that the Government has little discretion to avoid). As an example of the specificity required: A constructive obligation was created when the Government announced it would voluntarily purchase insured residential property in the red zones of Christchurch. This committed to an economic sacrifice to specific parties that was not adjustable at the discretion of the Government. In our view, this level of specificity does not exist for NDC1 because: • The Government has not announced a specific approach to achieving NDC1. This means the Government can modify its approach. For instance, it can adjust the timing, nature, or magnitude of the costs incurred by selecting different policy options. Inherently, a commitment is not an "obligation" if it can be adjusted at the discretion of the entity which made it. • The Government has realistic alternatives to settling NDC1 through a transfer of resources. Because it has not announced specific plans, the Government has realistic alternatives to sacrificing its own resources to settle the NDC1 obligation. For instance, it could pass the costs of achieving NDC1 on to private entities. Not entirely achieving NDC1 also remains a possible outcome, even if this is not the government's intention, though this would carry reputational risk. • No counterparties exist. A constructive obligation requires clearly identified parties to whom obligations are owed. This is not the case with NDC1. For instance, the Government has not confirmed which entities it will procure offshore mitigation from. In our view, the general public is not a counterparty.
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The McGuinness Institute argues that the Government's past actions, taken collectively, generate a constructive obligation

12. A recent discussion paper by the McGuinness Institute argues that the Government indicated it would accept certain responsibilities and thus created a constructive obligation through its past actions, including:
- ratifying the Paris Agreement,
 - publishing emissions budgets,
 - publishing the first Emissions Reduction Plan,
 - reforming the Emissions Trading Scheme,
 - agreeing in-principle to an NDC Strategy in July 2023, and
 - signing a Free Trade Agreement with the European Union which includes a commitment to implement the Paris Agreement.⁴

⁴ The EU FTA states that: "each Party shall effectively implement the UNFCCC and the Paris Agreement, including commitments with regard to nationally determined contributions".

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13. The paper argues:

"These indicate an established pattern of past practice and published policies. These well-publicised actions and events collectively were sufficient for the New Zealand Government to indicate to the New Zealand public that it would accept certain responsibilities, and created a 'valid expectation' by the New Zealand public that the New Zealand Government will discharge its responsibilities under the Paris Agreement."

14. Our view is that these actions are not specific enough to produce a constructive obligation, for the reasons noted above. The approach remains adjustable, there are alternatives to settling the commitment through transfer of the Crown's resources, and no counterparty exists to whom an obligation is owed. The Government has not published plans specific enough to remove its discretion to pass the costs of meeting NDC1 onto private entities. Passing on some or all of these costs remains a realistic option for the Government, meaning it has not created an obligation with "little or no realistic alternative but to settle".

Even if an obligation existed, NDC1 would not meet the criteria for reporting a liability

15. Once the existence of a present obligation has been established, a liability will only be reported if:
- a future economic sacrifice is probable, and
 - the amount of the obligation can be reliably measured.
16. Table 3 summarises the relevant tests and our application of those tests to NDC1.

Table 3: Tests for the recognition of a liability

Test	Application to NDC1
Is it probable that an outflow of resources will be required to settle the obligation?	<u>No probable outflow of resources</u> because: The Paris Agreement does not require NDCs to be "settled" in any way if they are not met. Where the Crown intends to meet NDC1 through domestic and offshore abatement, it has discretion to pass these costs onto the private sector.
Can a reliable estimate be made of the amount of the obligation that cannot practically be avoided?	<u>No reliable estimate can be made</u> because: There is uncertainty over future emissions reduction policies (both domestic emissions reduction policies and offshore mitigation purchases) and their cost-effectiveness. The Crown can shift the costs of meeting NDC1 onto the private sector, creating uncertainty over fiscal costs.

17. Our conclusion that no liability exists has been discussed with the Office of the Auditor General in the course of preparing previous Financial Statements of Government. OAG's current position is that "recognising a liability for the Government's emissions reductions targets at this point in time is a reasonable interpretation of the financial reporting standards and that the disclosures are appropriate".

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18. However, given that the landscape of climate litigation continues to evolve, we will continue to closely monitor the matter for developments that could cause this judgement to change.
19. We are not aware of any party to the Paris Agreement reporting their NDC on their government balance sheet. Australian and UK government officials have confirmed this understanding.

Government choices could change this accounting treatment in future

20. Future government actions, policies and announcements could cause the criteria above to be met, thereby changing NDC1's accounting treatment.
21. If these criteria were met in future, the resulting recognition of a liability would produce a corresponding expense, and a negative OBEGAL impact. However, these impacts would likely occur gradually, accruing as New Zealand produces emissions in excess of the allowed volume under NDC1. This accounting treatment is due to recent developments in the interpretation of accounting standards, explored further in Annex One.
22. Box 1 below provides one example of a step towards offshore mitigation purchases that might affect the accounting treatment of NDC1.

Box 1: Example of a Government action affecting the accounting treatment of NDC1

The Government publishes a detailed formal strategy for pursuing offshore mitigation purchases towards NDC1, identifying:

- the types and approximate number of entities who will benefit from offshore mitigation purchases
- the amount of payments that will be made can be measured reliably
- when the payments will be made.

Such a publication could generate a constructive obligation and, depending on the exact circumstances, could lead to a liability being recognised. The timing of that recognition would depend on when all the relevant tests were judged to have been met.

23. Whether an action, policy or announcement causes the above "liability" criteria to be met is a matter of judgement, relying on all relevant circumstances. The cumulative impact of several actions could lead to the recognition of a liability where no single action would be sufficient on its own.
24. Therefore, it is difficult to determine precisely which Government actions would lead to the recognition of a liability ahead of time.
25. However, the following principles provide a general guide. Actions, policies and announcements are more likely to contribute to the recognition of a liability if they:
 - are highly specific about how NDC1 will be achieved,
 - have costs that can be reliably measured,

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- have funding allocated to them,
 - cannot reasonably be altered in future,
 - make a commitment to identified parties, or
 - are made publicly, with little discretion to avoid.
26. We will provide advice to you ahead of any Government decisions that would materially affect the accounting treatment of climate targets.

Offshore mitigation purchases could soon meet the tests for inclusion in the forecasts

27. As discussed, NDC1 does not currently meet the criteria for a “liability”. However, if the Government is to achieve the NDC1 target through future offshore mitigation purchases, significant costs will be incurred in the future. These costs will need to be considered for inclusion in fiscal forecasts, published at each Economic and Fiscal Update.
28. Items are included in fiscal forecasts where they are:
- more likely than not to occur,
 - quantifiable, and
 - likely to have a fiscal impact within the forecast period (the current fiscal year plus the following four fiscal years).
29. The Treasury’s forecast period currently extends into 2028. Moving forward, the end of this forecast period will approach the end of the NDC1 period (which ends in 2030). This means that we will need to consider whether the tests for inclusion in the forecasts are met, because the forecast period will increasingly cover the period when purchases could be made. As a result, future offshore mitigation purchases could soon meet the tests for inclusion in the fiscal forecasts. This would occur irrespective of whether NDC1 is treated as a liability.
30. Factors that will influence our judgement on whether offshore mitigation purchases are quantifiable and likely to occur within the forecast period include:
- any announcements the Government makes on its offshore mitigation strategy
 - whether the Government funds any Budget bids towards offshore mitigation
 - whether the Government enters into any agreements with overseas parties to procure offshore mitigation.
31. We would be unlikely to include offshore mitigation in fiscal forecasts prior to Cabinet decisions on an offshore mitigation strategy and indicative costings being available.

Including offshore mitigation in fiscal forecasts could make it more likely that NDC1 will be considered a liability in future

32. Publishing fiscal forecasts which include future offshore mitigation purchases could contribute to a “reasonable expectation” that the Government will make these

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purchases. This could therefore influence whether NDC1 is considered a constructive obligation, and thus a liability.

33. However, this factor alone will not be sufficient to generate a liability for the Crown. It represents one of many factors which, taken together, will inform the judgement of whether the relevant tests have been met.

Offshore mitigation purchases could be classified in several different ways

34. Regardless of whether NDC1 overall is recorded as a liability, offshore mitigation purchases will be included in:
- fiscal forecasts (when future purchases are sufficiently certain and quantifiable, as discussed above), and
 - the Government's financial statements (when purchases are actually made).
35. The accounting treatment of offshore mitigation in these publications is not yet settled, and purchases could be classified in several different ways. For instance, offshore mitigation purchases could be classified as an expense, the purchase of an asset, or (if a liability has been recorded by that stage) a decrease in the NDC1 liability.
36. One important factor is whether New Zealand can onsell offshore mitigation that it has purchased. The Paris Agreement allows for onselling, but individual purchase agreements could contain their own restrictions. However, we understand from the Ministry for the Environment that none of our negotiating partners are currently requesting this, so it is likely that units will be able to be onsold.
37. Table 4 below considers several possible accounting classifications for offshore mitigation purchases. It also explores the potential impact of onselling restrictions, and the impact of whether or not NDC1 is treated a liability (this analysis is illustrative only).

Table 4: Possible accounting classifications for offshore mitigation purchases

Conditions	Offshore mitigation classification	Explanation
The purchase agreement prohibits onselling. NDC1 has been recognised as a liability.	Decrease in the NDC1 liability (revenue- and expense-neutral)	Because a liability and an expense (and consequently the impact on OBEGAL) had already been recognised, the purchase of offshore mitigation causes that liability to decrease (as it contributes towards settling the NDC1 obligation). Cash also decreases, meaning the event is revenue- and expense-neutral. OBEGAL is unaffected.
The purchase agreement prohibits onselling. No NDC1 liability has been recognised.	Operational expenses	Because onselling of the offshore mitigation is prohibited, the purchase cannot be treated as an asset. The means it is treated as an operational expense. OBEGAL is negatively affected.
The purchase agreement allows onselling.	Asset purchases	Since the offshore mitigation can be onsold, it will be classified as an "asset" for the Crown

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	(capital expenditure)	until it is "cancelled" to count it towards our NDC1 commitment. This would be the case regardless of whether an NDC1 liability had been recognised at that point or not. Because revenue and operating expenses are unchanged, OBEGAL is unaffected by the purchase of the offshore mitigation. Rather OBEGAL is impacted when the offshore mitigation units are required to be cancelled.
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Next steps

38. We will continue monitoring developments in this area, and will advise you ahead of any Cabinet decisions that have accounting implications.

IN-CONFIDENCE**Annex One: Recent developments from the International Financial Reporting Interpretations Committee*****The International Financial Reporting Interpretations Committee has recently released a draft decision on the treatment of climate commitments***

The International Financial Reporting Interpretations Committee (IFRIC) is a body that seeks to maintain and support the consistent application of IFRS Accounting Standards, by responding to questions about their application. Because of its authoritative nature, IFRIC decisions impact on accounting treatments globally.

IFRIC is currently in the process of responding to a question about a zero carbon commitment by a private manufacturing company. It recently released a draft decision, stating that:

- Whether a constructive obligation exists will depend on the facts and circumstances of the case.
- If a constructive obligation exists, a present obligation is not triggered when an entity publicly states its commitment to a climate change target.
- Instead, it is triggered when the entity emits in excess of the volume that its commitment allows. This only applies if:
 - the other criteria for a constructive obligation have also been met, and
 - the entity has committed to offset that excess.
- At that point, the entity has a present obligation to retire the carbon credits required to offset those emissions.

IFRIC's draft decision was based on a hypothetical involving a private company. However, it will likely be analogised to the public sector and therefore apply to the Government.

The decision will not immediately impact the accounting treatment of NDC1

As explained in this report, our judgement is that the constructive obligation test has not currently been met for NDC1. This means that, under current circumstances, no liability will accrue even once New Zealand begins emitting in excess of its allowed volume under NDC1.

However, this would change if or when the conditions for a constructive obligation were met in future. In those circumstances, the IFRIC decision would mean that an expense and a liability would accrue as emissions are emitted in excess of the allowed volume under NDC1.

IN-CONFIDENCE**Annex Two: The Climate Economic and Fiscal Assessment 2023**

The Treasury published the “Climate Economic and Fiscal Assessment” (CEFA) in 2023, which provides illustrative estimates of the fiscal cost of offshore mitigation purchases required to achieve NDC1.⁵ The CEFA's illustrative estimates are calculated by multiplying the required purchase volume by an assumed purchase price in each year.

Volume scenarios

The volume of required offshore mitigation purchases to achieve NDC1 will be the difference between New Zealand's domestic net emissions and its allowed emissions under NDC1.

The CEFA considers three volume scenarios based on potential pathways for domestic emissions:

Volume scenario	Source
1. Emissions under current policies	MfE's baseline projection under current policies for domestic emissions
2. Meeting domestic emissions budgets	New Zealand's three published emissions budgets
3. 'Lower-emission' projection under current policies	MfE's 'lower-emission' projection under current policies

Price scenarios

Future prices for offshore mitigation are uncertain because these opportunities are still being developed, with many international carbon markets still relatively immature. Prices will also vary across different types of mitigation sources and locations.

The CEFA analysis considered three different per-tonne purchase price scenarios:

Price scenario	Source
1. Purchase price from emerging and developing economies	International Energy Agency's (IEA's) 2022 World Energy Outlook (assumes a scenario of high global climate ambition)
2. Average of current market prices	Current market price for four selected offshore Emissions Trading Schemes
3. Purchase price from advanced economies	International Energy Agency's (IEA's) 2022 World Energy Outlook (assumes a scenario of high global climate ambition)

⁵ The Treasury and the Ministry for the Environment; Ngā Kōrero Āhuarangi Me Te Ōhanga Climate Economic and Fiscal Assessment 2023, p 86.

Endnotes

Please note the Institute is finalising dates and citations for Cabinet papers and will update these on receipt of our OIA requests.

- 1 See New Zealand Submission to the ADP New Zealand's Intended Nationally Determined Contribution. (7 July 2015). Retrieved 20 December 2023 from www4.unfccc.int/sites/submissions/INDC/Published%20Documents/New%20Zealand/1/New%20Zealand%20INDC%202015.pdf
- 2 See Ministry for the Environment and The Treasury. (2 July 2021). *Funding and Financing the Transition*. Retrieved 25 May 2023 from www.treasury.govt.nz/sites/default/files/2024-02/oia-20230564.pdf

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Wendy McGuinness is the founder and Chief Executive of the McGuinness Institute, which she established in 2004 as a way of contributing to New Zealand's long-term future. Originally from the King Country, Wendy went on to study at Manukau Technical Institute (gaining an NZCC), University of Auckland (BCom), University of Otago (MBA), Massey University (completing a range of environmental papers), Harvard University (completing the Executive Programme on Driving Corporate Performance), and London School of Economics (completing two short courses in Behavioural Economics and Macroeconomics). In 1988 she wrote a report for the New Zealand Treasury titled *Implementation of accrual accounting for government departments*. In 2009 she received a fellowship from the NZICA, becoming a Fellow Chartered Accountant.

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