



TENTATIVE AGENDA DECISION: NEGATIVE LOW EMISSION VEHICLE CREDITS

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ICAEW welcomes the opportunity to comment on the Tentative Agenda Decision: Negative Low Emission Vehicle Credits published by IASB on 10 February 2022, a copy of which is available from this [link](#).

For questions on this response please contact our Financial Reporting Faculty at frf@icaew.com quoting REP 34/22.

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ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

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Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

KEY POINTS

1. ICAEW welcomes the opportunity to comment on the IFRS Interpretation Committee's tentative agenda decision regarding negative low emission vehicle credits.
2. 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.
3. Our understanding of the Interpretation Committee's rationale from the explanation provided in the tentative agenda decision is that the obligating event that may give rise to a liability is the production or import of vehicles with average fuel emissions higher than the government target. An entity that incurred such an obligation would be required to deliver positive credits to the government. However, if an entity failed to deliver such positive credits, the government could impose sanctions on the entity but that those sanctions would not lead to an outflow of economic benefits. This obligation:
 - a. is a legal one, if accepting government sanctions is not a realistic alternative;
 - b. is a constructive one, if accepting government sanctions is realistic but action has been taken to create valid expectations in other parties that the negative credits generated will be eliminated; or
 - c. does not exist, if accepting government sanctions is realistic and valid expectations to eliminate the negative credits have not been created.

If the final scenario is applicable, then an entity would not recognise a liability and should effectively ignore the economic consequences of accumulating negative low emission vehicle credits.

4. 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.
5. In the specific fact pattern considered in the tentative agenda decision, the law cannot enforce settlement of the obligation, even if the trigger event for the remedies set out in the legislation has happened. The law may ultimately impose sanctions (if remedies are not made), but these sanctions do not result in direct financial penalties. Therefore, we question the presence of a legal obligation under these circumstances.
6. IFRIC 21 describes an example whereby the obligating event is triggered by the generation of revenue in a current period, but the liability is calculated based on revenue generated in a prior period (paragraph 8). In this example the generation of revenue in the previous period is necessary, but not sufficient, to create a present obligation. The facts and circumstances considered as part of this tentative agenda decision are not dissimilar and it may be argued on this basis that the import/production of high emission vehicles is necessary, but not sufficient, to create a present obligation because the law cannot enforce settlement nor

impose sanctions at the point the high emission vehicles are imported or produced. 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.

7. We believe this tentative decision also contradicts paragraph 19 in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which states that when an entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised. In this case, changing its method of operation could be exiting the market. Again, there is no requirement to assess whether or not this action is realistic.

8. In addition:
 - a. The tentative agenda decision does not explain that the government sanctions themselves would not result in direct financial penalties on the entity. This factor was included in paragraph 10 of staff paper 4 for the November 2021 Interpretations Committee meeting. This factor seems to be critical to the conclusion in the tentative agenda decision and should be included in the agenda decision itself.
 - b. We were unable to identify an explanation of how an entity might test whether accepting the sanction is or is not realistic. We would welcome further guidance to help those that need to make such an assessment, as, according to the tentative agenda decision, this appears to be a fundamental factor in identifying the presence of a legal obligation.
 - c. We note that in this fact pattern the entity can settle its obligation by generating positive credits itself in the next year – for example by switching its activity to lower emissions vehicles. This raises questions as to whether and why the obligation exists independently of the entity’s future actions and also whether an obligation might exist at an interim period end that falls within the legal measurement period. We think a final agenda decision should address these matters.
 - d. If accepting government sanctions is deemed a realistic option for an entity, and therefore a provision is not recognised in respect of the negative credits accumulated, the tentative agenda decision does not describe any considerations that an entity should have towards other economic consequences of accepting these sanctions, such as impairment of inventory or other assets. We feel that the tentative agenda decision should highlight a need to consider any wider consequences.

9. 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 the 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.