IFRS

STAFF PAPER

June 2022

IFRS® Interpretations Committee meeting

Project	**Negative Low Emission Vehicle Credits (IAS 37)**	
Paper topic	Proposed wording for final agenda decision	
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Appendix B—proposed wording for final agenda decision

B1 This appendix sets out the staff suggestions for the wording of the final agenda decision. The staff suggest:

(a) re-ordering paragraphs from the published tentative agenda decision. For ease of reading, paragraphs have been reordered without the moves being marked.

(b) further changes to the text. These further changes are marked up. They include both changes made to respond to comments on the tentative agenda decision (as explained in the body of this paper) and editorial changes required as a result of reordering paragraphs.

B2 A clean version follows the marked-up version in this appendix.

Proposed agenda decision—marking changes from published tentative agenda decision

Negative Low Emission Vehicle Credits (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)	*Agenda Paper 4 paragraph reference*
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~~,~~ by obtaining and surrendering positive credits. The entity can obtain positive credits either by purchasing ~~positive credits~~ them from another entity or by generating ~~positive credits~~ them 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. 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 restrict the entity's access to the market.	60 35-38
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’.	
The Committee observed that in determining whether it has a liability, the entity described in the request would consider:	65
(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; and	25(a)
(c) whether it has a realistic alternative to settling the obligation.	
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:~~	
Outflow of resources embodying economic benefits	
~~an entity can~~ The Committee concluded that the settlement of an obligation to eliminate negative credits would result in an outflow of resources embodying economic benefits. These resources are the positive credits the entity would have to purchase ~~settle its obligation either by purchasing~~	

~~positive credits~~ from another entity or ~~by~~ generate~~ing positive credits~~ itself in the next year and ~~using those positive credits~~ surrender to eliminate the negative balance. ~~In either case, settlement involve 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.	60
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 ~~further clarifies~~ 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 those 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.	25(b)
(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 of the entity that triggers the payment of the levy, as identified in the legislation. In the fact pattern described in the request, the activity ~~that may give rise to~~to which the measures link an obligation to eliminate negative credits (or in other words, the activity that triggers a requirement 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. To the extent that an entity has produced or imported such vehicles by the end of the reporting period, ~~that~~ an obligation: (a) has arisen from past events; and (b) ~~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 positive 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 therefore concluded that, in the fact pattern in the request, the activity that gives rise to a present obligation is the production or import of vehicles whose average fuel emissions are higher than the government target.	
The Committee observed that, because the obligating event is the 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.	50

No realistic alternative to settling an obligation

~~Paragraph 17 of IAS 37 clarifies that an~~ An entity has no realistic alternative to settling an obligation only ~~if~~ where 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's actions~~)~~ have~~s~~ created valid expectations in other parties that the entity will discharge the obligation (paragraph 17 of IAS 37).

The Committee concluded that the measures described in the request could give rise to a legal obligation—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~~is 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 would have a legal obligation that is enforceable by law unless accepting the possible sanctions for non-settlement is 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. 56

~~The Committee considered the position of an entity that:~~

The possibility of a constructive obligation

a. ~~has produced or imported vehicles with average fuel emission higher that 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 Committee concluded that, if an entity judges 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: 44

(a) 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 settle its obligation to 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 ~~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, it ~~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.

Proposed agenda decision—clean

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, 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 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 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'.

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; and

(c) whether it has a realistic alternative to settling the obligation.

The Committee's conclusions

Outflow of resources embodying economic benefits

The Committee concluded that the settlement of an obligation to eliminate negative credits would result in an outflow of resources embodying economic benefits. These resources are the positive credits the entity would have to purchase from another entity or generate itself in the next year and 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 those 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 of the entity that triggers the payment of the levy, as identified in the legislation.

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

(a) has arisen from past events; and

(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.

The Committee therefore concluded that, in the fact pattern in the request, the activity that gives rise to a present obligation is the production or import of vehicles whose average fuel emissions are higher than the government target.

The Committee observed that, because the obligating event is the 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.

No realistic alternative to settling an 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 concluded that the measures described in the request could give rise to a legal obligation—the measures derive from an operation of law, and the sanctions the government can impose are the means by which settlement is enforced by law. An entity would have a legal obligation that is enforceable by law unless accepting the possible sanctions for non-settlement is 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 judges 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) 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 settle its obligation to 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 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, 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.