IFRIC *Update* February 2022

IFRIC *Update* is a summary of the decisions reached by the IFRS Interpretations Committee (Committee) in its public meetings. Past *Update*s can be found in the IFRIC *Update* archive.

The Committee met on 1 February 2022, and discussed:

Committee's tentative agenda decisions

- Negative Low Emission Vehicle Credits (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2

Agenda decisions for the IASB's consideration

- TLTRO III Transactions (IFRS 9 *Financial Instruments* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*)—Agenda Paper 3

Other matters

- Profit Recognition for Annuity Contracts (IFRS 17 *Insurance Contracts*)—Agenda Paper 4
- Work in Progress—Agenda Paper 5

Related information

The work plan

Supporting consistent application

Committee's tentative agenda decisions

The Committee discussed the following matters and tentatively decided not to add standard-setting projects to the work plan. The Committee will reconsider these tentative decisions, including the reasons for not adding standard-setting projects, at a future meeting. The Committee invites comments on the tentative agenda decisions. Interested parties may submit comments on the open for comment page. All comments will be on the public record and posted on our website unless a respondent requests confidentiality and we grant that request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. The Committee will consider all comments received in writing up to and including the closing date; comments received after that date will not be analysed in agenda papers considered by the Committee.

Negative Low Emission Vehicle Credits (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)—Agenda Paper 2

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, and 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 those negative credits, either by purchasing positive credits from another entity or by generating positive credits itself in the next 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.

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 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'. Paragraph 10 of IAS 37 distinguishes legal obligations (which derive from an operation of law) from constructive obligations (which derive from an entity's actions) and 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'. Paragraph 17 of IAS 37 clarifies that an entity has no realistic alternative to settling an obligation only if settlement can be enforced by law or, in the case of a constructive obligation, where an event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. Paragraph 19 of IAS 37 further clarifies 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.

The Committee's conclusions

The Committee 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 the sanctions that the government can impose is a realistic alternative to eliminating negative credits for that entity. The Committee's reasoning was that:

- 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.
- 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 the government can impose 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.
- 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. The entity could otherwise have used those self-generated positive credits for other purposes—for example, to sell to other entities with negative credits.
- the obligation arises from past events and exists independently of the entity's future actions (the future conduct of its business). Under the measures, the only action required to trigger 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. The fact pattern described in the request differs from the fact pattern in other examples that illustrate or interpret the application of paragraph 19 of IAS 37 and for which the conclusion is that no present obligation exists—for example, part (a) of Illustrative Example 6 (Legal requirement to fit smoke filters), IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and Example 2 in IFRIC 21 *Levies*. In all these other examples, the entity has not yet taken the actions necessary to trigger an obligation under the applicable legislation.

The Committee 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.

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 negative credits generated from its past production or import activities.

The request asked only whether the government measures give rise to obligations that meet the definition of a liability in IAS 37. The Committee noted 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 those 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, an entity 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.

Agenda decisions for the IASB's consideration

TLTRO III Transactions (IFRS 9 *Financial Instruments* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*)—Agenda Paper 3

The Committee considered feedback on the tentative agenda decision published in the June 2021 IFRIC *Update* about how to account for the third programme of the targeted longer-term refinancing operations (TLTROs) of the European Central Bank (ECB).

The Committee reached its conclusions on that agenda decision. In accordance with paragraph 8.7 of the IFRS Foundation's *Due Process Handbook*, the International Accounting Standards Board (IASB) will consider this agenda decision at its March 2022 meeting. If the IASB does not object to the agenda decision, it will be published in March 2022 in an addendum to this IFRIC *Update*.

Other matters

Profit Recognition for Annuity Contracts (IFRS 17 *Insurance Contracts*)—Agenda Paper 4

The Committee received a request about the recognition of profit when applying IFRS 17. An entity includes unearned profit in the measurement of insurance contracts and recognises it as revenue as the entity provides services. The request is about determining how to recognise unearned profit as revenue by assessing the services an entity provides to policyholders of annuity contracts.

The Committee will discuss this matter at a future meeting. To prepare for that discussion, the staff provided the Committee with an overview of the applicable IFRS 17 requirements and other background related to those requirements.

The Committee was not asked to make any decisions.

Work in Progress—Agenda Paper 5

The Committee received an update on the status of open matters not discussed at its meeting in February 2022.