8 April 2022

Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Bruce,

RE: Tentative agenda decision – Negative Low Emission Vehicle Credits

We are responding to your invitation to comment on the tentative agenda decision (TAD) – Negative Low Emission Vehicle Credits, published in February 2022, on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the TAD. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We understand that the Committee's aim is to demonstrate the IAS 37 obligation recognition principles through application to the fact pattern in the submission. Although we do not necessarily disagree with the outcome of the TAD, we are concerned that the technical analysis in this TAD can be interpreted as placing emphasis on the form of the legislation rather than the substance of the legislation ('a legalistic approach'), which could result in scenarios that are economically equivalent being accounted for differently – in other words, opposing accounting conclusions, depending on differences in wording in the legislation, that ultimately have the same economic effect.

We recommend that the Committee update the agenda decision to clearly explain how this fact pattern is consistent with the application principles in IFRIC 21, IFRIC 6 and IAS 37 Illustrative examples 6 and 11A–11B. In particular, we are concerned that legislation giving rise to levies under IFRIC 21 might not have been interpreted in this legalistic way in the past and that this agenda decision might therefore require further analysis of levies already being accounted for under IFRIC 21.

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For illustrative purposes, we have analysed, in Appendix A, the possible impact of a legalistic approach on a number of scenarios with similar legislative objectives.

In addition, we suggest that the following points are considered before finalising the words in the agenda decision:

- The Committee has concluded that, in the fact pattern provided, the obligation is derived from a legal requirement. In the absence of a detailed analysis of a fact pattern in which the obligation is derived from a constructive obligation, we are concerned that this agenda decision will be applied more broadly than intended, and that it might introduce a risk of misinterpretation. This is of particular concern in the current environment, in which many entities are making public statements with respect to environmental and social commitments (for example, net zero commitments, where there is judgement about whether the statement made by entities might constitute 'a sufficiently specific current statement' or whether the future actions proposed to meet the commitments are more akin to an executory contract). Consequently, we suggest that the Committee remove any discussion of constructive obligations from the final agenda decision, given the broad impacts of such considerations which have not been fully analysed by the Committee.

- The TAD could be interpreted to imply that the existence of positive credits for an entity would give rise to an asset (*"the resources are the positive credits the entity will receive for the next year …"*). We understand that this technical analysis was not the focus of the TAD. We note that there is mixed practice when accounting for positive credits under the various carbon offset allowance programmes, and so we suggest clarifying this position by explicitly stating in the final agenda decision that the accounting by the holder of positive credits was not considered by the Committee.

- The description of the relevant sanctions in the TAD fact pattern are not clearly defined (*"the government can impose sanctions on the entity, for example restrict the entity's access to the market"*). In the original submission, we observe that the sanctions described are vague (for example the government not granting licences for new vehicle types, slowing down imports, etc). It would be helpful if the agenda decision was clearer on the specific assumptions related to the proposed sanctions that support a legal obligation.

If you have any questions in relation to this letter, please do not hesitate to contact Henry Daubeney (henry.daubeney@pwc.com) or Gary Berchowitz (gary.x.berchowitz@pwc.com).

Yours sincerely,

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Appendix A – Examples

Consideration for the Committee: We anticipate that, in the absence of further clarification, the application of the TAD could result in different accounting conclusions driven by the form of the legal requirements rather than their substance, as demonstrated in these examples. We ask the Committee to further clarify how the fact pattern in the TAD is different from the existing guidance in IFRIC 21, IFRIC 6 and IAS 37 Illustrative examples 6 and 11A–11B.

These examples are for illustrative purposes, to demonstrate the possible contradicting interpretations between the existing guidance and the TAD. The conclusions do not necessarily reflect PwC's view, which would be dependent on an assessment of the full facts and circumstances.

Example 1:

Fact pattern: *Under new legislation, an entity is required to fit smoke filters to its kitchens by 1 January 2023.*

Question: Should the entity recognise a liability to fit the smoke filters before 1 January 2023?

Assessment under guidance in IAS 37 Illustrative examples: Before 1 January 2023, there is no obligating event, since the obligation does not arise until 1 January 2023. No provision is recognised for the costs of fitting the smoke filter. Even on 1 January 2023 and beyond, if the smoke filters have not yet been fitted (the obligating event), the entity does not have a present obligation to fit the smoke filter, but it might have an obligation for fines/penalties starting from that date.

Amended fact pattern: *Under new legislation, any entity that operated as a restaurant during 2021 is required to fit smoke filters to its kitchen by 1 January 2023, and fines/penalties will be levied from 1 January 2023 for non-compliance.*

Possible assessment under the TAD: We understand that the logic in the TAD would imply that the obligating event that gives rise to a present obligation is the operation as a restaurant during 2021. Therefore, if an entity operated as a restaurant during 2021, the obligating event has taken place, and so a provision should be recognised in 2021.

Example 2:

Fact pattern: *Legislation imposes a levy to be paid on 1 June 2022 by an entity that both (a) operated as a financial institution during 2021 and (b) continues to operate as a financial institution in 2022. The levy is calculated as a percentage of revenues recognised in 2021.*

Question: Should the entity recognise a liability as of 31 December 2021?

Assessment under IFRIC 21: The obligating event that gives rise to a liability to pay a levy is both operating as a financial institution in 2021 and the decision to operate as a financial institution in 2022. The mere fact that an entity has operated as a financial institution in the past does not provide certainty that it will continue to do so in the future. The entity can avoid

payment of the levy by discontinuing its financial services activities on 31 December 2021. Therefore, the liability arises in 2022, once the entity has triggered a requirement to pay by continuing to operate as a financial institution (para 9 of IFRIC 21).

Possible assessment under the TAD: Operating as a financial institution in 2021 gives rise to an obligation for the entity, considering that ceasing operations in December 2021 is not an economically realistic alternative course of action* at 31 December 2021. Consequently, an obligation arises progressively throughout 2021, based on the logic in the TAD.

*Applying a similar logic to that in the TAD's fact pattern, whereby accepting sanctions was not considered a realistic alternative to eliminating negative credits.

Example 3:

Amendment to the fact pattern in the TAD: Assuming that the fact pattern analysed in the TAD is modified as follows:

The legislation requires entities to compare the average fuel emissions of vehicles produced or imported from 1 January 2023 to 30 June 2024 to a specified target. If the average fuel emissions of the vehicles produced or imported during that period exceed the target, a levy is paid; and, if they are below the target, no levy is paid. The payment will be triggered only based on the calculation of the average emissions of all vehicles produced/imported during the period from 1 January 2023 to 30 June 2024 compared to the target.

Technical analysis: Following IFRIC 21 and IAS 37 Illustrative example 11B, entities will not have a legal obligation at the 31 December 2023 year end. Before 30 June 2024, no obligation exists independently of the entity's future actions – the entity could avoid paying the levy, for example by importing or producing more vehicles that lower the average emissions, even if the average exceeds the target at certain times within the period. For example, between 1 January 2023 and 31 December 2023, vehicles with emissions higher than the target might be produced/imported and, in the period from 1 January 2024 to 30 June 2024, vehicles with emissions lower than the target are produced / imported such that no payment is triggered at 30 June 2024.

Despite the substance of the legislation being similar to that in the TAD, the form of the legislation could drive a different outcome, depending on which accounting guidance is applied.