International Organization of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores
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المنظمة الدولية لهيئات الأوراق المالية

8 April 2022

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

Our Ref: 2022/O/C1/IFRIC/MS/32

RE: Tentative Agenda Decision: Negative Low Emission Vehicle Credits

Dear Mr. ~~Mackenzie~~, Bruce

The International Organization of Securities Commissions ("IOSCO") Committee on Issuer Accounting, Auditing and Disclosure ("Committee 1") thanks you for the opportunity to provide our comments on the IFRS Interpretations Committee ("IFRS IC") tentative agenda decision, *Negative Low Emission Vehicle Credits* ("TAD").

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 ("members" or "we") seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Pollutant Pricing Mechanisms ("PPMs"), like the one described in the IFRS IC submission, are becoming more prevalent in many jurisdictions as countries and entities focus on reducing carbon emissions. We support the IFRS IC's objective to reduce the diversity in practice and provide an analysis for certain types of PPMs that entities may use going forward.

Members note that while a majority of IFRS IC members agreed with the conclusion, several IFRS IC members did not. Many Committee 1 members believe that this may be attributed to the fact that there is insufficient information contained in the submission to explicitly conclude that either a legal or constructive obligation exists. Furthermore, due to the limited information provided in the submission, it is unclear whether or how it differs from part (a) of Illustrative Example 6 (Legal requirement to fit smoke filters) of IAS 37, IFRIC 6 Liabilities arising from Participating in a Specific Market—Waste

Electrical and Electronic Equipment and Example 2 in IFRIC 21 Levies. The submission is unclear in the minds of some members as to whether a legal obligation exists. Likewise, the submission does not indicate that management has taken steps that would give rise to a constructive obligation. Therefore, we recommend the IFRS IC amend the TAD to remove the conclusion that a legal obligation exists in the fact pattern described in the submission and instead provide a framework that begins with an assessment for a specific fact pattern as to whether a legal obligation exists and if so, what the obligating event is. A revised TAD would then go on to explain that if a legal obligation does not exist, the entity would then need to evaluate whether management has made representations that give rise to a constructive obligation (e.g., if management of an entity has made a sufficiently specific current statement that it plans to purchase positive credits or has established a past practice of purchasing credits[1]).

Members believe this approach is important to highlight that the determination of whether a legal obligation or a constructive obligation exists are two separate and distinct evaluations. While PPMs may be similar across jurisdictions, subtle differences in the program can have an impact on the accounting conclusions.

Members also expressed concerns that the measurement of the liability has not been addressed in the TAD. IAS 37.14 states:

> *A provision shall be recognised when:*
> *(a) an entity has a present obligation (legal or constructive) as a result of a past event;*
> *(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*
> *(c) a reliable estimate can be made of the amount of the obligation.*

As a consequence, even if a legal or constructive obligation exists (criterion (a)), a provision might not be recognized because one of the other criteria is not met, including the ability to make a reliable estimate. Given the alternatives available in the submission to address the negative credits (e.g., purchase credits or generate additional credits in the future period), it is unclear how an entity would measure a provision. One approach could be to measure the negative credits based on the current purchase price in the open market. However, since IAS 37's measurement is based on how management intends to settle the obligation, if management's plan is to generate positive credits, use of existing market prices would seem inconsistent with management's intended method of settlement. We, therefore, believe the IFRS IC should include in the TAD how an entity would approach measurement of the obligation after it has determined that a present obligation exists.

Members agree with the IFRS IC's conclusion that the IFRS Accounting Standards provide a sufficient basis for evaluating the question submitted in circumstances where the totality of the arrangement is

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[1] IAS 37.10

known. However, we would like to highlight that the PPM in question raises other accounting and financial reporting questions that may need to be considered including:

- While the submission focused on the existence of a liability arising from negative credits, we believe the IFRS IC should expand the TAD to highlight the considerations for recognizing an asset when positive credits are generated/produced.
- The TAD evaluates whether a liability should be recognized, the credit journal entry, but it does not address where the offsetting debit journal entry should be made – should it be made to inventory (and then to cost of goods sold) or recognized immediately in the statement of profit or loss as a "new energy vehicle" credit expense.
- The TAD only discusses the year-end reporting considerations for entities with calendar year ends. We believe the agenda decision should evaluate reporting considerations for those entities whose fiscal year ends are not aligned with the calendar year end. In addition, we strongly recommend the TAD should also evaluate interim-reporting considerations because many producers of passenger vehicles are subject to interim reporting requirements.[2]

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

Yours sincerely,

Makoto Sonoda

Chair
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[2] For example, if an entity had a negative balance at the half-year reporting date but expected to generate enough positive credits by the end of the year, would they recognize a liability at that interim date?