IFRS

STAFF PAPER

July 2022

IASB® meeting

Project	**Negative Low Emission Vehicle Credits (IAS 37)**
Paper topic	Finalisation of agenda decision

CONTACT Joan Brown jbrown@ifrs.org

Purpose of meeting

1. At its June 2022 meeting, the IFRS Interpretations Committee (Committee) decided not to add a standard-setting project to the work plan in response to a submission on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Committee instead decided to finalise an agenda decision.

2. The purpose of this meeting is to ask IASB members whether they object to the agenda decision, as required by paragraph 8.7 of the IFRS Foundation *Due Process Handbook*.

Background

3. The Committee received a request asking whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37.

4. In February 2022, the Committee discussed the request and decided to publish a tentative agenda decision, having 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 request, an entity has an obligation that meets the definition of a liability in IAS 37.

Overview of the feedback on the tentative agenda decision

5. The Committee received 21 comment letters on its tentative agenda decision.

6. As reported further in Agenda Paper 4 for the Committee's June 2022 meeting, most respondents agreed, or did not disagree, with the Committee's conclusions and tentative decision. However, some of these respondents commented on aspects of the analysis. Respondents suggested that the Committee:

   (a) reconcile the logic it applied in reaching its conclusions to the logic applied in other examples that interpret or illustrate the application of IAS 37, especially IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*.

   (b) refine the drafting of the agenda decision. Suggestions included setting out the analysis in the form of a framework for the assessments an entity would make in determining whether a liability exists.

7. Three respondents disagreed with the Committee's conclusions and tentative agenda decision, expressing views that:

   (a) no legal obligations arise under the measures because, in the view of the respondents, settlement cannot be 'enforced by law';

   (b) the logic applied by the Committee was inconsistent with that applied in other examples that interpret or illustrate the application of IAS 37, especially IFRIC 21; or

   (c) the fact pattern described did not give sufficient information for a conclusion to be reached on whether an entity had an obligation that meets the definition of a liability.

8. At its June 2022 meeting, the Committee considered both:

   (a) the feedback; and

   (b) staff proposals for responding to the feedback by reordering and refining the analysis in the tentative agenda decision, including by adding further information to reconcile the Committee's conclusions to those in IFRIC 6 and IFRIC 21.

9. On the basis of the feedback, the Committee confirmed the analysis and conclusions in the tentative agenda decision and approved the staff proposals for reordering and refining the analysis. The Committee observed that the reordering and refinements did not change either the conclusions in the tentative agenda decision, or any of the arguments supporting these conclusions.

10. Twelve of the 14 Committee members voted to finalise the agenda decision.

11. The appendix to this paper includes the wording of the agenda decision approved by the Committee.

Questions for the IASB
Do you object to the Committee's: (a) decision not to add a standard-setting project to the work plan; or (b) conclusion that the agenda decision does not add or change requirements in IFRS Accounting Standards?

Appendix—The Agenda Decision

A1. The Agenda Decision set out below was approved by the Committee at its meeting in June 2022.

Negative Low Emission Vehicle Credits (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)

The Committee received a request asking whether particular measures to encourage reductions in vehicle carbon emissions give rise to obligations that meet the definition of a liability in IAS 37.

The request

The request described government measures that 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 government target. Entities receive negative credits if, in that year, they have produced or imported vehicles whose average fuel emissions are higher than the target.

The measures require an entity that receives negative credits for one year to eliminate these negative credits by obtaining and surrendering positive credits. The entity can obtain positive credits either by purchasing them from another entity or by generating them itself in the next year (by producing or importing more low-emission vehicles). If the entity fails to eliminate its negative credits, the government can impose sanctions on the entity. These sanctions would not require payment of fines or penalties, or any other outflow of resources embodying economic benefits, but could deny the entity opportunities in the future, for example by restricting the entity's access to the market.

The request 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.

Applicable requirements

Paragraph 10 of IAS 37:

a. defines a liability as ‘a present obligation 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’;

b. distinguishes legal obligations (which derive from a contract, legislation or other operation of law) from constructive obligations (which derive from an entity’s actions); and

c. defines an obligating event as ‘an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation’.

An entity has no realistic alternative to settling an obligation only where settlement can be enforced by law or, in the case of a constructive obligation, where the entity’s actions have created valid expectations in other parties that the entity will discharge the obligation (paragraph 17 of IAS 37).

The Committee observed that, in determining whether it has a liability, the entity described in the request would consider:

a. whether settling an obligation to eliminate negative credits would result in an outflow of resources embodying economic benefits;

b. which event creates a present obligation to eliminate negative credits; and

c. whether the entity has no realistic alternative to settling the obligation.

The Committee’s conclusions

Outflow of resources embodying economic benefits

An entity can settle an obligation to eliminate negative credits either by purchasing credits from another entity or by generating positive credits itself in the next year. The Committee concluded that either method of settling the obligation would result in an outflow of resources embodying economic benefits. These resources are the positive credits the entity would surrender to eliminate the negative balance. The entity could otherwise have used self-generated positive credits for other purposes—for example, to sell to other entities with negative credits.

The event that creates a present obligation

The definition of a liability in IAS 37 requires an entity to have a 'present obligation … arising from past events'. Paragraph 19 of IAS 37 adds that it is only those obligations arising from past events existing independently of an entity's future actions that meet the definition of a liability. Two IFRIC Interpretations of IAS 37 provide further relevant requirements—they address specific types of government-imposed charges and specify which events give rise to a present obligation for these types of charges:

a. IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* addresses a charge for the cost of waste management. Legislation links the charge to an entity's participation in a specified market in a specified period. The consensus in IFRIC 6 is that an obligation arises when an entity conducts the activity to which the charge is linked.

b. IFRIC 21 *Levies* addresses levies imposed by governments. The consensus in IFRIC 21 is that the event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified in the applicable legislation.

In the fact pattern described in the request, the activity that triggers a requirement to eliminate negative credits (or in other words, the activity to which the measures link that requirement) is the production or import of vehicles with average fuel emissions higher than the government target. If in a calendar year an entity has produced or imported vehicles with average fuel emissions higher than the government target, an obligation:

a. has arisen from past events.

b. exists independently of the entity's future actions (the future conduct of its business). The entity's future actions will determine only the means by which the entity settles its present obligation—whether it purchases positive credits from another entity or generates positive credits itself by producing or importing more low-emission vehicles.

Therefore, the Committee concluded that, in the fact pattern described in the request, the activity that gives rise to a present obligation is the production or import of vehicles whose fuel emissions, averaged for all the vehicles produced or imported in that calendar year, are higher than the government target.

The Committee observed that a present obligation could arise at any date within a calendar year (on the basis of the entity's production or import activities to that date), not only at the end of the calendar year.

No realistic alternative to settling an obligation

The Committee concluded that the measures described in the request could give rise to a legal obligation:

a. obligations that arise under the measures derive from an operation of law; and
b. the sanctions the government can impose under the measures would be the mechanism by which settlement may be enforceable by law.

An entity would have a legal obligation that is enforceable by law if accepting the possible sanctions for non-settlement is not a realistic alternative for that entity.

The Committee observed that determining whether accepting sanctions is a realistic alternative for an entity requires judgement—the conclusion will depend on the nature of the sanctions and the entity's specific circumstances.

The possibility of a constructive obligation

The Committee concluded that, if an entity determines that it has no legal obligation to eliminate its negative credits, it would then need to consider whether it has a constructive obligation to do so. It would have a constructive obligation if it has both:

a. in a calendar year, produced or imported vehicles with average fuel emissions higher than the government target; and

b. taken an action that creates valid expectations in other parties that it will eliminate the resulting negative credits—for example, made a sufficiently specific current statement that it will do so.

Other IAS 37 requirements

The request asked only whether the government measures give rise to obligations that meet the definition of a liability in IAS 37. The Committee observed that, having identified such an obligation, an entity would apply other requirements in IAS 37 to determine how to measure the liability. The Committee did not discuss these other requirements.

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 request, it has an obligation that meets the definition of a liability in IAS 37. Consequently, the Committee decided not to add a standard-setting project to the work plan.