

IFRS® Interpretations Committee meeting

Project	Negative Low Emission Vehicle Credits (IAS 37)	
Paper topic	Comments on tentative agenda decision	
CONTACTS	Syamsul Hidayah	shidayah@ifrs.org
	Joan Brown	jbrown@ifrs.org

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Introduction

1. In February 2022, the IFRS Interpretations Committee (Committee) published a [tentative agenda decision](#) in response to a submission about *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*. The submission asked whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37.
2. In the fact pattern described in the submission:
 - (a) government measures apply to entities that produce or import passenger vehicles for sale in a specified market. Under the measures, entities receive positive credits if in a calendar year they have produced or imported vehicles whose average fuel emissions are lower than a target set by the government, and negative credits if in that year they have produced or imported vehicles whose average fuel emissions are higher than the target.
 - (b) the measures require an entity that receives negative credits for one year to eliminate those negative credits, either by purchasing positive credits from another entity or by generating positive credits itself in the following year (by producing or importing more low emission vehicles) and using those positive credits to eliminate the negative balance. If the entity fails to eliminate its

negative credits in one or other of those two ways, the government can impose sanctions on the entity, for example restrict the entity's access to the market.

3. The submission considered the position of an entity that has produced or imported vehicles with average fuel emissions higher than the government target, and asked whether such an entity has a present obligation that meets the definition of a liability in IAS 37.
4. The Committee observed that:
 - (a) the activity that may give rise to an obligation to eliminate negative credits is the production or import of vehicles. To the extent that an entity has produced or imported vehicles with average fuel emissions higher than the government target by the end of the reporting period, that obligation has arisen from past events.
 - (b) the measures that create the obligation and give the government the authority to impose sanctions derive from an operation of law. Hence, the obligation is a legal obligation and the sanctions are the means by which settlement can be enforced by law. The requirement that 'settlement of the obligation can be enforced by law' is met, unless accepting sanctions for non-settlement is a realistic alternative for an entity.
 - (c) an entity can settle its obligation either by purchasing positive credits from another entity or by generating positive credits itself in the next year and using those positive credits to eliminate the negative balance. In either case, settlement involves an outflow from the entity of resources embodying economic benefits. In the first case, the resource is cash; in the second case, the resources are the positive credits the entity will receive for the next year and surrender to eliminate its current negative balance.
 - (d) the obligation arises from past events and exists independently of the entity's future actions. Under the measures, the only action required to create an obligation is the production or import of vehicles with average fuel emissions higher than the government target, and this action has already occurred. The entity's future actions will determine only the means by which the entity settles its present obligation—whether it purchases credits from another entity

or generates positive credits itself by producing or importing more low emission vehicles.

5. The Committee therefore concluded that an entity that has produced or imported vehicles with average fuel emissions higher than the government target has a legal obligation that meets the definition of a liability in IAS 37, unless accepting sanctions is a realistic alternative to eliminating negative credits for that entity.
6. The Committee also considered the position of an entity that:
 - (a) has produced or imported vehicles with average fuel emissions higher than the government target; but
 - (b) does not have a *legal* obligation that meets the definition of a liability in IAS 37, because accepting sanctions is a realistic alternative for that entity, meaning the obligation cannot be enforced by law.
7. The Committee concluded that such an entity nevertheless could have a constructive obligation that meets the definition of a liability in IAS 37. The entity would have such an obligation if it has taken an action (for example, made a sufficiently specific current statement) that has created valid expectations in other parties that it will eliminate its negative credits generated from its past production or import activities.
8. Based on its analysis, the Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine whether, in the fact pattern described in the submission, an entity has an obligation that meets the definition of a liability in IAS 37. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan.
9. The objective of this paper is to:
 - (a) analyse comments on the tentative agenda decision (paragraphs 11–75 and Appendix A); and
 - (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision (paragraph 76).
10. Appendix B to this paper sets out the proposed wording of the agenda decision.

Comment letter summary

11. We received 21 comment letters by the comment letter deadline. All comment letters received are available on our [website](#)¹. This agenda paper includes an analysis of comment letters received by the comment letter deadline, which are reproduced in Agenda Paper 4A.
12. Most respondents agree (or do not disagree) with the Committee’s conclusions and tentative decision not to add a standard-setting project to the work plan.
13. However, some of those respondents comment on aspects of the analysis in the tentative agenda decision. Respondents say:
 - (a) the logic the Committee has applied in reaching its conclusions is (or might appear to be) inconsistent with that applied in other examples that interpret or illustrate the application of IAS 37, especially:
 - (i) IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment*;
 - (ii) IFRIC 21 *Levies*; and
 - (iii) two Illustrative Examples accompanying IAS 37—Example 6 (Legal requirement to fit smoke filters) and Example 11B (Refurbishment costs – legislative requirement);
 - (b) it is not sufficiently clear that accepting government sanctions would be an alternative to settling a liability only if the sanctions do not themselves result in an outflow of resources embodying economic benefits;
 - (c) without a detailed analysis of a fact pattern in which a constructive obligation arises, the conclusions reached about the possible existence of a constructive obligation might be applied more broadly than intended—for example, to an entity’s environmental or social commitments—with a risk of misinterpretation;

¹ At the date of posting this agenda paper, there were no late comment letters.

- (d) it is unclear whether a liability to eliminate negative credits arises:
 - (i) only at the end of a calendar year (because an entity will receive negative credits only if its average fuel emissions for the year as a whole are above the government target), or
 - (ii) progressively during the year (by reference to the entity's cumulative production or import activities to date);
 - (e) more guidance is needed on the circumstances in which accepting government sanctions would be a realistic alternative to eliminating negative credits; and
 - (f) the analysis would be clearer if, instead of providing a conclusion for the fact pattern described, the agenda decision provide a framework for the assessments an entity would make—first to determine whether a legal obligation exists, and, if no legal obligation exists, secondly to determine whether a constructive obligation exists.
14. Two respondents—EY and the Capital Market Authority of Saudi Arabia—disagree with the Committee's conclusions and tentative decision not to add a standard-setting project to the work plan. In these respondents' view:
- (a) the generation of negative credits is insufficient to create a legally enforceable obligation—the government cannot force an entity to eliminate its negative credits; an entity could accept restrictions on its future activities or exit the market to avoid settling its obligation. So, at the reporting date, the requirement in paragraph 17(a) of IAS 37 that 'settlement of the obligation can be enforced by law' is not met. A requirement to settle an obligation by purchasing or generating positive credits will arise only if an entity decides to operate in the future in a manner that would otherwise be restricted by the sanctions imposed on the entity.
 - (b) the conclusions in the tentative agenda decision are inconsistent with other requirements in IFRIC 6, IFRIC 21 and IAS 37. They would therefore effectively amend IAS 37 and could lead to diversity in applying its requirements. If the Committee intends to amend IAS 37, the matter should be referred to the International Accounting Standards Board (IASB) to be addressed in a standard-setting project.

15. A third respondent—the Securities and Exchange Commission of Brazil—also disagrees with the Committee’s conclusions. It says the fact pattern described has insufficient information—in particular about the nature of the sanctions—to reach a conclusion on whether there is a legal or constructive obligation as defined in IAS 37. It suggests that, instead of providing a conclusion, the agenda decision provide guidance on the factors an entity would consider in reaching a conclusion.
16. One respondent—David Hardidge—states neither agreement nor disagreement with the Committee’s conclusions but says the agenda decision should not be published until several matters have been resolved. These matters are covered in the staff analysis below. They include the apparent inconsistency with IFRIC 21 (as described in paragraph 13(a)) and need for greater clarity about whether a liability arises at the end of a calendar year or progressively during the year (as described in paragraph 13(d)).

Staff analysis

17. We have separately analysed:
 - (a) comments on the technical analysis in the tentative agenda decision (paragraphs 18–65), specifically on;
 - (i) the consistency of the conclusions with those in IFRIC 6, IFRIC 21, and Illustrative Examples accompanying IAS 37 (paragraphs 18–27);
 - (ii) whether obligations to eliminate negative credits can be enforced by law (paragraphs 28–34);
 - (iii) the description of the government sanctions (paragraphs 35–39);
 - (iv) constructive obligations (paragraphs 40–45);
 - (v) whether a liability arises before the end of a calendar year (paragraphs 46–51);
 - (vi) guidance on the meaning of ‘no realistic alternative’ (paragraphs 52–58);
 - (vii) the outflows required to settle the obligation (paragraphs 59–61); and
 - (viii) structure of the analysis (paragraphs 62–65);

- (b) requests for additional guidance or a standard-setting project (paragraphs 66–74); and
- (c) other comments (paragraph 75).

The technical analysis in the tentative agenda decision

Consistency with IFRIC 6, IFRIC 21, and Illustrative Examples 6 and 11B

Respondents' comments

18. Respondents say the logic the Committee has applied in reaching its conclusions is (or might appear to be) inconsistent with that applied in other examples that interpret or illustrate the application of IAS 37, especially IFRIC 6, IFRIC 21 and Illustrative Examples 6 and 11B accompanying IAS 37.
19. A few respondents suggest that, if the logic applied in the tentative agenda decision is (or appears to be) different from that applied in other examples that interpret or illustrate the application of IAS 37, there is a risk that entities will account for economically equivalent fact patterns differently, depending on which examples an entity refers to for guidance. PwC includes within its comment letter a description of three fact patterns that it suggests illustrate this risk.
20. Respondents refer most frequently to IFRIC 21, some noting that in developing the consensus in IFRIC 21, the Committee explicitly rejected an argument that a liability to pay a levy could arise when an entity has no realistic alternative to taking the actions that will trigger payment of the levy. For example the ICAEW says:

We believe that as the government introduces additional incentives, levies and penalties with the intention of encouraging a low carbon economy, the accounting framework to be applied must be robust and clear in order to result in consistent application of the principles to different fact patterns. In this context, we have a concern that this tentative agenda decision for the fact pattern considered, potentially creates ambiguity as to when a liability might exist. In particular, it

appears to be a shift from the practice established by IFRIC 21 *Levies* for when a liability should be recognised. ...

As described in IFRIC 21, paragraph 8, the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation. Within the tentative agenda decision, the obligating event is described as the production or import of vehicles with average fuel emissions higher than the government target. However, this action does not necessarily trigger a payment (or outflow of resources), as identified by the legislation, because this outflow of resources can be avoided by accepting sanctions in the future. We observe that in applying IFRIC 21 an entity would not consider whether avoiding an outflow of resources by exiting a market is realistic.

... While we appreciate that IFRIC 21 covers a different fact pattern to that covered within the tentative agenda decision, we believe there are strong parallels between the two and the distinction is very delicate. Therefore the apparent tension between the 'trigger point' for recognising an obligation under IFRIC 21 and this tentative agenda decision causes us some concern that we believe needs addressing, if only through more precise use of language in the tentative agenda decision.

... In summary, while we do not necessarily disagree with the tentative conclusion we think the final agenda decision should more clearly identify the relevant differences between the fact pattern in question and similar IFRIC 21 fact patterns referred to above (as well as Illustrative Example 6 to IAS 37 'Legal requirement to fit smoke filters' and IFRIC 6, as referred to in the tentative agenda decision), and explain why these lead to different outcomes. We are concerned that as drafted the tentative agenda decision may create more confusion than clarity.

21. EY raises similar concerns regarding the consistency of the conclusions in the tentative agenda decision with those in Illustrative Example 11B accompanying IAS 37. EY says it is unclear why accepting the restriction on activities that could result from sanctions is different from selling an aircraft, because both are future decisions an entity could make. In both cases, an entity can avoid a legal obligation by changing its method of operation, so no obligation exists independently of the entity's future actions.

Staff analysis

22. To help the Committee decide how to respond to these concerns, Appendix A to this paper sets out a staff analysis reconciling the conclusions in the tentative agenda decision to the conclusions in other examples that interpret or illustrate the application of IAS 37.
23. The staff analysis in Appendix A focuses on the need to distinguish between actions that *create* an obligation and actions that *settle* the obligation. The analysis notes that the 'no realistic alternative' criterion in IAS 37 applies only to actions that settle the obligation—in other words, that criterion is a factor to consider in assessing the enforceability of an obligation, not the timing of its creation. The analysis applies this observation to explain why the 'no realistic alternative' criterion is considered in the tentative agenda decision (where there are questions about legal enforceability) but not in IFRIC 6 and IFRIC 21 (where legal enforceability is assumed). The analysis also demonstrates how the criterion applied in the tentative agenda decision to determine when an obligation is created is the same as the criterion applied in IFRIC 6 and IFRIC 21.
24. The staff also comment in Appendix A on the three fact patterns described by PwC in its comment letter. We use the analysis in Appendix A to help explain our view that, for each of the three fact patterns, the conclusions reached applying the logic in the tentative agenda decision would be the same as those reached in IFRIC 6, IFRIC 21 and the Illustrative Examples 6 and 11B accompanying IAS 37.

25. On the basis of the analysis in Appendix A, we think the conclusions in the tentative agenda decision are consistent with those in IFRIC 6, IFRIC 21 and Illustrative Examples 6 and 11B accompanying IAS 37, but that this consistency would be clearer if the agenda decision:
- (a) more clearly separates its analysis of when an obligation arises (which activities create an obligation) from its analysis of the enforceability of the obligation (whether the entity has a realistic alternative to settling the obligation); and
 - (b) uses the same wording as is used in IFRIC 6 and IFRIC 21 in the analysis of when an obligation arises.
26. Staff suggestions for redrafting the tentative agenda decision are reflected in the revised wording proposed in Appendix B.
27. If the Committee decides to finalise the agenda decision and agrees with the analysis in Appendix A, the staff could develop that analysis into educational material (for example, an article or webcast). We could place the educational material on the IFRS Foundation website to support the agenda decision.

Whether obligations to eliminate negative credits can be enforced by law

Respondents' comments

28. Two respondents who disagree with the Committee's conclusions and tentative agenda decision—EY and the Capital Market Authority of Saudi Arabia—say any legal obligations that arise under the measures do not meet the definition of a liability because the obligations are not legally enforceable. These respondents:
- (a) observe that paragraph 17(a) of IAS 37 states that for an entity to have a legal obligation, it is necessary that 'settlement of the obligation can be enforced by law'; and
 - (b) say the legal obligations that arise under the measures are not enforceable by law—an entity could avoid settling its obligation by accepting restrictions on its future operations or exiting the market.

29. For example, the Capital Market Authority of Saudi Arabia says:

It appears to us that the requirements of IAS 37 are abundantly clear in paragraph 17(a) relating to legal obligations; if settlement cannot yet be enforced, there is no obligating event. ... [If the entity exits the market] there is no settlement; nothing is paid to the government or anyone else in compensation for the negative credits position. Whether or not IFRIC members believe that such a course of action is realistic is irrelevant; the standard defines ‘no realistic alternative’ in paragraph 17(a) with respect to legal obligations as being strictly when settlement can be enforced. As ‘no realistic alternative’ is defined in the standard with respect to legal obligations, it is not possible to form subjective views as to what is or isn’t realistic in the context of this fact pattern. The IFRIC tries to argue in the TAD that the enforceable settlement criterion is somehow met, but does not explain how this can possibly be the case when the entity is able to exit the market and pay nothing.

30. The ICAEW also questions the existence of a legal obligation, noting that the government cannot enforce settlement.

Staff analysis

31. The criterion in paragraph 17(a) of IAS 37 that settlement of a legal obligation ‘can be enforced by law’ is a specific application of the more general requirement for an entity to have ‘no realistic alternative’ to settling the obligation. We think the criterion in paragraph 17(a) should be interpreted in the context of that more general requirement.
32. The respondents who disagree with the Committee’s conclusions interpret the criterion narrowly—the law must give the government the ability to take an action that *forces an entity to settle* its obligation. In contrast, the Committee has interpreted the criterion more broadly—the law must give the government the ability to take an action that effectively *forces an entity to choose to settle* the obligation.

33. We think the broader interpretation is consistent with the general requirement that an entity has *no realistic* alternative to settlement—the narrower interpretation would be consistent with a general requirement that an entity has *no* alternative to settlement.
34. Accordingly, we continue to support the conclusion that the requirement that ‘settlement of the obligation can be enforced by law’ is met unless accepting the possible sanctions for non-settlement is a realistic alternative for an entity.

Description of the government sanctions

Respondents’ comments

35. A few respondents note that the effect of sanctions on the conclusion depends on the nature of the sanctions—if the sanctions were such that their imposition on an entity resulted in an outflow of resources from that entity, the entity would have a legal liability even if accepting those sanctions were a realistic alternative to settling the obligation. Respondents say the agenda decision does not make this fact sufficiently clear.
36. They suggest different ways of amending the agenda decision:
- (a) the ICAEW and Cristian Munarriz suggest adding to the fact pattern a statement that the sanctions would not themselves result in an outflow of resources from an entity. The ICAEW notes that the original submission specified that the sanctions would not result in direct financial penalties.
 - (b) Deloitte suggests explaining that, if accepting sanctions is a realistic alternative for an entity, an entity would consider whether this realistic alternative:
 - (i) indicates that the entity does not have a legal obligation (because the sanctions would not require an outflow of resources); or
 - (ii) represents a lower cost method of settling the legal obligation, and therefore would be considered in measuring the obligation.

Staff analysis

37. The analysis in the tentative agenda decision assumes that the sanctions would not require an outflow of economic resources, but this assumption is not explicit in the fact pattern. We agree we should either make the assumption explicit (as the ICAEW suggests), or acknowledge how different types of sanctions could lead to different conclusions about the existence of a liability (as Deloitte suggests).
38. We suggest making the assumption explicit—stating in the fact pattern that the sanctions would not themselves result in an outflow of resources. The question of whether an entity has a liability if it could avoid an outflow of resources is at the heart of the submission and restricting the fact pattern to such situations allows for a more focused and simpler analysis.
39. Staff suggestions for clarifying the nature of the sanctions are reflected in the revised wording for the agenda decision proposed in Appendix B.

Constructive obligations

Respondents' comments

40. Most respondents agree (or do not disagree) with the Committee's conclusion that, in the absence of a legal obligation, an entity could nevertheless have a constructive obligation that meets the definition of a liability in IAS 37.
41. One respondent—the Capital Market Authority of Saudi Arabia—disagrees with the conclusion. It questions how the potential imposition of sanctions arising from non-compliance with legal requirements could give rise to a constructive obligation. It refers to the Basis for Conclusions on IFRIC 21, which notes that the Committee rejected an argument that an entity has a constructive obligation to pay a levy if it would have to take an unrealistic action to avoid a future legal obligation.
42. Some respondents who agree (or do not disagree) with the conclusion nevertheless comment on aspects of the supporting analysis:
 - (a) several respondents, including IOSCO and the Securities and Exchange Commission of Brazil, say the description of the fact pattern does not identify any actions of the entity that might have created a constructive obligation.

- (b) PwC and academics from Brazilian Universities say without a detailed analysis of a fact pattern in which a constructive obligation arises, the conclusions in the agenda decision might be applied more broadly than intended, with a risk of misinterpretation. These respondents say this risk is of particular concern in the current environment, in which many entities are making public statements about environmental and social commitments—for example, ‘net zero’ commitments. For that reason, PwC suggests removing the discussion of constructive obligations from the agenda decision. David Hardidge also asks whether the reasoning in the agenda decision about the possible existence of a constructive obligation would apply to entities that have made ‘net zero’ commitments and will have to purchase ‘offsets’ to eliminate excess emissions.
- (c) EY observes that two events must have occurred for a constructive obligation to exist—the incurring of negative credits and the public statement or other action that creates a valid expectation that the entity will eliminate those credits.
- (d) EY and the Accounting Standards Committee of Germany say the assessment of whether an action of the entity has created a valid expectation that it will eliminate its negative credits may require significant judgement.

Staff analysis

- 43. We suggest that the Committee retain the discussion of constructive obligations in the final agenda decision:
 - (a) most respondents agree (or do not disagree) that an entity with negative credits could have a constructive obligation to eliminate those negative credits. The analysis in the agenda decision would be incomplete if it failed to acknowledge that possibility.
 - (b) the Capital Market Authority of Saudi Arabia’s disagreement is based on the Committee’s rejection in IFRIC 21 of an argument that an entity has a constructive obligation to pay a levy if it would have to take an unrealistic action to avoid a future legal obligation. However, those who argued that an

entity has a ‘constructive’ obligation in such situations were using that term loosely to describe a possible future legal obligation, not a constructive obligation as defined in IAS 37 and described in the tentative agenda decision.

- (c) if an entity has made public environmental or social commitments, it would need to consider various aspects of IAS 37 in judging whether those commitments give rise to present obligations that meet the definition of a liability. We discuss these aspects in paragraphs A19–A23 and A26 of the supplementary analysis in Appendix A. In our view, the discussion of constructive obligations in the agenda decision would not increase the risk of an entity reaching the wrong conclusions:
- (i) the tentative agenda decision describes a constructive obligation using, and without going beyond, the wording of the definition of a constructive obligation in IAS 37; and
 - (ii) the analysis in the agenda decision (see Appendix B) demonstrates that it is not sufficient that an entity has taken an action that creates a valid expectation on the part of other parties that the entity will eliminate negative credits—the entity must also have conducted the activity that creates negative credits.

44. As explained further in paragraph A23 in Appendix A, we agree with EY’s observation that, for an entity to have a constructive obligation, the entity must have taken two actions—an action that creates a valid expectation that it will settle an obligation, and an action that creates the obligation. We suggest refinements to the drafting of the agenda decision to make this point clearer. Our suggestions are reflected in the revised wording proposed in Appendix B.
45. We suggest that the Committee not expand the description of the fact pattern or analysis in the agenda decision to describe possible actions of an entity that could give rise to a constructive obligation. The important message is not what the actions are, but whether they have created a valid expectation on the part of other parties that the entity will settle its obligation to eliminate its negative credits.

Whether a liability arises before the end of a calendar year

Respondents' comments

46. Some respondents ask the Committee to clarify whether a liability to eliminate negative credits arises only at the end of a calendar year (because an entity will receive negative credits only if its average fuel emissions for the year as a whole are above the government target), or progressively during the year (by reference to the entity's cumulative production or import activities to date). Respondents say the answer to this question would be important for:
- (a) entities whose annual reporting periods do not end on 31 December; and
 - (b) entities preparing interim financial statements.
47. Deloitte says the wording in the tentative agenda decision suggests that the liability arises over time, and not at a point in time. It says the fact pattern is not sufficiently specific to reach such a conclusion and suggests:
- (a) amending the agenda decision to state that 'to the extent that an entity has produced or imported vehicles with average fuel emissions higher than the government target by the end of the ~~reporting period~~ calendar year, [an] obligation has arisen from past events'; and
 - (b) adding a statement that the entity would assess whether the obligation arises progressively or at a point in time considering the specific terms of the scheme.

Staff analysis

48. We disagree with Deloitte's view that the fact pattern is not sufficiently specific to reach a conclusion that a liability arises over time. The Committee's analysis of the requirements in IAS 37 (as interpreted by IFRIC 6 and IFRIC 21) leads to a conclusion that the activity that triggers an obligation is the production or import of vehicles whose average emissions exceed a government target. In the fact pattern in the request, such an obligation could exist at any date within a calendar year, and would be assessed by reference to the entity's cumulative production or import activities at the reporting date.

49. The agenda decision (especially with the drafting changes proposed in Appendix B) identifies the obligating event as being the production or import of vehicles with average emissions higher than the government target. We think the description of the obligating event is sufficient to clarify that an obligation could arise over time and would be assessed at any date within a calendar year by reference to the entity's cumulative production or import activities at the reporting date.

50. However, for the avoidance of doubt, the Committee could add to the agenda decision wording along the lines of:

The Committee observed that, because the obligating event is the entity's production or import of vehicles (not the government's assessment of the entity's position at the end of the calendar year), a present obligation could exist at any date (on the basis of the entity's cumulative production or import activities to that date), not only at the end of the calendar year.

51. This paragraph is included in the revised agenda decision wording proposed in Appendix B.

Guidance on the meaning of 'no realistic alternative'

Respondents' comments

52. The ICAEW and the Accounting Standards Board of the Institute of Chartered Accountants of India suggest adding guidance to the agenda decision to clarify the circumstances in which accepting possible sanctions is a realistic alternative for an entity, because that judgement is so important to the conclusion about the existence of a legal obligation.

53. PwC suggests including more information about the nature of the sanctions, to explain why accepting those sanctions would not be a realistic alternative to settlement for an entity. Such information would be necessary to support a conclusion that an entity has a legal obligation.

54. The academics from Brazilian Universities say the agenda decision does not clearly point out that an entity might accept sanctions but still have no realistic alternative to

settling its obligation and therefore should still recognise a liability; the respondent expresses concern that the tentative agenda decision, as written, might generate a misinterpretation in this scenario.

55. David Hardidge says the reference to ‘no realistic alternative’ raises questions about the implications of economic compulsion. Cristian Munarriz suggests that the Committee apply paragraph 4.34 of the *Conceptual Framework* and add a statement that accepting sanctions is not a realistic alternative if the economic consequences of doing so would be significantly more adverse than the economic consequences of settling the liability.²

Staff analysis

56. We agree that determining whether accepting possible sanctions is a realistic alternative for an entity will require judgement, and the conclusion will depend on the nature of the sanctions and the entity’s specific circumstances. We have suggested adding a statement to this effect to the agenda decision—see the proposed wording in Appendix B.
57. We think it is beyond the scope of this agenda decision to provide guidance on the factors on which the judgement would be based, so we suggest that the Committee not add any such guidance.
58. We agree with PwC that the fact pattern does not give enough information about the sanctions to reach a conclusion on whether accepting those sanctions would be a realistic alternative to settlement in this case. However, the agenda decision does not include a conclusion on this matter—it instead states that the conclusion will depend on whether accepting sanctions is a realistic alternative to settlement. We think this point will be clearer with the addition of the statement that the conclusion will depend on the nature of the sanctions and the entity’s specific circumstances.

² Paragraph 4.34 of the *Conceptual Framework* supports the definition of a liability. It states that ‘the factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity’s duty or responsibility’. Paragraph 4.34 gives an example, stating that ‘in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the transfer itself’.

The outflows required to settle the obligation

Respondents' comments

59. Almost all respondents agree (or do not disagree) that settling an obligation to eliminate negative credits requires an outflow of economic resources, even if an entity settles the obligation by generating positive credits itself, instead of by purchasing positive credits from another entity.

Staff analysis

60. Although respondents generally support this aspect of the analysis, we now think the tentative agenda decision articulated it slightly incorrectly. The tentative agenda decision said the resources would be *either* cash (if the entity purchases positive credits from another entity) *or* positive credits (if the entity generates the positive credits itself). However, we now think the correct analysis is slightly different:
- (a) the resources are *always* the positive credits an entity must surrender to eliminate its negative credits; but
 - (b) the way an entity *obtains* those resources can vary—an entity can obtain the positive credits either by purchasing them from another entity or by generating them itself.
61. We have refined the drafting proposed for the final agenda decision to reflect this updated analysis—see Appendix B.

Structure of the analysis

Respondents' comments

62. IOSCO says governments in various jurisdictions are introducing measures to reduce vehicle emissions and, although the measures may be similar across jurisdictions, there are subtle differences between them that can affect the accounting conclusions. IOSCO suggests that, instead of providing a conclusion for the fact pattern described, the agenda decision provide a framework for the assessments an entity would make:

- (a) first to determine whether a legal obligation exists and, if so, what the obligating event is; and
 - (b) if no legal obligation exists, secondly to evaluate whether management has made representations that give rise to a constructive obligation.
63. IOSCO says it is important to highlight that the determination of whether a legal obligation or a constructive obligation exists are two separate and distinct assessments.
64. The Securities and Exchange Commission of Brazil makes a similar point. It says ‘low carbon emissions programs may have innumerable and very distinct characteristics worldwide’. It suggests that the Committee redraft the agenda decision to provide more guidance on the assessment of the existence of a legal or constructive obligation based on the requirements in IAS 37 and avoid reaching a conclusion on the fact pattern in the submission.

Staff analysis

65. We agree the analysis could be clearer if it focuses more on the assessments an entity would make, and less on the conclusions for the specific fact pattern. In refining the drafting of the agenda decision to more clearly separate questions of enforceability from questions of timing (as described in paragraph 25), we also have taken the opportunity to:
- (a) focus less on the overall conclusion and more on the factors an entity would consider in reaching a conclusion; and
 - (b) identify the two separate assessments an entity might need to make—first to assess whether it has a legal obligation and, if it concludes that it does not have a legal obligation, secondly to assess whether it has a constructive obligation.

Requests for additional guidance or a standard-setting project

Scope of agenda decision

Respondents' comments

66. Mazars, IOSCO and the Accounting Standards Committee of Germany suggest that the agenda decision also provide guidance on *measuring* liabilities to eliminate negative credits. Mazars says IAS 37 lacks guidance on how to apply its measurement requirements and that diversity could arise from different views on, for example:
- (a) whether to measure provisions on the basis of:
 - (i) the expected costs of settling the obligation (as required by paragraph 36 of IAS 37), or
 - (ii) the amount the entity would pay to settle or transfer the obligation at the reporting date (as required by paragraph 37 of IAS 37); and
 - (b) how to measure the costs of generating (as opposed to purchasing) positive credits.
67. A few respondents ask the Committee to expand the scope of the agenda decision to address other matters, namely:
- (a) how an entity accounts for the debit entry when it recognises a liability to eliminate negative credits—whether the cost is added to the cost of inventory or recognised immediately as an expense.
 - (b) the need to consider the wider consequences of a judgement that accepting sanctions is a realistic alternative to settling a liability to eliminate negative credits—for example, the possibility that inventory or other assets are impaired.
 - (c) accounting requirements for *positive* credits.
68. In contrast, PwC suggests adding to the agenda decision a statement that the Committee did not consider how an entity would account for positive credits. PwC says there is mixed practice in accounting for positive credits under the various carbon offset programmes, and the agenda decision's description of positive credits as a resource might be read as implying that an entity with positive credits has an asset.

Staff analysis

69. The request to the Committee considered only the position of an entity that has produced or imported vehicles with average fuel emissions higher than the government target and asked only whether such an entity has a present obligation that meets the definition of a liability in IAS 37. The staff think the explanation of the agenda decision should discuss only the question asked. We are aware that entities have encountered other IAS 37 application questions in practice and we consider those to be beyond the scope of this agenda decision. We therefore suggest that the Committee not expand the analysis to discuss other topics.
70. We also think the scope of the agenda decision is clear—it is not necessary to explicitly ‘scope out’ positive credits.

Requests for a standard-setting project

Respondents’ comments

71. Some respondents, including the External Reporting Board’s New Zealand Accounting Standards Board, the Securities and Exchange Commission of Brazil and Masahiro Hoshino, note that the tentative agenda decision addresses a narrow fact pattern and only one of several matters that arise from that fact pattern—there are other recognition, measurement and disclosure matters to consider. The matters respondents highlight include those discussed in paragraphs 66–67.
72. These respondents suggest that because environmental regulations are proliferating, and because the matters they give rise to are broader than those covered in the agenda decision, the Committee or the IASB conduct a broader project on accounting for such regulations. Suggestions include:
- (a) referring those matters to the IASB or adding a project to the Committee’s work plan; and
 - (b) prioritising the possible standard-setting project on pollutant pricing mechanisms discussed in the IASB’s Request for Information *Third Agenda Consultation* (RFI), and covering matters relating to emissions trading rights and obligations within the scope of that project.

Staff analysis

73. The matters for which respondents think a standard-setting project is needed are outside the scope of this agenda decision. The respondent who suggests prioritising the project on pollutant pricing mechanisms provided similar feedback in its response to the RFI, and the IASB has considered the feedback from all respondents to the RFI. At its meeting in April 2022, the IASB decided to create a reserve list of projects that could be added to the work plan if additional capacity becomes available, and to add to that reserve list a project on pollutant pricing mechanisms.
74. Accordingly, the staff suggest the Committee need take no further action in response to the requests for a standard-setting project.

Other comments

75. The following table summarises respondents’ comments on other matters together with our analysis of these comments:

Respondents’ comments	Staff analysis and suggestions
<p><i>1. Conceptual Framework</i></p> <p>Masahiro Hoshino suggests the Committee consider the conclusions that would be reached applying the new definition of a liability in the <i>Conceptual Framework for Financial Reporting (Conceptual Framework)</i>, in the same way as the Committee considered the definition of an asset in the <i>Conceptual Framework</i> in its agenda decision ‘Deposits relating to taxes other than income tax’, issued in January 2019.</p>	<p><i>We suggest no further action</i></p> <p>The questions raised by the submission relate to transactions within the scope of IAS 37. The definition of a liability in IAS 37 has not yet been aligned with the new definition in the <i>Conceptual Framework</i>.</p> <p>In contrast, the agenda decision ‘Deposits relating to taxes other than income tax’ addresses a transaction in which any asset may not clearly be within the scope of an IFRS Accounting Standard. The Committee referred to the <i>Conceptual Framework</i> definition of an asset in the absence of a standard that specifically applies.</p>

Respondents' comments	Staff analysis and suggestions
<p><i>2. Clarifying scope of agenda decision</i></p> <p>The tentative agenda decision clarifies that the Committee did not consider how an entity would <i>measure</i> a liability for negative credits. Masahiro Hoshino suggests clarifying that the Committee also did not consider how an entity would apply the recognition criteria and disclosure requirements in IAS 37. Mr Hoshino says without such a clarification readers might assume that the recognition requirements are met.</p>	<p><i>We suggest no further action</i></p> <p>The agenda decision refers to measurement because Committee members were concerned that analysis in the agenda decision might otherwise be read to imply a requirement to measure a liability in a particular way. The agenda decision addresses one of the recognition criteria in IAS 37 (an entity has a present obligation as a result of a past event), so it would be inaccurate to say that the Committee did not consider recognition. We are not aware of any concerns that the analysis in the agenda decision might be read to imply that the other recognition criteria in IAS 37 have or have not been met.</p>
<p><i>3. Changes to business plan should not affect the obligation</i></p> <p>David Hardidge says the assessment of whether accepting sanctions is a realistic alternative for an entity might change from year to year, based on the entity's business plan. He says that changes to business plans should not affect the determination of whether an obligation exists.</p>	<p><i>We suggest no further action</i></p> <p>The assessment would be made by reference to the 'no realistic alternative' criterion. As we have suggested clarifying in the agenda decision (see paragraph 56), the outcome of such an assessment for an entity will depend on the nature of the sanctions and the entity's specific circumstances. The outcome could change from year to year, and might be reflected in the entity's business plan. But the 'no realistic alternative' criterion, not the entity's business plan (or any other evidence of management intentions), would be the basis for the assessment.</p>

Staff recommendation

76. Based on our analysis, we recommend finalising the agenda decision as published in IFRIC Update in February 2022 but redrafted as set out in Appendix B. If the Committee agrees with our recommendation, we will ask the IASB whether it objects to the agenda decision at the first IASB meeting at which it is practicable to present the agenda decision.
77. In its project Provisions—Targeted Improvements, the IASB plans to develop proposals to align the definition of a liability in IAS 37 with the new definition and supporting concepts in the *Conceptual Framework*. In developing recommendations for proposed amendments, we will make use of the insights we have gained from working on this submission.

Questions 1–2 for the Committee

1. Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 76 of this paper?
2. Do Committee members have any comments on the wording of the agenda decision in Appendix B?